

COBRA changes stimulated by the Recovery Act



Donald Sims
Penny Plante, CEBS

The American Recovery and Reinvestment Act (ARRA) was signed into law effective Feb. 17, 2009. There are important changes that affect almost all employer-sponsored health plans in the management of Consolidated Omnibus Budget Reconciliation Act (COBRA) provisions. Among the most important changes, the ARRA legislation provides a subsidy of 65% of the calculated COBRA premiums (cost) for certain qualified beneficiaries who have lost health coverage because of a separation from their employer and who are receiving coverage through COBRA. This paper reviews the new COBRA regulations, summarizes the material changes, and gives you some suggested action items.

HISTORICAL INFORMATION

COBRA requires group health plans to offer coverage to separated employees (and their eligible dependents) under their former employer's group health program. Employees who have experienced a reduction in hours and no longer qualify based on a full-time status are also eligible to participate in COBRA continuation coverage.

These participants typically pay the full cost of the coverage, in addition to a 2% administrative fee. Some employers provide subsidies to offset some of the cost of the COBRA coverage, but they are not required to do so under COBRA regulations.

Also, in some states there are programs that require types of continuation coverage similar to COBRA for groups that are too small to be subject to COBRA regulations (i.e., employers with fewer than 20 employees) or that extend beyond the federal COBRA requirements for certain age groups.

WHAT IS THE COBRA PROVISION IN ARRA?

The federal government will provide a tax credit equal to 65% of the premiums for those people who are eligible for COBRA because of an involuntary separation from employment that occurs between Sept. 1, 2008, and Dec. 31, 2009. These people are called *assistance eligible individuals* (AEIs). IRS Notice 2009-27, defines *involuntary separation* as a severance of employment by the employer that uses its unilateral authority to end such employment. This includes but is not limited to the following scenarios:

- a lay-off period with the right of recall or a temporary furlough (reduction to zero hours) resulting in the loss of health coverage
- involuntary termination while an individual is absent from work

- retirement, if the employer would have terminated the employee and the employee had knowledge that he or she would be terminated and chose to retire instead
- involuntary termination for cause, except due to gross misconduct
- resignation by an employee due to a material change in the geographic location of employment for the employee

To qualify for the subsidy, an AEI must have been enrolled in the employer's health plan at the time of the involuntary separation, elected the COBRA coverage within the time allowed, and paid the 35% share of the COBRA premiums. It cannot be paid by another source, including the employer. Those AEIs with incomes greater than \$125,000 (\$250,000 for joint tax return filers) will be required to pay an increased personal income tax to repay the federal government for some or all of the subsidy. The subsidy is available with respect to most premiums beginning March 2009, corresponding to the effective date of the legislation.

The subsidy is available for medical, dental, and vision coverage as well as for health reimbursement arrangements (HRAs)—provided these benefits were offered as part of the group benefit program. The subsidy program does not cover health flexible spending accounts (FSAs) even though these are allowable under regular COBRA regulations.

In no event will the subsidy last more than nine months per AEI, even though COBRA benefits last much longer.

WHAT PLANS ARE SUBJECT TO THE COBRA PROVISIONS IN ARRA?

Private-sector employer-sponsored group plans or employee organizations (unions) subject to federal COBRA provisions must comply with the subsidy provisions of ARRA. Other entities, such as state or local governments that are subject to continuation provisions under the Public Health Service Act or the Federal Employee Health Benefits Program (FEHBP), also must satisfy the provisions under ARRA. Group health plans required by state law to provide comparable continuation coverage may also seek subsidy relief under ARRA.

The subsidy is not available for those voluntary plans that are not required under federal or state laws, such as certain church plans.

WHO IS ELIGIBLE FOR THE SUBSIDY?

Employees and their qualified spouses and dependent children are eligible for the subsidy as long as the coverage needs arise from an involuntary separation of service. It is important to note that the subsidy does not apply to domestic partners or children of domestic partners. Therefore, employers, plans, and insurance issuers should be careful in their reporting when establishing the premium subject to the subsidy credit.

WHAT TYPES OF NOTICES

DO I NEED TO SEND TO EMPLOYEES?

Four model notices were released on March 19, 2009, by the Department of Labor. The notices are intended to provide information to *qualified beneficiaries* of their rights under COBRA for purposes of ARRA. (A qualified beneficiary is one who lost health coverage because of a qualifying event, and may or may not be subject to ARRA.)

- **General Notice (full):** The full notice must be sent to any qualified beneficiary, not just the employee, who experienced any qualifying event since Sept. 1, 2008, and has not received a notice that included information required by ARRA. The reason for becoming a qualified beneficiary is not relevant (i.e., termination of employment, divorce, child ineligible, etc.). The full notice includes COBRA election information; therefore, it should be sent to individuals who became eligible for a COBRA election on or after Sept. 1, 2008, and had not previously received a notice or had received a notice after ARRA's enactment that did not include the required ARRA information.
- **General Notice (abbreviated):** The abbreviated notice is similar to the full notice but it does not contain the election information. This notice is sent to individuals who experienced a qualifying event on or after Sept. 1, 2008, elected COBRA coverage, and are still covered by COBRA.
- **Alternative Notice:** The alternative notice applies to insurers or to plans subject to state continuation laws. Because each state has its own requirements, care must be taken to comply with state requirements.
- **Notice in Connection with Extended Election Periods:** This notice should have been mailed by April 18, 2009, to any AEI or individual who would be an AEI if COBRA had been elected, and had a qualifying event between Sept. 1, 2008, and Feb. 16, 2009. This includes any person who did not elect COBRA initially or who may have elected COBRA and has since dropped coverage.

