

The Answer Key.... For New Nondiscrimination Testing Under Health Reform

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The Answer Key...Introduction

- Nondiscrimination testing for health plans: not new (since '78) for *self-insured health plans*
 - Must pass 2 tests under Code Section 105(h):
 - Who's covered? ("Eligibility Test")
 - What benefits do they get? ("Benefits Test")
- Brand new (almost) for *insured health plans*
 - All insured plans will have to pass
 - Some now, others later
 - May not exactly align with Section 105(h) tests
- Much remains unsettled about the new rules

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The Answer Key...4 Main Points

- Key # 1: "Grandfathering" as a way to delay testing
- Key # 2: Overview of testing, including the "Benefits Test" and the "Eligibility Test"
- Key # 3: Examples of passing & failing
- Key # 4: Fixing problems

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“Grandfathering” to delay testing

- Two types of grandfathered plan status
 - No significant changes after 3/23/10
 - Plan includes employees covered by one or more CBAs as of 3/23/10; GF status continues until expiration of all CBAs in effect on 3/23/10
- Grandfathering protects against nondiscrimination testing and some other health reform requirements; but most are effective regardless

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Grandfathering Type 1

- No significant changes....
- These cause loss of GF status after 3/23/10
 - Increase any coinsurance % *or*
 - Decrease employer share of premiums > 5% *or*
 - Eliminate all or substantially all benefits for a specific condition *or*
 - Lower annual/lifetime limits* *or*
 - Increase deductible more than 15%** *or*
 - Increase copayment more than \$5 or 15%, whichever is greater**

*No ann. limits lower than former lifetime limits **Subject to medical inflation adjs.

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Grandfathering Type 2

- An *insured* health plan with coverage provided under CBAs keeps GF status....
 - Until the last CBA in effect on 3/23/10 expires
 - Does not apply to self-insured plans
- No clear law on what is a single “plan” in the governmental context
 - Different premium pools probably still constitute one plan
 - Free-standing insurance policies for different CBA groups may be seen as separate plans

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When Nondiscrimination Testing Begins....

- If grandfathering does not apply, testing begins with the first “plan year” beginning *after 9/22/10*
 - “Plan year” is straightforward for private plans
 - For government health plans it’s usually the fiscal or policy year, but not always
- Testing can start mid-year, after loss of GF status
- **Not as “simple” as applying Code Section 105(h)**

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New Rules Not Yet Firmly Set

- Health reform law: Insured plans must meet rules “similar to” Code Section 105(h), after losing grandfathered status
- Leaves open the **possibility** that Section 105(h) rules will be tweaked for insured plans
- IRS requested comments on regulations to implement new rules (deadline 11/4)
- **But: IRS has not exempted** insured plans while new regulations are developed
 - Instead, “**good faith**” compliance allowed

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New Rules Not Yet Firmly Set

- What is “good faith” compliance with new nondiscrimination testing rules while regulations are being developed?
 - As noted, “good faith” compliance is only required beginning after GF status is lost
- **Safest course:** Follow Section 105(h)
- **Alternatively, only deviate** from Section 105(h) with a **reasonable argument** why insured plans can’t follow the 105(h) rule; even this is not risk-free

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Overview of Section 105(h) Testing

- Most broadly, the question is whether highly-compensated employees (HCEs) are treated more favorably than non-HCEs
- **Critical differences** from pension plan nondiscrimination testing:
 - No governmental plan exemption
 - For testing, a pension plan may have **no HCEs** – but there are **always HCEs** for Code Section 105(h) tests
 - For Section 105(h) testing, usually **more** HCEs than for pension plan testing

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HCEs vs. non-HCEs

- HCEs for Code Section 105(h)
 - Top 5 highest paid officers
 - Any 10% or greater shareholder
 - Any individual who is one of the highest-paid 25% of employees
- Non-HCEs – everyone else
- Note, exemptions can apply
 - Collectively bargained employees
 - “Excludable” employees – e.g., some part-time workers (< 35 hours), shorter-term employees

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Testing – Benefits Test & Eligibility Test

- **Must pass both** Benefits Test and Eligibility Test to satisfy Section 105(h)
- **Benefits Test overview:**
 - Whether HCEs and non-HCEs are provided the same benefits, or the same benefit options at the same cost
 - Not just top-line employee premium amounts, but equality on waiting periods, copays, benefits, etc.
 - Plan also must not discriminate based on vague “facts and circumstances” test

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Testing – Benefits Test & Eligibility Test

- The other half: The Eligibility Test
- The Eligibility Test can be met using any of three increasingly complex equations
 - Option 1: At least 70% of all employees actually have benefits (not just eligibility)
 - Option 2: At least 70% of all employees are eligible, and of those eligible, at least 80% actually have benefits
 - Option 3: A form of testing like IRS regulations under Code Section 410(b) for retirement plans*
- “Excludable” employees are not counted – but only if no one in the “excludable” group participates

*Can pass 410(b) if % of non-HCEs eligible divided by % of HCEs eligible is > or = 50%

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Examples of Passing & Failing

- If the same benefits or benefit options are provided to all employees (other than any “excludable employees”), at the same cost, both the Eligibility and Benefits Tests are met and the plan passes
- If all employees in the plan are collectively bargained, the plan passes both tests
- Differences between groups of collectively-bargained employees won’t cause a failure, but still need to look at non-CBA employees

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Examples of Passing & Failing

- Different benefits for collectively-bargained and non-collectively bargained employees
 - CBA employees are ignored for testing purposes
 - If all non-collectively-bargained employees actually have the same benefits or benefit options at the same cost, the plan passes

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Examples of Passing & Failing

- Part-time employees working less than 35 hours a week can be excluded from testing, but only if no one in the excluded group participates in the plan and other tests are met; this may allow passage for the remaining group
- Differing premium contribution amounts: will likely be found discriminatory if any HCEs have better premium rates than any non-HCEs

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Fixing Testing Problems

- Sometimes, a complicated process of “disaggregation” into “separate plans” (just for testing purposes) will allow a plan to pass – this does not often work, however
- If there is a violation of Section 105(h) –
 - The employer faces penalties of up to \$100 per day per affected participant until the problem is fixed
 - Fixing requires either raising non-HCEs’ benefits, or recovering excess paid for HCEs

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Fixing Testing Problems

- If there is a testing failure, changes to benefits generally must be made retroactively
 - This would require a “fix” going back to the time the plan became subject to testing
 - Since it may not be feasible to bring the non-HCEs “up” to the HCEs’ level, this will probably require retroactively bringing HCEs “down” to the non-HCEs’ level and providing other comp to the HCEs
 - Probably permissible to renegotiate superintendent/administrator contracts to do this
 - No easy health benefit substitute for HCEs

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What to Do Next

- Determine if the plan is grandfathered and when grandfathering ended or will end
- Before GF status ends, assess whether changes will be needed to avoid nondiscrimination testing problems
 - Work with a qualified consultant, benefits professional, or attorney
 - Check current law and agency guidance
- If future changes are needed, plan for the fix
- If problems have already occurred, develop a retroactive correction plan to solve the problem

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