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CLIENT ALERT

# Departments Issue Final Rules on Health Reimbursement Arrangements

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The Departments of Treasury, Labor, and Health and Human Services (the Departments) recently issued final rules on the use of health reimbursement arrangements (HRAs) in conjunction with individual health insurance coverage. The final rules reverse prior federal guidance issued under the Obama administration by allowing HRAs to fund premiums for individual health insurance coverage. Our comprehensive overview of the proposed regulations is linked here. While the final rules are substantially similar to the proposed rule, the final rules contain some important changes and clarifications which we highlight below.

## Requirements for Integration of HRAs with Individual Health Insurance Coverage

The final rules permit employers to offer HRAs to employees who have individual health insurance coverage, which had previously been prohibited under the Affordable Care Act (ACA) and related guidance. Under the final rules, "Individual Coverage HRAs" can be integrated with individual health insurance coverage if certain requirements are met. These requirements are intended to provide additional options for employers to offer less robust health coverage to employees, while mitigating the risk of adverse selection which could increase if less healthy individuals move from the group market to the individual market.

*Enrollment in Individual Health Insurance Coverage and Related Substantiation*

Participants covered by an Individual Coverage HRA must be enrolled in (i) individual health insurance coverage (aside from coverage that consists solely of excepted benefits) that complies with the terms of the ACA, including the prohibition on lifetime and annual limits on essential health benefits and first dollar coverage of preventive care benefits, or (ii) Medicare Part A and B or Part C. The final rules permit Individual Coverage HRA integration with (i) individual health insurance coverage obtained in a state with an ACA Section 1332 waiver, (ii) catastrophic plans, (iii) grandmothered plans (*i.e.* certain non-grandfathered plans that are not ACA-compliant but for which CMS will not take any enforcement action), or (iv) grandfathered plans, even though concerns regarding HRA integration with such plans were raised by commenters on the proposed rules. Family members covered under an Individual Coverage HRA are not required under the final rules to have the same coverage – that is, a participant may be covered under Medicare while his or her dependents have individual health insurance coverage. The preamble to

the final rules notes that while the final rules do not allow the HRA to be integrated with other group health plan coverage, such as spousal coverage, this is an area that the Departments may explore in future rulemaking.

Under the final rules, failure to maintain individual health insurance coverage results in a forfeiture of the Individual Coverage HRA. The final rules clarify that the forfeiture applies prospectively. In addition, if an individual is in a grace period where the individual has not yet paid the premiums for individual health insurance coverage, the individual is still considered enrolled in the coverage and the HRA will reimburse for expenses incurred during the grace period. However, if the individual never pays premiums and coverage is terminated or cancelled, the HRA may not reimburse any expenses incurred on or after the cancellation or termination date. The final rules clarify that it is not a Consolidated Omnibus Budget Reconciliation Act (COBRA) qualifying event if an individual fails to satisfy the integration requirement of maintaining individual health insurance coverage. However, if an individual's HRA coverage is lost due to a termination of employment or reduction of hours, this would be a loss of coverage due to a qualifying event.

Individuals covered by the Individual Coverage HRA are required to annually substantiate their individual health insurance coverage and the Departments have issued a model attestation form for this purpose. The final rules clarify that the HRA may establish the deadline for providing the annual substantiation, but the date may be no later than the first day of the HRA plan year, and that substantiation is required for the period during which the individual is covered by the HRA, rather than for the entire plan year, if the individual is not covered by the HRA for the entire plan year.

**Winston Takeaway:** The final rules largely adopt the proposed rules and reiterate that an Individual Coverage HRA is itself a group health plan subject to ERISA. However, ERISA does not extend to the individual insurance policies purchased with HRA dollars if certain requirements are met and the employer does not select or endorse any particular issuer or insurance coverage. Notably, the Departments did not adopt employer recommendations to establish a safe harbor for private exchange based platforms offering individual insurance coverage purchased with HRA dollars. Accordingly, employers will have to separately evaluate such arrangement to determine the extent to which ERISA applies. Employees may, however, pay for premiums for individual coverage on a pre-tax basis through a cafeteria plan without subjecting the individual coverage to ERISA treatment.

