

EMPLOYEE BENEFITS CLIENT ALERT

COBRA PROVISIONS OF THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

MARCH 2009

The President signed the “American Recovery and Reinvestment Act of 2009” (the “Act”) on February 17, 2009. The Act contains provisions that allow certain individuals who elect health care continuation coverage (“COBRA coverage”) to temporarily pay a lower amount for that coverage. A brief summary of the Act’s premium assistance program is provided below, with additional details set forth in the attached document. The Act requires immediate action on the part of any employer who offers a group health plan—whether through insurance or through a self-funded program.

Under the Act, any individual who is eligible for COBRA coverage at any time between September 1, 2008 and December 31, 2009 due to involuntary termination of employment during such period will be eligible for premium assistance if the individual elects COBRA coverage. Eligible individuals who pay 35% of the regular COBRA coverage premium amount are treated as having paid the full premium. The reduced premium generally lasts up to nine months, although the period can be shorter if the individual becomes eligible for coverage under another group health plan or Medicare or if the individual’s normal COBRA period expires.

The recipient of premiums for COBRA coverage (the employer in the case of a self-funded plan, or the insurance company if the plan is fully insured) will be reimbursed for the reduction in premiums through credits to FICA and income tax withholding. Such recipient is treated as having paid withholding in the amount of the subsidy (65% of the premium) as of the date the premium is paid. If the amount of this credit exceeds the premium recipient’s withholding liability, the IRS will issue a refund to the recipient.

If the employer is the recipient of the COBRA premiums, immediate steps must be taken to determine the amount that the “assistance eligible individuals” will pay and the amount that constitutes the subsidy for each level of COBRA coverage under the employer’s health care plan. In addition, if payroll and tax withholding are prepared in-house, the payroll/withholding systems must be adjusted to provide for the credits against withholding and to identify the information required to be supplied to the IRS to substantiate the credit.

The Act also contains important notice requirements. First, former employees who would be eligible for the subsidy but who had not elected COBRA coverage by February 17, 2009 must be given an additional sixty-day period in which to elect coverage. These individuals must be given a notice of this election right no later than April 18, 2009. Second, COBRA election notices must now include additional provisions (or an addendum) describing the premium subsidy and providing additional information in connection with the subsidy. Failure to observe these notice requirements could result in significant penalties. Under the Act, the Department of Labor is required to issue model notices by March 19, 2009 to assist employers and other entities in meeting the notice requirements.

Because the Act contains deadlines in the near future for providing notices and taking other actions, it is important that all employers quickly identify their responsibilities under the Act. For employers with self-funded plans or plans subject to federal COBRA requirements, the Act will likely require significant action by the employer, including identification of “assistance eligible individuals,” calculation of reduced premium amounts, preparation and distribution of required notices, modification of processes for payment of withholding taxes, and implementation of a process to gather and report additional information that will be required in order to claim withholding tax credits.

For employers with fully-insured plans, some action on the part of the employer will be required. For such an employer, the first step is to contact the employer’s group health insurer to determine how responsibility for implementing the premium assistance provisions will be allocated. If the insurer will not take full responsibility for compliance with the Act, then the employer will need to evaluate what actions it will need to take. The specific actions that will be necessary depend in large part on how an employer’s COBRA program is currently administered.

In addition to planning the administrative actions that will be required to comply with the Act, employers should begin thinking about the Act’s potential impact on the cost of providing group health coverage. Because of the depth of the current recession, most employers making significant staff cuts should expect a surge in COBRA applications. Traditionally, individuals with COBRA continuation coverage have generated loss ratios around 150% (i.e., for every dollar of premium, the plan pays \$1.50 in health care expenses). An increase in the number of individuals electing COBRA coverage may reduce this historic loss ratio somewhat—possibly to 130% according to some industry estimates. However, this reduction may be offset if former employees keep COBRA coverage longer due to the recession. Self-funded plans may be particularly impacted because the cost of such plans are wholly based on loss experience. Risk managers should be prepared to address increased costs and explore creative ways to mitigate the impact of such increases.

SUMMARY OF COBRA PREMIUM ASSISTANCE PROVISIONS OF THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009

The following summarizes the major provisions of the COBRA premium assistance provisions of the American Recovery and Reinvestment Act of 2009 (“the Act”). Although the Act uses the term “COBRA” in outlining the requirements for the premium assistance program, the reduced premiums also apply to continuation coverage under other federal laws and under state-law continuation coverage rules. Therefore, the following rules will apply to church plans as well as plans maintained by other employers. Because of the broad scope of the new law, nearly every employer will be impacted by these provisions.

