

Historic Legislation Passes that Provides a *Shared Responsibility* Solution for Long-term Funding of Retiree Health Care

Anticipated Retired & Active Member Questions

INTRODUCTION

The following information is provided to answer a number of questions we expect from active members and retirees following passage of legislation this session contained in House Bill 540. This legislation sets in place a plan of Shared Responsibility, designed to provide long-term funding for retired teachers' medical benefits.

House Bill 540 is a Shared Responsibility solution that provides permanent funding for retiree health care and ends the long history of underfunding this important benefit. Shared Responsibility calls upon each party (active teachers, retired teachers, school districts, and the state) to share in a piece of the solution by investing a little more now to receive substantial returns later.

Teachers in Kentucky are rather fortunate in that they have one of the best pension systems in America and when coupled with retiree medical benefits, can provide complete financial security in retirement. Most retired teachers in America have a pension benefit of some type, but many do not have medical benefits, leaving their financial security during retirement in doubt.

The medical benefit, first provided in 1964, was established on a pay-as-you-go basis similar to Medicare. In other words, all dollars coming in were used to pay for retiree medical benefits as they became due, leaving no spare funds to invest to cover future costs. The source of funding consisted of contributions from active members with the state paying an equal amount. Currently these contributions are .75% of salary (1.75% for those members hired after June 30, 2008). For years now, the costs of providing retiree health care have overwhelmed the contributions generated by these two sources of funding.

For the most recent year, these contributions generated only \$48 million of the \$182 million cost, a shortfall of \$134 million.

As previously reported, to make up this growing shortfall, the state has been redirecting contributions away from the teachers' pension fund to the medical insurance fund. Since 2004, over \$560 million has been redirected with the agreement it will be repaid by the state with interest over staggered 10 year terms. At this rate, even with repayment, the assets of the pension plan would be depleted by 2029. Though all involved knew this practice wasn't sustainable long-term, we are extremely grateful to the General Assembly and Governor for providing this short-term strategy without which retiree health care would have been drastically cut years ago. This short-term strategy provided needed time to develop a long-term solution.

RETIRED MEMBER QUESTIONS

- **If this bill had not passed, what would have happened?**

Without a long-term solution to fund retiree health care, the medical benefit for retired teachers under age 65 would have gone away and retirees would have to pay the full cost of health care, currently \$7,068 per year. In addition, existing funding was not sufficient to cover costs of health care for retirees age 65 and over, and they too would have to pay an additional amount for coverage.

- **Can you put the added cost for retirees under age 65 in perspective?**

Retirees under age 65 have an average pension of \$36,000 per year and currently receive a medical benefit of \$7,068 per year that is non-taxable. This is a combined benefit of \$43,068 per year of which only \$36,000 is taxable.

If this legislation had not passed, and retirees under age 65 were required to pay the total cost of the medical benefit out of their pension, the outcome would be quite different. Now the \$7,068 cost would be paid

from the \$36,000 retirement benefit and the retiree would still be responsible for tax on the total \$36,000 pension, reducing the amount available to under \$29,000.

- **Why can't retirees pay for medical insurance pre-tax?**

By federal law, the medical benefit for retirees cannot be deducted pre-tax from the retirement benefit.

- **How do retirees participate in the plan of Shared Responsibility?**

Retirees participate by paying either the Medicare Part B premium to Social Security if they are age 65 and over, or by paying the Medicare Part B premium equivalent into the Medical Insurance Fund if under age 65. Since retirees age 65 and over are already paying the Medicare Part B premium, (current standard rate of \$99.90 per month effective 1/1/2012) they will experience no change.

- **What is the Medicare Part B premium *equivalent*?**

Effective July 1, 2010, this is the payment retirees under age 65 will contribute into the Medical Insurance Fund if they have coverage through the Kentucky Employees' Health Plan (KEHP).

- **How much is the Medicare Part B premium equivalent retirees under age 65 will contribute?**

This amount is based on the Standard Medicare Part B premium that is currently paid by retirees age 65 and over. The amount was 1/3 of the cost of the Standard Medicare Part B premium for the last six months of 2010. The Standard Medicare Part B premium is subject to adjustment by the Centers for Medicare and Medicaid Services each January 1st.

