Insights, News & Events

AGENCIES PUBLISH GUIDANCE REGARDING "GRANDFATHERED" HEALTH PLANS

Insights
Jun 23, 2010

On June 17, 2010, the Internal Revenue Service (IRS), Department of Labor (DOL) and Department of Health and Human Services (HHS) jointly issued interim final regulations regarding a group health plan's status as a "grandfathered health plan" (i.e., one in existence on March 23, 2010) under provisions of the recent healthcare reform legislation. This legislation creates a multitude of new requirements for group health plans ranging from the minimum level of benefits that must be provided to dictating which individuals must be offered coverage under a plan.

However, various provisions of the new laws either do not apply at all or have extended compliance deadlines for grandfathered plans. The interim regulations help explain what changes a group health plan that was in existence on March 23, 2010 may make to its plan terms without losing its status as a grandfathered plan.

The regulations are designed to take into account reasonable changes routinely made by plans or insurance issuers without the plan or health insurance coverage losing its grandfathered status, so that individuals may retain the ability to remain enrolled in the coverage they had on March 23, 2010. As such, plans and issuers are generally permitted to make voluntary changes to increase benefits, to conform to required legal changes and to voluntarily adopt other provisions of the new healthcare reform laws that the plans, as grandfathered plans, would not otherwise be required to adopt. A group health plan's status as a grandfathered health plan also is not affected by new enrollees enrolling in the plan after March 23, 2010.

Changes That Will Cause A Plan To Lose Grandfathered Status
A plan will lose its grandfathered plan status if changes are made to the plan's coverage that significantly decrease the benefits, materially increase cost sharing by participants in ways that might discourage covered individuals from seeking needed

treatment, or substantially increase the cost of coverage paid by participants. Specifically, the following changes will cause a health plan to lose its grandfathered status:

- increasing non-fixed amount cost sharing requirements (such as increasing an employee's portion of all costs from 20% to 25%);
- increasing fixed-amount co-payments by an amount that exceeds the greater of (i) a percentage that is more than 15% plus the amount of medical inflation above the levels in effect on March 23, 2010 or (ii) $5 increased by medical inflation above the levels in effect on March 23, 2010;
- increasing fixed-amount cost sharing payments other than copayments (such as deductibles and out-of-pocket limits) by a percentage that is more than 15% plus the amount of medical inflation (set by the DOL using the overall medical care component of the Consumer Price Index for All Urban Consumers, unadjusted) above the copayment levels in effect on March 23, 2010; or
- decreasing the employer contribution rate by more than 5% below the contribution rate in effect on March 23, 2010. The "contribution rate" for this purpose is defined as the amount of contributions made by an employer compared to the total cost of coverage, expressed as a percentage. This rule applies to all tiers of coverage.

In addition, changing policies (or insurance carriers) will cause a plan to lose grandfathered status, and the elimination of all or substantially all benefits to diagnose or treat a particular condition will cause a plan to cease to be grandfathered. The elimination of benefits for any necessary element to diagnose or treat a condition is considered the elimination of all or substantially all benefits to diagnose or treat a particular condition.

The regulations provide that if the principal purpose of a corporate merger, acquisition or similar business restructuring is to cover new individuals under a recipient grandfathered health plan or if a recipient plan is different enough from a transferor plan to be considered a change that would cause the transferor plan to lose its grandfathered status if the recipient plan terms were considered to be an amendment to the transferor plan, then the recipient plan will cease to be a grandfathered health plan.

Disclosure Of Grandfather Status Required

In order to maintain grandfathered status, a plan must include a statement in any plan materials provided to participants and beneficiaries describing the benefits provided under the plan (such as a summary plan description, or SPD) that the plan believes it is a grandfathered health plan. This statement must include contact

information for questions and complaints. The new regulations provide model language for this disclosure statement.

The regulations also require that a plan maintain records documenting the plan or policy terms in connection with the coverage in effect on March 23, 2010 to verify the plan's continued status as a grandfathered health plan. Such records must be made available for examination upon request.

