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Management Alert

A Work in Progress: July 1 Requirements of The Massachusetts Health Care Reform Act

Just over one year ago, then Massachusetts Governor Mitt Romney signed into law a novel health care reform act, the Act Providing Access to Affordable, Quality, Accountable Health Care (the AQAHC). Twice the subject of technical amendments, the AQAHC seeks to create a "culture of insurance" in which individuals, employers and insurers all shoulder the burden of health care coverage. However, as the clock ticks down to the effective date of July 1, 2007 for certain employer and insurer mandates, the AQAHC remains very much a work in progress, often lacking in clear regulatory guidance on critical provisions.

Recently, the newly created Commonwealth Connector (the Connector) and the Division of Unemployment Assistance (DUA) issued regulations relating to the AQAHC employer mandates. The Division of Health Care Finance & Policy (DHCFP) has withdrawn two of the three AQAHC regulations it promulgated, with re-issuance of the two as emergency regulations anticipated shortly before July 1. The Division of Insurance has issued two guidances.

This Management Alert summarizes imminently effective employer and insurer mandates and the new regulatory landscape.

Employer Mandates

The AQAHC imposes four mandates on Massachusetts employers, including self-insured employers: adoption of a Section 125 cafeteria plan; imposition of a "fair share" contribution; potential liability for a free rider surcharge; and collection of certain health care information.

Establishment of a Section 125 Plan By July 1

Effective July 1, 2007, employers with more than 10 full-time equivalent employees working in Massachusetts (other than non-profit entities staffed exclusively by volunteers and sole proprietors) must adopt, maintain and file with the state a cafeteria plan that fulfills the requirements of Section 125 of the federal Internal Revenue Code (Tax Code) and the rules and regulations of the Massachusetts Connector.

An employer who fails to meet the Section 125 cafeteria plan requirement faces the Free Rider Surcharge (discussed below) as a penalty.

Premium-Only Plan

On May 1, 2007, the Connector published a long-awaited Section 125 Plan Handbook, *Helping Your Employees Connect to Good Health: Section 125 Plan Handbook for Employers*, available on the Connector's website at www.mahealthconnector.org. The Handbook contains the Connector's regulations for such plans, 956 CMR 4.00 *et seq.*, effective July 1, 2007. The Handbook also contains a model cafeteria plan document and adoption agreement.

The Handbook clarifies that, for AQAHC purposes, a "premium-only plan" satisfies the AQAHC Section

125 plan requirement. Employers need not contribute to the cost of health care coverage options and are not responsible for any premium shortfalls if an employee's earnings cannot cover a premium payment. Employers may exclude certain classes of employees from the premium-only plan.

The regulation defines a premium-only plan as one that allows eligible employees to contribute to the cost of health care coverage on a pre-tax basis *and provides no other benefits to employees*. The premium-only plan must offer access to "medical care coverage options" available through the Connector or elsewhere.

Plan Requirements

In order to meet the Connector regulation, an employer's Section 125 plan must meet the federal requirements for a Tax Code Section 125 plan, including the requirement that the employer (and any affiliated or participating employers) must adopt a written plan document on or before the expressly stated effective date of the plan, in accordance with its corporate governance procedures.

Employers must also ensure compliance with the maze of nondiscrimination rules under Section 125, particularly if the employer subsidizes some, but not all, group health benefits.

The written plan document must contain:

- a description of the benefits that may be elected,
- eligibility rules,
- method and timing and irrevocability of participant elections,
- plan year,
- maximum amount of employee contributions,
- employer contributions (if any), and
- manner of employer contributions (if any).

Under the regulation, an employer may exclude the following employees:

- employees less than 18 years of age,
- temporary employees,
- part-time employees working on average fewer than 64 hours per month per employer,
- certain wait staff and service employees earning on average less than $400 in monthly payroll wages,
- student interns,
- co-op students, and
- seasonal international workers on US J-1 student visas or H2B visas enrolled in travel health insurance.

