

Nondiscrimination rules an elephant in the room

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Health care reform is here, and benefits managers everywhere are frantically planning to meet the new requirements. The problem is that planning with the rules currently in place is like trying to build a skyscraper on a piece of swampland in the Florida Everglades.

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As most employers worry about whether to “pay or play” as of 2014 and whether or not certain employees will need to be counted as full-time for health care reform purposes, there is an elephant in the room that is not yet getting enough notice. This elephant is the approaching nondiscrimination rules that apply to all health plans that are not grandfathered.

One of the most common questions I receive from employers is, “can we offer different health benefits to different employees?” For the better part of the last 20 years, the answer has been, “yes, *as long as your plan is fully insured.*”

Prior to health care reform, the law prohibited only self-funded health plans from discriminating in favor of highly compensated employees with regard to health insurance benefits. Employers were able to provide executive medical plans, class-based benefits, and overall better benefits packages to executives. But health care reform changes that, applying nondiscrimination to all group health plans. This may not seem that significant, but in reality, it changes the entire health insurance landscape.

The real problem with the extension of the nondiscrimination rules is that the rules – as currently written – are convoluted and hard to apply.

Under the current law applicable to self-funded health plans, the term “highly compensated” means:

- The five highest paid officers of the company;
- A shareholder who owns 10% in value of stock of the company; and
- An employee among the highest paid 25% of all employees.

Once an employer determines who is a highly compensated employee and who is not, the employer is then tasked with making sure that the health insurance plan or plans being provided are not discriminating in favor of those highly compensated employees as to either eligibility or benefits.

While eligibility is usually the easier part of the test – a health plan that applies the same eligibility rules to all employees regardless of compensation, position, etc. will pass this part of the test – many plans treat different groups of employees differently. This will need to end to avoid failing the nondiscrimination test.

Another important aspect of the eligibility rule is that it is applied on a “controlled group” basis. This means that employees of another company in the same controlled group must be considered in your company’s nondiscrimination testing even if those employees are not eligible for the plan being tested. This has always been a hassle for self-funded plan and will surely be just as much of a hassle for all health plans in the future.

High penalties for noncompliance

What’s even worse than the current test provided under the law is that fully insured plan sponsors that violate the nondiscrimination rules will be subject to a \$100 per day per failure penalty, which will likely apply to each non highly compensated employee who is impermissibly excluded under the plan.

The employer could also be subject to a civil lawsuit to compel it to provide nondiscriminatory benefits.

To put this in perspective, the penalty for non-compliance: \$100 per day *per non-highly compensated individual discriminated against* would mean that providing a “discriminatory benefit” to even one highly compensated employee could trigger a penalty of \$100 per day times 75% of the total number of employees in the employer’s workforce (because the top 25% are considered highly compensated under the current rules). For an employer with 500 employees, this means a penalty of up to \$37,500 per day!

Rules don’t yet exist

The elephant in the room is that every aspect of future planning will likely be affected by rules that do not yet exist in usable form.

For example, if an employer with a large population of variable hour employees decides to provide an affordable minimum-wage-type of health plan to that group of employees in order to avoid paying a penalty to the government, then that would seem reasonable and is likely to be quite common.

However, if all of those variable hour employees actually enroll in that minimum wage plan, then it’s likely that the benefits test will be failed by the employer because the highly compensated employees are likely to choose a better plan, provided one is being offered. Planning to avoid one penalty will result in the employer paying a different – and more substantial – penalty. How is that fair?

There are plenty of other issues – how do you apply nondiscrimination rules when one benefit option under a fully insured plan is grandfathered but another benefit option is not? How do you apply the rules when one employer maintains one plan that is fully insured and another plan that is self-funded? Will you need to include employees who enroll in a state or federal exchange in the testing?

Even if the rules get ironed out so they aren’t contradictory, many companies will have to undertake significant plan redesigns.

The government has said it will not impose any penalties until further guidance is provided, and it has also said that it will provide time for employers to adjust to comply with the new rules before it starts sanctioning those that don’t comply. But, in the meantime, planning for the eventual application of the nondiscrimination rules to fully insured plans is virtually impossible, because at this point, no one knows how similar the new rules will be to the existing rules.

To further complicate matters, there are many open questions regarding how to apply the *current* rules to self-funded plans. Those regulations are now over 30-years-old. Health plans have changed significantly in that time. Therefore, it is possible, if not likely, that the IRS may issue guidance that addresses *both* the application of nondiscrimination rules to self-funded plans *and* the application of nondiscrimination rules to non-grandfathered fully insured plans.

So hold on tight and stay informed. Until we know more about the elephant in the room, we are all in for a long and arduous planning process.