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Immediate Healthcare Reform Law Issues for Group Health Plans Come Into Sharper Focus

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The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (the Healthcare Reform Law), creates a number of immediate issues for employer group health plans.

Some of these issues have already received wide attention in the popular press and resulted in many telephone calls and email inquiries from employees.

This LawFlash updates, consolidates, and expands prior information from Morgan Lewis and focuses on issues through 2013. Additional employer group health plan components of the Healthcare Reform Law are applicable in 2014 and subsequent years and will be addressed in future LawFlashes.

While employers await the inevitable regulations necessary to flesh out and implement the Healthcare Reform Law (and what are likely to be a fair amount of technical corrections to it), they should begin to focus on the following select items:

Immediate Steps

Retiree Drug Subsidy Taxation

The Healthcare Reform Law eliminates the tax deduction for the subsidy that some employers receive for continuing their retiree prescription drug program. Further, accounting rules require an immediate recognition of the changed tax treatment in an employer's financial statements. Some employers have already booked significant charges associated with this change, and a congressional hearing is scheduled to investigate this area.

Possible responses for employers include terminating their retiree drug programs (particularly as the Healthcare Reform Law will eventually eliminate the "donut hole" from the Medicare Part D program, making Part D programs more attractive) or switching to an Employer Group Waiver Plans, where the insurer rather than the employer receives the Part D subsidy. While the accounting impact is immediate, the provision becomes effective for tax years beginning after December 31, 2013.

Early Retiree Medical Reinsurance Program

The Healthcare Reform Law establishes a $5 billion reinsurance fund to help employers with the cost of certain early retiree medical claims. For claims incurred for retirees aged 55 through 64, the new law will reinsure 80% of annual claims between $15,000 and $90,000. This program begins June 23, 2010 and runs through December 31, 2013, or until the funds are exhausted. However, as demand will likely outstrip supply, employers should immediately apply to participate in the reinsurance program once guidance establishes the application process.

Small Employer Tax Credit

Small employers (generally those employers with 25 or fewer employees with average full-time wages of less than $50,000) are eligible to apply for a tax credit if they offer health insurance and subsidize, on a uniform basis, at least 50% of the cost of the coverage. The tax credit is paid in full for employers with 10 or fewer full-time equivalent employees (with average wages of $25,000 or more) and phases out as employer size and average wage increases.

First Plan Year Beginning After September 23, 2010 (January 1, 2011 for Calendar-Year Plans)

Adult Child Coverage Until Age 26

The Healthcare Reform Law requires health plans to cover adult children until they reach age 26. The Healthcare Reform Law treats the coverage for such adult children as tax-free, permits such adult children to be covered under a VEBA or 401(h) plan, and allows employers to impose, until January 1, 2014, a requirement that such an adult child cannot be eligible to enroll in another employer group health plan. An "Adult Child" is an individual who is a son, daughter, stepson, stepdaughter, or legally adopted or eligible foster child of the employee. This change has generated the most interest of all of the health plan changes. It will have far-reaching effects on plans that have traditionally imposed restrictions on dependent coverage, will likely eliminate full-time student verification processes, and will greatly reduce the need for the recently passed Michelle's Law requirements.

Pre-existing Condition Exclusions

The Healthcare Reform Law prohibits the application of pre-existing condition exclusions for plan years beginning on or after January 1, 2014. Note, however, that for children who are under age 19, this prohibition applies to plan years beginning after September 23, 2010. Note also that the Healthcare Reform Law does not clearly require allowing such children into coverage, but rather eliminates pre-existing condition limitations for children already covered under a plan; however, forthcoming regulations are expected to require plan entry, as well as coverage, for children with pre-existing conditions.

Lifetime Maximums

The Healthcare Reform Law prevents health plans from applying a lifetime maximum on benefits that are essential health benefits (the scope of which is to be determined by the Secretary of Health and Human Services (HHS)).

Annual Maximum

Under the Healthcare Reform Law, health plans may not impose annual limits on essential health benefits, effective for plan years beginning after December 31, 2013. Further, until 2014, employers may apply some limits to essential benefits as long as those limits will not violate other federal or state laws. It remains to be seen how broadly employers can limit essential health benefits prior to 2014 and whether it will be practical for employers to limit nonessential benefits in their plans.

Prohibition on Rescissions

The Healthcare Reform Law prevents health plans from rescinding health coverage once an individual is covered under the plan, unless the individual acted fraudulently or made an intentional misrepresentation of a material fact. It remains to be seen how this will impact individuals who are mistakenly enrolled in a plan or, indeed, how this will impact a plan amendment that prospectively eliminates coverage for a group of individuals.

60-Day Prior Notice of Material Modification

Plans must now, under the Healthcare Reform Law, provide 60 days' prior notice of a material modification. This will create timing and notification issues for changes associated with the annual enrollment process and, for the first time, prevent employers from immediately changing plan terms during a plan year. This accelerated requirement is paired with a new $1,000-per-participant penalty for each willful failure to meet the new 60-day advance notice requirement.

Nondiscrimination Testing

The Healthcare Reform Law applies parts of the existing Internal Revenue Code (the Code) section 105(h) self-insured plan nondiscrimination rules to insured health plans. This will make it much more difficult to offer new insured health plans to a small group of executives. However, it appears that the penalty for offering a discriminatory insured medical plan will be a $100-per-day excise tax instead of imputing income to plan participants in a discriminatory self-insured plan. See "Grandfather Rules" below for the application of this rule to grandfathered plans.

Preventive Services

The Healthcare Reform Law requires health plans to cover certain preventive services such as immunizations and infant preventive care and screenings without cost to the employee. See "Grandfather Rules" below for the application of this rule to grandfathered plans.

