Issue 14

Nondiscrimination in Fully-Insured Group Health Plans

This is the fourteenth issue in our series of alerts for employers on selected topics in health care reform. (Click here to access our general summary of health care reform and other issues in this series) This series of Health Care Reform Management Alerts is designed to provide an in-depth analysis of certain aspects of health care reform and how it will impact your employer-sponsored plans.

The Patient Protection and Affordable Care Act (PPACA), as modified by the Health Care and Education Reconciliation Act of 2010 (HCERA) (collectively the "Act"), requires all group health plans to comply with certain mandates, although some of these mandates apply only to non-grandfathered plans (see our earlier alert on *grandfathering*). This issue focuses on the Act's prohibition against fully-insured plans discriminating in favor of highly compensated individuals ("HCIs") in benefits or eligibility. Recently released IRS Notice 2010-63 provides a glimpse of how the agencies may apply this rule to non-grandfathered plans.

[ ]	**Applies to grandathered plans**
[√]	**Applies to new health plans and plans that lose grandfathered status**

Background

For purposes of the new nondiscrimination rule, it is important to understand the distinction between self-funded and fully-insured health plans. Self-funded plans are those that are, in essence, "insured" by the employer (although some claims may be paid by a "stop loss" carrier). These arrangements are more common for large employers who have more employees and, as a result, a larger risk pool. On the other hand, a fully-insured arrangement involves an employer paying a health insurance company a premium (part of which may be paid by the participant) and, when the participant incurs a medical claim, the insurance company (not the employer) pays the health care provider. These types of arrangements are more common for smaller employee populations, because the insurance company can consolidate many different independent employee populations into a single risk pool.

PPACA Extends Non-Discrimination Rule to Fully-Insured Plans

For many years, Internal Revenue Code Section 105(h) has limited the tax exemption for benefits payable by self-funded health plans that discriminate in favor of HCIs with respect to either eligibility or benefits. The Act contains a provision that extends nondiscrimination rules "similar to the rules" contained in Code Section 105(h) to fully insured plans. This provision does not apply to grandfathered plans, but does apply to plans that lose grandfathered status or new plans, starting with plan years beginning on or after September 23, 2010.

While it is currently unclear whether the nondiscrimination tests that will apply to insured plans will be the same as currently apply to self-funded plans, the agencies have stressed that the penalty for discriminating in favor of an HCI in a fully-insured plan is much more substantial. If a self-funded plan discriminates in favor of HCIs, then amounts reimbursed to the HCIs that constitute "excess reimbursements" will be taxable to them. In other words, the HCIs lose a tax benefit. Under the Act, if an insured plan discriminates in favor of HCIs, then the plan or plan sponsor is subject to an excise tax or civil money penalty of $100 per day per individual discriminated against. Thus, the penalty for a discriminatory insured plan could amount to $100 *per day, per non-highly compensated individual*. Normally, this penalty caps at the lesser of 10% of the group health plan costs or $500,000, but the DOL has indicated this would be a willful violation, so there is no cap on the penalty.

Currently, employers attempt to avoid nondiscrimination testing by providing health benefits for HCIs through various methods. For example, employers with self-funded plans impute income on the fair value of coverage and/or ask former HCIs to pay the fair value of coverage with after-tax dollars. Alternatively, employers provide insured coverage for HCIs. the Act eliminates this last alternative, and employers offering non-grandfathered insured coverage to HCIs in the future will face substantial penalties. In addition, it is unclear to what extent employers will be able to offer a discriminatory insured plan where the HCI pays 100% of the premium with after-tax dollars and/or where the employer maintains a retiree-only plan.

Unanswered Questions

- Will the IRS take this opportunity to step up enforcement of the existing Code Section 105(h) rules for self-funded plans?
- What are the fax consequences if employers pay COBRA premiums for HCIs as part of a severance agreement?

Employer Action Plan

- Determine whether your health plan is insured or has an insured option (such as an HMO).
- If you maintain a non-grandfathered insured plan, review your plan to ensure it does not discriminate in favor of HCIs, either in benefits or eligibility.
- Consider, in particular, employment agreements or severance agreements for HCIs that may extend health coverage that is not available to rank-and-file employees during a severance period. Consider alternative approaches to compensating executives outside of medical benefits in light of the Act's nondiscrimination requirements.

For further details, or if you have any questions regarding the fully-insured plan nondiscrimination requirements, contact your Seyfarth Shaw LLP attorney or any Employee Benefit attorney listed on the website, or send your questions to HealthReform@seyfarth.com.

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