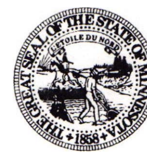

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Edward Burek, Deputy Director EB

RE: S.F. 641 (Pogemiller); H.F. 695 (Osskopp): MSRS; Health Care Reimbursement Plan
S.F. 1322 (Stumpf); H.F. 1294 (Mares): MSRS; Post Retirement Healthcare Savings Plan
S.F. ; H.F. 2029 (Haas): DOER Health Care Account Establishment
S.F. 1484 (Pogemiller); H.F.____ ( ):MPRA; Minneapolis Police Relief Association Voluntary Employee Benefit Organization
S.F. 1755 (Stumpf); H.F. 1868 (Davids): School Employee Health Care Accounts

DATE: March 23, 2001

Several bills have been introduced which would create systems to help public employees offset healthcare costs following retirement. The bills differ in several key respects, as follows:

The bills differ in the scope of the covered group. Some approaches would mandate that all state employees in MSRS plans and certain other plans must also be contributing members to a health care reimbursement plan. S.F. 1755 (Stumpf); H.F. 1868 (Davids): School Employee Health Care Accounts, is directed at teachers and similar education employees. S.F. 1484 (Pogemiller); H.F. ____ ( ):MPRA; Minneapolis Police Relief Association Voluntary Employee Benefit Organization, is very limited in the scope of covered employees, involving only Minneapolis Police Relief Association covered employees and their survivors and dependents.

Some bills would mandate coverage; others provide options coverage.

At least one bill, S.F. 641 (Pogemiller); H.F. 695 (Osskopp): MSRS; Health Care Reimbursement Plan, has direct pension plan implications, since a portion of the assets in the MSRS active employee investment pool (the SBI Basic Fund) would be used to provide an additional benefit to existing retirees. This bill, and a few of the others, also have budget implications, because employer contributions are mandated.

Different bills would use different investment providers and plan service providers. At least one, S.F. 641 (Pogemiller); H.F. 695 (Osskopp): MSRS; Health Care Reimbursement Plan, would mandate that the State Board of Investment (SBI), invest plan assets. Others would use SBI and/or outside providers. Some would use MSRS as the administering agency. Another would use the Department of Employee Relations (DOER). Others would establish a separate board composed of employee and employer representatives. One would permit local administration, by the Minneapolis Police Relief Association, possibly through a separate corporation established by that organization.

Some bills use a defined contribution approach, while at least one uses a defined benefit approach. S.F. 641 (Pogemiller); H.F. 695 (Osskopp) uses a defined benefit approach, where benefits levels are specified in law. Others use a defined contribution approach. The bills that use a defined contribution approach set up separate accounts for each covered member. The member has a right to the value of the account; the covered employee bears the investment risk; and investments tend to be self-directed. In contrast, S.F. 641 (Pogemiller); H.F. 695 (Osskopp) uses a single investment pool, invested by SBI, consistent with a defined benefit approach.

A somewhat more detailed summary of each set of companion bills follows.

Summary

S.F. 641 (Pogemiller); H.F. 695 (Osskopp) S.F. 641 (Pogemiller); H.F. 695 (Osskopp): MSRS; Health Care Reimbursement Plan, would establish a healthcare cost reimbursement plan following a defined benefit pension plan model, but with far more restrictive vesting requirements. The plan would be established consistent with Internal Revenue Code, Section 401(h) requirements, permitting tax sheltering of incoming contributions and benefit payments. These bills have pension fund implications because a healthcare reimbursement benefit would be paid to some individuals who retire before the effective date of the legislation, funded by a transfer of MSRS pension fund assets from the State Board of Investment (SBI) Basic Fund.

Under this proposal, the plan will be funded by a 0.5 percent of salary employee contribution with a matching employer contribution. The purpose is to develop a sufficient asset base to support payments to certain long-service employees when they retire, to help cover the cost of health insurance premiums or other health expenses. Contributions are mandated by all members of the MSRS Legislators Plan; MSRS General Plan; MSRS Correctional Plan; MSRS State Patrol Plan; MSRS Unclassified Plan; MSRS Judges Plan; and the Arts Board, Humanities Commission, Minnesota Historical Society Individual Retirement Account Plan. Retiring members who meet the vesting requirements of the healthcare reimbursement plan are eligible to receive monthly healthcare-cost-reimbursement payments ranging from $55 per month (if benefits to the individual commence in the July 1, 2001 to June 30, 2003 period), escalating to $158 per month if benefits commence on or after July 1, 2012.