Appeals and Reviews

The Healthcare Reform Law requires health plans to adopt ERISA-like claims and appeals processes but goes further than current ERISA rules by guaranteeing the receipt of benefits during the appeals process and also requiring an external review process. Regulations will hopefully address the scope of the continued benefits requirement during an appeal (such as whether this means that a disputed treatment must be provided and paid for during an appeal about covering the treatment) and whether self-insured plans must cede their operation to an external reviewer. See "Grandfather Rules" below for the application of this rule to grandfathered plans.

Primary Care Physicians

Plans that require the designation of a primary care provider must permit the designation of any participating primary care provider, with special rules for emergency services, pediatric care, and ob-gyn care. See "Grandfather Rules" below for the application of this rule to grandfathered plans.

Grandfather Rules

The Healthcare Reform Law contains limited provisions that exempt parts of existing health plans from the application of some of the new law's improvements in healthcare coverage and quality. These grandfather provisions were originally quite broad but were narrowed by the Reconciliation Act.

The grandfather rules apparently apply permanently to individuals who were enrolled in an existing plan as of March 23, 2010, and also allow family members and new employees to subsequently join an existing plan without ending the grandfather protection. However, for collectively bargained plans, the grandfather rules sunset on the date the last related collective bargaining agreement terminates. The grandfather rules may not apply to employees who were employed on March 23, 2010 but were not yet enrolled in a plan, were subject to waiting periods, or were covered under a different plan. It is expected that future guidance will flesh out the grandfather requirements and opportunities and, in the interim, employers should be very careful about changing existing health plans and possibly losing this still-valuable grandfather treatment.

2011

Form W-2 Reporting

The Healthcare Reform Law requires employers to report on Form W-2 the aggregate cost of employer-provided group health coverage excludable from the employee's gross income (other than through an Archer MSA, an HSA, or employee salary reductions to a flexible spending arrangement under section 125 of the Code). The aggregate cost is determined under COBRA-like rules.

Over-the-Counter Drug Prohibition

The Healthcare Reform Law ends the tax-advantaged treatment of over-the-counter drugs by limiting the use of amounts paid from HSAs or Archer MSAs, or expenses incurred for medical FSAs or HRAs, to prescribed drugs or insulin.

HSA and Archer MSA Penalty Increase

The Healthcare Reform Law helps pay for the cost of expanded coverage by increasing the additional tax for nonmedical HSA and Archer MSA distributions to 20%.

Small Employer "Simple" Cafeteria Plans

An employer with 100 or fewer employees can establish a streamlined cafeteria plan that escapes nondiscrimination testing requirements as long as the employer satisfies minimum eligibility, participation, and contribution requirements.

CLASS Act

The Healthcare Reform Law creates a new national employee-funded long-term care benefit known as the "Community Living Assistance Services and Supports Act" (the CLASS Act). While involvement is voluntary, employers are encouraged to participate in the CLASS Act and to adopt automatic enrollment rules that default employees into the CLASS Act.

2012

Research Trust Fund Fee

All plans, starting with plan or policy years ending after September 30, 2012, will have to pay a $2 per participant or enrollee fee ($1 for fiscal year 2013) to finance the newly established Patient-Centered Outcomes Research Trust Fund. This fee ends in 2019 and contains exceptions for certain exempt governmental programs.

Uniform Explanation of Coverage

The Healthcare Reform Law directs the Secretary of HHS to develop standards for a new uniform explanation of coverage, which must be distributed to plan participants. Such explanation must be no longer than four pages and use 12-point type. The explanation must be written in a "culturally and linguistically appropriate manner," and be distributed to new participants beginning March 23, 2012. This new explanation is paired with a new $1,000-per-participant penalty for each willful failure to distribute the explanation.

2013

Flexible Spending Account Limit

As widely anticipated, the Healthcare Reform Law caps the maximum health flexible spending account salary deferral at $2,500. The cap is indexed for years beginning in 2014. The cap is structured to exclude true employer matching or other contributions to an FSA and still creates planning opportunities for FSAs that offer a grace period for submitting claims.

Employer Notice Regarding Exchanges

By March 1, 2013 employers are required under the Fair Labor Standards Act to inform employees about the new State Exchanges starting in 2014, whether the employer subsidizes 60% of any employer-provided coverage, and whether purchasing coverage through an Exchange may result in losing the employer subsidy for the employer-provided coverage.

Unclear Effective Date

Automatic Enrollment

At some time after enactment (perhaps not until the Secretary of Labor issues regulations), employers are required under the Fair Labor Standards Act to automatically enroll new employees in their health plans (subject to a waiting period) and apparently also to adopt an evergreen approach to existing elections during an annual enrollment period for current plan participants. Given that this

seems geared toward helping smooth the transition to individual health coverage mandates in 2014, perhaps it will begin in 2013 or 2012.

Numerous other provisions, beyond the scope of this discussion of employer group health plan near-term issues, will take effect in later years. These include rules regarding the individual mandate, broader pre-existing condition exclusions, Medicare changes, essential benefits package requirements, waiting periods, employer free rider assessment, premium bands, guaranteed availability, guaranteed renewability, and wellness plan reward increases.

Morgan Lewis will continue to monitor developments as regulations are released. To learn more about how the Healthcare Reform Law will affect employee group health plans, join us for a webcast on the subject, "Healthcare Reform: Employer Group Health Plan Considerations," on Wednesday, April 14, 2010, at 12:00 pm ET. To learn more about the webcast and to register for the event, visit http://www.morganlewis.com/documents/m/Events/2010/EB_HealthcareReform_Webcast_100452.html.

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