*No Choice of Individual or Group Coverage*

An employer may not offer employees a choice between an Individual Coverage HRA and traditional group health plan coverage. The final rules confirm that this requirement applies regardless of the size of the employer (*i.e.,* there is no exception for small employers). However, an employer may offer an Individual Coverage HRA to certain classes of employees and traditional group health coverage to other classes of employees. This may permit employers to offer limited coverage to groups of employees that previously did not have coverage, such as temporary or part-time employees.

*Employee Classes – New Minimum Class Size Requirement*

The final rules also add a minimum class size requirement that is applicable where an employer offers a traditional group health plan to one or more classes of employees and offers an Individual Coverage HRA to one or more other classes of employees. If applicable, the minimum class size requirement applies only to certain classes of employees offered the Individual Coverage HRA, and only in certain circumstances. The minimum class size requirement does not apply if the plan sponsor utilizes the new hire exception discussed below where new hires in a class are offered Individual Coverage HRAs while the members of the class hired prior to the new hire date are offered a traditional group health plan.

For purposes of determining the members of the employee classes, the final rules clarify that classes are determined based on the employees of a common law employer, not the employees of a controlled group of employers (*i.e*. the employee classes are not determined at the controlled group level).

**Winston takeaway**: The minimum class size requirement will likely be a significant administrative burden on small employers offering Individual Coverage HRAs, and employers should determine their ability to track and monitor class members and size when deciding whether to offer Individual Coverage HRAs. In addition, nondiscrimination

rules applicable to group health plans must also be satisfied with respect to eligibility and benefits provided under both traditional group health plans and Individual Coverage HRAs.

*Employee Classes – "Same Terms" Requirement*

The final rules make clarifications to the requirement that employers offering Individual Coverage HRAs must offer the HRA on the same terms (same amount and on the same terms and conditions) to all employees within a specified class of employees. The final rules provide that this requirement will be satisfied even if the maximum dollar amount made available under the terms of the HRA increases as the age of the participant increases, as long as the maximum dollar amount available to the oldest participant is not more than three times the maximum dollar amount made available to the youngest participant. In addition, the final rules clarify that a participant's age for purposes of this requirement may be determined by the plan sponsor using any reasonable method for a plan year, as long as the plan sponsor determines each participant's age for this purpose using the same method for all participants in the employee class for the plan year, and the method is determined prior to the plan year.

The final rules also contain an exception to the same terms rule as applied to new hires. An employer offering a traditional group health plan to a class of employees may prospectively offer employees in that class hired on or after a certain date in the future an Individual Coverage HRA, while continuing to offer employees in the class prior to that hire date a traditional group health plan. This rule will permit employers to grandfather certain classes of employees into traditional group coverage while moving new hires to a less comprehensive offering.

The proposed rules had included a list of permissible classes of employees for purposes of applying the same terms requirement. The final rules make changes to this list and add a minimum class size requirement that is applicable in certain instances. The final rules remove employees who have not attained age 25 prior to the beginning of the plan year from the list of permitted classes, clarify the application of the rule to employees governed by collective bargaining agreements, and add salaried and non-salaried employees as additional permitted classes. In addition, the final rules add as a permitted class employees of temporary staffing agencies, provided certain requirements are met. A plan must determine the definitions used to identify classes of employees prior to the start of a plan year, and changes to these definitions are not permitted during the plan year.

If an employee moves from one class of employees offered an Individual Coverage HRA to a different class of employees offered an Individual Coverage HRA, amounts made available in an Individual Coverage HRA for the employee are disregarded for purposes of applying the same terms rule, provided that the practice of taking such amounts into account are done on the same terms for all employees in a class.

*Notice Requirement*

Both the final and proposed rules require plan sponsors of Individual Coverage HRAs to provide a notice to individuals eligible for HRA participation that includes information regarding the HRA and opt-out information. The final rules require that the notice include a statement of availability of a special enrollment period for employees and dependents who gain access to the HRA. A model form was issued for this purpose. In order to provide individuals with HRA affordability information that is relevant to the premium tax credit rules, the final rules add the requirement that the notice include a statement regarding how the participant may find assistance for determining their Individual Coverage HRA affordability, and notes that model language will be issued that can be used to satisfy this requirement.

