COBRA Expansion and Subsidy Update

Title III of The American Recovery and Reinvestment Act of 2009 (ARRA) – Health Insurance Assistance for the Unemployed Act of 2009 was signed into law on February 17 and has an immediate impact on employers. The following is a summary provided by The Bostonian Group and Bostonian Solutions to help employers understand the scope of the law and what their obligations will be.

Please contact your consulting team if you have any questions.

This document is divided into three sections:

1. Summary of Key Provisions of Title III

2. What Must Employers Do Now and in the Near Future?

3. Key Questions and Answers

Section I – Summary of Key Provisions of Title III

COBRA Premium Subsidy

Effective March 1, 2009, "Assistance Eligible Individuals" (AEI) are eligible for a 65% subsidy of their group health benefits under COBRA. The subsidy does NOT apply to health care flexible spending accounts. It is not entirely clear if the subsidy would be available for dental or vision plan continuation, however we would advise clients that the subsidy would NOT apply because ARRA refers to section 607(1) of ERISA to define "group health plan", which focuses on medical. In addition, a subsidy for dental and vision does not seem to have been envisioned by the crafters. The Department of Labor will further clarify in the next 30 days.

The subsidy is based on 65% of the COBRA premium itself, including the 2% administrative load, and it will be available to the AEI for up to **nine (9)** months.

If an employer does NOT charge COBRA eligible participants the full COBRA premium, the subsidy is based on what the employer actually charges someone. For example, the single rate is $500, but the employer decides to pay half the cost plus the 2% administrative fee as part of a severance agreement. The former employee pays $250 to continue coverage. The available subsidy would be 65% of $250 (or $162.50), NOT 65% of $500 or $510 (the full COBRA premium, including 2%)

How Will Employers Obtain the Subsidy?

Employers will claim a credit against their federal payroll taxes (including income tax withholding) for the subsidy or, if payroll taxes do not cover the subsidy amount, through a direct payment from the government. The COBRA premium on which the subsidy is based is the premium actually charged to the individual (and thus does not include any amounts currently being picked up by the former employer). Employers will need to file a report to accompany the claim for credits, but the Treasury Department may release a format or form within 30 days.

The report must include:

- An attestation of the involuntary termination of the covered employee(s)
- Supporting calculation of the amount of the subsidy in the current period and an estimate of the subsidy offsets for the next reporting period
- The social security numbers or tax ID numbers of covered employees
- The amount of the subsidy provided to each individual
- Information as to whether the subsidy provided was for individual or family coverage

AEI's Cost

AEI's must pay 35% of the COBRA premium. Included with this notice is a spreadsheet to help you calculated the subsidized cost for participants.

Eligibility

The Act defines an "Assistance Eligible Individual" (AEI) as someone who:

- Is eligible for COBRA coverage at any time on or after September 1, 2008 and on or before December 31, 2009; and
- Elects COBRA coverage either during the original COBRA election period or during the special election period provided by the Act; and
- Is a COBRA qualified beneficiary because of an ***involuntary*** termination of a covered employee's employment (other than for gross misconduct) that occurs on or after September 1, 2008 and on or before December 31, 2009.

An AEI may be a covered employee **OR** a covered employee's covered spouse or dependent child who became a qualified beneficiary because of the involuntary termination of the covered employee's employment.

A qualified beneficiary is NOT entitled to a COBRA subsidy during a year in which he or she is a taxpayer, or spouse or dependent of a taxpayer, whose federal modified adjusted gross income exceeds $145,000 (or $290,000 in the case of a taxpayer filing a joint return). The available COBRA subsidy is reduced for years in which gross income exceeds $125,000 (or $250,000 for joint returns). The income limitation is applied by increasing the qualified beneficiary's federal income tax by the amount of the COBRA subsidy overpayments made on his or her behalf. As a result, employers and insurers will not have to consider this income limitation when making COBRA subsidy payments or taking payroll tax credits.

An AEI loses eligibility for the subsidy when they become *eligible* for other health coverage, either through Medicare or a group health plan. Currently, a person loses COBRA eligibility when they elect other coverage, note that this may happen sooner.

