

Compliance Corner: COBRA Qualifying Events

CONEXIS

The Consolidated Omnibus Budget Reconciliation Act Of 1985 (COBRA) amends sections of the Employee Retirement Income Security Act (ERISA), the Internal Revenue Code, and the Public Health Service Act (PHSA). COBRA requires group health plans to offer “each qualified beneficiary who would otherwise lose coverage under the plan as a result of a qualifying event an opportunity to elect, within the election period, continuation coverage under the plan.”¹

Group Health Plan Defined

Generally, a plan is a group health plan if it provides healthcare and is “maintained” by the employer. IRS COBRA regulations define a group health plan as “...a plan maintained by an employer or employee organization to provide healthcare to individuals who have an employment-related connection to the employer or employee organization or to their families.”²

¹ Treas. Reg. §54.4980B-1, Q/A-(a)
² Treas. Reg. §54.4980B-2, Q/A-1(a)

Help for Employers: Much-Needed Guidance on HSA Rules

Kiplinger Business Forecasts
Martha Lynn Craver

Some answers to tricky questions for firms that offer health savings accounts...

The IRS will issue some long-awaited health savings account guidance for employers that offer the plans and make voluntary contributions to encourage participation. HSAs allow employees to set aside cash tax free, often with matching contributions from employers, to pay for their out-of-pocket medical care. For employees to get the tax benefits, the HSAs must be combined with a high-deductible insurance policy. Because premiums are lower than other forms of health insurance, many firms are eager to have employees try this relatively new option.

The proposed IRS rules apply to two specific situations:

- When an employee fails to establish an HSA by Dec. 31 (or when the worker sets up an HSA but fails to notify the employer).
- When an employer wants to speed up contributions to an account because the employee has incurred medical expenses greater than the amount available in the account.

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Qualified Beneficiary Defined

Treasury Regulations §54.4980B-3, Q/A-1 defines a qualified beneficiary as an individual, who is, on the day before a qualifying event, a covered employee³, the spouse of a covered employee, or a dependent child of the covered employee; a child who is born to or placed for adoption with a covered employee during a period of COBRA continuation coverage; and, in the case of a qualifying event that is the bankruptcy of the employer, a covered employee who had retired on or before the date of substantial elimination of group health plan coverage.⁴

Qualifying Event Defined

ERISA defines a qualifying event as any of the events listed within the statute “which, but for the continuation coverage required under this part [COBRA], would result in the loss of coverage of a qualified beneficiary.”⁵

Qualifying Events

COBRA specifies seven types of qualifying events:⁶

- Termination
- Reduction in hours
- Divorce or legal separation
- Loss of dependent child status
- Employee’s entitlement to Medicare
- Death of the covered employee/retiree
- Employer’s bankruptcy (applies only to retirees)

An event is a qualifying event only “if, under the terms of the group health plan, the event causes the covered employee, or the spouse or a dependent child of the covered employee, to lose coverage under the plan.”⁷ Due to this requirement, the occurrence of one of the listed events will not always result in a qualifying event. An employer must carefully review the terms of its group health plan(s) when determining if a qualifying event has occurred.

Example 1: Some group health plans dictate that a spouse must be removed from the plan upon legal separation from the covered employee. Under such a plan, legal separation constitutes a qualifying event because the legal separation causes the spouse to lose coverage under the terms of the group health plan.

Example 2: Many group health plans will allow a spouse to remain covered under a plan when a legal separation occurs. These plans dictate that the spouse must be removed from the plan upon divorce from the covered employee. Under such a plan, legal separation does not constitute a qualifying event because the legal separation does not cause the spouse to lose coverage under the terms of the group health plan.

³ See Treas. Reg. § 54.4980B-3, Q/A-2 for a definition of “covered employee”

⁴ See Treas. Reg. § 54.4980B-3, Q/A-1(2) for information regarding the spouse, surviving spouse, and dependents of such retirees

⁵ ERISA §603

⁶ Treas. Reg. §54.5980B-4, Q/A-1(b)(1) through (6)

⁷ Treas. Reg. §54.4980B-4, Q/A-1(c)

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Termination

The covered employee's termination of employment is a qualifying event for the covered employee, the covered spouse, and any covered dependents.

COBRA draws no distinction between voluntary and involuntary termination of employment. Therefore, termination of employment includes retirement, quitting, strikes, layoffs, lock outs and other employer-initiated actions resulting in a separation of employment.

COBRA specifies that termination due to gross misconduct is not a qualifying event⁸ and that COBRA continuation coverage need not be offered in such scenarios. However, the COBRA regulations do not define gross misconduct and the courts have not agreed on a common standard. Without a clear definition of gross misconduct, employers should be extremely cautious in denying COBRA coverage in such scenarios.

Reduction of Hours

A reduction of hours is a qualifying event for the employee, the covered spouse, and any covered dependents.

A reduction of hours is most commonly experienced by an employee that goes from full-time to part-time. However, temporary lay offs,

leaves of absence, strikes, and lock outs can also result in a reduction of hours.

Special circumstances surround a reduction of hours due to a leave of absence or severance arrangement. These topics are beyond the scope of this article but additional information will be provided in future editions of *Compliance Corner*.