Vesting requirements are restrictive. To be eligible for these monthly benefits, the individual must have at least fifteen years of allowable service, be at least age 60, and be eligible to draw retirement benefits at the time of separation from state service. Any terminated employee who does not meeting these vesting requirements (and any vested member who prefers a refund) has a right to a refund of employee contributions plus five percent interest in lieu of any other payments, if applicable. Fund assets would be invested by the State Board of Investment (SBI) in an account separate from retirement fund assets.

Individuals who retire or are disabled before the effective date of the bills from the applicable plans are to receive a $55 per month payment providing the individual had 15 years of service credit and is at least age 60. Retirees and disabilitants who had 15 years of covered service but who are not yet age 60 are entitled to the $55 benefit upon reaching age 60. The healthcare reimbursement benefits for these existing retirees are financed by retirement plan assets in the SBI Basic Fund. Suitable reserves are transferred to the SBI Post Fund.

S.F. 1322 (Stumpf); H.F. 1294 (Mares) S.F. 1322 (Stumpf); H.F. 1294 (Mares): MSRS; Post Retirement Healthcare Savings Plan, would establish a healthcare savings plan with an individual account for each eligible member. The plan will create one or more trusts, eligible for tax-preferred or tax-free treatment. MSRS would contract with public and private entities to provide investment services, record-keeping, and benefit payouts. Contributions are to be determined through a personnel policy of collective bargaining agreement between the state public employer and the applicable bargaining unit.

S.F. ; H.F. 2029 (Haas) S.F. ; H.F. 2029 (Haas): DOER Health Care Account Establishment, would authorize the Commissioner of the Department of Employee Relations to create healthcare accounts or savings plans to prefund retiree health care costs, as determined through collective bargaining, the commissioner's plan, or the managerial plan. The accounts are to be funded by the employees. The state is prohibited from contributing to the accounts or plans or from covering any administrative costs of the accounts or plans.

S.F. 1484 (Pogemiller); H.F ( ). S.F. 1484 (Pogemiller); H.F. ____ ( ):MPRA; Minneapolis Police Relief Association Voluntary Employee Benefit Organization, would authorize the MPRA to create a voluntary employee benefit organization (VEBO), consistent with Internal Revenue Code, Section 501 (c)(9). The purpose of the VEBO is to provide for payment of health-care-related benefits to MPRA members, retirees, and surviving spouses. Individual accounts are to be established, funded by transfers from the member's health insurance accounts, contributions by active members with more than 25 years of service which are not directed to the employee's other health insurance account, and a portion of any disability benefit or post-retirement adjustment paid by the association, which the member designates is to be directed to the VEBO, and any transfer of funds from the city. Local approval is required.

S.F. 1755 (Stumpf); H.F. 1868 (Davids) S.F. 1755 (Stumpf); H.F. 1868 (Davids): School Employee Health Care Accounts, would establish a School Employees Insurance Plan, to be funded by the state and (presumably) matching employee contributions. Individual accounts are to be established. (The drafting refers to a "state-funded plan", and to matching contributions by the employees, but no specific contribution rates are mentioned in the bills.) Employee groups could elect not to participate if health coverage is provided for those employees through another plan. The plan is to be administered by a board composed of employee and employer representatives.

Discussion, Policy Issues.

S.F. 641 (Pogemiller); H.F. 695 (Osskopp) S.F. 641 (Pogemiller); H.F. 695 (Osskopp): MSRS; Health Care Reimbursement Plan, is virtually identical to bills submitted during the previous legislative session. (Those bills were S.F. 2796 (Pogemiller); H.F. 2999 (Mares): MSRS; Health Care Reimbursement Plan.) The LCPR staff memo prepared last session for those bills is attached. The policy issues raised in last session's memo are summarized as follows:

Design issues. This plan is modeled after a defined benefit pension plan. A single fund or trust is established in which all plan assets are pooled. Individuals receive specific dollar benefits, as specified in law, depending upon whether the individual has sufficient service to vest for a monthly benefit upon termination of service. If not eligible for an annuity, the individual's only option is to take a refund.

