American Benefits Council

PPACA Compliance Call

New Nondiscrimination Rules for Insured Plans

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General

- PPACA amends PHSA to add new section 2716, which imposes new nondiscrimination rules on certain health plans
- New rules are effective for plan/policy years beginning on or after September 23, 2010
- Only applies to non-grandfathered plans
- New rules are by reference to existing IRC section 105(h), which previously applied only to self-insured health plans

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Background on IRC Section 105(h)

- IRC section 105(h) was added to the IRC in 1978
- Treasury/IRS issued final regulations in 1981 as well as limited number of private letter rulings (PLRs)
- IRC section 105(h) was temporarily repealed in 1986 following the enactment of IRC section 89, which provided for more expansive nondiscrimination rules
- IRC section 89 was soon thereafter repealed and IRC section 105(h) was reinstated retroactively

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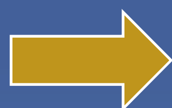
Background on IRC Section 105(h)

- Since the reinstatement of IRC section 105(h), Treasury/IRS has generally avoided the nondiscrimination rules
  - **IRS has not issued any precedential guidance since the reinstatement**
  - **Instituted "no rule" on IRC section 105(h)**
  - **Very limited enforcement to date of self-insured plans**



Existing IRC section 105(h) and related regulations are very unclear and thus raise compliance issues for both self-insured and insured plans

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New PHSA Section 2716

- New PHSA section 2716 applies existing IRC section 105(h) rules to insured <u>non</u>-grandfathered plans, for plan/policy years beginning on or after September 23, 2010
  - **PHSA section 2716 is incorporated by reference into ERISA and the group health plan requirements of the IRC, *i.e.*, Chapter 100**
- On September 20, 2010, IRS issued Notice 2010-63
  - **States that insured plans must comply for this plan/policy year**
  - **Suggests insured plans are subject to existing 105(h) regulations**
  - **Requests written comments**
  - **Clarifies that the penalties for violations of these rules by insured plans are those that apply for insurance reform violations versus 105(h) violations for self-insured plans**

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What Plans Are Subject to PHSA Section 2716?

IN

- ✓ Non-grandfathered group health and medical plans that are not HIPAA-excepted, including:
  - Major medical
  - Mini-med plans
  - HRAs
- ✓ Non-grandfathered governmental plans

OUT

- ✓ HIPAA-excepted
  - Health FSAs
  - HSAs
  - Dental
  - Vision
  - LTC
  - Specified disease
  - Fixed/hospital indemnity
  - Med supplemental
  - Disability
  - On-site medical
- ✓ Retiree-only plans

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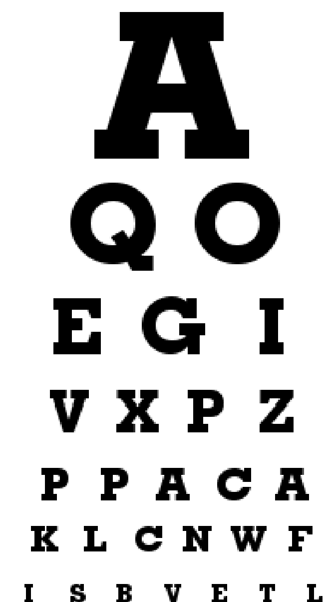
How Do the Tests Work?



- Must satisfy the following two tests:
  - **Eligibility test (really more participation test)**
  - **Benefits test (really universal availability test)**
- Both tests look to if the plan disproportionately benefits highly compensated employees (HCEs):
  - **5 highest paid officers**
  - **10% or more shareholder; AND**
  - **Highest 25% paid (disregarding excludable employees)**
- Excludable employees include:
  - **Employees with < 3 years of service**
  - **Part-time employees working < 35/hrs per week**
  - **Seasonal employees**
  - **Employees subject to collective bargaining agreement**
  - **Employees < age 25**
  - **Nonresident aliens**