The Handbook directs that employees working for two or more employers must select one employer's Section 125 plan for pre-tax contributions. However, affiliated or related employers, such as parent and subsidiary, may adopt a single Section 125 plan so long as the plan document clearly identifies all participating employers.

Section 125 plans that function as flexible spending account only plans, or as premium-only plans offering access to benefits options that do not include access to any health care coverage, will not satisfy the Connector's regulations.

Commonwealth Care Options

The Handbook lists health care coverage options that the Connector has approved as Commonwealth Choice options, all of which offer comprehensive coverage including inpatient and outpatient medical care, emergency care, mental health care, substance abuse services, rehabilitation services, hospice and vision care, with pharmacy coverage options also available.

Fair Share Contribution and New Proposed Regulation

Effective October 1, 2006, the AQAHC mandates that an employer with 11 or more full-time equivalent employees who perform services within Massachusetts pay an annual contribution to the state's new Commonwealth Care Fund of up to $295 per full-time employee (and a prorated amount per part-time or seasonal employee) unless the employer makes a fair and reasonable contribution to a group health plan.

The DHCFP Fair Share Contribution regulation defines a group health plan as one which provides medical services for the diagnosis, cure, treatment or prevention of a disease, and one which either (a) an employer "sponsored and paid for, in whole or in part" or (b) a self-employed person or an employee organization sponsored. The definition includes self-funded plans.

The employer assessed a Fair Share Contribution may choose to pay the state annually (by November 15), semi-annually (on November 15 and May 15) or quarterly (on November 15, February 15, May 15 and August 15). The DUA's recently proposed regulation provides for payment of the Fair Share Contribution by electronic funds transfer and imposes a penalty of 12% interest for late payments.

An employer may avoid the Fair Share Contribution by passing one of two tests to demonstrate that it has made a fair and reasonable premium contribution to a group. The calculation period for the two tests runs from October 1 through September 30 each year.

Employers who can demonstrate the relatively low threshold of 25% participation by full-time employees in their group health plans meet the so-called "primary test" for avoiding the assessment. An employer who does not meet the primary test, but who offers to contribute at least 33% of the premium costs of its group health plan for all full-time employees employed more than 90 days from October 1, 2006 to September 30, 2007 meets the so-called "secondary test" for avoiding the assessment. The Connector has issued an Employer Handbook, also available on its website, addressing these two tests[1].

The proposed DUA regulation places the responsibility for collecting the Fair Share Contribution and remitting it to the state upon the leasing company, but the client company retains the liability for the Fair Share Contribution.

1 Adding a note of confusion, the proposed DUA regulation only contains the secondary test and defines an employee as a person employed for at least one month at a Massachusetts location. However, the DUA regulation expressly cautions that the provisions of the DHCFP regulation will govern whether an employer must make a fair and reasonable contribution.

The proposed DUA regulation also provides that an employer to demonstrate that it can avoid the assessment in the "initial base year" ending on September 30, 2007, by having made a fair and reasonable contribution to its Massachusetts' employees' health care coverage, the employer must make its health care plan available to full-time employees no later than July 1, 2007.

Free Rider Surcharge, Effective July 1

Effective July 1, 2007, an employer with more than 10 Massachusetts employees will become subject to the Free Rider Surcharge if: 1) it fails to comply with the Health Insurance Responsibility Disclosure (HIRD) employer mandate; 2) it is a "non-providing employer" who fails to comply with the AQAHC's Section 125 cafeteria plan mandate; or 3) above a fiscal-year exemption level of $50,000, the employer has five or more instances of employees (or their dependents) receiving a "free ride" of state-funded health services or any of the employer's employees (or his or her dependents) receives free health services more than three times in a fiscal year.

Employers who offer to contribute towards or arrange for health care coverage options remain exempt from the Free Rider Surcharge. Employers with fewer than 10 employees, employers who participate in the state's Insurance Partnership, and employers with collective bargaining agreements that govern health care also remain exempt.