Under a defined benefit approach, there are cross-subsidy effects which the LCPR may wish to consider. To be eligible for any monthly benefit from the plan at retirement, contributing employees who terminate from service must have at least 15 years of covered service, be age 60 or older, and be immediately eligible for a retirement annuity. All other terminating members are eligible only for a refund of the employee contribution plus five percent interest. Because of the long vesting period, coupled with the requirement that the individual must be immediately eligible for a retirement annuity upon termination (age 55 in most of the plans), some groups within the broad proposed membership are more likely to qualify for annuities than other groups. Members of the State Patrol Plan, Correctional Plan, and Judges Plan are most likely to meet vesting requirements of this healthcare reimbursement plan to receive monthly benefits. Members of MSRS General are least likely to qualify, particularly females in that plan, because of the higher turnover rates for females in general employee positions.

Also, as drafted, the proposal provides a windfall to existing retirees financed by retirement plan assets.

Fairness issues. The many contributing members who will never qualify for monthly benefits raises questions of fairness. The LCPR may wish to decide whether the cross subsidies reflect a fair policy. Given that many contributing members will never get a monthly benefit, the LCPR may wish to consider whether it is fair to provide $55 per month health care payment reimbursements to many existing retirees, who never contributed to this healthcare reimbursement plan. Those additional annuities are to be financed by transfers from the MSRS retirement funds (for MSRS General, Correctional, etc.) to the SBI Post Fund. Active employees in those pension plans may view that transfer as unfair. The LCPR may also wish to consider whether the refund is fair. The refund provided to any member who is ineligible to receive a monthly health-care cost reimbursement is an amount equal to the employee contribution plus five percent interest, which is less generous than the refund from a retirement plan.

Use of pension funds for healthcare costs. Since retirement funds are used to finance healthcare reimbursement benefits for some of the retirees, the proposal has a cost to each plan. In any plan that is not fully funded, presumably this will add to amortization requirements. In any plan which has assets in excess of liabilities, the transfer uses some of that excess.

Employer funding support. The plan requires state funds, through the one-half of one percent employer matching contributions.

S.F. 1322 (Stumpf); H.F. 1294 (Mares) S.F. 1322 (Stumpf); H.F. 1294 (Mares): MSRS; Post Retirement Healthcare Savings Plan, would establish a healthcare savings plan with an individual account for each eligible member. The plan will create one or more trusts, eligible for tax-preferred or tax-free treatment. MSRS would contract with public and private entities to provide investment services, record-keeping, and benefit payouts. Contributions are to be determined through a personnel policy of collective bargaining agreement between the state public employer and the applicable bargaining unit.

This approach is s defined contribution approach. The bills require MSRS to create a healthcare savings account for each plan member. MSRS could run the plan itself, or contact with other providers, either within government or outside, to provide various services.

This approach raise several policy issues:

Efficiency questions. Use of outside providers may lead to higher costs for administering the plans. If the accounts are to be self-directed (and that is the impression given in the drafting) the investment growth, in general, is likely to be considerably less than would occur under an SBI fund approach, where SBI is given investment authority to invest the funds of a single group plan.

Coverage issues. Coverage is not mandated in law. Rather, participation is to be determined through collective bargaining agreements. Ultimately, some groups may have the coverage while others do not. Contribution rates are not stated in the bills. Perhaps these are to be determined through separate agreements, which could lead to differences in contribution rates, and different levels of employer-provided support, between different groups.

Cost. The bill drafting suggests that employer contributions would be involved, leading to budgetary impacts.

Issues stemming from defined contributions approach. Under a defined contribution approach, each individual owns the value of his or her account—the accumulated employee contributions and employer contributions (if any) plus all investment earnings. There are no cross subsidization effects, in the sense found under a defined benefit approach. Other consequences of this defined contribution approach, some of them clearly negative, are that the value of an individual's account will be a function of pay. At the same contribution rates, lower paid individuals will have fewer dollars going into their account than a higher paid individual. Over time the lower paid individual will have an account that is worth considerably less than that of the higher paid individual, but the health-care reimbursement needs may be the same. Also, in a defined contribution approach, investment risk is born by the individual. Weak investment markets or poor investment decisions could cause considerable harm.

Administrative issues. One administrative issue is whether MSRS should be the lead organization under this approach, or whether the various functions should be performed by the DOER or some other executive branch agency. Whatever organization provides administrative support for this program, handling the numerous accounts could be problematic. Numerous separate accounts would need to be maintained, some with very low value, created by individuals who were contributing members for short periods.