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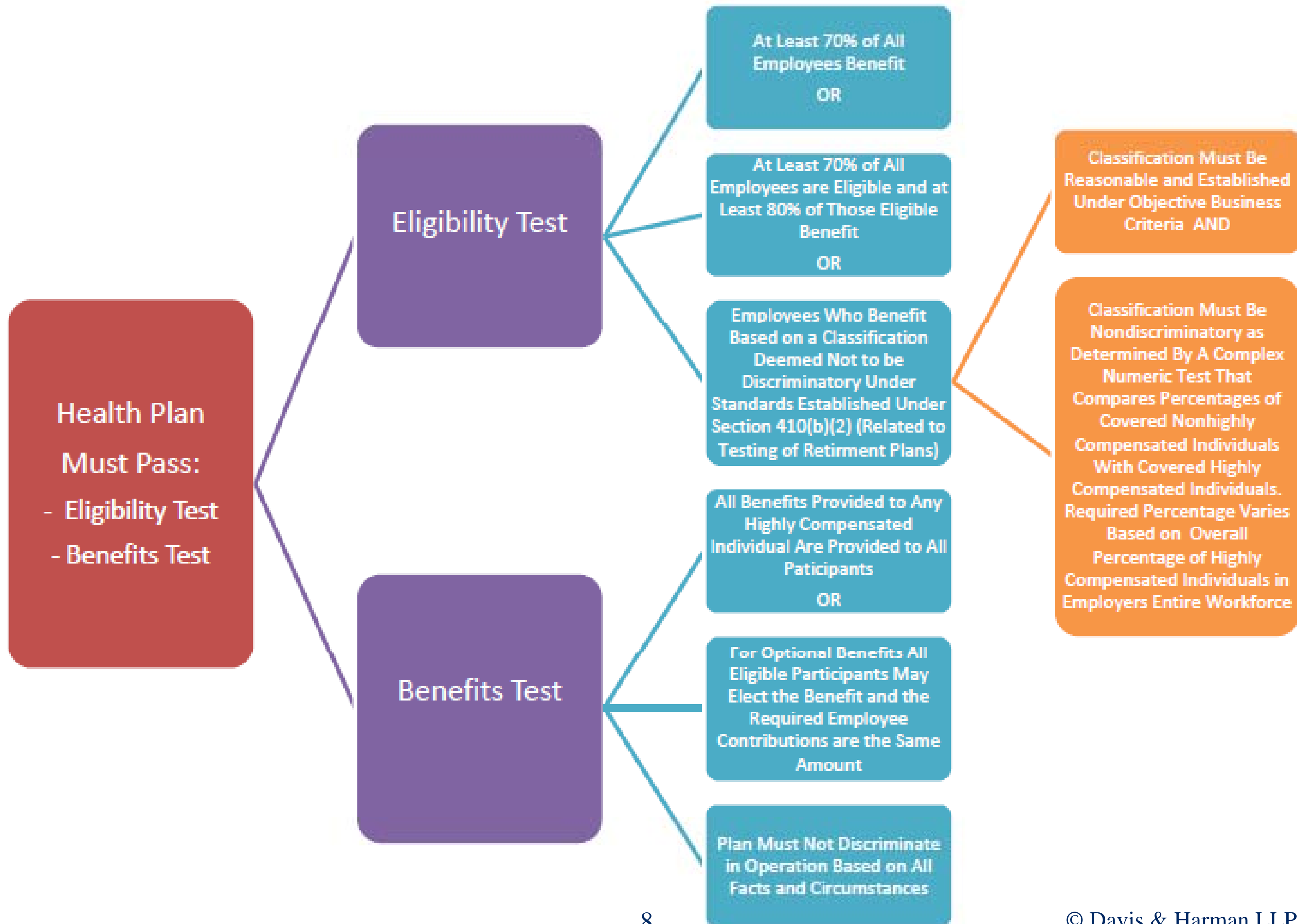
How Do the Tests Work?



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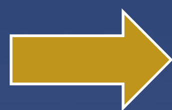
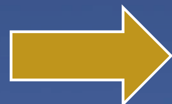
Eligibility Test

- A plan must satisfy one of the following:



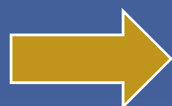
At least 70% or more of all controlled group employees participate in the plan (70% Test)

OR



70% of all controlled group employees are eligible to participate in the plan, AND at least 80% or more of those eligible in fact participate (70/80 Test)

OR



The plan benefits a nondiscriminatory class of employees (the "nondiscriminatory classification test")

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Eligibility Test

- 70% Test and 70/80 Test are very difficult to pass especially where sponsor has more than one plan

→ **Puts lot of emphasis on use of nondiscriminatory classification test**

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Eligibility Test

- Example:

  Employer has 75 non-HCEs and 25 HCEs (assume none are excludable employees). The employer sponsors group medical coverage for all of its employees working in its home state of Maryland. Thus, 45 of the non-HCEs and all 25 HCEs are eligible, of which 30 non-HCEs and 22 HCEs actually participate.

