

DEPENDENT ELIGIBILITY UNDER HEALTH CARE REFORM
*Cost-Containment Strategies Employers Should Take From The
Signing of the Bill to Beyond 2014*

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The Patient Protection and Affordable Care Act (PPACA) and The Health Care and Education Affordability Reconciliation Act (HCEARA) have changed the landscape of dependent eligibility for employer-based health coverage. Much of the uncertainty within the new health care legislation is yet to be clarified by the regulatory bodies. However, there are some strategic actions that employers can take now that will reduce the financial impact of the health reform bills to their health plan.

Two Types of Plans - Grandfathered and New Plans

PPACA extended dependent coverage in group health plans to adult dependents who are not married and below 26 years of age. HCEARA struck the marriage clause while creating an opportunity for grandfathered plans (defined below) to lessen the impact this extension of dependent coverage has on their plan. PPACA states that the Secretary of the HHS “shall promulgate regulations to define the dependents to which coverage shall be made available”.¹ Even though employers need to wait to see exactly how the HHS defines a dependent, there are a few items spelled out in the bills that need to be considered right away.

Grandfathered Plans

PPACA provided currently existing group health plans with the opportunity to limit the exposure to the requirements and changes imposed by the legislation for plan years beginning before 1/1/2014. PPACA defined these plans as “grandfathered health plans”.² The definition of a grandfathered group health plan within PPACA is “a group health plan or health insurance coverage in which an individual was enrolled on the date of enactment of this Act”.

The bill is clear that renewing a plan will not cause it to lose its grandfathered status. However, it is still unclear what types of plan changes will be allowed while still maintaining grandfathered status. Regulatory updates should clarify this issue. But it is very clear that employers should do everything they can to maintain their plan’s grandfathered status until after 1/1/2014. This status is critical to shielding group health plans from the full financial impact of the changes brought by health care reform.

Key Concept:
Maintaining the grandfathered status of the health plan will provide employers with additional tools to contain costs

HCEARA brought many of the changes regarding dependent eligibility in PPACA to grandfathered health plans, with one very important exception related to dependent eligibility. Grandfathered plans are required to offer coverage to adult dependents “only if such dependent is not eligible to enroll in an eligible employer sponsored plan”. This exclusion to the blanket requirement to cover adult dependent

¹ PPACA - SEC. 2714. Extension of Dependent Coverage

² PPACA - SEC. 1251. Preservation of Right to Maintain Existing Coverage

children below age 26 will be a key factor in determining an employer’s strategy for cost-containment over the next few years.

New Plans

Plans that were not grandfathered and plans that lose their grandfathered status prior to 1/1/2014 will not be able to use the exclusion regarding adult dependents who are offered coverage by virtue of their own employment. This document will primarily focus on strategies for grandfathered plans, but plans that are not in a grandfathered status can still leverage some of the cost-containment tools discussed.

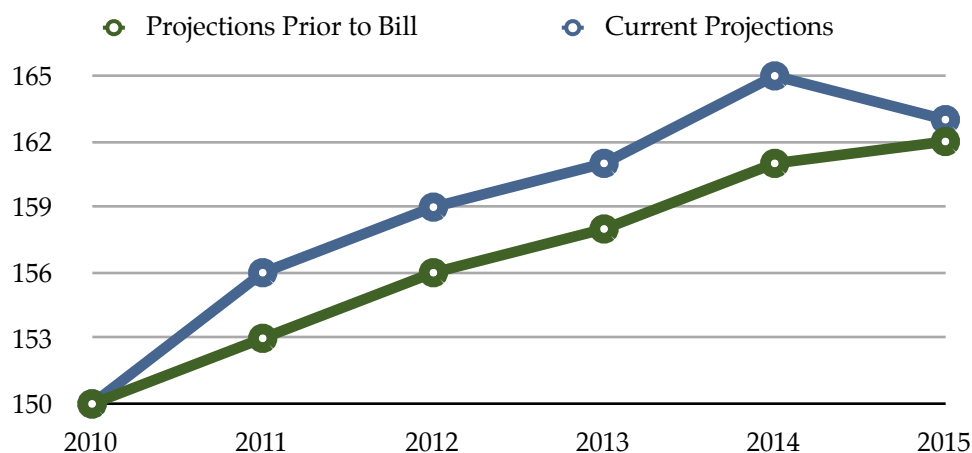
Important Factors to Consider as Employers Formulate a Cost-Containment Strategy