S.F. ; H.F. 2029 (Haas) S.F. ; H.F. 2029 (Haas): DOER Health Care Account Establishment, would authorize the Commissioner of DOER to create healthcare accounts or savings plans to prefund retiree health care costs, as determined through collective bargaining, the commissioner's plan, or the managerial plan. The accounts are to be funded by the employees. The state is prohibited from contributing to the accounts or plans, or covering any administrative costs of the accounts or plans.

This approach seems similar to that suggested by S.F. 1322 (Stumpf); H.F. 1294 (Mares): MSRS; Post Retirement Healthcare Savings Plan, raising many of the same issues. In this proposal, DOER is the lead agency, not MSRS. Employing units are prohibited from contributing.

S.F. 1484 (Pogemiller); H.F ( ). S.F. 1484 (Pogemiller); H.F ( ):MPRA; Minneapolis Police Relief Association Voluntary Employee Benefit Organization, would authorize the MPRA to create a voluntary employee benefit organization (VEBO), consistent with Internal Revenue Code, Section 501 (c)(9). The purpose of the VEBO is to provide for payment of health-care-related benefits to members, retirees, and surviving spouses. Individual accounts are to be established, funded by transfers from the member's health insurance accounts, contributions by active members with more than 25 years of service which are not directed to the employee's health insurance account, and a portion of any disability benefit or post-retirement adjustment paid by the association, which the member designates is to be directed to the VEBO, and any transfer of funds from the city. Local approval is required.

This is a defined contribution approach, bearing some similarity to that in bills previously discussed and raise some similar policy issues. We note that S.F. 1484 (Pogemiller); H.F ( ), is limited to a small local group, the group of Minneapolis police officers covered by the MPRA and the survivors and dependents of those members. The proposal mentions separate accounts for each member, and involves investing each of those accounts in an investment vehicle or vehicles selected by a board, to be established.

There a few issues specific to S.F. 1484 (Pogemiller); H.F ( ). The coverage group is very limited. If any new health care arrangement is to be created, one question is whether the coverage group should be this small. Alternatives are any new arrangement covering all Minneapolis police officers, not just those in the old relief association, or including Minneapolis Fire Relief Association, or all Minneapolis firefighters, or all Minneapolis city employees, or Hennepin County employees, or regional public employees, or a statewide public employee health savings plan. There is also the question of whether the MPRA should play any role in setting up or administering this healthcare plan proposal, given the well documented problems on the current MPRA board, weak past investment performance in general, and specific past investment irregularities. Perhaps the city should take a lead administering position. While the bills permit Minneapolis to make contributions or transfers to the new health care arrangement, there is a question of whether employer contributions are appropriate.

S.F. 1755 (Stumpf); H.F. 1868 (Davids) S.F. 1755 (Stumpf); H.F. 1868 (Davids): School Employee Health Care Accounts, would establish a School Employees Insurance Plan, to be funded by the state and (presumably) matching employee contributions. Individual accounts are to be established. (The drafting refers to a "state-funded plan", and to matching contributions by the employees, but no specific contribution rates are mentioned in the bills.) Employee groups could elect not to participate if health coverage is provided for those employees through another plan. The plan is to be administered by a board composed of representatives of the employers and the employee groups.

The proposal suggested in S.F. 1755 (Stumpf); H.F. 1868 (Davids): School Employee Health Care Accounts is vague. While it suggests that state money would be involved, the specific nature of the plan and contribution requirements are not indicated.

Concluding Comments.

Hopefully, this memo provides an adequate overview of the various retiree healthcare-related bills presented to the Legislature during this session. Staff has not attempted to draft any amendments to these bills, pending a decision by the LCPR and Legislature regarding which proposal or proposals, if any, warrant further consideration.

