LC 90206.01 – Would create a health care savings plan for all supreme and district court judges

Proposal	Section	Actuarial and Technical Comments	PERS Comments and Recommendations
As proposed, this bill would modify the State Century Code as follows: • It allows the NDPERS Board to create and implement an IRC Section 115 (integral part governmental) Trust for retiree healthcare expenses for all state supreme and district court judges that participate in NDPERS if at least 75% of the active participating supreme and district court judges vote to approve the program. • If at least 75% approve the program, the contribution level specified in the vote applies to all current and future participating supreme and district court judges according to the plan document developed by the NDPERS Board. • The approved contribution level can only be changed by a vote of at least 75% of the total active participating supreme and district court judges at that time.	Section 1	The bill appears to meet the IRS requirments	PERS has no comments and is neutral on the bill

APPENDIX N

October 16, 2008

Representative Bette Grande, Chair
Employee Benefits Programs Committee
State of North Dakota
Bismarck, North Dakota

Dear Representative Grande,

Re: Review of Proposed House Bill 90206.0100 – A bill relating to the creation and enactment of a new subsection to section 54-52-04 of the North Dakota Century Code to provide the public employees retirement system the authority to create a trust health care savings plan for all supreme and district court judges participating in the public employees' retirement system.

The following summarizes the above referenced proposed legislation and our assessment of the financial and technical impacts of the bill.

Overview of the Proposed Bill

As proposed, this bill would modify the State Century Code as follows:

- It allows the NDPERS Board to create and implement an IRC Section 115 (integral part governmental) Trust for retiree healthcare expenses for all state supreme and district court judges that participate in NDPERS if at least 75% of the active participating supreme and district court judges vote to approve the program.

- If at least 75% approve the program, the contribution level specified in the vote applies to all current and future participating supreme and district court judges according to the plan document developed by the NDPERS Board.

- The approved contribution level can only be changed by a vote of at least 75% of the total active participating supreme and district court judges at that time.

Technical Discussion

The state supreme and district court judges want a supplemental financial vehicle to allow pre-funding of eligible retiree healthcare expenses in a tax efficient manner. An IRC Section 115 Trust is one of several permissible funding vehicles that can be used by public sector employers and their employees to pre-fund retiree healthcare expenses.

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Employee contributions can be made pre-tax to a Section 115 Trust. In order to obtain this tax-favored treatment, all employees in the defined group must participate in the retiree healthcare pre-funding plan. Participation cannot be elective. Contributions to a Section 115 Trust and interest earnings accumulate without taxation. Employees can direct their contributions to different investment options, if the plan is designed to allow this. As long as the accumulated funds are used for qualified medical expenses, they are not taxed upon distribution.

The Minnesota State Retirement System (MSRS) currently offers a Health Care Savings Plan (HCSP), which uses a Section 115 Trust as its funding vehicle. For employees subject to collective bargaining, all employees in the bargaining group must participate. For non-bargaining employees, all employees in a defined group must participate.

What constitutes a "group" for Section 115 purposes is subject to some debate. However, one common definition is:

> "...individuals who become entitled to participate by reason of their being employees and whose membership is defined by objective standards that constitute an employment related common bond. This can include....members of a bargaining unit....nonunion administrative staff. Further membership can be restricted. Restrictions can be based on any objective criteria related to employment such as...job classification."[1]

Section 115 Trusts are subject to the non-discrimination rules for health reimbursement arrangements under IRC Section 105(h). Violation of the non-discrimination rules by any participating employer has no effect on the tax exemption of the Trust. However, violation of the non-discrimination rules will cause the health reimbursement arrangement payments to be taxable for highly compensated employees of the violating employer. As long as the established Trust contribution arrangement is uniformly applicable (such as flat dollar amount or percentage of salary) to all members of the group, meeting the non-discrimination rules should not be problematic.

IRS approval of a Section 115 Trust is not required. However, NDPERS may wish to consider requesting an IRS private letter ruling (PLR), especially if it intends to develop a proto-type plan document to be used by other employee groups that may request a health care savings plan in the future. The PLR will give assurance to any future employee groups and NDPERS that the judges' program meets IRS guidelines for compliance. MSRS obtained a private letter ruling from the IRS confirming the tax exempt benefit status of its HCSP in July 2002, although it started offering its HCSP a

(1) International Foundation for Employee Benefits, "VEBA, Who May Be Eligible?"

full year earlier. It is our understanding that IRS rulings on Section 115 Trusts take a minimum of six months after submission. Because the ruling is not required, NDPERS could implement its plan before receiving the IRS opinion. This appears to be the approach that MSRS used.

