MICHAEL BEST
& FRIEDRICH LLP

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Employee Benefits Alert

Health Care Reform Compliance Alert IRS, DOL & HHS Issue Final Regulations on Grandfathered Plan Status

On June 17, 2010, final regulations relating to "grandfathered" health plans were published. A copy of the regulations may be found here. A White House fact sheet describing the regulations is available by clicking here.

Patient Protection & Affordable Care Act's Exemptions. Some of the provisions in the health care reform law (known as "PPACA") do not apply to a grandfathered health plan. For example, a grandfathered health plan does not currently have to cover an older child (up to age 26) if the child has other employer-sponsored coverage available. In contrast, a non-grandfathered health plan generally would have to cover such an older child.

Unfortunately, the statute gives little guidance on when a plan is grandfathered. The new regulations from the Internal Revenue Service ("IRS"), Department of Labor ("DOL") and Department of Health and Human Services ("HHS") fill in this gap and provide important guidance for plan sponsors.

How Can We Lose Grandfathered Status? There are several ways a plan can lose its grandfathered health plan status, as described below. However, some changes will not result in a loss of grandfathered status. This chart provides a quick overview of these changes; see below for more detail.

Change or Event	Will Grandfathered Status be Lost?	Comments
1. Complete turnover of employees. Example: no one who was in plan on 3/23/2010 remains	No (unless plan ceased to cover anyone—i.e., had zero participants)	Helpful to employers—avoid having to track who is in or out
2. Fail to include statement that plan is grandfathered	Yes	Will likely require summary plan description to be amended; may require other materials (e.g., enrollment materials) to be modified
3. New insurance policy	Yes (but an exception exists for collectively bargained plans)	
4. Add new employees (whether "newly hired" or "newly eligible")	No, provided plan offered coverage on 3/23/2010	Appears "brand new" plans that add new employees cannot be grandfathered (e.g.,

		new business started on 5/1/2010 and it starts offering plan on 6/1/2010)
5."Abusive" corporate transaction. Examples: (a) acquiring another employer for principal purpose of acquiring that employer plan's grandfathered status; or (b) transferring employees from high-cost option to low-cost option (if no bona fide employment-based reason exists)	Yes	The first example, (a), will likely be rare. However, the second example, (b), likely will be more common.
6. Eliminate benefits for particular condition or benefits to diagnose or treat particular condition. Example: eliminate cystic fibrosis coverage	Yes	Grandfathered status lost even if only a few participants or beneficiaries are affected
7. Any increase in percentage cost-sharing requirement. Example: 20% coinsurance requirement increased to 25%	Yes	
8. Increase in fixed-amount cost-sharing requirement other than copayment. Example: increase $500 deductible or $2,500 out-of-pocket maximum	Perhaps. Safe harbor where no loss of grandfathered status if cost of change equals or is less than "medical inflation" + 15%	
9. Increase in fixed-amount copayment. Example: increase office visit copayment from $30 to $40	Perhaps. Safe harbor where no loss of grandfathered status if cost of change equals or is less than the greater of: (a) $5 (increased by medical inflation); or (b) "medical inflation" + 15%	
10. Decrease in employer's contribution rate by more than 5 percentage points. Example: On 3/23/2010 employer contributes 60% of	Yes	Note that standard is based on employer's contribution rate—not on overall cost increasing. So, if fully-insured plan receives renewal quote with 6% increase,

plan's cost; now drops to 50%		grandfathered status can be retained, provided employer does not decrease (by more than five percentage points) what it pays
11. Adding new annual limit. Example: Plan did not have annual dollar limit on benefits on 3/23/2010 but is amended to include it 1/1/2011	Yes	
12. Decrease in dollar value of annual limit if plan imposed annual limit on 3/23/2010	Yes	

Rules Apply Separately to Each "Benefit Package." If a plan offers more than one "benefit package," each benefit package is considered separately. So, if a single plan offers an HMO option and a PPO option, the HMO option could lose its grandfathered status without affecting the PPO option's grandfathered status (and vice versa). Note that the term "benefit package" is not defined in the regulations. Presumably sponsors can designate which plan terms constitute a separate benefit package (and presumably many sponsors would want to do so, in order to ensure that losing grandfathered status in one option does not cause a loss in other options).