MEMO FOR LAST SESSION'S MSRS HEALTH-CARE BILL

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Edward Burek, Deputy Director EB

RE: H.F. 2999 (Mares); S.F. 2796 (Pogemiller): MSRS; Health Care Reimbursement Plan

DATE: February 24, 2000

Summary

H.F. 2999 (Mares); S.F. 2796 (Pogemiller): MSRS; Health Care Reimbursement Plan, would establish a health care reimbursement plan funded by a 0.5 percent of salary employee contribution with a matching employer contribution, to provide payments to certain long-service employees when they retire to help cover the cost of health insurance premiums or other health expenses. An eligible retiree is a former employee who is drawing monthly retirement benefits from the MSRS Legislators Plan, General Plan, Correctional Plan, State Patrol Plan, Unclassified Plan, or Judges Plan, and the individual must be eligible for the Rule of 90; or the individual must have at least fifteen years of allowable service, be at least age 60, and be eligible to draw retirement benefits at the time of separation from state service. A terminated employee has a right to a refund of employee contributions plus five percent interest in lieu of any other payments, if applicable. Fund assets are to be invested by the State Board of Investment (SBI), in an account separate from retirement fund assets.

For existing retirees, a right to a $55 per month payment is extended to existing retirees and disabilitants in the above MSRS plans providing the individual had 15 years of service credit and is at least age 60, or qualified for the Rule of 90. Retirees and disabilitants who are otherwise comparable, but who are not yet age 60, are entitled to the $55 benefit upon reaching age 60. The healthcare reimbursement benefits for these existing retirees are financed by retirement plan assets in the SBI Basic Fund.

Section-by-Section Summary

Article 1. Health Care Reimbursement Plan.

Section 1. [352G.01] Definitions.

Subdivision 1. Terms. Unless clearly indicated otherwise, terms used in the bill have the meanings as defined in this section.

Subdivision 2. Included Participants. Participants are active members after July 1, 2000 of the Legislators Plan, MSRS General, MSRS Correctional, the State Patrol Plan, the Unclassified Plan, and the Judges Plan.

Subdivision 3. Eligible retired employee is a former employee drawing a monthly benefit from any of the MSRS plans mentioned in Subdivision 2, with at least 15 years of service, and who is eligible to draw retirement benefits at the time of separation from state service.

Subdivision 4. Disabled employee is a disabilitant under the MSRS plans mentioned above.

Subdivision 5. Ineligible Terminated Employee is an employee not eligible for benefits.

~~Subdivision 6. Accumulated contributions is the total accumulated contributions of the employee.~~

Subdivision 7. Health Care Reimbursement Fund is the fund which accumulates employee and employer contributions and investment earnings on those contributions.

Subdivision 8. Allowable service is allowable service under any of the MSRS plans mentioned above except any allowable service reinstated by repaying a refund on or after July 1, 2000.

Subdivision 9. Salary is wages and other periodic compensation.

Subdivision 10. Designated beneficiary is the beneficiary designated by the participant.

Subdivision 11. Executive Director is the MSRS Executive Director.

Subdivision 12. Board is the MSRS Board.

Subdivision 13. Employee is a person contributing to any one of the designated MSRS plans.

Section 2. [352G.02] Health Care Reimbursement Plan. A health care reimbursement plan is established for employees in the covered MSRS plans. The plan is to be consistent with IRS Code, Section 401(h), to provide tax free contributions and benefit payments.

Section 3. [352G.03] Coverage Termination. Coverage ends when the individual terminates service or is no longer covered by a designated MSRS plan.

Section 4. [352G.04] Appeals Procedure. The appeal process in Chapter 352 applies.

Section 5. [352G.05] Fund Created, Employee and Employer Contributions. The health care reimbursement fund is created, funded by a 0.5 percent of pay employee contribution, a matching employer contribution, and the investment earnings on those contributions.

Section 6. [352G.06] State Treasurer to be Treasurer of Health Care Fund. The State Treasurer or the successor is the treasurer of the fund.

Section 7. [352G.07] Investment Board to Invest Funds. SBI will invest the fund in investments authorized by existing SBI law.

Section 8. [352G.08] Health Care Reimbursement Plan Benefits. After separation from state service, an employee at least age 60 with at least 15 years service who is eligible for a retirement or disability benefit or an employee who qualifies for the Rule of 90 regardless of age is entitled to benefits from the fund. The amount of the monthly benefit increases over time, depending upon the individual's retirement date. For individuals who become eligible between July 1, 2000 and June 30, 2002, the benefit is $55 per month, escalating to $158 per month for individuals who become eligible on or after July 1, 2001.

Section 9. [352G.09] Annual Increases. Benefits may be increased, depending upon a medical inflation rate, but not to exceed five percent per year.

Section 10. [352G.10.] Refund of Employee Contributions. Individuals who terminate employment or move to ineligible employment can apply for a refund of employee contributions, plus five percent interest. It is unclear whether refunds may be repaid (one subdivision appears to authorize a refund, while another states that refunds may not be repaid.