The topics in this section help establish the framework of understanding that employers need to know as they determine which cost-containment strategies are appropriate for them to leverage.

Impact of Legislation on Enrollment in Employer-Based Health Plans

According to the Congressional Budget Office (CBO), roughly 150 million people are covered by employer-based health care coverage. Prior to the enactment of health care reform that number was projected to increase to 153 million in 2011. However, the CBO estimates that the combined effect of the two bills will cause that number to increase by an additional 3 million lives in 2011 alone.³ This increase is felt right away and persists through 2015 as expressed in Figure 1.

FIGURE 1 - PEOPLE COVERED BY EMPLOYER-BASED HEALTH CARE (IN MILLIONS)



Source: Congressional Budget Office

³ Congressional Budget Office - Estimated Effects of the Insurance Coverage Provisions of the Reconciliation Proposal Combined with H.R. 3590 as Passed by the Senate

It is evident that the legislation will increase the number of people covered by employer-sponsored health plans in the short term. However, it is the number of dependents that are enrolled as a result of this legislation that is important in the scope of this document. The Centers for Medicaid & Medicare Services (CMS) estimated that over 95% of the increase in lives covered under employer-based coverage would consist of dependents joining their parents plan.⁴ Paying attention to dependent eligibility is more important than ever before.

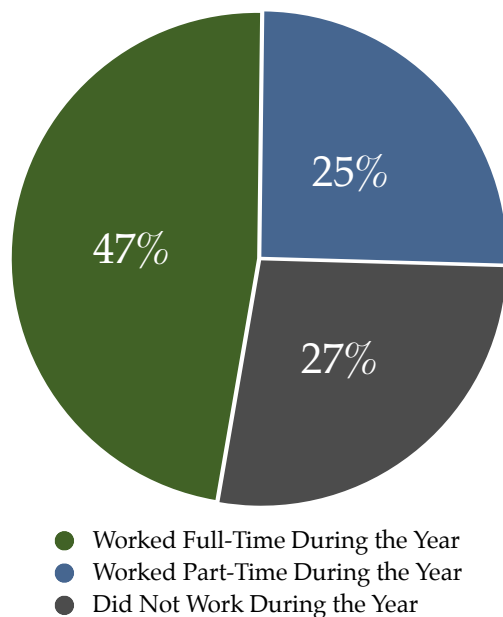
Profile of 19 to 25 Year-Old Uninsured Adults

As noted above, HCEARA provides grandfathered plans with an exemption from providing coverage to adult dependent children if they have access to health coverage as a result of their own employment. Understanding the access to employer-based health coverage that dependents age 19 to 25 may have as a result of their own employment is fundamental to employers formulating a cost-containment strategy.

Key Concept:
Adults age 19-25 are more likely to turn down health coverage offered to them by their own employer

According to the U.S. Census Bureau there were nearly 9 million uninsured adults ages 19 to 25 in 2008. Nearly half of those uninsured adults worked full-time during the year and one quarter worked part-time during the year (See Figure 2).⁵