# Premium Tax Credits and Exchange Enrollment Eligibility

The final rules generally follow the proposed rules in regards to the effect of participation in an Individual Coverage HRA on premium tax credit eligibility for coverage on the health marketplace exchanges. The final rules contain some clarifications on affordability calculations for Individual Coverage HRAs. Notably, the final rules provide that if there is a silver-level plan that has one rate for tobacco users and one rate for non-tobacco users, the rate for non-tobacco users will apply to determine affordability of the Individual Coverage HRA, and if a wellness program incentive is allowed in the individual market, the lowest cost silver plan premium is determined without regard to any premium discount or rebate under that program unless the wellness program incentive relates exclusively to

tobacco use. In addition, participants must be able to opt out of an Individual Coverage HRA and waive future HRA reimbursements on an annual basis and in advance of the start of the plan year to allow eligible individuals to qualify for premium tax credits.

The final rules enact the special enrollment period provisions from the proposed rules, with certain changes and clarifications regarding an individual's eligibility for a special enrollment period.

Treasury intends to issue proposed regulations regarding application of the ACA employer shared responsibility rules to Individual Coverage HRAs in the near future.

**Winston Takeaway:** Individual Coverage HRAs can be used to satisfy the employer shared responsibility requirements under the ACA. However, employers will have to carefully evaluate affordability requirements when setting the level of HRA contributions. Despite legislative challenges to the ACA, the IRS is continuing to vigorously enforce the employer shared responsibility requirements and has indicated that it will be issuing further guidance on the issue of affordability and minimum value for Individual Coverage HRAs in the form of proposed regulations. The IRS has also issued Notice 2018-88 on this issue.

# Excepted Benefit HRAs and Reimbursement of STLDI Premiums

In a nod to employers that maintained stand-alone HRAs prior to the enactment of the ACA, the final rules adopt the Excepted Benefit HRA model from the proposed rules with few changes. Excepted Benefit HRAs can be used to reimburse for excepted benefits (such as limited-scope vision or dental benefits) as well as other types of medical expenses. In order to offer an Excepted Benefit HRA, the employer must provide some other type of group health coverage that satisfies the requirements under Sections 2711 and 2713 of the ACA. One welcome change from current law is that enrollment in Excepted Benefit HRAs is not limited to those employees who actually enroll in their employer's (or some other employer's) traditional group health plan. As with the proposed rules, the maximum reimbursement amount under an Excepted Benefit HRA is capped at $1,800 per plan year, indexed for inflation with carryover amounts disregarded for purposes of the $1,800 limit. Notably, an Excepted Benefit HRA cannot be used to reimburse premiums for individual health insurance coverage, group health plan coverage (other than COBRA continuation coverage), or Medicare Parts A, B, C, or D, although out-of-pocket expenses under these coverages may be reimbursed. The Excepted Benefit HRA may, however, be used to reimburse premiums for Short-Term Limited Duration Insurance (STLDI) plans and COBRA coverage.

The final rules add a special rule applicable to small employers offering an Excepted Benefit HRA that reimburses premiums for STLDI coverage. Under the special rule, the Departments may restrict the Excepted Benefit HRA from reimbursing STLDI premiums if the following five criteria are met: (i) the Excepted Benefit HRA is offered by a small employer, (ii) the other group health plan coverage offered by the small employer is either fully-insured or partially-insured, (iii) the Secretary of Health and Human Services (HHS) finds that the reimbursement of STLDI premiums by Excepted Benefit HRAs in a state has caused significant harm to the small group market in the state that is the principal place of business of the small employer, (iv) the applicable state regulatory agency has submitted a written recommendation, in the form and manner specified by HHS, that includes evidence that the reimbursement of STLDI premiums by Excepted Benefit HRAs established by insured or partially-insured small employers in the state has caused significant harm to the state's small group market, including on small group market premiums, and (v) the restriction (or discontinuance of the restriction) must be imposed by publication by the Secretary of a notice in the Federal Register and shall be prospective only with a reasonable time for plan sponsors to comply.

# Effective Date

The final rules are effective for plan years beginning on or after January 1, 2020. This is unchanged from the effective date in the proposed rules; however, many employers may need more time to fully analyze and implement changes in benefit offerings in response to the final rules.

## Next Steps

Whether the final rule results in a wave of employers moving from comprehensive group coverage to more limited health benefit offerings remain to be seen, but the rule does pave the way for employers, particularly small employers, to migrate certain classes of employees into the individual markets. Plan sponsors wishing to offer Individual Coverage HRAs or Excepted Benefit HRAs for plan years beginning January 1, 2020 or later should consult with legal counsel on plan design, documentation, and notice requirements and work with third-party administrators to ensure compliant administration of these new types of HRAs.

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