Section 11. [352G.11] Payments Upon Death. If no other benefit has been paid and a participant dies, the designated beneficiary is entitled to an employee contribution refund with five percent interest.

Section 12. [352G.12] Payments Upon Death of Retiree. If a benefit recipient dies, the designated beneficiary is entitled to an employee contribution refund with five percent interest, minus the value of benefits already received.

Section 13. EFFECTIVE DATE. The article is effective July 1,2000.

Article 2. Current Retirees, Right to Amend.

Section 1. Current Retirees and Disabled Employees. Any current retiree (presumably an individual in that status on the effective date, July 1, 2000) who has 15 or more years of service credit and is at least age 60,

or any individual who at the time of termination qualified for the Rule of 90, is eligible to receive an additional $55 per month benefit, payable along with the individual's retirement annuity. The assets to finance this benefit for the expected lifetime of the retiree are to be transferred from the applicable MSRS plan's retirement fund for active members to the SBI Post Fund. The $55 increase is to be escalated along with the individual's retirement benefit, per the increases generated by the SBI Post Fund.

Section 2. Retirees and Disabilitants Under Age 60. A retired or disabled employee with at least 15 years of service who is under age 60 is entitled to a deferred monthly $55 benefit. At age 60, the necessary actuarial reserves for the benefit are transferred from the applicable retirement fund to the SBI Post Fund.

Section 3. First Increase. The first retiree increase is authorized for January 1, 2003.

Section 4. Unlimited Right to Amend. The provisions of this bill may be amended in any manner and for any reason.

Section 5. EFFECTIVE DATE. The article is effective on July 1,2000.

Discussion, Policy Issues.

At an earlier LCPR meeting, LCPR members were provided with an overview of the Health Care Reimbursement Plan proposal. That presentation described some of the characteristics of the proposal and members were provided by MSRS with the attached handout, entitled Minnesota State Retirement System: Insurance Presentation.

In its current state, H.F. 2999 (Mares); S.F. 2796 (Pogemiller) should be viewed as an early-stage proposal rather than a near-finished product. The proposal raises fundamental questions regarding how the program should be designed, who should administer the program, who should pay and in what proportion, and who should be covered.

Some general areas for consideration are:

Design issues. A fundamental question is who the system should help. One approach is a design which benefits all participants by helping each active MSRS member cover their health care costs when he or she retires, whether or not that person remains in state employment until retirement. Another approach is to design a system to help a minority of active members, financed by the employer and all active members. This MSRS proposal takes the latter approach, plus the proposal provides a windfall to existing retirees financed by retirement plan assets. Regarding the provisions for current active members and any new hirees, every active MSRS plan member will contribute, the employer will contribute a matching amount, and the plan will pay meaningful benefits down the line only to a self-selecting minority of the population--an individual who terminates service with at least 15 years of covered service, is at least age 60, and is immediately eligible for a retirement annuity, or any individual who qualifies for the Rule of 90, regardless of age.

This structure bears similarity to the funding structure of a defined benefit pension plan, in that part of the cost for the minority who draw will eventually draw healthcare reimbursement payments is covered by turnover gain from the majority of the employees. In this proposal, any member who terminates service with less than fifteen years service credit is not entitled to a benefit other than a refund of employee contributions plus five percent interest. The health care fund keeps investment earnings above five percent, and the full employer match plus all investment earnings on that amount. These are used to finance the benefits to those who remain.

Saying that a plan is financed in part by turnover gain means that the plan obtains part of the financing by shortchanging much of the membership. In this proposal, the shortchanged group is the active members who terminate service with less than fifteen years of service (and a few other subgroups who are also left out). A considerable majority of individuals who enter state service terminate before 15 years of service is reached. For this group, the proposed program amounts to a forced savings plan with a substandard return. These employee contribution refunds with five percent interest penalize all members of this group. These members would be better off if that money were placed in an individual account for the member--in the deferred compensation plan, or a similar arrangement. Over the long term, that account would have considerably more value than the proposed forced savings plan.