"Involuntary" Termination

The term "involuntary termination" was not defined in the Act. At a minimum, employees must have been terminated involuntarily and not for reasons of gross misconduct. Job elimination, death of the employee or any other situation in which the employee lost their job involuntarily would also qualify. It is not clear how terminations such as constructive discharge, participation in voluntary termination programs or early retirement, and mutual agreement of the employer and employee to terminate employment apply. We hope the DOL will clarify this in the next 30 days.

Notices

By April 17, 2009 (60 days of the bill's enactment) you or your COBRA administrator MUST notify all AEI's of the availability of the premium subsidy and (if not already enrolled) that they will have a new period to enroll for COBRA coverage. They will then have 60 days after notification to make an election. If the individual elects COBRA during this period, the coverage becomes effective as of March 1, 2009.

New notices will need to be produced and must include:

- A description of the subsidy
- A description of the extended election period available to subsidy-eligible individuals who do not have a COBRA coverage election in place as of the date of enactment
- A description of the individual's obligation to inform the plan if he or she becomes eligible for Medicare or another group health plan
- The forms necessary for establishing eligibility for the subsidy

- Contact information for the plan administrator
- A description of alternative COBRA coverage options, if the employer elects to provide these

The legislation directs the DOL to develop model notices for this purpose within 30 days of the bill's enactment.

Transition Period (March and April 2009)

Employers may have COBRA participants that qualify for the subsidy due to a previous involuntary termination. If a qualified beneficiary pays more than 35 percent of the applicable COBRA premium amount for March and/or April, the employer may decide either to:

A. Reimburse the qualified beneficiary for the overpayment and treat the reimbursement as a credit toward payroll tax, or
B. Credit the overpayment toward future premium payments. In order to credit the overpayment toward future payments, the employer must reasonably expect the overpayment to be exhausted within 180 days.

This provision allows employers and insurers to continue to require qualified beneficiaries to pay the full COBRA premium for a short time while they establish the necessary procedures to administer the subsidy.

New COBRA Coverage Option

At the option of the employer, an individual eligible for this special subsidy may elect a different COBRA health coverage option from the one in which he or she had been enrolled at the time of termination of employment. This other coverage must be one of the options offered by the employer to active employees, not be more expensive than the option in which the individual had been enrolled, and not be a health flexible spending account (or certain other forms of limited coverage). Eligible individuals have 90 days after notification to elect this different form of COBRA coverage.

What Must Employers Do Now and in the Near Future?

With the subsidy effective date on March 1, employers will need to quickly address the administrative, payroll, and other systems changes necessary to accommodate this revision of the COBRA rules. The following action items will vary if you administer COBRA in-house or use a third-party COBRA administrator.

The following are our recommended action items that you should begin immediately or very soon:

- Identify all potential AEI's who previously became eligible for COBRA. Remember – an AEI is an individual eligible for COBRA who was terminated on an involuntary basis on or after September 1, 2008, and their spouse and/or dependents. Identify which of these individuals are AEIs currently receiving COBRA coverage and which are entitled to the special enrollment period. Both groups will need to be notified, but the message will differ to each.

- Use the provided spreadsheet to determine the subsidized COBRA premium amount.

- Revise and update COBRA communication materials, placing a priority on creating a notice for those terminated employees immediately entitled to a new COBRA enrollment period. The DOL is tasked with creating a model notice within 30 days, and we would advise clients that any notice produced now may be temporary.

- Coordinate with your payroll, finance and COBRA administration personnel to revise processes and procedures for recovering the government's 65% subsidy of the COBRA premium and for reflecting the revised charges on premium statements sent to participants.

- Notify eligible individuals by April 17 of their new COBRA election period and of the availability of the premium subsidy (and, if applicable, other COBRA coverage options).

- Include a process for permitting "high income individuals" to permanently waive the premium subsidy. The Treasury Department is developing model language as well

- Implement procedures for determining participant premium overpayments and crediting the payments to future premiums or returning the overpayments directly to the participant during the March/April transition period.

- Develop and implement a process to end the subsidy when the individual no longer is able to claim it and to reinstate the 100% COBRA premium charge if the individual continues to be eligible for COBRA after termination of the subsidy.

