Determining COBRA Premiums for Fully Insured and Self-Funded Health Plans

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) allows qualified beneficiaries who lose health benefits due to a qualifying event to continue group health benefits. While some group health plans may provide COBRA continuation coverage at a reduced rate or at no cost, most qualified beneficiaries must pay the full COBRA premium. The COBRA election notice should include information about COBRA premiums.

For fully insured health plans, the premium is the cost to maintain the plan for similarly situated employees. For self-insured plans, the premium is the cost to maintain the plan for similarly situated employees as determined by an actuary or the past cost from the preceding determination period. The applicable premium calculation for both fully- and self-insured plans includes the cost of providing coverage to both active employees and COBRA qualified beneficiaries. All COBRA premiums must be calculated in good faith compliance with a reasonable interpretation of COBRA requirements.

Generally, COBRA payments are made on an after-tax basis. Qualified beneficiaries have 45 days after the election date to make an initial premium payment. The plan may terminate the qualified beneficiary's COBRA rights if no initial premium payment is made before the end of the 45-day period. In addition, plans must allow monthly premium payments and cannot require payment on a quarterly basis. As established under COBRA, premiums are due on the first day of each month with a minimum 30-day grace period. A plan may terminate COBRA coverage for nonpayment or insufficient payment of premiums after the grace period.

If a qualified beneficiary makes an insignificant underpayment, then the premium payment will still satisfy the payment obligation. An underpayment is deemed insignificant if the shortfall is no greater than the lesser of $50 or 10 percent of the required amount. However, if the plan notifies the qualified beneficiary of the shortfall and grants a reasonable amount of time to correct the underpayment (usually 30 days after the notice is provided), then the qualified beneficiary is required to make the payment; otherwise, COBRA coverage may be canceled.

Fully Insured Health Plans

Generally, the applicable COBRA premium amount for fully insured plans is the insurance premium charged by the insurer. The applicable premium is based on the total cost of coverage, which includes

both the employer and employee portions. The premium amount is based on the cost of coverage for similarly situated individuals who have not incurred a qualifying event.

A group health plan may charge at most 102 percent of the premium during the standard COBRA coverage period for similarly situated plan participants (100 percent of the total cost of coverage plus an additional 2 percent for administrative costs). However, the plan may increase the premium for a disabled qualified beneficiary and charge 150 percent of the applicable premium during the 11-month disability extension period (months 19 through 29). In addition, COBRA regulations permit a plan to charge a 150 percent premium to nondisabled qualified beneficiaries as long as the disabled qualified beneficiary is covered under the plan. If the disabled qualified beneficiary is no longer covered under the plan, then the remaining qualified beneficiaries may continue coverage up to 29 months at 102 percent of the cost of the plan.

If an employer maintains more than one plan, then a separate applicable premium is calculated for each plan. Also, the applicable premium for a single plan may vary due to factors such as the coverage level, the benefit package, and the region in which covered employee resides. For instance, single employees may pay a different applicable premium than employees who include their spouse on the plan. Thus, the plan may charge different premiums based on the varying coverage levels.

The most common tier structures include employee-only, employee-plus-spouse, employee-plus-children, and employee-plus-family. According to Internal Revenue Ruling 96-8, a fully insured plan that pays different premiums for individual versus family coverage must use those same premium tiers for COBRA continuation coverage. Thus, COBRA premiums are divided into multi-rate and single-rate tier structures.

Applicable Premiums under Multi-Rate Structures

The applicable premium for a covered employee and spouse who each lost plan coverage due to termination, reduction of hours, or death of the covered employee is determined by comparing the qualified beneficiaries to the most similarly situated non-COBRA beneficiaries.

If both the covered employee and spouse elect COBRA, then they will be charged the family rate. However, if only the spouse elects COBRA, then only the spouse will be charged the individual rate. Thus, the applicable premium is determined by the multi-rate structure.

> *Example:* Jim is laid off and his wife and children lose coverage. Jim and his wife elect COBRA for themselves, but not their children. They will be jointly charged 102 percent of the family rate each month for COBRA coverage.
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> *Example:* Same as the example above except only the wife elects COBRA coverage. She will be charged 102 percent of the employee-only rate per month for COBRA coverage.

In terms of other qualifying events such as divorce, legal separation, or a child ceasing to be dependent, the applicable premium is unclear since the covered employee will still be an active employee under the plan and the rule does not provide much guidance for these circumstances.

> *Example:* Sue (the covered employee) and John are married with no children. They divorce and John elects COBRA. Since there is minimal guidance for this qualifying event, there are two potential arguments for how much John should pay. First, the plan may charge John 102 percent of the employee-only rate per month for the COBRA coverage because he is the only one who elected COBRA. However, since John and Sue are no longer members of the same family, John may also pay 102 percent of the difference between the employee-only rate and the employee-plus-spouse rate.

Applicable Premiums under Single-Rate Structures

Some plans charge a single rate for all active employees regardless of the composition of the family unit even though the IRS discourages merging the rates for all qualified beneficiaries.