Since the plan requires that the individual provide at least 15 years of service to qualify for healthcare reimbursement plan benefits following his or her retirement, along with numerous other requirements, it is useful to briefly examine who is likely to be burdened by the contributions to the plan while never qualifying for any healthcare reimbursement benefits. Copies of actuarial assumption tables for the MSRS General Plan, MSRS State Patrol Plan, and MSRS Judges Plan are attached. The withdrawal columns indicate the number of expected withdrawals (terminations) per 10,000 participants. These numbers can be converted to probabilities of withdrawal, or alternatively, probabilities of remaining in service. For instance, in the MSRS General Plan for males age 25, out of an assumed 10,000 individuals in this category, 1,600 are likely to withdraw by the end of the year. This amounts to a probability of withdrawing by year end of 16 percent. Alternatively, the probability that a male age 25 will remain in service to year end is one minus 16 percent, or 84 percent. Using this information, staff determined that for males age 25, the *majority* of that group (52 percent) would leave state service by the end of *five* years. Scanning the withdrawal columns, it is evident that the result would be even higher for males under age 25, since they withdraw at much higher rates. Chances of remaining would be better at older ages, but even in those groups many will never qualify for this program.

Members will also note from information in the attached MSRS General table that females are far more likely to terminate service than a comparable male. Therefore, a female is far less likely to qualify for healthcare reimbursement benefits than a male, and most males will never quality. Thus, from this information, it is evident that for members with MSRS General coverage, the proposed healthcare reimbursement plan with its fifteen-years-of-service requirement is most likely to eventually provide assistance to older employees. It is highly unlikely that younger males will ever qualify for benefits. The program is particularly disadvantageous to females, because at all ages they are far more likely to withdraw, and are therefore far less likely to ever achieve the 15-year vesting requirement.

In summary, this proposed plan is not in the best interest of the broad MSRS membership. Like most defined benefit plan benefit increase proposals which the Commission hears, this healthcare proposal is desired by those with long service who are close to retirement, and is to be financed at the expense of those who remain.

Also attached is the withdrawal rate table used for the MSRS State Patrol Plan. Again, the withdrawals are expressed in that table as withdrawals per 10,000 participants. LCPR members will note that the withdrawal rates are much lower than the comparable MSRS General table. This reflects that individuals in public safety employment are far less likely to leave that service than is true of individuals of the same age in non-public safety employment. The low withdrawal rates mean that it is quite likely that MSRS State Patrol Plan members will provide at least 15 years of service and therefore be eligible to receive benefits from the proposed healthcare reimbursement program. The healthcare reimbursement program has a single fund, financed by the employer and all employees from all the MSRS General Plans. This means that the MSRS General members, the majority of whom will never qualify for the healthcare benefits, will pay for benefits for the State Patrol Plan members. The members of the State Patrol Plan have considerably higher pay than a typical MSRS General Plan member, they have a pension plan which pays far higher benefits and at a much earlier age, and it is staff's understanding that State Patrol Plan members generally receive paid healthcare benefits through collective bargaining. If this is the case, presumably the proposed healthcare reimbursement plan would assist with any medical-related expenses by State Patrol Plan members which is not covered by other payment sources. MSRS General members may view this as unfair. Not only are General Plan members subsidizing the portion of the pie that MSRS State Patrol members will receive, most MSRS General Plan members will never receive any of that pie.

Also attached are the withdrawal rates from the MSRS Judges Plan. Very few judges leave that employment prior to retirement. Withdrawal is so low that the actuary assumes *no withdrawal at any age* prior to retirement. Any judge who enters the system at least fifteen years prior to retirement can be presumed to meet the 15-year vesting for the healthcare reimbursement benefit. As an employee group, judges have the highest pay and have a very generous pension plan. Again, the MSRS General members, the majority of whom will never qualify for health care reimbursement benefits, will pay for benefits for highly paid individuals in a generous pension plan. MSRS General members may view the health care reimbursement plan as a proposal to transfer further wealth from the "have-nots" to the "haves."

In choosing to assist the minority, the proposed system denies that the majority of active state employees have long-term health care funding needs. Encouraging use of deferred compensation plans would be a better way to help all employees meet health care costs later in life. The employer match program in existing law could be utilized to assist in that effort. The arguments made at the time that the employer

match provision was added to the deferred compensation law is that the program would be a useful tool to help individuals save for later health care costs. It would be appropriate to again encourage use of that tool for that purpose.

Another design issue is the nature of the benefit schedule. The payment is a fixed dollar amount in any year, rather than being related to the contribution amount of the individual, years of service beyond 15, or salary. This is in direct contrast to the design of MSRS defined benefit plans with which the health care provisions are at least partially merged.