- Determine whether you will allow the former employee to switch to alternative health coverage for COBRA purposes.

- If you are self-insured and have made significant "involuntary terminations" since September 1, 2008 or if layoffs are anticipated in the near future, work with us to determine how these new rules will affect COBRA claims experience and administrative costs. Future working rates may change.

Key Questions and Answers

The following Q&A was produced primarily using information from Butzel Long in New York City. Some of the points above are repeated:

1. What COBRA premium subsidy does the Act provide?

Under the Act, the federal government will subsidize 65% of the COBRA premium actually charged to an "assistance eligible individual" (AEI) for up to 9 months.

2. How is the subsidy provided?

Under the subsidy program, a group health plan can only require an AEI to pay 35% of the COBRA premium that the AEI would otherwise be required to pay. The federal government will reimburse an employer for the remaining 65% of the COBRA premium by allowing the employer to take a credit against the employer's liability to deposit payroll taxes and federal income taxes withheld from employees' compensation.

3. Who are "Assistance Eligible Individuals" (AEI)?

An AEI is a COBRA qualified beneficiary who:

- is eligible for COBRA coverage at any time on or after September 1, 2008 and on or before December 31, 2009; and
- elects COBRA coverage either during the original COBRA election period or during the special election period provided by the Act (discussed below); and
- is a COBRA qualified beneficiary because of an ***involuntary*** termination of a covered employee's employment (other than for gross misconduct) that occurs on or after September 1, 2008 and on or before December 31, 2009.

An AEI may be a covered employee **OR** a covered employee's covered spouse or dependent child who became a qualified beneficiary because of the involuntary termination of the covered employee's employment.

4. When does the subsidy begin?

The subsidy applies to periods of COBRA continuation coverage beginning after the enactment of the Act. A "period of coverage" is the monthly (or shorter) period for which COBRA premiums are charged. For group health plans using calendar months as the period of coverage, the subsidy applies beginning March 1, 2009.

5. When does the subsidy end?

The subsidy ceases to apply (and a plan administrator may again charge the full COBRA premium) as of the **earliest** of:

- The date the AEI becomes ***eligible*** for coverage (not actually covered) under another group health care plan (other than plans providing only dental, vision, counseling, or referral services, a health care flexible spending plan, or a health reimbursement arrangement) or Medicare coverage; or
- 9 months after the first day of the first month to which the subsidy applies; or
- The end of the maximum COBRA coverage period required by law (including permissible early terminations); or
- For an AEI who elects COBRA during the special enrollment period (discussed below), the end of the maximum COBRA coverage period that would have applied if the AEI had elected COBRA coverage when first entitled to do so.

The Act requires an AEI who becomes eligible for coverage under another group health plan to notify the plan providing COBRA coverage in writing. An AEI who fails to provide the required written notice is subject to a penalty 110% of the subsidy provided for the AEI after the date the AEI became eligible for the other coverage.

6. Does the subsidy apply to COBRA premiums for all types of group health plans?

No. The subsidy does NOT apply to COBRA premiums for health care flexible spending accounts.

7. How does the subsidy apply in situations where the group health plan charges the AEI less than the maximum permissible COBRA premium?

The Act specifically states that 35% of the premium must be paid by the AEI or on the AEI's behalf *by someone other than the AEI's employer* and that an employer cannot claim a subsidy credit until the group health plan has actually received the 35% of the COBRA premium as required by the Act.

This means that an employer is only permitted to claim a subsidy credit of 65% of what the total COBRA premium would be if the amount actually paid by the AEI was 35% of the total COBRA premium. For example, if the maximum permissible COBRA premium is $500 per month, but the employer only requires the AEI to pay $100 per month, the employer can only claim a subsidy credit of $185 ($100/35% = $285 x 65% = $185). The employer cannot claim a subsidy credit of $325 (65% of the maximum permissible $500 COBRA premium) or of $400 (the difference between the maximum permissible COBRA premium and the $100 actually paid by the AEI).