"Laminate" Your March 23, 2010 Plan Document. For as long as the plan wishes to maintain its grandfathered status, the plan must maintain records documenting the terms of the plan in effect on March 23, 2010. A plan also must maintain any "other documents" necessary to verify, explain, or clarify its status as a grandfathered health plan. These other documents could include intervening and current plan documents or SPDs; documentation of premiums or cost of coverage; and documentation of required employee contribution rates. A plan also must make these records available for examination upon request. Sponsors wishing to maintain their grandfathered status may want to ask whether their insurers and third party administrators ("TPAs") will assist with these documentation requirements.

No Need to Track Individual Enrollees. A plan will not cease to be grandfathered merely because one or more (or even all) individuals enrolled on March 23, 2010 cease to be covered (as long as the plan has continuously covered someone since March 23, 2010). For example, suppose the plan sponsor has a 100% turnover rate from March 23, 2010 to March 23, 2011. That is, no employee covered on March 23, 2010 remains covered on March 23, 2011. The plan can still retain its grandfathered status, provided someone was covered during this one-year time period.

Disclosure of Grandfathered Status. If a plan wishes to retain its grandfathered status, it must include a statement indicating that the plan is grandfathered (a "Disclosure Statement"). The Disclosure Statement must be included in any "plan materials" provided to a participant or beneficiary and must provide "contact information for questions and complaints." The preamble to the regulations notes that "plan materials" can include a summary plan description ("SPD"). It

is unclear if other materials (e.g., enrollment materials) must also include the Disclosure Statement.

The regulations do not specify who can or must field "questions and complaints." This includes questions about how a plan can lose its grandfathered status (as noted below in the sample Disclosure Statement). *Presumably the plan administrator could do so, but employers likely should discuss with their insurance carriers and TPAs whether they could provide this service (and what the cost, if any, would be for this service).*

The regulations provide the following sample Disclosure Statement:

> This [group health plan or health insurance issuer] believes this [plan or coverage] is a "grandfathered health plan" under the Patient Protection and Affordable Care Act (the Affordable Care Act). As permitted by the Affordable Care Act, a grandfathered health plan can preserve certain basic health coverage that was already in effect when that law was enacted. Being a grandfathered health plan means that your [plan or policy] may not include certain consumer protections of the Affordable Care Act that apply to other plans, for example, the requirement for the provision of preventive health services without any cost sharing. However, grandfathered health plans must comply with certain other consumer protections in the Affordable Care Act, for example, the elimination of lifetime limits on benefits.
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> Questions regarding which protections apply and which protections do not apply to a grandfathered health plan and what might cause a plan to change from grandfathered health plan status can be directed to the plan administrator at [insert contact information]. [For ERISA plans, insert: You may also contact the Employee Benefits Security Administration, U.S. Department of Labor at 1-866-444-3272 or www.dol.gov/ebsa/healthreform. This website has a table summarizing which protections do and do not apply to grandfathered health plans.] [For individual market policies and nonfederal governmental plans, insert: You may also contact the U.S. Department of Health and Human Services at www.healthreform.gov.]

New Insurance Policy Generally Results in Loss of Status. If an employer enters into a new policy, certificate or contract of insurance after March 23, 2010 (e.g., if a prior policy is not being renewed), then that policy, certificate or contract is not a grandfathered health plan. For example, suppose a fully-insured health plan receives its policy from Big Insurer as of March 23, 2010. For the plan year beginning January 1, 2012, the plan enters into a new policy with Little Insurer. The policy from Little Insurer would not be "grandfathered" and must comply with the full scope of PPACA. There is an exception to this rule for collectively bargained plans, as noted below.

New Employees. If a plan provided coverage on March 23, 2010, it generally can enroll new employees and their families in the plan and retain its grandfathered status. For these purposes a "new employee" includes both a "newly hired" employee and a "newly enrolled" employee—an important clarification that was not clear under PPACA.

New Family Members. If an individual is enrolled in the plan on March 23, 2010, the plan can enroll family members in the individual's coverage without causing a loss of grandfathered status.

Anti-Abuse Rules. Some employers could choose to acquire another employer simply to obtain the other employer plan's grandfathered status. (We suspect this would be quite rare.) If a "principal purpose" of the acquisition is to cover new individuals under a grandfathered health plan, the plan will lose its grandfathered status.

Similarly, transferring employees from one plan or coverage into another, without a bona fide employment-based reason, could cause the transferee plan to lose its grandfathered status. For example, suppose Acme Co. offers Options A and B to its employees. Acme eliminates Option A because of its high cost and transfers employees covered under Option A to Option B. Option B generally would lose its grandfathered status because the high cost of Option A is not considered a "bona fide business reason" for the transfer.

