

## **Employer Group Health Plans Face Immediate Issues as Healthcare Reform Becomes Law**

**March 25, 2010**

The Patient Protection and Affordable Care Act (the Healthcare Reform Law) that President Obama signed into law on March 23 contains a number of items that will affect employer group health plans in the coming months—although many of these items are subject to further modification through the reconciliation process. Other employer group health plan components of the Healthcare Reform Law are applicable in subsequent years and will be addressed in future LawFlashes.

While employers await action on the reconciliation legislation, they should begin to focus on the following select items:

### **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 may require an immediate recognition of the changed tax treatment on an employer's financial statements. Possible responses for employers include terminating their retiree drug program (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 Plan. This provision becomes effective for tax years beginning after December 31, 2010, but reconciliation may postpone the tax deduction loss until 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 90 days after enactment 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.

### **Dependent Coverage Until Age 26**

The Healthcare Reform Law requires health plans to cover dependents until they reach age 26 (as long as they are not married), starting with plan years beginning six months after the date of enactment.

Reconciliation language, if approved, may eliminate the marriage restriction, treat the coverage for such dependents as tax-free, permit such dependents to be covered under a VEBA or 401(h) plan, and impose, until January 1, 2014, a requirement that such a dependent cannot be eligible to enroll in another employer group health plan. See “Grandfather Rules” below for the application of this rule to grandfathered plans.

### **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 six months after enactment. See “Grandfather Rules” below for the application of this rule to grandfathered plans.

### **Lifetime Maximums**

The Healthcare Reform Law prevents health plans from applying a lifetime maximum on benefits, effective for plan years beginning six months after enactment. See “Grandfather Rules” below for the application of this rule to grandfathered plans.

### **Annual Maximum**

Under the Healthcare Reform Law, health plans may only impose restricted annual limits on essential health benefits, effective for plan years beginning six months after enactment, and cannot impose any annual limits for plan years beginning after December 31, 2013. See “Grandfather Rules” below for the application of this rule to grandfathered plans.

### **Nondiscrimination Testing**

The Healthcare Reform Law applies existing Internal Revenue Code section 105(h) self-insured plan nondiscrimination rules to insured health plans. This new requirement is effective for plan years beginning six months after enactment. This will make it much more difficult to offer insured health plans to a small group of executives. See “Grandfather Rules” below for the application of this rule to grandfathered 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. The rescission restriction is effective for plan years beginning six months after enactment. 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. The preventive services requirement is effective for plan years beginning six months after enactment. 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 that both guarantee receipt of benefits during the appeals process and also provide for external review. The appeals and external review requirements are effective for plan years beginning six months after enactment. See “Grandfather Rules” below for the application of this rule to grandfathered plans.

## **Grandfather Rules**

The Healthcare Reform Law contains broad provisions exempting existing health plans from the application of many of the new law’s improvements in healthcare coverage and quality. The Grandfather Rules apparently apply forever to individuals who were enrolled in a plan as of March 23, 2010 and also allow family members and new employees to subsequently join a plan without ending the Grandfather protection. For collectively bargained plans, the Grandfather Rules end on the date the last related collective bargaining agreement terminates. 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 Grandfather treatment.

However, the pending reconciliation language modifies and limits the application of the Grandfather Rules. In particular, the pending reconciliation rules are expected to impose the new law’s requirements on otherwise-grandfathered plans regarding the following:

- Dependent coverage until age 26
- Preexisting exclusions
- Lifetime maximums
- Annual maximums
- Rescission of coverage

## **Flexible Spending Account Limit**

As widely anticipated, the Healthcare Reform Law caps the maximum health flexible spending account salary deferral at \$2,500. This restriction applies under the Law to tax years beginning after December 31, 2010, but may be delayed under reconciliation until 2013.

## **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). The aggregate cost is determined under COBRA-like rules. This reporting applies to tax years beginning after December 31, 2010.

## **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. This restriction is applicable for amounts paid or expenses incurred for tax years beginning after December 31, 2010.

## **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%. The increased additional tax applies to distributions made after December 31, 2010.

## **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, starting January 1, 2011.

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 preexisting condition exclusions, Medicare changes, essential benefits package requirements, automatic enrollment, waiting periods, employer free rider assessment, premium bands, guaranteed availability, guaranteed renewability, and wellness plan reward increases.

Morgan Lewis will continue to monitor developments with respect to the impact of reconciliation upon the Healthcare Reform Law. Morgan Lewis will also hold a webcast on employee benefits aspects of the Law, after the end of the reconciliation process.

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys from the Employee Benefits and Executive Compensation Practice:

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