The Act provides for the following:

Temporary Reduction in COBRA Premiums

Premiums for a period of coverage (e.g., a month of coverage) for an “assistance eligible individual” (AEI) beginning on or after February 17, 2009 are treated as fully paid if the AEI pays 35% of the regular premium.

An AEI is any COBRA qualified beneficiary: (i) who is eligible for COBRA at any time between September 1, 2008 and December 31, 2009, (ii) whose eligibility results from involuntary termination of the covered employee's employment during such period, and (iii) who elects COBRA coverage.

The premium subsidy ends after nine months of reduced premiums or sooner if the individual becomes eligible for coverage under another group health plan or Medicare or if the individual's maximum COBRA period expires. If an AEI becomes eligible for other coverage or for Medicare, the AEI is required to notify the plan of such eligibility.

Optional Election to Choose Different Coverage

An AEI may elect to enroll in a different coverage option than the option covering the AEI at the time of the qualifying event if: (i) the employer offers this election, (ii) the premiums for the alternate coverage options are less than the premiums for the coverage in place at the time of the qualifying event, (iii) the alternate coverage is offered to active employees, and (iv) the alternate coverage is not a limited form of coverage (such as dental, vision, health FSA, or an on-site medical facility). If an employer elects to implement this provision, the election must be available to an AEI for a period of 90 days following the AEI's notification of the right to make such an election.

Second Chance to Elect COBRA Coverage for Certain Individuals

If a former employee is not an AEI only because he or she had not elected COBRA as of February 17, 2009, such individual may elect COBRA coverage during the period beginning February 17, 2009 and ending 60 days after the individual is notified of the right to make such an election. If an individual elects coverage under this provision, the coverage is not retroactive, but instead will begin as of the first period of coverage beginning on or after February 17, 2009. In addition, this coverage does not extend beyond the COBRA period that would have applied had the individual elected COBRA when it was first offered. For purposes of the HIPAA pre-existing coverage rules, the individual's break in coverage is suspended from the date of the qualifying event until the date coverage elected under this provision begins.

Required Notices

Election notices provided to AEIs must include the following: (i) any forms necessary to establish eligibility for the premium reduction, (ii) the name, address and phone number of the plan administrator or other person who has information about the premium reduction, (iii) a description of the extended election period that could apply as a result of the "Second Chance" election discussed above, (iv) a description of the AEI's obligation to notify the plan of his or her eligibility for other coverage (or Medicare) and the penalty for not providing such notification, (v) a prominently displayed description of the qualified beneficiary's right to a reduced premium and any conditions on entitlement, and (vi) a description of the option to enroll in different coverage options (if permitted by the employer). This information may be incorporated into the regular election notice or may be provided as a separate document.

In addition, by April 18, 2009, the plan administrator of a group health plan must notify individuals eligible for the "Second Chance" election described above of their right to make such an election.

By March 19, 2009, the Department of Labor is required to issue model notices in connection with the notice requirements discussed above.

Reimbursement of Premium Subsidy to Employer, Insurer or Plan

The entity to which COBRA premiums are payable will be reimbursed for the premium reduction through a payroll tax credit. Reimbursement is to be made to the health plan in the case of a multiemployer plan, to the employer in the case of a self-funded single-employer plan or a single-employer plan that is subject to federal COBRA requirements, or to the insurance company in the case of a fully-insured plan that is not subject to federal COBRA requirements. The entity entitled to reimbursement is treated as having paid payroll taxes in the amount of the premium reduction as of the date the AEI's premium payment is received. Payroll taxes include FICA and income tax withholding. The AEI's premium payment must have been actually received in order to claim the credit. Any overstatement of the credit will be treated as an underpayment of payroll taxes and will be subject to resulting underpayment penalties. Certain reporting requirements will apply in connection with the credit, including an attestation of involuntary termination for each applicable COBRA participant, the amount of payroll tax offset for the reporting period and an estimate of the offset for the subsequent reporting period, a report identifying the affected individuals, the amount of the subsidy reimbursed with respect to each individual, a designation as to whether such subsidy is for coverage of one individual or two or more individuals, and any other information that the IRS may require.

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