Collectively Bargained Plans. Collectively bargained plans are treated more favorably than non-collectively bargained plans. A collectively bargained plan that was ratified before March 23, 2010 is grandfathered at least until the date on which the last such collective bargaining agreement ("CBA") relating to the coverage that was in effect on March 23, 2010 terminates. Plan amendments made solely to comply with PPACA-required changes are not treated as a termination of the CBA. This special rule probably does not apply to a self-funded collectively bargained plan, but the regulations are somewhat unclear.

An example of how this rule favors collectively bargained plans is as follows. Suppose a fully-insured plan is maintained pursuant to a CBA. The policy is provided by Big Insurer and existed on March 23, 2010. The CBA has not been amended and will not expire before December 31, 2011. The plan enters into a new insurance policy with Little Insurer for the plan year starting January 1, 2011 (i.e., before the CBA expires). The plan here will <u>not</u> lose its grandfathered status. In contrast, as noted above, a non-collectively bargained plan <u>would</u> lose its grandfathered status when it changes insurers.

Negative Plan Design Changes Can Cause Loss of Status. Various plan design changes (usually those that work against a plan participant) can cause a loss of grandfathered status.

Elimination of Benefits. If a sponsor eliminates all or substantially all benefits to diagnose or treat a particular condition, the plan will cease to be a grandfathered plan. This is true even if the change affects only a few people under the plan. For example, the preamble notes that eliminating coverage for cystic fibrosis may affect few enrollees—but would still cause a loss of grandfathered status. For these purposes, eliminating benefits necessary to diagnose or treat a condition is considered the elimination of benefits.

Increase in Percentage Cost-Sharing Requirement. <u>*Any*</u> increase, measured from March 23, 2010, in a percentage cost-sharing requirement will cause a loss of grandfathered status. For example, suppose a plan had a 20% coinsurance requirement for inpatient surgery as of March 23, 2010. The plan is later amended to increase this coinsurance requirement to 25%. The plan will lose its grandfathered status.

Increase in Fixed-Amount Cost-Sharing Requirement Other than Copayment. Any increase in a fixed-amount cost-sharing requirement other than a copayment (such as deductible or out-of-pocket maximums) can cause a plan to lose its grandfathered status if the plan fails this mathematical test: If the total percentage increase in the cost-sharing requirement measured from March 23, 2010 exceeds the "maximum percentage increase", the grandfathered status is lost.

The "maximum percentage increase" equals medical inflation plus 15 percentage points. The regulations provide a method for calculating medical inflation which is based on the overall medical care component of the Consumer Price Index for All Urban Consumers ("CPI-U"). For example, raising a $500 deductible or a $2,500 out-of-pocket limit by a total percentage that is more than the sum of medical inflation and 15 percentage points would likely cause a loss of grandfathered status.

Increase in Fixed-Amount Copayment. Any increase in a fixed-amount copayment causes a plan to cease to be grandfathered, but only if the total increase in the copayment exceeds the greater of:

a. An amount equal to $5 increased by medical inflation (as described above) or
b. The maximum percentage increase, determined by expressing the total increase in the copayment as a percentage.

EXAMPLE:

On March 23, 2010 our grandfathered health plan had an office visit copayment of $30 for specialist visits. We want to raise this to $40. Will that cause our plan to lose its grandfathered status? You need to take out your calculator and run the numbers. Here is how the numbers work (with some extra assumptions included).

Assume (as the regulations do; see 26 CFR 54.9815-1251T(g)(4), Example 3) that within the 12-month period before the $40 copayment takes effect, the greatest value of the overall medical care component of the CPI-U (unadjusted) is 475. If so, the increase in the copayment from $30 to $40, expressed as a percentage, is 33.33% (40 - 30 = 10; 10 ÷ 30 = 0.3333; 0.3333 = 33.33%). Assume medical inflation from March 2010 is 0.2269 (475 – 387.142 = 87.858; 87.858 ÷ 387.142 = 0.2269). If so, the maximum percentage increase permitted is 37.69% (0.2269 = 22.69%; 22.69% + 15% = 37.69%). Because the 33.33% increase here does not exceed 37.69%, the change in the copayment requirement at that time does not cause the plan to cease to be a grandfathered health plan.

When calculating future changes to a fixed-amount copayment, a plan needs to consider the prior changes as well, as illustrated in this example.

