

PORAC RETIREE MEDICAL TRUST

BULLETIN

March 2008

Important Information About PORAC's Medical Expense Reimbursement Plan

PORAC is implementing a retiree medical benefit trust in Spring 2008, which each member Association may decide to join, similar to the Legal Defense Fund. The purpose of this Bulletin is to answer common questions about the "Medical Expense Reimbursement Plan" (hereafter, the "Plan"), created by the Trustees.

What is a retiree medical trust?

The Trust is a vehicle to put away money while you're working, to pay for medical expenses after retirement, pursuant to the rules of the Plan. Pre-tax contributions are invested by the Trust, and after retirement, tax-free withdrawals reimburse participants for covered medical expenses and health insurance premiums. The Trustees reserve the right to amend the Plan, but this Bulletin will give you a general outline of the operation and structure of the Plan and Trust.

A. ELIGIBILITY AND BENEFITS

1) **What kind of benefits will be available to me under the Plan?** The Plan will provide a monthly cash stipend that will be available to you for reimbursement toward the cost of post-retirement "covered expenses" paid by you, on or after the date you become an Eligible Retiree in the Plan. "Covered expenses" are those medical expenses excludable from gross income under Internal Revenue Code Section 213(d), i.e., costs for the diagnosis, cure, mitigation, treatment, or prevention of disease or injury, which have not been claimed by you as a deduction on your personal tax return.

This also includes premiums for health insurance, which is broadly defined: It includes insurance for medical and/or hospital expenses, dental or vision care, hearing aid and prescription drug expenses and long-term care. The premium can be paid to a wide variety of health care Plans, e.g., to a traditional insurance company for individual coverage, to your spouse's employer Plan for group coverage, to Medicare, etc.

2) **When will benefits commence?** Benefits commence after retirement, assuming you meet the eligibility rules.

3) **How do I enroll?** In order to comply with IRS guidelines, enrollment must be done as a bargaining unit. This would be accomplished by MOU agreement with your employer, to either make employer contributions on behalf of every employee in the bargaining group, and/or to take a pre-tax deduction from every employee's paycheck to pay into the Trust. A combination of employer and employee money may be used. The amount of contribution by or on behalf of every employee must be the same within the bargaining unit. Contact a trustee for sample MOU agreements and enrollment requirements.

4) **Is there a vesting period?** There is an eligibility period, but benefits are never "vested" as the benefit level may be changed by the trustees based on the Trust's investment performance, demographics, etc.

5) **How do I become eligible?** Eligibility for benefits is generally open to any individual who becomes an Eligible Retiree by: a) earning five years of Active Service in the Plan (10 years for new employees hired after the bargaining unit joins the Trust); b) attaining age 55 (58 for non-safety members); c) being eligible to receive retirement benefits from the retirement Plan of your employer; and d) contributions having been made to the Plan on your behalf for all Active Service.

6) **What about my members who will retire before 5 years of contribution?** Current members who retire before participating in the Plan for 5 years will still receive benefits. If they have contributed for 3.5 years, they can continue to self-pay for up to 18 months per COBRA rules in order to reach the threshold for a lifetime benefit. Otherwise, their contributions will be moved into an individual account managed by the Trust. They will be eligible to receive benefits as long as there is money in their individual account.

7) **We have 3% at 50. Why do we have to wait until 55?** This Plan was designed for all PORAC members, and there are many different retirement formulas among the members. Even with 3% at 50, many employees may delay retirement in order to maximize their retirement benefits, and those who do retire before 55 will often find other employment or maintain benefits under a spouse. If we allowed benefits to begin at age 50, the actuarial assumptions would have to include the possibility of everyone retiring at age 50 and the trustees would have to decrease the amount of the benefit to Plan for that possibility. For example, assuming that employees entered the Plan at age 27 and retired at 50 instead of 55 could result in a 38% decrease in benefits. The same employee retiring at age 50, but waiting until 55 to collect benefits under the current Plan, may only cause an 8% decrease in benefits to that individual.

8) **How long will benefits last?** It is PORAC's intent that the Plan be designed so that benefits for Eligible Retirees will last until death. All contributions and earnings into the Plan can be spent only on benefits and administrative expenses. However, the Trustees will have the authority to reduce or terminate benefits earlier, if prudent, to preserve the soundness of the Plan for all of the participants. (If an Eligible Retiree returns to work with a participating employer, benefits will be temporarily suspended until he or she retires again.)

9) **What will the benefit level be?** The Trustees will calculate the benefit levels from time to time for eligible retirees and send notice to all beneficiaries. The Trustees are in discussions with a nationally recognized actuarial firm to help set the proper benefit levels.

The advantages of tax-free earnings and compound interest allow significant appreciation on the contributions, which an employee could not obtain for his own savings Plan. (For example, the actuarial projection for a police association in California with a similar-type Plan indicated that approximately \$22,000 would be contributed on behalf of the average employee over his or her career (join at age 27, retire at age 53); and that employee would receive approximately \$125,000 in (non-taxable) benefits from retirement to death. The actuary for that Plan projected 7% growth on the money.)

