

COBRA 2009: A PRACTICAL PRIMER

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On February 17, 2009, when President Obama signed the American Recovery and Reinvestment Act (ARRA), employers and COBRA Administrators across the country were left with more questions than there were answers with regard to provisions to the Consolidated Omnibus Reconciliation Act of 1985 (COBRA).

Prior to the signing of the ARRA, there were two versions of the COBRA bill that were being debated. One version was

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presented by the House and the other by the Senate. The bill that was proposed by the House, but ultimately not passed, included a highly controversial provision which would have included a permanent extension to the continuation period for individuals who lost health coverage due to termination of employment (other than by reason of gross misconduct) and, who at the date of their loss of coverage, were either 55 years or older or had completed 10 years of service (with service calculated under the retirement plan rules). The extended period would have started with the loss of coverage and ended with one of the following events: 1) failure to pay premiums; 2) obtaining coverage under another group health plan; or 3) becoming Medicare eligible. COBRA coverage would have also ended if the employer terminated all group health plans for all employees.

The impact of the House's version of the bill could have been devastating for employers. Keep-

ing terminated employees on the health plan, especially older individuals, for such a significant period of time could adversely affect the employer's claims history and would potentially make them riskier from an insurance company's perspective, resulting in insurance premium increases. Even though the House's version of the bill was not passed, there are still many provisions included in the final bill that could prove to be just as devastating to employers.

The final version of the stimulus bill that was announced included a 65% COBRA premium subsidy for nine months for any individual who has experienced (or will experience) involuntary termination from September 1, 2008 through December 31, 2009. Employers and COBRA Administrators struggled to make sense of the vague language pertaining to what qualified as an involuntary termination. The Department of Labor was given until March 19, 2009 to clarify the verbiage. In the meantime, employers were left to crunch the

numbers to see how these new regulations would impact their business both in the short-term from a cash flow perspective, as well as the long-term effects of these changes.

SHORT-TERM EFFECTS

While employees benefit from the regulations that were put into effect (in some instances the subsidy amount of 65% of their COBRA premium is more cost effective than if they were still employed!), the repercussions of the temporary COBRA subsidy could be devastating for employers. The financial impact on employers stems from two sources: the cost of funding the COBRA premium while waiting for government reimbursement, and the cost of compliance with the new regulations.

COBRA Premium Funding

Previously, under COBRA legislation, employers would not be responsible for paying any portion of health care premiums for terminated employees. Under the new regulations, employers are responsible for paying 65% of the COBRA premium which will later be credited back to them through their 941 payroll tax filing. This reimbursement could take up to three months to receive from the government, and this temporary funding of insurance premiums could have a severe consequence for businesses that are struggling with cash flow during this economy.

One can assume that an employer who has laid-off a portion of their employees due to the economic climate is experiencing a substantial decrease in revenue. Cash-strapped employers are faced with difficult decisions

if they cannot afford to make what one source refers to as “an interest-free loan”¹ to the government for up to 90 days. If cash-poor employers are really having trouble they may be forced to lay off more employees, implement a salary freeze or reduction, or possibly eliminate group health coverage altogether.

Employers have no way of predicting what the exact impact of these regulations will have on cash flow—ultimately it will depend on how many of the “involuntarily terminated” employees elect COBRA coverage. The more people that elect coverage, the bigger the impact will be on cash flow. According to a survey conducted by Spencer’s Benefits Reports in 2006, COBRA election was 27%² of eligible employees. Speculation about a surge in COBRA enrollees due to the COBRA provisions points to as many as 50%³ of COBRA eligible individuals enrolling in coverage.

The amounts associated with the premium subsidy will differ from employer to employer as each will have a different premium. However, data shows that the average cost for family medical coverage in an employer sponsored health plan in 2008 was \$1,057 per month and the average cost for single medical coverage was \$392 per month⁴. Employers that are “fronting” 65% of the COBRA premium for as many as three months could be looking at a considerable financial squeeze.

The Cost of COBRA Compliance

The new regulations set forth in the ARRA require specific action to be taken by employers within a designated timeframe. If an employer administers their own

COBRA plan, than they are left footing the bill in order to be in compliance with the new regulations. As part of the new COBRA legislation under the ARRA, employers are required to send Qualifying Event notifications retroactively to all individuals, as well as their beneficiaries (if residing at a different address), who were involuntarily terminated since September 1, 2008. Additionally, employers administering COBRA internally are responsible for sending out all other notifications required by COBRA on an ongoing basis. The cost to mail a typical Qualifying Event Notification is \$.59, plus an additional \$1.25 for a “proof of mailing” certification. While postage fees and charges may seem like an insignificant expense, it is an additional fee that can easily add up. According to one company, the postage alone for mailing the five-page notices has cost them more than \$1,000.⁵

Additional administrative expenses incurred by employers administering COBRA in-house include the time taken to physically print and mail notifications, research the changes to the law, identify which individuals are Assistance Eligible Individuals (AEIs), as well as the cost associated with seeking legal advice. Time spent on these tasks is time taken away from normal job responsibilities and therefore can result in lost productivity.

Employers administering COBRA internally also assume full liability for compliance. Employers who fail to notify terminated employees and qualified beneficiaries of their COBRA privileges may be subject to a non-deductible excise tax penalty equal to \$100 per

day, per affected individual, per violation. In instances where there is more than one qualified beneficiary, this fee can be increased to \$200 per day. In addition, ERISA calls for notice penalties of up to \$110 per day, payable to each qualified beneficiary, from the date of the compliance failure.⁶

Even if companies outsource COBRA administration to reduce liability, the Administrator is likely to charge additional fees as a repercussion of the ARRA. COBRA Administrators have determined two different pricing models to compensate for recent fluctuation in administration. One arrangement includes a one-time fee per AEI of \$20-\$50. The other option charges employers a one-time fee per AEI of \$10-\$15 with an additional ongoing monthly administration fee of \$10-\$15 per AEI that elects COBRA coverage. The fees could accumulate to a substantial amount of money depending upon how many AEIs are designated and of those, how many elect COBRA coverage.