Assume the same facts as above, except the plan subsequently increases the $40 copayment (noted above) to $45 for a later plan year. Suppose the CPI-U equals 485 during the 12-month period when this change occurs. Now do we lose our grandfathered status? Yes. In this example, the increase in the copayment from the original $30 in the prior example (the copayment that was in effect on March 23, 2010) to $45, expressed as a percentage, is 50% (45 - 30 = 15; 15 ÷ 30 = 0.5; 0.5 = 50%). Medical inflation from March 2010 is 0.2527 (485 – 387.142 = 97.858; 97.858 ÷ 387.142 = 0.2527). The increase that would cause a plan to cease to be a grandfathered health plan is the greater of the maximum percentage increase of 40.27% (0.2527 = 25.27%; 25.27% + 15% = 40.27%), or $6.26 ($5 x 0.2527 = $1.26; $1.26 + $5 = $6.26). Because 50% exceeds 40.27% and $15 exceeds $6.26, the change in the copayment requirement at that time causes the plan to cease to be a grandfathered health plan.

Decrease in Contribution Rate. A plan will lose its grandfathered status if it decreases its contribution rate based on cost of coverage by more than five percentage points below the contribution rate for the coverage period that includes March 23, 2010. A similar rule applies where the contribution rate is based on a formula.

For example, suppose a plan provides two tiers of coverage—self-only and family. On March 23, 2010, the employer contributes 80% of the total cost of coverage for self-only and 60% of the total cost of family coverage. Subsequently, the employer reduces the contribution to 50% for family coverage but keeps the same contribution rate for self-only coverage. This decrease of 10% (60% - 50% = 10%) causes the plan to lose its grandfathered status. The fact that the contribution rate for self-only coverage remains the same does not change the result.

Changes in Annual Limits. Changes to annual limits can cause a loss of grandfathered status:

a. **Adding New Annual Limit.** If a plan adds an overall annual limit on the dollar value of benefits and the plan did not have such a limit on March 23, 2010, the grandfathered status will be lost. Similarly, grandfathered status will be lost if the plan imposed a lifetime limit on March 23, 2010 but no annual limit, then the plan is modified to include an annual limit whose dollar value is less than the dollar value of the lifetime limit.

b. **Decrease in Annual Limit.** If the plan imposed an annual limit on the dollar value of coverage on March 23, 2010 and the plan decreases the dollar value of the annual limit, the grandfathered status will be lost.

Benefit Increases. A sponsor can apparently increase its benefits without risking grandfathered plan status. As noted above, the loss of grandfathered status generally occurs when benefits are decreased.

Transitional Rules. Certain amendments that might otherwise cause a loss of grandfathered status will be disregarded. Such amendments are limited, however, to changes that are effective after March 23, 2010 that are pursuant to: (a) a legally binding contract entered into on or before March 23, 2010; (b) a filing on or before March 23, 2010 with a State insurance department; or (c) written amendments to a plan adopted on or before March 23, 2010.

"Do-Over" of Amendment That Would Cause Loss of Grandfathered Status. A plan amendment may have been adopted after March 23, 2010 but prior to the release of the new regulations. Such an amendment may cause a loss of grandfathered status. The regulations allow this amendment to be revoked or modified prior to the first day of the first plan year beginning on or after September 23, 2010. If the amendment is so revoked or modified, the plan will not lose its grandfathered status.

Value of Grandfathered Status. The regulations note the various PPACA provisions that apply (or do not apply) based on the plan's grandfathered status. Note, though, that the regulations do not address whether losing grandfathered status is significant from a cost or risk perspective. Sponsors should carefully consider just how valuable it will be to retain grandfathered status in light of the potential complexity of these grandfathered status rules.

Adult Child Clarification. As noted above, some health plans may need to cover an older child until age 26, unless the child has other employer-sponsored coverage available. The regulations clarify that, if the adult child is eligible for coverage under the plans of both parents, neither parent's plan may exclude the adult child based on the fact that the child is eligible to enroll in the other parent's employer-sponsored plan.

Many Dental and Vision Plans, along with Retiree-Only Plans, are Not Subject to PPACA. The regulations also provide a very important clarification: most of PPACA's changes apparently will not apply to: (1) retiree-only health plans; and (2) "excepted benefits", including stand-alone dental and stand-alone vision plans. Thus, for example, it appears that a stand-alone dental plan generally will not need to extend coverage to an older child (i.e., offer coverage until age 26, as noted above).

This rule applies whether the plans are provided by a private employer or by a non-federal governmental plan. However, the preamble leaves open the troubling possibility that a participant or beneficiary could enforce the PPACA rules (even if HHS would not) against a non-federal governmental plan offering retiree-only coverage or stand-alone dental or vision coverage. The preamble seems to indicate that major medical plans of non-federal governmental plans will be subject to PPACA's changes.