Issue Date: October 16, 2018

Determining the COBRA Premium for an HRA

Setting the correct COBRA premium for a Health Reimbursement Arrangement (HRA) can be challenging. COBRA defines "applicable premium" as the cost to the plan of providing coverage to similarly situated beneficiaries who have not experienced a qualifying event. For self-insured plans, such as HRAs, the premium must be actuarially determined, or be determined by using a "past-cost" method. It should not be based on an individual's actual HRA balance at the time of the COBRA event.

DETERMINING THE HRA COST

IRS COBRA regulations describe two acceptable methods of setting the COBRA premium for an HRA. Under the actuarial method, the applicable premium *"shall be equal to a reasonable estimate of the cost of providing coverage for such period for similarly situated beneficiaries which…is determined on an actuarial basis… ."* Under the past-cost method, the applicable premium equals *"the cost to the plan for similarly situated beneficiaries for the same period occurring during the preceding determination period…adjusted by…the percentage increase or decrease [cost of living]."* The past-cost method cannot be used *"in any case in which there is any significant difference between [plan years], in coverage under, or in employees covered by, the plan."*

Using the Actuarial Method to Set HRA COBRA Premiums

The actuarial method requires the administrator to make a reasonable actuarial estimate of the cost of providing HRA coverage for similarly situated beneficiaries. Note that COBRA rules do not require an employer to hire an actuary to use the actuarial method. In fact, many employers rely on actuarial determinations made by the third-party administrator or insurance company administering the plan.

The Past-Cost Method

To set HRA premiums using the past-cost method, the employer looks at the total claims reimbursed by the HRA during a 12-month "determination period." This cost basis can then be adjusted by a trend factor, and reasonable plan administrative costs can be added to determine the total cost of the plan.

Obviously, new HRAs cannot use the past-cost method (they have no past cost for a prior year). Even HRAs that have been around for a while might not be able to use the past-cost method if they have a carryover feature. The carryover may produce a significant difference in coverage from one year to the next (i.e., higher or lower coverage limits in a subsequent year).

Note that the rules state that the past-cost method cannot be used if there is a significant difference in coverage from one year to the next. However, we doubt that anyone would object to the use of the past-cost method if the result would be to charge qualified beneficiaries (Q.B.s) a lower premium than would be justified by the actuarial method.

When either method is used, the resulting COBRA premiums should be based on total plan cost, not on the individual HRA balance of a participant electing COBRA. IRS has provided "safe harbor" language that supports this position, stating: *"An HRA complies with the COBRA requirements for calculating the applicable*

continued >

premium under Code Section 4980B if the applicable premium is the same for qualified beneficiaries with different total reimbursement amounts available from the HRA…" In other words, under the safe harbor, the COBRA applicable premium is "blended" so that it is the same for all HRA COBRA Q.B.s, regardless of their account balances.

SETTING SINGLE VS. FAMILY COBRA RATES

Once the applicable HRA plan cost has been calculated, the employer must figure out what to change for single vs. family COBRA coverage. Unfortunately, there is even less IRS guidance on this process. At this point, a "per participant" COBRA rate can be determined using the number of participants eligible for the coverage during the determination period. Limited IRS guidance provided implies that a single individual electing COBRA should be charged the "single employee" rate, even if that individual was a covered spouse or dependent prior to the COBRA event.

For COBRA Q.B.s electing family coverage, employers should take into account the average number of participants eligible for HRA benefits among active employees who have elected family coverage. For example, if active employees with family coverage have an average of 3.7 HRA participants (employee, spouse, and dependents) eligible for benefits, an employer would charge 3.7 times the single rate for an employee electing family COBRA coverage.

ONE PLAN VS. TWO?

Under existing rules, an HRA must be integrated with the employer's group health plan for active employees. This means that the HRA can be offered only to employees, spouses, and dependents who are actually enrolled in the employer's group health plan. This makes the COBRA offer easier. HRA coverage would generally be offered only to COBRA Q.B.s who also elect to continue with the employer's health plan. The HRA premiums would simply be added to the COBRA premiums due for continuation of the group health plan.

SUMMARY

HRA sponsors implementing a do-it-yourself approach may take some comfort from the fact that the IRS has never issued regulations governing the determination of the applicable premium. From COBRA's inception, the compliance standard to which administrators have been held, when no final regulations exist, is good faith compliance with a reasonable interpretation of COBRA. Nevertheless, in many cases it may be more prudent to retain an actuary or to rely on the TPA that administers the employer's HRA to set the COBRA premium actuarially. Most importantly, employers should make sure HRA coverage is offered to any Q.B.s covered by the HRA who has a COBRA event, including spouses and dependents.

As always, should you have any questions, please contact your Parker, Smith & Feek Benefits Team. For additional employee benefit compliance news and information visit our Healthcare Reform Explained website.

As always, should you have any questions, please contact your Parker, Smith & Feek Benefits Team. While every effort has been taken in compiling this information to ensure that its contents are totally accurate, neither the publisher nor the author can accept liability for any inaccuracies or changed circumstances of any information herein or for the consequences of any reliance placed upon it.