10) **What happens to the benefits when I die?** The Plan includes benefits to surviving spouses and dependents of an Eligible Retiree. The benefit level for a surviving spouse is 50% of the benefit level of the deceased Retiree. If there is no surviving spouse and there are surviving dependents, the benefit amount will be 50% of the benefit amount for the eligible retiree (to be divided equally among the dependents). However, if the surviving spouse has surviving dependents in the household, the benefit amount will be 100% of the Retiree's benefit amount. These benefits are paid to the surviving spouse during two periods: first, they will be paid to the spouse for 24 months immediately after the retiree's death, while the widow(er) adjusts to the new circumstances. Second, the benefit payments will resume when the spouse reaches age 55.

Individual Account Benefits for Surviving Spouse. If the employee qualifies for an individual account because the employee did not have the required years of Active Service, the individual account may also be utilized by the spouse and dependents after the retiree dies, to pay for covered medical expenses until the account balance reaches zero.

B. FUNDING

1) **How is the Plan funded?** The Trustees have set contributions rates, which the Associations and the Cities must negotiate in order to join the Trust. The contribution rates have been set at \$50 increments starting at \$100/month with a maximum of \$400/month. Each bargaining group must select a contribution level within that range in order to participate. The benefit rate for your Association will correlate with the contribution rate -- i.e., the benefit level for any retiree will depend on the contribution rates selected by his or her association, while the retiree was working. Also, if the Association increases its contribution rate during the career of the retiree, his or her benefit level will reflect that increase.

2) **May I elect whether or not to participate (like a cafeteria or 457 Plan)?** No, there is no individual election into the Plan. It is for the entire bargaining unit or no one. The tax advantages depend, to some extent, on the absence of individual election. *This requirement is set by the IRS.*

3) **What if I want to contribute more? Can we contribute our accumulated sick or vacation leave on retirement?** No individual increase in contributions is allowed. However, the Trust will accept deposits of accumulated sick and vacation leave balance payouts at retirement if negotiated in the MOU at a uniform level (e.g., 50% of accumulated sick leave; 100% of accumulated sick leave, etc.) for all employees in the bargaining unit. These amounts will be held in individual Employee Accounts for each person. See item B5. The prohibition on individual election is imposed by the IRS; any violation will jeopardize the Trust's tax advantages.

4) **What are the tax advantages of the Plan?** The Trustees have structured the Plan to obtain three separate tax breaks:

- a) The employer contributions to the Trust are not taxable wages;
- b) The Trust itself will accrue earnings on a non-taxable basis; and
- c) Your benefits will not be taxed when you receive them.

This means that the contribution to the Plan will never be taxed (unlike pension benefits which are taxed upon receipt). You will receive the non-taxable benefit payments after retirement for medical coverage, unlike distributions from a 457 Plan which are taxable income to you.

5) **Will I have an individual account in the Plan?** Generally, no; most of the contributions are held in a pooled account in the Trust. With a pooled account, the Trustees can set the benefit level so that benefits last indefinitely, e.g., for life or until Medicare age. The problem with individual accounts is that your account may reach zero before you die, and you would not receive any more benefits at a time when you may need them the most.

However, if you do not reach the eligibility threshold (generally five years), then your employee contributions will be held in an individual "Employee Account," from which you can draw benefit payments after you retire, for medical expenses. This account will also hold any deposits of sick or vacation leave made, pursuant to your labor agreement.

C. OPERATION OF PLAN

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1) **What is the legal structure of the Plan?** Plan assets (i.e., contributions and investment earnings) will be held in the PORAC Retiree Medical Trust, which is a legally separate entity from PORAC, the participating Associations or employers. The Trust is controlled and administered by a Board of Trustees, composed of members of the participating Associations. The Board designs the Plan, selects investment vehicles, decides on distribution options, etc. The Board will hire a professional investment manager to advise regarding investment of Plan assets.

The Trust is regulated by federal law and (unlike state law) the Trustees are charged with fiduciary responsibility to administer the Plan for the “exclusive benefit” of the participating employees. If the Trustees fail to do so, they are subject to civil and criminal penalties. All contributions and earnings into the Plan can be spent only on benefits and administrative expenses. It would violate federal law if the assets ever were paid to any local, to PORAC, the Trustees, or the employers.

2) **Who can become a Trustee?** There will be five Trustees, one elected from each PORAC Region, and one appointed by the PORAC President. Currently, PORAC has appointed a five-member interim committee, until elections are held. Members of the Committee are:

Earl Titman
Novato Police Association
Cell: 415.798.4098
etitman@ci.novato.ca.us

Russ Reinhart
Huntington Beach Police Officers Association
Cell: 916.612.9908
R-reinhart@cox.net
treasurer@porac.org

John Snowling
Ventura Police Officers Association
Tel: 805.339.4496
Cell: 805.797.8858
jsnowling@ci.ventura.ca.us

Rusty Rea
Chula Vista Police Officers Association
Rrea@ci.chula-vista.ca.us

Bill Harbottle
Tulare County Deputy Sheriffs Association
Cell: 559.859.0167
bharbot106@hotmail.com

>We hope this Bulletin provides you with an understanding of the basic purpose and operation of the PORAC Retiree MedicalTrust. This material is designed to give general information on the subject covered. It is not intended to be comprehensive or to treat exhaustively the subject or to provide legal advice. Any conflict between this Bulletin and the formal Plan documents of the Trust will be resolved in favor of the formal Plan documents.

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