A True Story

A printing company located in northeast Ohio had been struggling during the economic downturn. The majority of their employees were terminated in mid-April, which triggered a Qualifying Event notification from their COBRA Administrator, CPI-HR, an employer services organization specializing in Employee Benefits, HRIS and payroll software, and Administration Services. The terminated employees of the printing company may have thought that the only silver lining to their unfortunate situation was the temporary COBRA subsidy that required payment of only 35%

of the 102% insurance premium previously required for COBRA.

The new COBRA regulations were intended, in part, to aid the unfortunate victims of these economic times by temporarily subsidizing a majority of their group health insurance. However, the COBRA regulations would be of no help to the former employees of this printing company. On April 30, 2009 the printing company closed their doors for good. "Because the printing company went out of business, their health plan was cancelled, and therefore COBRA was no longer available to them," says Bill Svatos, Administration Services Manager at CPI-HR. "This means that not only did they not receive the 65% subsidy for COBRA, they were left uninsured altogether. The options available to these individuals were limited—they could apply for an individual policy or they could continue to go uninsured until they found new employment and satisfied the waiting period requirement for their new employer." If the gap between coverage under the printing company's health plan and a new policy that employees were to enroll in (either through individual health insurance or another group health plan) were to last more than 63 days, then those employees may lose the ability to offset a pre-existing condition exclusion period in their new health plan. Typically pre-existing condition waiting periods can last up to 12 months.⁷

Loss of Coverage

An additional concern to employees is that employers may cancel their group health plan to save money and/or to avoid their re-

sponsibilities pertaining to COBRA under the new regulations. Employees of companies that choose to cancel the group health plan are left to suffer the consequences of possibly becoming uninsured. If this situation were to occur on a widespread basis the number of uninsured individuals could drastically increase and potentially could be viewed as a negative side-effect of the regulations.

LONG-TERM EFFECTS

While the short-term effects of the temporary COBRA subsidy are potentially devastating for employers, the long-term consequences can be just as debilitating. It has long been known that individuals that elect COBRA are usually higher utilizers than those who opt to shop for their own individual health insurance policy when termination occurs. This phenomenon is known as "adverse selection."

Adverse Selection

Adverse selection in the health care industry occurs when a high-risk/high-utilization individual chooses a health plan differentially than a low-risk person when selecting among plans. The assumption is that high-risk individuals benefit more than low-risk individuals from increased plan generosity.⁸ Generosity can be in the form of plan design with rich benefits, or generosity can be in the form of premium subsidies. Ultimately, according to the theory of adverse selection, employees are going to choose a health plan based on a benefit-cost calculation whereby those who believe they are likely to need more coverage purchase the generous more expensive policy. Individuals who are not as

likely to utilize the policy opt for more moderate plans.⁹

Adverse selection occurs in COBRA because the individuals who opt to elect this coverage typically cannot find viable options in the individual health insurance market¹⁰. Therefore, the 102% COBRA premium is not a deterrent to these individuals. Healthier individuals, meanwhile, usually can find a comparable plan in the individual health insurance market for a reasonable price.

Additionally, the impact of COBRA participants on an employer's health plan was measured in the 2006 survey conducted by Spencer's Benefit Reports produced by Wolters Kluwer Law & Business and exemplifies the effects of adverse selection. The study found that compared to an average annual cost for an active employee, COBRA participants were 45% more costly.¹¹ Other sources site that for every \$1 that is spent in premium for COBRA participants, the cost is \$1.50 in COBRA claims.¹² Loss ratios—as they are known in the insurance world – averaging 150% usually trigger action by the insurance carrier. Insurance companies' response to this outcome is predictable; to recoup monies lost on higher claimants they increase the costs to cover active employees through premium increases at renewal.

Some predictions indicate that due to the recent economic downturn, more employees are likely to enroll in COBRA and will stay enrolled longer. The long-term impact that this will have on an employer's benefit plan is unknown. It could significantly increase the group's insurance premiums at renewal if claims costs dramatically increase, especially if more individuals and

families elect to have services performed that they had previously been holding off on to take advantage of insurance while they are still covered. A significant increase in claims during this year could lead to an increase in the group's rates for the next several years – another long-term effect of the ARRA COBRA revisions.

On the contrary, the impact of adverse selection could be mitigated by healthier individuals electing COBRA. Because the premium subsidy would be advantageous for both high-risk and low-risk individuals the benefit of the subsidy may incent COBRA participation from healthier individuals, thereby tempering the effect that adverse selection has on COBRA.

CONCLUSION

While it's hard to pinpoint exactly what will happen down the road, it is evident that the ARRA's COBRA regulations are having a dramatic impact on companies and individuals right now, and for the foreseeable future. The long-term and short-term effects experienced by employers due to the regulation changes may vary from company to company depending on how many AEIs elect COBRA coverage, the overall health status of those individuals, and the length of time associated with offsetting the subsidized premium against tax credits.

AEIs will benefit from the temporarily reduced premium payment required for COBRA, however, if their former employer continues to struggle in this economy these same AEIs may find themselves without coverage if their ex-employer cancels group health coverage to reduce

costs or if the company ceases to exist altogether.

NOTES

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