Effective July 1, 2011, the amount was 2/3 of the cost of the Standard Medicare Part B premium, and **effective July 1, 2012, the amount will then be equal to the full Standard Medicare Part B premium paid by retirees age 65 and over. The standard Part B premium for 2012 is \$99.90/month.**

- **How do retirees pay the monthly Medicare Part B premium equivalent?**

This amount will be automatically deducted from the monthly pension.

- **Why is there a three year phase-in for retirees under age 65?**

The phase-in is planned to coincide with the 1.5% Cost of Living Adjustment (COLA) scheduled for the July annuity checks and, on average, should offset the additional cost.

- **Is the Medicare Part B premium equivalent all I will have to pay for coverage?**

This contribution is in addition to any amounts you are currently paying for coverage. Such as:

- If you have less than the necessary years of service for unreduced health insurance benefits.
- If you select any option other than the Standard Plan.
- If you select any level of coverage other than single.
- If you do not qualify for the non-smoker discount.

- **Does this impact me if I do not get my insurance coverage with the Kentucky Employees' Health Plan (KEHP)?**

No. If you choose to waive your insurance coverage with the KEHP, you will not pay the Medicare Part B premium equivalent.

- **What happens when I turn age 65 or become Medicare eligible?**

When you turn 65 and become Medicare eligible, you will pay the Medicare Part B premium directly to Social Security. The Medicare Part B premium equivalent contribution will no longer be deducted from your pension.

- **Can I avoid paying the Medicare Part B premium equivalent by terminating my coverage with the Kentucky Employees' Health Plan (KEHP)?**

According to KEHP rules, you must either have a qualifying event to terminate coverage immediately or you may terminate coverage during open enrollment to become effective the following January 1. The requirement to pay the Medicare Part B premium equivalent beginning July 1, 2010 is not considered a qualifying event.

- **Will disability retirees pay the same Medicare Part B premium equivalent as service retirees?**

Yes. Both the benefit and the cost will be the same as for service retirees.

- **I am a reciprocity retiree. Can I avoid the Medicare Part B premium equivalent by selecting coverage through another retirement system?**

No. If you select coverage with the Kentucky Employees' Health Plan through a state funded retirement system, you will be subject to a pro-rata portion of the Medicare Part B premium equivalent.

ACTIVE MEMBER QUESTIONS

- **If this bill had not passed, what would have been the consequences?**

Without a long-term solution to fund retiree health care, the medical benefit for retired teachers under age 65 would have gone away and teachers upon retiring would have to pay the full cost of health care, currently \$7,068 per year. Under Shared Responsibility, active members will have medical benefits available when they retire. As is clearly evident, without medical benefits, retirement security is uncertain. The likely outcome would be that teachers would need to work much longer (closer to age 65) to make up for the loss of this benefit. Shared Responsibility means teachers will be able to retire at a time of their choice, with greater retirement security.

- **How and when does this affect me as an active member?**

Most active members will begin contributing an additional $\frac{1}{4}$ of 1% of salary on a pre-tax basis into the Medical Insurance Fund effective July 1, 2010. For the average teacher earning \$45,000 per year, the net amount will be approximately \$8 per month in the first year. Over six years, this will gradually increase to three percent. Historically, salary increases over that time span have been more than sufficient to offset this amount.

- **How does this impact my take home pay?**

For the average teacher earning \$45,000/year, this net amount will be approximately \$8 a month in the first year. The gradual increase in contributions should be less than the step and rank adjustment coupled with any cost of living adjustments you may receive, thus hopefully protecting your take home pay from decreasing.

- **Is this contribution tax-sheltered?**

Yes. The benefit of this being tax-sheltered is it reduces the impact of the contribution to your take home pay.

- **What is the time-line for the changes to occur?**

Beginning July 01, 2010, most active contributing members will contribute an additional ¼ of 1% of salary on a pre-tax basis to the Medical Insurance Fund. This will be gradually increased to an additional 3% over a six-year period. The total contribution will be 3.75% on July 1, 2015. The additional rates will phase in as follows:

Effective Date	Hired before 7/1/08	Hired on or after 7/1/08
July 1, 2010	.25%	.00%
July 1, 2011	.25%	.00%
July 1, 2012	.50%	.00%
July 1, 2013	.50%	.50%
July 1, 2014	.75%	.75%
July 1, 2015	.75%	.75%

- **I was hired after June 30, 2008, will this impact me?**

Yes. See chart above. Individuals who became members after June 30, 2008 are already paying an additional one percentage point (1.0%) to the Medical Insurance Fund and therefore will not start making an additional contribution until 2013. At that time, all members will contribute at the same rate.