The Importance Of Grandfather Status
Every plan, eventually, whether it is fully-insured or self-insured, will lose its grandfathered status. Something as basic as changing insurance carriers will cause a fully-insured plan to lose its grandfathered status. Paying fewer claims during a plan year could cause an unfunded self-insured plan to lose its grandfathered status. Since most plans will lose their grandfather status eventually, it is useful to focus on why a plan sponsor might want to retain grandfathered status at all. Why not just embrace non-grandfathered status and its requirements now to gain the most flexibility for ongoing plan design?

One healthcare reform change â€“ the extension of coverage to children under age 26 â€“ provides for an extended compliance date for grandfathered plans. Non-grandfathered plans must extend coverage to dependents under age 26 (regardless of student, marital or financial status) as of the first day of the first plan year that begins on or after September 23, 1010. Grandfathered plans must fully comply with this rule beginning in 2014. But before 2014 grandfathered plans do not have to extend coverage to a dependent if the dependent has access to medical coverage under the dependent's employer's group health plan.

Many employers may find this exception difficult to administer and therefore decide to offer coverage to all dependents under age 26 at the beginning of their next plan year even though they could take advantage of the exception for grandfathered plans. For plans that do want to take advantage of the exception, maintaining grandfathered status is important. For those that do not, maintaining grandfathered status may be less important.

Healthcare reform changes that will never apply to grandfathered plans include some of the changes with near-term effective dates: 1) the requirement to install an external review process; 2) mandatory 100% coverage of preventive care services (to be defined, but will most likely include immunizations, mammograms, pap smears, etc.); 3) greater access to emergency services (removal of increased cost sharing for out-of-network emergency services); 4) participants' freedom to choose any network doctor as their primary care provider (such as a pediatrician or OB/GYN); and 5) most significantly, the application of the nondiscrimination rules of Internal Revenue Code section 105(h) to fully-insured plans (these rules already apply to self-insured plans).

Many plans already provide some of these new coverage mandates, such as 100% coverage of most preventive services. Accordingly, it could be that for most employers that sponsor fully-insured plans, the importance of maintaining grandfathered status will come down to the impact of having to apply the 105(h) nondiscrimination rules to their plans. These rules require that a plan not discriminate in favor of "highly-compensated individuals" with regard to both contributions and benefits. For purposes of these rules, a "highly-compensated individual" is an employee who 1) is one of the 5 highest-paid officers, 2) owns more than 10% of the value of the employer's stock or 3) is among the highest 25% of employees ranked by pay. Accordingly, roughly 25% of employees (including most closely-related domestic affiliates) will be classified as "highly compensated" under this definition, regardless of how much compensation they earn.

Having different waiting periods for different classes of employees or contributing different amounts of employer subsidies towards premiums for different classes of employees could cause a plan to fail its annual 105(h) nondiscrimination test. Also, a plan with two or more benefit options that do not have substantially the same benefits could fail nondiscrimination testing if the highly-compensated individuals tend to elect the benefit option with the better benefit and the non-highly-compensated individuals elect the other option. If any of these circumstances apply to a plan, compliance with the 105(h) nondiscrimination rules could have a significant impact.

Summary
Before getting overwhelmed with the restrictions on maintaining grandfathered plan status, it's important to take a step back and evaluate the relative benefits of such status. In many cases, the only significant upside to grandfathered status may be the ability to avoid the 105(h) nondiscrimination rules. If this is not important to you, then the restrictions of maintaining grandfathered status may be more hassle than they are worth. But if you wish to avoid the 105(h) nondiscrimination rules or any of the other rules that apply to non-grandfathered plans, then it will be important to ensure that any future changes to your plan are within the parameters set by the new interim regulations.

If you need assistance in evaluating the grandfathered plan issue or any other aspect of healthcare reform, please contact one of the attorneys in the Employee Benefits Practice Group at Fisher Phillips.

This Legal Alert presents an overview of complex new regulations. It is not intended to be, and should not be construed as, legal advice for any specific fact situation.