Equity issues. The above comments raise equity issues, mainly, whether a program with mandatory membership which penalizes most of the members can be considered fair. There are some additional issues. As drafted, it appears that many active members who terminate service, even if they have 15 years of service, and become deferred annuitants are never eligible to receive health care payments. Perhaps this is a drafting problem rather than intentional. If not, it is unclear why some are excluded and others are included. In another issue, in Article 2 of the bill, there are uncoded law provisions which allow current existing retirees, and possibly some deferred retirees, to receive $55 per month health care payment reimbursements. These are to be financed by transfers from the MSRS retirement funds (for MSRS General, Correctional, etc.) to the SBI Post Fund. These retirees who are cut into the program receive a windfall. They retired before the health care insurance program was implemented and thus never contributed to the plan, yet they receive benefits. Since those benefits are financed by the employer and the active employees through their contributions to the applicable retirement fund, it can be argued that the active members contribute toward the windfall benefits to retirees, yet the majority of active members will never receive any meaningful benefit themselves from the health care plan. Active employees may view that as unfair.

Merging of health care benefits into retirement fund. Article 2 of the bill, in sections 1 and 2, uses assets of the MSRS retirement plans to finance health care reimbursement payments. The blending of health care provisions into retirement funds should concern the LCPR. If this health care plan is enacted, and as it is revised over the years, pension funds will become heavily involved in funding health care. Given the large liabilities that can occur through health care costs and the unpredictable nature of health care cost increases, it is wise to keep pension funding and health care funding totally separate. These sections raise other issues. First, for some of the pension funds these sections have the effect of using some of the surplus assets in the fund--assets in excess of full funding. The proposal uses those assets in a way that benefits only a portion of the membership--some but not all of the retirees. The issue is whether the LCPR concludes that is an appropriate use of those assets. Second, the proposal proposes to use retirement assets for purposes other than paying authorized benefits of the retirement plan and authorized expenses, which is in violation of existing law for permissible uses of pension funds and is a fiduciary breach under existing law. Third, section 1 indicates that if the retiree has service in more than one MSRS fund, the assets needed for the actuarial reserves to support the additional health care payment benefit are to be taken entirely from the plan in which the individual has the most service credit. While in a practical sense it does not matter, normally taking assets from one fund to cover liabilities related to service in another plan would raise strong objections from the fund administrators. Fourth, while the health care benefit to the existing retirees is merged into the retirement funding, those for the active employees does not appear to be. In the long term, this will be problematic, as benefits and adjustments for one group begin to diverge from that of the other group. It would be best to completely isolate this proposed health care program from the retirement system.

Cost. Since retirement funds are used to finance healthcare reimbursement benefits for some of the retirees, the proposal has a pension cost on each plan. Perhaps MSRS can provide estimates.

Refund issues. The refund provisions are unclear and misdrafted. Page 8, lines 15 and 16 state that a refund from the health care fund can not be repaid, while the subdivision on lines 17 to 21 specify procedures for repaying that refund. The allowable service definition on page 2, lines 12 to 15 state that if allowable service in an MSRS plan is reestablished by repaying a refund to the pension fund, that service is not to be included in determining allowable service for purposes of the 15-year service credit vesting requirement for the health care payments. The reason for the prohibition is unclear.

Employer funding support. The LCPR may wish determine whether there is support from the Executive branch for the 0.5 percent of payroll employer contribution, and, more generally, whether the Executive branch supports the general approach proposed for this program.

Employee support. The LCPR may wish to hear testimony to help the LCPR to assess whether the membership groups support the bill, and whether the membership groups have an adequate understanding of the bill's impact on the members.

Proper administrative agency. As drafted, MSRS would be the administrative agency. MSRS is mandated under existing law to be the administrative agency for MSRS pension plans. Administering a health care payment reimbursement system is not consistent with the mission of the organization. In recent years, MSRS has proposed several changes to its pension systems which promote administrative ease at the expense of good pension policy. At the same time, MSRS has devoted increased attention to the deferred compensation plan and proposals like this health care proposal, which diverts MSRS attention from its core responsibilities. Having MSRS administer a health care payment reimbursement system will further divert attention from its mission, and it is likely to lead to a further blurring of the line between pension liabilities and healthcare liabilities. If a program is established, it should be administered by an executive branch agency.