# Response to Questions on the FY 2013 Budget

**Request By:** Supervisor Gross

**Question:** Should the County pursue the formation of a VEBA as a vehicle for employees to fund retiree health insurance premiums through unused, accrued sick leave balances over 2,080 hours at the time of retirement?

**Response:** ***Background.*** Certain changes are recommended to the County's defined benefit retirement plans to bring those programs more in line with the competitive marketplace in response to the Post-Employment Benefits study conducted by AON-Hewitt. One recommendation would place a 2,080 hour cap on the amount of unused, accrued sick that can be used for determining eligibility and level of benefits under the County's pension plans.

Such a cap would be applied on a prospective basis to employees hired after a future date that has yet to be determined. The changes proposed are designed to bring the County more in line with the marketplace, but not to erode a competitive edge necessary to successfully attract and retain employees.

During the discussion of the County Executive's recommendations at the March 13th meeting of the Personnel and Reorganization Committee, representatives of the International Association of Fire Fighters (IAFF) Local 2068 requested exploration of the potential for a "VEBA" to be used as a repository for employees with unused sick leave balances in excess of the 2,080 hour cap. Dollars associated with these unused balances would be used to fund retiree health insurance premiums. The Board directed staff to provide further information on VEBAs as part of the FY 2013 Budget Q and A process.

***Discussion of VEBAs.*** A Voluntary Employee Benefit Arrangement (VEBA) is a type of tax-exempt trust that is governed by section 501(c)(9) of the Internal Revenue Code (the "Code") and provides for the payment of certain types of benefits (such as health, life or accident insurance) for its members. Due to its tax-favored status, a VEBA must meet a stringent set of requirements set forth in the Code.

VEBAs may be funded by employers and/or employees and have been in use since the late 1920s. They have gained recent attention as the mechanism that U.S. auto makers used to transfer liabilities for retiree medical plans to a fund created through negotiations with the United Auto Workers union. This type of VEBA is referred to as a "defeasance VEBA." The fund, which is overseen by the union, uses the pool of assets to provide retiree benefit programs that are actually designed by and offered through the VEBA. In the public sector, VEBAs have been historically used by state and local governments to set aside funds to cover employer costs for future Other Post-Employment Benefit (OPEB) obligations. (Note: The Virginia OPEB Trust, of which Fairfax was a founding member, considered the use of a VEBA, but elected instead to organize as a Trust under section 115 of the Code.) Other public sector employers have made VEBAs available for employee contributions to fund future health insurance premiums, including contributions arising out of unused sick leave balances.

***VEBAs for Fairfax County.*** As part of its evaluation of the County's retiree medical offerings, staff reviews all options to provide a competitive, comprehensive and cost-effective benefits program for retirees While a VEBA offering is one option under consideration, staff is also examining other options to help retirees pay health coverage expenses, including both health reimbursement arrangements (HRAs) and health savings accounts (HSAs). The pros and cons of all three of these tools must be weighed in the overall context of plan design and a rapidly changing regulatory environment, as well as in the context of the "total" retirement package offered by the County.

A VEBA whose primary source of funding is unused sick leave balances over the 2,080 hour cap proposed by the County Executive is not practicable at this time for the following reasons:

- Currently, only 4.37% of County employees have sick leave balances over the proposed 2,080 hour cap. The average sick leave balance for ***all*** County employees currently eligible for retirement is 469 hours. Given that the County Executive's proposal applies only to future new hires, a VEBA that is funded only with unused sick leave balances in excess of 2,080 hours at retirement would probably not receive its first contributions for decades. It is difficult to predict the trends in medical plan design or regulatory environment that far into the future, making it impractical to design an optimal funding mechanism for health insurance programs.

- Under the Code, VEBAs must satisfy "nondiscrimination" requirements that ensure that both benefits and eligibility are provided fairly and proportionally across segments of the employer's population. Given the small size of the population that would have sick leave hours above the 2,080 hour cap to contribute to the VEBA, there is the potential that the program would have nondiscrimination testing issues.

- The conversion of hours above the 2,080 hour cap to dollar values in the form of a VEBA contribution will carry a cost to the County that is not currently part of its compensation or benefits budget. In addition to this expense, a VEBA would require the formation of a separate oversight body as required by the Code. Such an administrative entity would require funding in its own right to properly manage the VEBA both from an investment and operational perspective.

- HRAs and HSAs might have potentially more benefits for both retirees and active employees.

Staff is currently evaluating the County's retiree health programs in the larger context of its role in an overall "total retirement" portfolio of benefits. Over the next several months, it is expected that more information, as well as recommendations for future modifications to the program, will be presented to the Board in an effort to enhance and contemporize offerings.