The model notices are available on the Department of Labor's site at: <http://www.dol.gov/ebsa/COBRAModelNotice.html>.

General COBRA notices must be modified to include the ARRA language for employees with a qualifying event from now until the end of 2009.

WHAT DOES THE SPECIAL COBRA ELECTION PERIOD COVER?

Qualified beneficiaries (employees, spouses, or qualified dependent children) with a qualifying event that occurred as of Sept. 1, 2008, through Feb. 16, 2009, who did not enroll for COBRA coverage or enrolled and dropped COBRA prior to Feb. 16 are eligible for a special election period. The *Notice in Connection with Extended Election Periods* is sent to these individuals. It provides retroactive coverage effective with the first effective date following Feb. 16. This will typically be March 1. The special election period does not extend the AEI's COBRA coverage period; therefore, coverage will still end based on when the original qualifying event occurred.

HOW DOES THE SUBSIDY WORK?

Employers cannot apply and claim the tax credit unless they have actually received the 35% premium payments from the COBRA participants. The employer, plan, or insurer must pay the 65% portion of the premiums not paid by the COBRA participants, which should include the 2% administrative fee. The employer, plan, or insurer would then be eligible to receive a tax credit for the 65% of COBRA premiums paid under the ARRA provision.

The tax credit is taken as an offset against payroll taxes otherwise payable to the federal government (i.e., federal income tax and FICA withholding, employer FICA taxes). In the event of a multi-employer plan, the plan takes the credit, not the employer groups participating in the plan.

If the tax credit exceeds the payroll tax liability of the employer, the excess credit will be paid directly to the employer by the federal government or applied as a credit towards the next payroll tax payment by the employer.

Note that if the employer normally subsidizes the COBRA premiums for eligible participants (as, for example, in some separation agreements or severance programs), that subsidy is *not* eligible for the tax credit under ARRA. However, there may be situations where the employee is required to pay a portion of the COBRA premium as part of the severance agreement. That portion could be eligible for the subsidy arrangement under certain circumstances. Additionally, the employer's subsidy and the ARRA subsidy credit period run concurrently. This means, for example, that if the severance period runs for the first three months of the COBRA coverage and then on the fourth month the employee is required to pay the full COBRA premium, the employee potentially has a remaining six months of subsidized premium because of ARRA.

ARE THERE ANY CHANGES FOR THOSE ALREADY PARTICIPATING IN COBRA?

Because of the timing of the Act and the subsequent notifications, it is reasonable to assume that AEIs who are already paying COBRA premiums will continue to pay the total premium amounts until they receive the notifications regarding the subsidy program and submit the necessary documentation. Under a transition rule for ARRA, if the AEI pays the complete cost of COBRA for the months of March and

April 2009 the employer has the option to provide the AEI a refund of the amount received in excess of the required 35% contribution or use the overpayments as a credit against the COBRA premiums payable in future months. The employer can receive the subsidy for the months paid by the AEI in advance.

WHEN DOES ARRA ELIGIBILITY END?

Normally, COBRA coverage ends either when the limit of the coverage is reached (18 months, for example), or when the participant *enrolls* in another group health program (Medicare would also qualify). Under ARRA, the eligibility for subsidy ends when the AEI simply becomes *eligible* for other group coverage, regardless of whether the AEI actually enrolls or not. This clause only applies for eligibility for medical coverage—eligibility for dental, vision, and other types of coverage would not void ARRA eligibility.

Of special note: An employee must qualify as an AEI on or before December 31, 2009, to receive assistance beyond December 31, 2009. Should an employee suffer an involuntary separation in December and would not start COBRA until January 1, 2010 (i.e., because group coverage continued through December 31, 2009), the employee is not eligible for a subsidy under ARRA.

ARE THERE OTHER CHANGES FROM REGULAR COBRA?

Normally, an election of COBRA means selecting the same coverage that the separated employee had as an active employee. A change in coverage was allowed only during open enrollment as with any similarly situated active employee. Under ARRA, AEIs may be allowed to enroll in a coverage level that is lower than the option in which they were previously enrolled, provided that the alternate coverage is available through the employer's group plan. There is no subsidy for moving into a higher-cost benefit program, and there is

no requirement for the employer to even allow the trade-down into the cheaper benefit option.

Employees receiving the Health Coverage Tax Credit (HCTC) are not eligible for the subsidized premium under ARRA.

SUGGESTED ACTION ITEMS:

- Identify those individuals who lost coverage because of an involuntary termination since Sept. 1, 2008, and prepare a notification mailing list
- Prepare special election notices and/or revise existing COBRA election forms to reflect ARRA eligibility and distribute as required
- Reflect ARRA COBRA changes in all plan documents and summary plan descriptions using a Summary of Material Modification
- Confirm with COBRA administrators (or internal departments) their knowledge of the ARRA requirements and their readiness level
- Confirm that payroll departments are prepared to recapture the premium subsidy through payroll tax credits and that accounts payable is prepared to process the 65% contribution requirements for employers

For more information, contact Donald Sims (donald.sims@milliman.com, 813.282.9262), Penny Plante (penny.plante@milliman.com, 206.504.5592), or your local Milliman consultant.

The materials in this document represent the opinion of the authors and are not representative of the views of Milliman, Inc. Milliman does not certify the information, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

Copyright © 2009 Milliman, Inc.