Employee Benefits Alert:

COBRA Subsidy Provisions of the American Recovery and Reinvestment Act of 2009

FEBRUARY 23, 2009

FENWICK & WEST LLP

On February 17, President Barack Obama signed the American Recovery and Reinvestment Act of 2009 ("ARRA") into law. This stimulus package provides significant health care continuation coverage relief for lower- and moderate-income employees who are involuntarily terminated between September 1, 2008 and December 31, 2009. In most cases, such employees may no longer purchase their health care coverage at the employer-subsidized rate, but must pay continuation coverage premiums equal to 102% of the full employer group rate, as mandated by the Consolidated Omnibus Budget Reconciliation Act ("COBRA"). Otherwise, they risk loss of their health care coverage.

Additional clarifying guidance and regulatory explanations regarding the COBRA subsidy provisions of ARRA are still forthcoming, as is a model notice from the Department of Labor that explains the availability of COBRA premium assistance to affected employees. The information contained in this summary may be modified as further guidance becomes available. In the meantime, the general highlights of ARRA's COBRA provisions are as follows.

Who is Eligible?

Under ARRA, employees who are involuntarily terminated between September 1, 2008 and December 31, 2009, as well as their spouses and dependent children, are generally considered "assistance eligible individuals" ("AEIs"). However, only lower- and moderate-income individuals are eligible for a COBRA subsidy. Generally, if the terminated employee's "modified adjusted gross income," defined in the statute, is over $125,000 in a taxable year, the available subsidy is reduced. If the amount is over $145,000, no subsidy is available.

What Benefit Coverage Qualifies for the COBRA Subsidy?

It appears that the ARRA COBRA subsidy is only available for medical group health care continuation coverage. Health care flexible spending accounts ("FSAs") offered through a cafeteria plan are not subject to the subsidy provisions.

Alternative Coverage for Employees Covered by Costly Health Plan Options. At the employer's option, involuntarily terminated employees who were covered under a more expensive group health plan program (such as PPO coverage) will be permitted to change to a less expensive group health plan alternative (such as an HMO) without waiting for open enrollment. Employers will want to give serious consideration to making this option available to terminated or laid-off employees. Because, strictly speaking, this provision does not involve a subsidy, presumably terminated employees at all income levels could opt to reduce their post-termination expenses by switching to such a less expensive alternative. This issue should be clarified in forthcoming guidance and regulatory explanations. Such individuals have 90 days after they receive employer-required notice of their ARRA COBRA rights to elect alternative coverage.

State "Mini-COBRA" Coverage (such as Cal-COBRA). The provisions of ARRA apply to health care continuation coverage provided under federal COBRA as well as "a State program that provides comparable continuation coverage." Thus, in California, involuntarily terminated employees of companies with fewer than 20 employees should also be eligible for the ARRA COBRA subsidy.

How Long Does the Subsidy Last?

The subsidy is available for a total of nine (9) months. However, it will be terminated at an earlier date if any of the following occur: (i) an AEI becomes eligible for coverage under a new group health plan, (ii) an AEI becomes eligible for Medicare, or (iii) the AEI's maximum period of COBRA continuation coverage expires. If an individual ceases to be eligible for the ARRA subsidy due to one of these reasons, he or she must notify the group health plan (i.e., the employer) as soon as possible, or become liable for a penalty equal to 110% of the total amount of the subsidy improperly received.

When Does the Subsidy Become Effective?

The COBRA provisions of ARRA become effective with the first coverage period after February 17 (generally, March 1). However, employers have 60 days from the effective date of ARRA to provide the required notice to AEIs of their COBRA subsidy rights, and the Department of Labor is required to issue a model notice within 30 days.

Note that individuals who do not have a COBRA election in place as of February 17, 2009, but who would be AEIs if such election were in effect, have a special window of opportunity to elect COBRA coverage during the period starting February 17, 2009, and ending 60 days after the required employer notice is provided to such individual. Thus, an AEI who failed to elect COBRA, or elected COBRA and then dropped it because of the cost, can re-enroll with no penalty. Note that the maximum duration of COBRA coverage is still calculated from the date of the original qualifying event; ARRA does not extend the total length of COBRA coverage.

How is the Subsidy Paid?

Employees must pay 35% of the COBRA premium amount. Employers initially pay the remaining 65%, but are reimbursed by the government through a credit against the employer's payroll tax liability. If such credit is not large enough to offset the total premium subsidy offered to involuntarily terminated employees and their families, the employer will receive a direct payment from the federal government.

What Should Employers Do?

(1) Review personnel records back to September 1, 2008, and identify everyone, including spouses and dependents, who had a qualifying event or any kind. Due to a technicality in the ARRA statute, all of these individuals must get the required notice, even though AEIs are the only ones who can actually get the subsidy.

(2) Determine which AEIs elected COBRA coverage, and which did not, from September 1, 2008 through the present. AEIs who did not elect coverage, or who elected coverage and then dropped it, now have a special 60-day window after receiving the required notice in which to elect subsidized COBRA coverage.

(3) Decide whether to allow AEIs to opt for a less expensive coverage option, if available under the plan.

(4) Notify AEIs of the COBRA subsidy provisions as soon as possible. While the Department of Labor is required to issue a model notice within 30 days, if it fails to do so, the employer is not relieved of its notice obligation. Therefore, Fenwick & West LLP is drafting an interim notice to incorporate the provisions required by statute, subject to receipt of further guidance and regulatory explanations. As soon as the Department of Labor Model notice is available, our interim notice will be updated. (Such notices may also become available from other service providers such as insurance companies, third-party health plan or COBRA administrators, or benefits brokers).

Note that if an employer fails to notify AEIs in a timely fashion, such AEIs may be forced to pay their full COBRA premiums for two months. If this happens, within 60 days the employer must give the AEIs a credit against future premiums, or refund the subsidized portions of the full premiums paid.

(5) Work with payroll departments or payroll outsourcing entities to implement the ARRA COBRA subsidy as soon as possible.

(6) Continue to provide the employer's standard COBRA qualifying event election notice and form to all individuals who have qualifying events after the effective date of ARRA. The ARRA COBRA subsidy notice is a supplement to the standard required election notice and form, not a substitute for them.

Conclusion

Because of the complexity of ARRA's COBRA subsidy provisions, it is highly probable that further guidance, interpretation, and regulatory explanations will be forthcoming over the coming weeks to clarify ambiguities and unanswered questions. Fenwick & West LLP will continue to post additional information to this website as it becomes available.

For more information on this, or related matters, you may contact:

Mona A. Clee, Of Counsel
Employee Benefits Group, Corporate Group,
Employment & Labor Group
mclee@fenwick.com, 650.335.7806