  - **70% Test – Plan fails this test because need 70% minimum participation (measured across controlled group) and only have 52%**

  - **70/80 Test – Plan fails this test because even though 70% of all employees are eligible to participate, only 69% of those participate (versus the requisite 80%)**

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Eligibility Test

- Example:
  - **Nondiscriminatory Classification – In order to pass this test, the classification must be based on objective and reasonable criteria and satisfy certain numeric testing**
    - Here, have reasonable criteria based on objective business criteria (geographic location)

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Eligibility Test

- Example:
  - **Numeric Testing – Need to show that plan's "ratio percentage" exceeds the employer's "safe harbor percentage"**
    - The employer's safe harbor percentage equals 50% reduced (which is good!) by ¾ of a percent for each whole percent that the employer's non-HCE concentration exceeds 60%
      - **Here, plan's non-HCE concentration is 75%, thus, the employer's safe harbor percentage is reduced by 11.25% to equal 38.75%**
    - To determine the plan's ratio percentage, need to compare concentration of non-HCEs actually participating (measured across employer's controlled group) to concentration of HCEs actually participating (same measurement)
      - **Here, plan's ratio percentage is 45% (40% non-HCEs participating/88% HCEs participating)**
    - Given that the plan's ratio percentage of 45% exceeds the employer's safe harbor percentage of 38.75%, the plan satisfies the numeric testing

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Eligibility Test

- How do you establish a nondiscriminatory classification?

1) **Must establish a classification that is "reasonable" and established under objective business criteria**
   - Examples: specified job categories, nature of compensation (*e.g.*, salaried versus hourly), geographic location, "similar bona fide business criteria"

2) **Must satisfy a numeric test that is based on demonstrating that a specified percentage of non-HCEs benefit under the plan**
   - Look to see whether plan's "ratio percentage" exceeds the employer's "safe harbor percentage"; if so, then pass Eligibility Test
   - If not, then look to see whether plan's ratio percentage exceeds the employer's "unsafe percentage"; if so, then employer may be able to demonstrate the classification is nondiscriminatory based on facts and circumstances

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Benefits Test

- Default test – Very simple (but very strict) test
  - **Any and all benefits provided to an HCE under the plan MUST be provided to all other plan participants**
    - Looks to coverage, versus actual paid
    - Precludes lower deductibles or copayments
    - No option for actuarial equivalence in regulations
    - Makes testing two insured arrangements under one "plan" near impossible
- Special "optional benefit" test
  - **Provides that so long as each participant may elect any benefit under the plan, a plan is not discriminatory**
    - Ex: Plan offers HMO and indemnity option
    - Very helpful for testing plans with multiple insured arrangements

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Benefits Test

- Additional Requirements
  - **Regulations state that plans <u>cannot</u> vary benefits based on compensation**
    - This is markedly different than existing rules for retirement/pension plans
    - Note that new safe harbor for simple cafeteria plans (to be discussed) allows for compensation-based employer contributions to the cafeteria plan
  - **Plans must be operated in compliance with IRC section 105(h)**
    - Plan documentation not enough
    - Need to ensure actual compliance in operation

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Aggregation and Disaggregation

- Regulations give employers significant freedom to define the "plan" subject to testing
  - **May aggregate or disaggregate arrangements into component plans**
  - **BUT, if aggregate for Eligibility Test, must stay aggregated for Benefits Test**
  - **For employers with more than one insured plan, will likely need to use liberal disaggregation**

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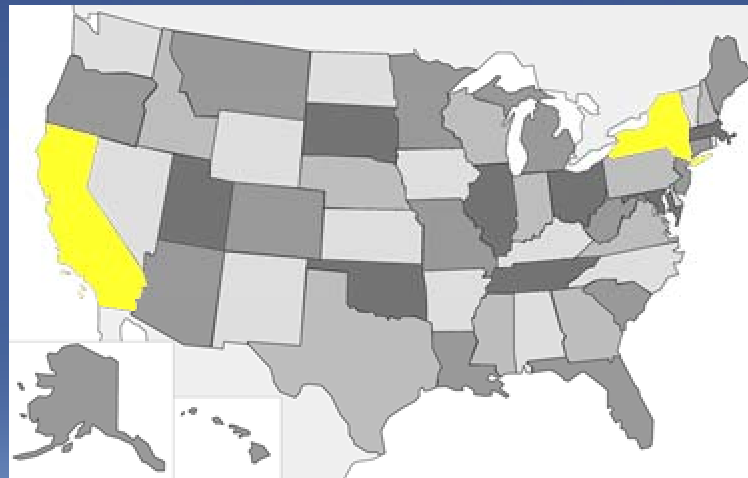
Aggregation and Disaggregation

- Example:

  An employer with employees in 13 states including New York and California has a self-insured plan that is available to all employees. The employer also sponsors an insured arrangement for its employees in California and a separate insured arrangement for employees in New York.