As drafted, HB 90206.01 will not reduce NDPERS' GASB 45 OPEB liability. In order to affect its OPEB liability, the retiree healthcare funds must come from the employer, GASB's irrevocable trust requirements must be satisfied and the funds would need to legitimately offset expenses otherwise incurred by NDPERS.

Analysis

There are two key questions to be answered regarding this proposed legislation. First, do the supreme and district court judges constitute a "group" for the purposes of achieving tax favored status of employee contributions? Second, does the bill meet the IRC requirements that all members of the group participate in the Trust with no opportunity for individual election?

Regarding the first question posed above, it does appear that the state supreme and district court judges do constitute a distinct group. They are already a distinct group within retirement system. Presumably, they are not subject to collective bargaining. Therefore, using the definition cited above, supreme and district court judges constitute a group whose membership is "defined by objective standards that related an employment related common bond." The group is exclusive and limited to a finite number of active employees who are active participants in NDPERS.

We have confirmed that the Minnesota State Retirement System (MSRS) does offer its Health Care Savings Plan (HCSP) to state judges. MSRS is comfortable that the judges qualify as a group for the purposes of allowing pre-tax employee contributions. This should be reassuring to NDPERS in its consideration of HB 90206.01.

The answer to the second question is relatively straightforward. The bill requires 100% of the supreme and district court judges to participate in the health care savings plan if ratified by vote of the entire group. Consequently, this IRC requirement for tax favored treatment of contributions would be met.

Financial Discussion

Although the bill is not specific about the sources of funding, we have assumed that there will be no direct employer contributions to the proposed health care savings plan. Consequently, contributions would be made by employees either through redirection of salary or transfer of future sick or vacation leave accruals.

If the above assumptions are correct, then the financial impact to the State from the passage of this bill would be twofold. First, there would be implementation and start-up costs. These would include development of the plan document, communications materials/website development, external administrator selection (if applicable) and any indirect costs associated with NDPERS staff time to roll out the new plan. These would be essentially one-time costs and would not normally recur. We do not have enough information to accurately estimate total implementation costs, but they should not be significant.

There would also be ongoing costs for the administration of the program. If plan participants are given different investment choices for their accumulated contributions, there may be financial management costs associated with these functions also. NDPERS would need to determine if it will absorb the administrative and financial costs or whether these costs will be assumed by the plan participants. MSRS, for example, presently assesses participants in its HCSP .65% of their account balances annually to cover administrative costs. We are unable to determine if this assessment level would be adequate to sustain a similar NDPERS program whether claims processing is done internally (as MSRS does) or externally by a third party vendor, but it could serve as a reasonable starting point should the program be established.

<u>Conclusions</u>

From our understanding of the proposed bill, it does appear to meet the two critical IRS requirements for a retiree healthcare pre-funding vehicle to allow pre-tax contributions, tax free accumulations and tax-exempt distributions for qualified expenses. The supreme and district court judges appear to qualify as a distinct group to which the health care savings plan will be offered. Further, the bill requires that 100% of the group participate in the plan, with no ability to opt-out. The fact that the MSRS offers a similar health care savings plan to its judges is reassuring that the proposed bill meets the IRS requirements.

To confirm presumed tax favored status of the health care savings account (particularly if PERS expects other groups to request a similar plan in the future), we suggest that it consider obtaining an IRS private letter ruling, similar to the one obtained by MSRS. As a PLR is not required for Section 115 Trusts, NDPERS could implement the program prior to receiving the formal ruling from the IRS.

Financially, the start-up costs for the health care savings plan should be nominal, but further discussion is needed to determine whether NDPERS or the plan participants will pay the one-time expenses. On an ongoing basis, there will be recurring administration and financial management expenses. The amount of these expenses will depend greatly on the plan design selected and features offered. A decision will need to be made whether these recurring costs will be paid by the State or NDPERS, the plan participants or both in some shared arrangement.

GBS is not qualified to render legal advice. As with all matters involving the interpretation of complex laws and regulations, we suggest that NDPERS obtained qualified legal counsel input before any final decision on this bill is made.

We appreciate the opportunity to review and analyze this proposed legislation. Please let us know if we can provide any further assistance.

Sincerely,

William F. Robinson, Jr.

William F. Robinson, Jr.
Area Senior Vice President