- **How was this plan of Shared Responsibility developed?**

The Board of Trustees and the staff of KTRS began working with constituent groups representing Kentucky's education community to save this benefit. This effort included organizations representing retired teachers, active teachers, school boards, school superintendents and the state to search for a solution to this problem. Numerous meetings among these constituent groups involved reviewing many options presented by experts. From these meetings, a consensus was formed to support a solution of Shared Responsibility. This proposed solution, developed only after serious deliberations by these groups of its effect on retirees,

members and employers, was introduced in the General Assembly on February 26, 2010, as House Bill 540.

- **What organizations were involved in developing the plan of Shared Responsibility?**

The organizations listed below in alphabetical order were instrumental in developing this plan and passing the legislation.

- Jefferson County Teachers Association
- Kentucky Association of School Administrators
- Kentucky Association of School Superintendents
- Kentucky Education Association
- Kentucky Education Association – Retired
- Kentucky Retired Teachers Association
- Kentucky School Boards Association
- KTRS Board of Trustees – fiduciary
- Universities and community colleges
- Other organizations both within and without the education community

- **Were different options considered?**

Absolutely. Many different scenarios proposed by experts were considered. The other scenarios either relied too heavily on one group to fund the benefit (i.e. active teachers or retirees) or failed to produce sufficient revenues to fund the benefit. Only the Shared Responsibility solution produced sufficient revenues and had unanimous support.

- **What does this plan mean for me long-term?**

Health care will be available when you choose to retire.

- **Is the benefit guaranteed?**

No, the benefit is not part of the inviolable contract and is not guaranteed. However, Shared Responsibility will provide the funding to pay for this benefit over the long-term. This funding mechanism gives the best

assurance of coverage when you retire and in many respects, more so than a guaranteed benefit that lacks the funding to back it up.

- **Why is the plan phased in over a six-year period?**

For budgeting on every level, the constituent groups that represent the Kentucky education community, including retired teachers, active teachers, school boards and school superintendents, wanted the solution to be phased in over a six-year period. The consensus was that this period of time will allow all groups impacted to work this into their budgets. Historically, increments over a six-year period, would allow active teachers to offset the increased contributions net of taxes.

- **What happens after the six-year phase-in?**

All participants in the Shared Responsibility solution will continue to contribute into the KTRS Medical Insurance Fund. The statute provides that should this benefit become sufficiently funded in the future, both active member and employer contributions will be adjusted.

- **Can I avoid paying the Medicare Part B premium equivalent amount by retiring before July 1, 2010?**

No. There is no advantage to retiring prior to July 1, 2010. All retirees under age 65, regardless of retirement date, who receive medical benefits through the Kentucky Employees' Health Plan, will pay the scheduled Medicare Part B premium equivalent to the Medical Insurance Fund.

- **Should I retire to avoid the increased contribution teachers will pay?**

No. The amount you would pay for your Medicare Part B premium or its equivalent as a retiree will be greater than the increased contribution active teachers will pay.

- **Will the amount contributed be refunded should I quit teaching?**

No. Per federal and state law, these contributions must remain in the Medical Insurance Fund to provide retirees' health care. This is similar to deductions for Medicare taxes that also are not refunded.

- **Will the money borrowed by the state to fund retiree health care be repaid to the pension plan?**

Yes.

- **How will the Shared Responsibility plan affect university employees?**

Beginning July 01, 2010, active contributing university employees will contribute the actuarial equivalent to $\frac{1}{4}$ of 1% of salary on a pre-tax basis to the Medical Insurance Fund to be gradually increased to the actuarial equivalent of 3% over a six-year period. Please see your employer for details. (NOTE: Individuals who became members after June 30, 2008 are already paying an additional one percentage point (1.0%) to the Medical Insurance Fund and therefore will not start making an additional contribution until 2014.)

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JG/KAT*