Divorce or Legal Separation

Divorce or legal separation from the covered employee is a qualifying event for the spouse that loses coverage as a result. As discussed previously, legal separation is only a qualifying event if, under the terms of the group health plan, the spouse loses coverage as a result of the legal separation.

COBRA does not define legal separation, although many states have established formal rules and procedures for granting legal separation. It should be safe for employers to rely on the policies established by the state(s) in determining if a legal separation has occurred.

A divorce (or legal separation) is not necessarily a qualifying event for a covered dependent as the action may not cause a loss of coverage for the dependent. However, a covered dependent may lose dependent status under the plan as a result of a divorce and in turn, experience a qualifying event.

⁸ Treas. Reg. §54.4980B-4, Q/A-1(b)(2)

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This can occur when a plan dictates that a dependent must live with the covered employee in order to be covered under the plan. If the covered dependent no longer lives with the covered employee as a result of the divorce, the dependent will lose dependent child status and will, in turn, lose coverage under the plan.

Loss of Dependent Child Status

Treasury Regulations §54.4980B-4, Q/A-1(b)(5) specify that a qualifying event occurs when a dependent child ceases “to be a dependent child of a covered employee under the generally applicable requirements of the plan.”

A dependent child may cease to meet the applicable requirements of the plan through a variety of ways, including the age requirements of the plan. Because plans may have different rules and age requirements, an employer should carefully review the terms of its group health plan(s) when determining if a loss of dependent child status has occurred.

Example: John is the covered dependent of a covered employee. John is 22 years old and a full-time student. The group health plan defines a dependent as a child younger than 19 years of age or, in the case of a full-time student, younger than 25 years of age. While still 22 years old, John graduates college and is no longer a full-time student. Because John

no longer meets the definition of a dependent child under the terms of the group health plan, John loses coverage under the plan. This loss of coverage is a qualifying event and John is eligible for COBRA continuation coverage.

Death of the Covered Employee

The death of the covered employee is a qualifying event for the spouse and covered dependents of the covered employee.

Employee’s Entitlement to Medicare

Although an employee’s entitlement to Medicare is one of the listed events in the statute, it is rare that Medicare entitlement will cause a loss of coverage under a group health plan providing coverage to active employees. The Medicare Secondary Payer rules prohibit most group health plans, in nearly all circumstances, from making Medicare entitlement an event that causes a loss of coverage.⁹ Therefore, Medicare entitlement is rarely a qualifying event. In the rare case that Medicare entitlement is a qualifying event, it is a qualifying event only for the covered spouse and covered dependents.¹⁰

Bankruptcy

An employer’s bankruptcy is not, by itself, a qualifying event for active employees. However, an

9 See Revenue Ruling 2004-22 for a discussion of the Medicare Secondary Payer rules and their application to COBRA

10 See §4980B(g)(1). The covered employee can only be a qualified beneficiary if the qualifying event is termination or reduction in hours.

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employer's bankruptcy is a qualifying event for covered retirees and their spouses and dependents that lose coverage as a result of the bankruptcy.

The COBRA statute and COBRA regulations contain different language regarding what constitutes a loss of coverage in the case of an employer's bankruptcy. Due to this conflict, and the lack of case law regarding this matter, employers facing such a scenario should consult with counsel.

Loss of Coverage Defined

For COBRA purposes, to lose coverage means "to cease to be covered under the same terms and conditions as in effect immediately before the qualifying event."¹¹ Under most circumstances, a loss of coverage will be the complete elimination of coverage. However, a partial loss in coverage (such as a change in the terms of the coverage without the actual elimination of the coverage) can also give rise to COBRA rights.

For example, "Any increase in the premium or contribution that must be paid by a covered employee (or the spouse or dependent child of a covered employee) for coverage under a group health plan that results from the occurrence of..."¹² one of the seven qualifying events listed in the statute is a loss of coverage.

Example: Bob is a full-time employee of ABC Company. As part of a corporate restructure, Bob's position is reduced to part-time. As a result of the change, Bob is required to make a greater contribution towards his group health plan coverage. The reduction in hours is one of the listed events and the increase in premiums constitutes a loss of coverage. Therefore, Bob has experienced a qualifying event and must be offered COBRA continuation coverage.

Loss of Coverage Must Occur During Maximum Coverage Period

Generally, the maximum coverage period under COBRA is either 18 or 36 months, depending on the type of qualifying event. This period is measured from the date of the qualifying event or the loss of coverage date, depending on plan design.

Typically, the loss of coverage will occur immediately following the qualifying event. However, there are certain circumstances under which the loss of coverage may be delayed or deferred. If the loss of coverage occurs after the expiration of the maximum coverage period, there is no qualifying event. Conversely, if the loss of coverage is deferred but still occurs within the maximum coverage period, there is a qualifying event and the qualified beneficiaries associated with the event must be offered COBRA continuation coverage for the remainder of the maximum coverage period. 🍷

¹¹ Treas. Reg. §54.4980B-4, Q/A-1(c)
¹² Treas. Reg. §54.4980B-4, Q/A-1(c)

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The rules will mandate that employers send out a notice by Jan. 15 to all workers who haven't registered an HSA with the firm. The notice will make it clear that, to be eligible for matching contributions, the worker has until the end of February to set up an account and inform the employer. The employer then has until April 15 to make any contribution due for the past year plus "reasonable" interest.