At various public appearances, personnel from the DHCFP have taken the position that an employer subject to the surcharge provisions of the AQAHC may become exempt from the Free Rider Surcharge simply be establishing a Section 125 cafeteria plan as described above.

The DHCFP will determine the amount of the Free Rider Surcharge applicable to a non-compliant employer each year. Regarded as the probable basis for a soon to be issued emergency regulation, the DHCFP's withdrawn Free Rider Surcharge regulation divides employers into four categories based upon number of employees: Category 1, 11-20 employees; Category 2, 21-35 employees; Category 3, 36-50 employees; and Category 4, more than 50 employees. In assessing the Free Rider Surcharge, the DHCFP will multiply the amount of state-

funded costs by an appropriate surcharge percentage, with smaller employers paying a smaller percentage, but with the percentage increasing in direct proportion to the increase in frequency of admissions for state-funded health care.

In addition, the withdrawn regulation imposes a penalty for failure to comply with the AQAHC's disclosure requirement. Those employers who do not comply with the HIRD requirement for two successive years will have the amount of their state-funded costs multiplied by 40% (Category 1), 45% (Category 2), 50% (Category 3), and 55% (Category 4), respectively. The percentage of the employer's enrolled employees for purposes of the Fair Share Contribution, up to a maximum of 75%, will reduce the product of this calculation.

Health Insurance Responsibility Disclosure (HIRD), Partially Effective July 1

All Massachusetts employers with more than 10 employees face additional administrative requirements and document retention requirements because of the AQAHC mandate that employers collect certain data on Health Insurance Responsibility Disclosure (HIRD) forms and file the forms with the state.

Employee HIRD Form

Each employee of a Massachusetts employer with more than 10 employees not offered or who declines employer-provided health care plans, or who declines the employer's offer to arrange for the purchase of health insurance, must execute an Employee HIRD form, according to the withdrawn HIRD regulation. The January 2007 Bulletin states that the new regulation will provide that only employees who have declined to enroll in an employer-provided health care plan or who have declined to participate in a Section 125 plan must execute an Employee HIRD form.

The withdrawn DHCFP regulation, again the probable basis for the anticipated emergency regulation, provided that the Employee HIRD form must contain:

- the employee's name,
- the employer's name,
- the employee's alternative insurance coverage, if any, and
- the employee's acknowledgment of the individual mandate and penalties for non-compliance.

The employer must obtain an Employee HIRD form for new hires within 15 days after the employee declines coverage. For incumbent employees who decline employer coverage, the employer must obtain an Employee HIRD form by the earlier of *a)* 15 days after the close of the open enrollment period for health insurance or *b)* by July 1 of the reporting year. Forthcoming regulations may alter these dates.

The employer must retain Employee HIRD forms for three years.

If an employee refuses to sign the HIRD form or to return the signed form, the employer must document its diligence in seeking to obtain the form. The employer must also retain such information for three years.

Employer HIRD Form

Massachusetts employers with more than 10 employees, whether fully insured or self-insured, must report certain information to the Commonwealth via an Employer HIRD form. Information on the Employer HIRD form will contain a "snapshot" of information as of September 30 of each year.

The withdrawn DHCFP regulation provided that the Employer HIRD form must contain:

- the employer's name,
- the employer's FEIN,
- the number of full-time and part-time employees of the employer,
- certification of the employer's offer of employer-provided health care coverage, if any, and
- certification that the employer has offered a Section 125 cafeteria plan.

The employer must file its Employer HIRD form by November 15 of each year, with the first Employer HIRD form due on November 15, 2007.

Insurer Mandates

The Act imposes two insurer mandates on health insurance carriers that enter into insurance contracts with Massachusetts employers: non-discrimination requirements and a dependent coverage requirement. Neither insurer mandate applies directly to employers or to self-insured plans.