Employers that do not charge the full COBRA premium (*e.g.*, when an AEI is charged a reduced COBRA premium under a separation agreement) will have to calculate the correct subsidy based on the amount actually paid by the AEI. If the employer pays 100% of the AEI's COBRA premium, the employer cannot claim any subsidy credit for that AEI.

8. Are all AEIs eligible for the subsidy?

Although all AEIs are technically eligible for the subsidy, any AEI who is a "high-income individual" or the spouse or dependent of a high-income individual will be required to repay the subsidy as an additional tax on the high-income individual's individual tax return for the year in which the subsidy was provided.

A "high-income individual" is a single taxpayer with modified adjusted gross income in excess of $145,000 or a married taxpayer filing jointly with modified adjusted gross income in excess of $290,000. The subsidy "recapture tax" begins to phase in for a single taxpayer with modified adjusted gross income in excess of $125,000 or a married taxpayer filing jointly with modified adjusted gross income in excess of $250,000.

A plan administrator must allow an AEI who is a "high-income individual" to permanently waive the subsidy in the manner to be prescribed by the Secretary of the Treasury. If waived, the "high-income individual" would pay the full COBRA premium charged by the group health care plan.

9. What does a group health plan administrator have to do now?

A group health plan administrator must take all necessary actions to provide the 65% subsidy to AEIs beginning March 1, 2009. This generally means ensuring that an AEI is only required to pay the reduced COBRA premiums for periods of coverage beginning on or after March 1, 2009.

However, because it is likely that a plan administrator will not be able to timely notify all AEIs of the reduced amounts effective for March premium payments, AEIs may pay the full COBRA premiums for one or two months. If an AEI pays the full COBRA premium for the first or second period of coverage beginning after the date of enactment of the Act (*i.e.*, periods of coverage for March and April 2009), the plan administrator must either credit the subsidized portion of the premium against future COBRA premiums (if the plan administrator reasonably expects the overpayment to be fully applied to future COBRA premiums within 180 days) or refund the subsidized portion within 60 days.

10. What does a group health plan administrator have to do in the near future?

For any individual who becomes a COBRA qualified beneficiary after the enactment of the Act, the group health plan administrator must include with all other required COBRA election notices and forms specific information about the availability of the subsidy.

A group health plan administrator also must provide notices to two groups of AEIs within 60 days after the enactment of the Act.

The first notice must go to all AEIs who **currently** have COBRA continuation coverage to advise them of the availability of the subsidy and the requirements to qualify for the subsidy.

The second notice must go to any individual who is entitled to the special enrollment period (discussed below). An individual is eligible for this special enrollment period if the individual qualifies as an AEI except that the individual does not have a COBRA coverage election in effect on the date of enactment of the Act. (This includes an individual who previously made a COBRA coverage election but whose COBRA coverage ended before the enactment date because of non-payment of premiums.) The notice to these individuals must advise them of the availability of the subsidy, the requirements to qualify for the subsidy and additional information required by the Act, as well as provide them forms necessary for electing COBRA during the special election period.

The Act requires the Department of Labor to provide model notices for plan administrators to use within 30 days after the enactment of the Act.

11. What is the special election period for AEIs?

An individual who would be an AEI except that the individual does not have a COBRA coverage election in effect on the date of enactment of the Act must be given a second chance to elect COBRA coverage. This special election period begins on the date of enactment of the Act and ends 60 days after the plan administrator provides the required notice described above to the individual.

If an AEI elects COBRA during the special election period, when does COBRA coverage begin?
COBRA coverage for an AEI who elects COBRA during the special election period begins on the first day of the first COBRA coverage period beginning after the date of enactment of the Act (March 1, 2009 for group health plans using calendar months as COBRA coverage periods). COBRA coverage is **NOT** retroactive to the date the AEI originally lost coverage.

If an AEI elects COBRA during the special election period, when does the COBRA coverage period end?
The COBRA coverage period for an AEI who elects COBRA during the special election period ends when COBRA coverage would otherwise have ended if the AEI had elected COBRA when initially eligible to do so after qualifying event.