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Aggregation and Disaggregation

- Example:
  - **Employer likely cannot satisfy the Benefits Test if its treats all three arrangements as a single plan for 105(h) purposes**
  - **THEREFORE, likely will need to disaggregate the insured arrangements from the self-insured plan and from each other**
  - **BUT, in order to pass the Eligibility Test (using the nondiscrimination classification test), likely will need to carve out self-insured component for California employees and aggregate with California insured arrangement as a single 105(h) plan (same for New York)**
  - **END RESULT: Three separate 105(h) plans: self-insured plan covering 11 states and excluding New York and California employees; plan for New York employees comprised of self-insured carve-out and insured arrangement; plan for California employees comprised of self-insured carve-out and insured arrangement**

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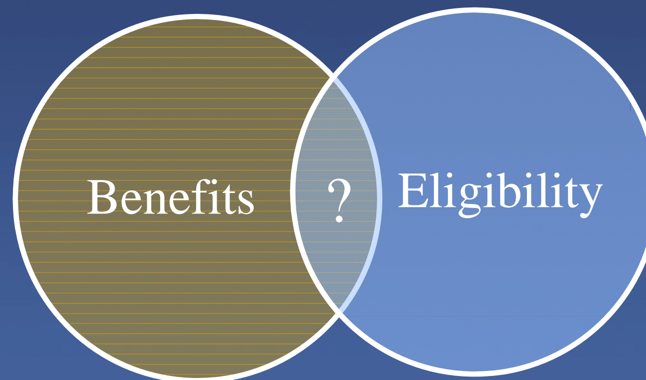
Interaction Between Tests

- PLRs issued in 1980s indicate that certain eligibility rules may need to be tested under the strict Benefits Test
  - **90-day waiting period for non-HCEs was tested under Benefits Test**



- Thus, suggests that differential waiting periods and premium subsidies may be prohibited
  - **For example, where employer allows for universal eligibility but imposes a longer waiting period on non-HCEs or provides for an increased employer premium subsidy for HCEs relative to non-HCEs**

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Additional Considerations

- No shifting to after-tax premiums
  - **Can avoid IRC section 105(h) with self-insured plans by shifting premiums to after-tax dollars (this operates to convert employer-paid self-insured coverage to IRC section 104(a)(3) coverage which is not subject to nondiscrimination rules)**
  - **Appears cannot do this with respect to insured coverage subject to PHSA section 2716**

- Interaction with cafeteria plan nondiscrimination rules
  - **Compliance with PHSA section 2716 does not give pass on cafeteria plan rules**
    - But see next slide on new simple cafeteria plan rules for small employers
  - **Substantial overlap with 105(h) rules (*e.g.*, both impose eligibility tests and allow for use of nondiscriminatory classifications), but there are notable differences (*e.g.*, different HCE definition, key employee concentration test)**

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New Simple Cafeteria Plan Rules

- PPACA allows for new simple cafeteria plan
  - **Allows eligible employers to avoid certain <u>IRC nondiscrimination rules</u> to the extent the employer in connection with its cafeteria plan provides for (i) universal eligibility, (ii) universal availability, and (iii) minimum employer contributions**
  - **Does <u>not</u> appear to except a plan from having to comply with new PHSA section 2716**
    - Compliance with simple rules, however, is likely to result in underlying plan's compliance with PHSA section 2716
  - **Limited availability**
    - Only applies to employers with on average < 100 employees (with special "grow in" rule up to 200 employees)

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Penalties for Noncompliance

- Unlike for self-insured plan violations, where amounts reimbursed from the plan are taxable to HCEs

- Penalties were clarified in IRS Notice 2010-63
  - **IRC**
    - $100 per day for "each individual to whom the failure relates", capped at the lesser of 10% of the group health plan costs or $500,000
  - **ERISA**
    - Suits for equitable relief (injunctive relief or benefits owed)
  - **PHSA**
    - Same as IRC except no maximum (our understanding is that it is aimed not at issuers who are subject to the PHSA, but rather sponsors of discriminatory governmental plans)

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Questions?

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