> *Example:* Samantha (the covered employee) is married to Michael and they have a child. Under her plan, the insurer charges a single premium of $150 each month for each employee, which covers the employee, the employee's spouse and dependent children. Samantha is terminated and she, her husband, and their child elect COBRA. The applicable COBRA premium is $153 because the plan has to pay the insurer $150 each month per employee regardless of family size.

All COBRA premiums must be established before a 12-month determination period. Generally, the determination period is the calendar year; however, the determination period can be any 12-month period selected by the plan sponsor. The 12-month determination period must be applied consistently each year to all qualified beneficiaries under the same health plan. However, if the employer has different health plans with various benefit options with different policy years and renewal dates, then different determination periods may be used for each health plan.

During the 12-month determination period, the applicable premium cannot be changed unless it is done for the following reasons:

- To increase the applicable premium to 150 percent during the disability extension
- To increase the applicable premium up to the permitted level of 102 or 150 percent
- To charge for new, more expensive coverage due to a new election during open enrollment or a second qualifying event
- To make changes for the next determination period

Self-Funded Health Plans

The IRS provides two methods for determining COBRA premiums for self-funded health plans. The plan administrator may determine the COBRA premium based on a reasonable actuarial estimate method or a past-cost method.

The actuarial estimate method requires retaining an actuary who will estimate the cost of providing coverage. The actuary will need the following information: the 12-month COBRA determination period; plan claims data for a prior period; information about administrative costs, stop-loss premiums, and stop-loss reimbursements; and an estimate of the average number of covered lives for each month of the determination period.

The past-cost method is used to determine COBRA premiums for self-funded plans only if there are no significant changes in coverage or in the number of employees covered under the plan. The applicable premium must be equal to the plan cost for similarly situated beneficiaries for the same period during the preceding determination period, which is referred to as the review period. In addition, the applicable premium must be adjusted for inflation for the 12-month period ending on the last day of the sixth month of the preceding determination period. However, if inflation measured by the implicit price deflator is lower than the actual medical trend, then the plan must use the actuarial method.

Most self-funded health plans have stop-loss insurance. The stop-loss insurance premium and the amount the stop-loss insurer reimburses the plan sponsor should be considered when determining the COBRA premium.

It is unclear whether COBRA premiums for self-insured plans are divided into tiers as they are with fully insured plans since the employee contributions charged to active employees under a self-insured plan are only a funding source, thus, they are not really premiums and they do not reflect the plan's cost.

Health flexible spending accounts (FSAs) and health reimbursement arrangements (HRAs) offer unique COBRA issues because the IRS has not provided much guidance on calculating the COBRA premiums for FSAs and HRAs.

Applicable Premiums for Health FSAs

The maximum amount that the health FSA can charge for COBRA coverage is 102 percent of the sum of the employee's salary reduction election for the year and any non-elective employer contributions. However, the employer may choose to charge less than 102 percent of that sum.

Please be aware that there are rules governing whether a health FSA is required to make COBRA coverage available for any subsequent plan year or for the current plan year.

If the following conditions are met for a plan year, then the health FSA is not required to make COBRA coverage available for any subsequent plan year:

1. Benefits provided under the health FSA are "excepted benefits;" and
2. The maximum amount the employee can be required to pay for a year of COBRA coverage equals or exceeds the maximum benefit available under the FSA for the year.

The health FSA is not required to make COBRA coverage available for the current plan year unless the employee's remaining balance will exceed the amount the health FSA can charge for the coverage. Practically speaking, if a plan will pay out an amount equal to or less than what the plan will collect from the employee, then COBRA coverage is not required.

When calculating the employee's remaining balance, use the amount that the employee elected to make in salary reduction contributions to the FSA for the year plus any carryover amount (if applicable), then subtract any reimbursements that the employee received for health care expenses from the FSA as of the date that the employee terminated employment. This will produce the employee's remaining balance. (Do not use the amount that the employee contributed to date.)

Total FSA salary reduction contribution election for the year
+ Carryover amount
- Reimbursements as of last day of employment
= Employee's remaining balance

Please be aware that a carryover amount is included in calculating the employee's remaining balance. However, a carryover amount is not included when calculating the maximum amount that the health FSA can charge for COBRA coverage.

When COBRA coverage is available for the current plan year, the COBRA premium is charged monthly, but the health FSA can only charge the employee for COBRA coverage until the remainder of the year.

Applicable Premiums for HRAs

The COBRA premium must be actuarially determined prior to the beginning of the first plan year of a new HRA. Then for subsequent plan years, the premium may be determined based on the HRA's past claims. The COBRA premiums must be the same for similarly situated participants even if they have different total reimbursement amounts available from the HRA. Similarly situated refers to the same annual limits and the type of coverage (family or single coverage) and not to the same account balance.

> *Example:* John has a $25,000 account balance in his HRA and Jill has a $5,000 balance. Both John and Jill must be charged the same monthly COBRA premium because similarly situated does not refer to a similar account balance.

Unlike with FSAs, the unused portions of the annual benefit amount from health HRAs may be carried over to later years; therefore, it is difficult to calculate the cost of the plan.

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