Nondiscrimination Requirement for Insurance Policies after July 1

In Notice 2007-4 issued in early April, the Massachusetts Division of Insurance (Division) clarified that the AQAHC's non-discrimination requirements do not apply to group insurance policies issued prior to July 1 until the policies renew (Nondiscrimination Notice). Effective for such policies entered into or renewed on or after July 1, 2007, the AQAHC mandates that no commercial carrier, non-profit carrier or HMO can enter into a group health policy contract issued in Massachusetts with an employer unless:

- the employer offers its fully insured group plans (excluding stand-alone dental plans) to all full-time employees who live in Massachusetts, and
- the employer contributes the same percentage contribution for all full-time employees (except employees covered by collective bargaining agreements).

For this purpose, a "full-time employee" is an employee who works at least 35 hours per week.

The AQAHC does not require employers to offer their fully insured group plans to retirees or to part-time, temporary or seasonal employees. The Division follows the Fair Share Contribution regulation definitions for part-time, temporary and seasonal employees (Nondiscrimination Bulletin).

The Nondiscrimination Bulletin clarifies that insurance contracts that provide for the following will satisfy this insurer mandate:

- uniform fixed contribution among all full-time employees, regardless of salary;
- different employer percentage or fixed dollar subsidies for different plan choices, provided that the contribution does not differ based on the salary level of full-time employees living in Massachusetts;
- greater contribution levels based on longevity of service, provided that the service-based formula is not a pretext for providing better health insurance contributions to more highly paid employees;
- greater contribution levels in compliance with wellness programs; and
- different contribution levels for dependents of covered full-time employees levels living in Massachusetts than contribution levels for full-time employees, provided that the dependent contribution level does not differ based on the salary of the full-time employee related to the dependent.

Dependent Coverage Requirement

Effective January 1, 2007, the AQAHC requires insurers who issue policies in Massachusetts to maintain coverage for dependents up to the earlier of age 26 or two years following the loss of dependent status under the Tax Code.

In Notice 2007-1 issued in January, the Division established a two-part test to determine dependent status: the purported dependent must satisfy the Tax Code criteria for dependent status and must have been properly claimed as a dependent on a subscriber's federal income tax form.

The AQAHC definition of dependent gives rise to imputed income to the employee whose dependent has aged out of the Tax Code definition of dependent. To value the benefit, the IRS has privately ruled in an analogous situation that an employer may use its COBRA rate in effect for single individuals, less the 2% administrative

load. The employer must report any such imputed income on the employee's W-2 form.

Actions to Consider

Employers subject to the AQAHC as described above should review their existing Section 125 plans for compliance with the requirements of both the federal Tax Code and the AQAHC before July 1, 2007. Those without a Section 125 plan who do not contribute to or arrange for the purchase of health care coverage for their Massachusetts employees should consider adopting such a plan in the form and manner prescribed by the Connector by July 1 in order to avoid the penalty of the Free Rider Surcharge.

Employers subject to the AQAHC should also assess before July 1 whether they meet either the primary or secondary test for a fair and reasonable contribution to their Massachusetts' employees' health care coverage. Those who do not should determine whether it makes economic sense to offer a premium-only Section 125 plan under which the employer makes no contribution other than to collect and to remit its employees' pre-tax dollars, with the understanding that such employers will become subject to a "fair share" contribution of no more than $295 per full-time employee annually.

All employers subject to the AQAHC should establish procedures for complying with the HIRD collection and retention requirements of the Act. Those employers who decide to offer or to expand enrollment in group health care plans (including a previously established Section 125 cafeteria plan) by July 1 will need to collect and retain HIRD forms reflecting the newly established plan options and their employees' election to participate or demonstration of alternative coverage.

Employers entering into or renewing full-insured group policies on or after July 1 should be aware of the AQAHC mandates with which their insurers must comply if the insurers issue policies in Massachusetts.

Employers should also anticipate that the DHCFP will issue at least two emergency regulations prior to July 1, and that the DUA and the DHCFP may address and correct any inconsistency in their regulations.

If you have any questions concerning this Management Alert, please contact the Seyfarth Shaw LLP employee benefits attorney with whom you work or any employee benefits or labor & employment attorney on the website at www.seyfarth.com.

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