- For example, an AEI who lost coverage and became entitled to elect COBRA continuation coverage that would have begun on October 1, 2008 elects COBRA under the special election. This AEI's COBRA coverage period begins on March 1, 2009 and ends on March 31, 2010 (18 months after the date the AEI's COBRA coverage would have begun because of the original qualifying event). The AEI's 18 month maximum COBRA coverage period is NOT measured from the date of enactment of the Act.

12. Can pre-existing condition exclusions be applied to an AEI electing during the special enrollment period?

The Act provides that the period beginning on the original qualifying event date and ending on the first day of the first COBRA coverage period beginning after the date of enactment of the Act is disregarded when determining if the AEI had a 63-day significant break in coverage for purposes of applying pre-existing condition exclusions.

13. What is the Act's "Plan Enrollment Option"?

Generally, a COBRA qualified beneficiary is only permitted to elect COBRA continuation coverage that is the same as the coverage the qualified beneficiary had as of the date of the COBRA qualifying event. The Act permits (but does not require) an employer to allow AEIs (including AEIs that have COBRA coverage without the special election) to elect a health care coverage option different from the health care coverage originally offered to the AEI under COBRA.

14. What requirements apply to the different coverage option?

- The COBRA premium for the different coverage cannot exceed the COBRA premium for the coverage in which the AEI was enrolled when the COBRA qualifying event occurred.
- The different coverage must be coverage the employer is offering to its active employees at the time the AEI elects the different coverage.
- The different coverage cannot provide only dental, vision, counseling or referral services (singly or in any combination) and cannot be a health care flexible spending account or an on-site facility primarily providing first aid, prevention, or wellness care.

15. When is an AEI permitted to elect different coverage?

If an employer decides to offer the different coverage option to an AEI, the employer must provide the AEI an election notice and allow an election period of not less than 90 days.

16. What questions or issues regarding the subsidy are not addressed by the Act?

The term "involuntary termination" is not defined in the Act. Despite this, an employer must attest that each AEI for whom the employer takes the subsidy credit was ***involuntarily*** terminated. This determination can be complicated by questions such as constructive discharge, participation in voluntary termination programs, and mutual agreement of the employer and employee to terminate employment. A determination that an employee was involuntarily terminated can impact eligibility for other benefits, including severance benefits and unemployment benefits.

There is no guidance as to when an AEI electing COBRA during the special enrollment period must pay the initial premium for COBRA coverage. We expect this will be addressed by the Department of Labor, perhaps in the model forms. It is possible that the existing rules governing when an initial COBRA premium must be paid may apply (payment of all premiums due must be made within 45 days of date COBRA coverage is elected).

17. How does the Act extend the COBRA coverage period?

The Act extends the initial COBRA coverage period for two distinct groups of COBRA qualified beneficiaries following a termination of employment or reduction in hours of a covered employee COBRA qualifying event:

- If the covered employee has (as of the qualifying event date) a nonforfeitable right to receive any pension benefits directly from the Pension Benefit Guaranty Corporation (PBGC), the maximum COBRA coverage period for the covered employee ends on the covered employee's date of death. The maximum COBRA coverage period for the covered employee's surviving spouse or dependent children ends 24 months after the covered employee's date of death.

- If the covered employee is a Trade Adjustment Assistance-eligible individual (as of the date COBRA coverage would otherwise end because of the regular 18-month or 36-month COBRA coverage periods), the maximum COBRA coverage period ends on the date the covered employee ceases to be a Trade Adjustment Assistance-eligible individual.

18. Is there a limit on these extended COBRA coverage periods?

Under the Act, a COBRA coverage period cannot be extended beyond December 31, 2010 under either of the provisions above.

19. When do the extended COBRA coverage periods become effective?

These extensions to the maximum COBRA coverage periods for these groups of qualified beneficiaries apply to any COBRA coverage periods that would otherwise end on or after the date of enactment of the Act.

20. What if an employee did not elect benefits prior to termination? Would they be eligible for this subsidy and would we be required to notify them?

If the employee was eligible for COBRA, then yes, they would also be eligible for the subsidy.

21. For current COBRA participants that were involuntarily terminated since September 1, would the subsidy be retroactive to their original election date?

No, the subsidy is not available until March 1, 2009. There would not be a retroactive payroll tax credit available.