Employers, who normally make contributions each pay period, just as workers usually do, will have the option to make early contributions, up to the annual limit, if the worker incurs expenses early in the year that exceed the account's balance. In some ways, this is similar to the arrangement for flexible spending accounts (FSAs), which requires that employers make workers' full annual amounts available Jan. 1 of the plan year, essentially loaning the money to the account if needed and collecting later through payroll deductions. The difference is that for HSAs, the rules apply only to employer contributions. There is no fronting of future worker contributions. And the early contributions to HSAs are voluntary as long as the company has a consistent policy for all workers. If an employer chooses to speed up contributions for one employee, the employer must do it for all workers in similar situations.

This should make HSAs more attractive to workers who have expressed concern about

what happens during their first year of participation in an HSA if funds aren't available in the account to cover expenses. In most cases, it will probably become less of a concern as time passes because funds not used one year roll over to the next, so after several years of participation, there will often be a sizable sum in the accounts.

The new IRS rules will affect mostly small to medium-size employers. Most large employers that offer HSAs to their workers make pre-tax contributions through a Section 125 cafeteria plan, and these issues have already been addressed for those plans. Small and midsize firms usually view Section 125 plans as being too expensive or difficult to administer.

Employers can rely on the rules now, even though they are not finalized yet. The full text of the rule is available at <http://edocket.access.gpo.gov/2007/pdf/E7-10529.pdf>. 

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Rapid HSA Growth Lies Ahead, but More Education is Needed

Bank Investment Consultant

Steve Garmhausen, American Banker

The number of Americans using health savings accounts (HSAs) is poised to grow quickly, recent research suggests, but more work is needed to help people understand how the accounts and their accompanying insurance plans work.

Mintel International Group projects that 29.5 million enrollees and dependents will be in high-deductible health insurance plans and HSAs by the end of 2009. That would be a 554% increase from the 4.5 million people the Chicago market research firm estimates were covered by such plans last Dec. 31.

HSAs, which let workers save for medical expenses in tax-free accounts, began to appear in 2004 to complement high-deductible insurance plans. By the end of last year, 3.6 million of the accounts had been opened, with \$2.5 billion of deposits, according to Mintel. The firm predicts assets will grow from \$8.8 billion this year to \$25.4 billion in 2008 and will hit \$57.4 billion by the end of 2009.

Structural changes appear to have primed the product for growth. The Tax Relief and Health Care Act of 2006, which President Bush signed into law on Dec. 20, allows a one-time rollover into HSAs from flexible spending accounts, health reimbursement accounts or individual retirement accounts.

Also, savers no longer need to limit their contributions to the corresponding health plan's

annual deductible cost. And people who open an HSA after their health plan's term begins can still deposit the total annual amount allowed. This year, the contribution cap rose 5.6% for individuals, to \$2,850, and 3.7% for families, to \$5,650.

Mintel's projection takes into account the rate at which individual retirement accounts and 401(k) plans grew in their early years, says Susan Menke, a senior financial services analyst at Mintel. "This is a pressing and immediate problem, so the growth rate will be even greater, I imagine," she says.

But growth could be hindered by confusion among consumers, Mintel's report warned. In a survey of 2,000 adults done for Mintel, the most frequent answer to questions about HSA features and preferences was "don't know." Furthermore, in every age group, at least half of the respondents said that they did not know what an HSA was or were not interested in one, even if their employer contributed to it.

Banks say lack of employer participation is a problem. Although many banks say they now have customer service reps who focus on answering questions about HSA, part of the education shortfall is beyond banks' control, says Kirk Hoewisch, the president of HSA Bank, a subsidiary of Webster Financial Corp. in


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Waterbury, Conn. His bank has 180,000 HSAs. Custodians and insurers can supply thorough, easy-to-understand materials, he says, but it is largely up to employers to put them into workers' hands.

However, as they gain experience with HSAs, banks are fine-tuning their educational tools and tactics. Last fall, HSA Bank started offering "Webinars" on the Internet to train employers and sales agents, and UMB Financial Corp. in Kansas City, Mo., is creating a service that will send HSA information directly to clients' cell phones, says Dennis Triplett, the president of the bank's healthcare services unit, which has \$85 million in HSA deposits. In April, Golden Rule Insurance started a Web page that it bills as a one-stop site for comprehensive HSA information. Golden Rule's sister company, Exante Bank, has 300,000 HSAs.

But technology is limited as a tool to reach the employees who are most likely to use HSAs because they're often blue collar workers lacking computer savvy, says Lee DeTurk, the HSA officer at Tower Financial Corp. in Fort Wayne, Ind., which has sold about 8,000 health savings accounts. "As much as we all want to rely on electronics, in the manufacturing world they don't spend their time on the computer," he says. To combat this problem, Tower started a paper newsletter this year that it distributes to employers and mails to employees along with their account statements. 

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