FIGURE 2 - EMPLOYMENT STATUS OF UNINSURED ADULTS AGE 19-25



The Kaiser Family Foundation indicates that 98% of employers with over 200 employees offer health care coverage to their employees. Additionally, 59% of employers with less than 200 employees offer health care coverage. Since nearly half of uninsured adults age 19 to 25 worked full-time during the year, many of them have access to their own employer-based coverage. These statistics alone should convince employers with grandfathered plans to verify that adult dependents do not have coverage available from their own employer. Since one quarter of adults age 19 to 25 work part-time, it is worth exploring that population as well. Over 50% of employers with 200 employees or more offer health coverage to their part-time employees. Over 30% of employers with less than 200 employees offer health coverage to their part-time employees.⁶ Employer-based health care coverage is

⁴ Estimated Financial Effects of the “Patient Protection and Affordable Care Act”

⁵ U.S. Census Bureau - Current Population Survey, ASE Supplement, 2009

⁶ Kaiser Family Foundation - Employer Health Benefits Survey 2009

widely available to the vast majority of employees, but those employees have the option to not enroll in that coverage.

Across all age groups and all employers roughly 20% of employees choose not to enroll in employer-based health coverage even when it is available to them.⁷ If the sample of employers is narrowed to only consider firms that either employ a large percentage of part-time workers the percentage of employees who choose not to enroll increases to over 30%. The same percentage holds true for employers who have a large percentage of workers under age 26. These percentages are significant on their own, but they include employees from all age groups. The Kaiser Family Foundation indicates that “young adults are less likely to take-up the employer coverage that is available to them”.⁸ The lower health coverage take-up rate of young adults is most likely due to differences in income level, health status, and attitudes about the importance of health insurance coverage.⁹ Employers with grandfathered plans should closely examine whether the adult dependents trying to enroll in their plan have access to health coverage as a result of their own employment.

Employees’ Perception of Reform

Since the passing of health care reform the White House and Congress have been extolling the benefits of the legislation to the public. News organizations have been reporting on the story and the major reforms that it will bring. However, the complexity of the legislation and the language within it have caused many news outlets and governmental bodies to attempt to simplify it so that the general public will understand what it means to them. But an over-simplification of the dependent eligibility clause could result in employees believing they can enroll their dependents when they are not actually eligible for coverage. The Miami Herald indicates that “questions reflecting confusion have flooded insurance companies, doctors’ offices, human resource departments and business groups”.¹⁰

Key Concept:
Employee confusion regarding health reform will increase the likelihood of ineligible dependents joining an employer’s plan

The miscommunication is related to both timing and scope. Some verbiage on the White House’s website illustrates the oversimplification that is rampant throughout the media and governmental bodies. As of April 6th 2010 the front page of www.whitehouse.gov linked to a summary of the health care reform legislation. Under a section titled “Immediate Benefits” the White House indicates that the legislation requires “plans to allow young people up to their 26th birthday to remain on their parents’ insurance

⁷ Kaiser Family Foundation - Employer Health Benefits Survey 2009

⁸Changes in Employer-Sponsored Health Insurance Sponsorship, Eligibility, and Participation

⁹ Urban Institute - Health Insurance Coverage of Young Adults

¹⁰ Health Care Overhaul Spawns Mass Confusion for Public, Miami Herald, 4-6-2010

policy, at the parents' choice." It also included a subtext that stated "Effective 6 months after enactment." The statement's appearance under the immediate benefits section is somewhat misleading on its own, but the sentence does not represent the bill in scope either. The definition of a dependent will be specifically described by the Secretary of the HHS at a later date. The statement does not mention that the vast majority of plans will be in a grandfathered state until plan years starting after 1/1/2014. As noted earlier, this means that employers are not required to offer coverage to adult dependents if they can obtain coverage from their own employer. Examples of oversimplification can be found in almost every summary of the bill presented to the general public. This will create an increased risk that ineligible dependents will attempt to join employer-based plans. Employers must understand this increased risk and put processes in place to address it.

Dependents will Likely Persist On The Health Plan In Which They Are Enrolled (Status Quo Bias)

An individual's decision making process regarding which health plan they will join is complex, but the one thing that can be predicted with great accuracy is that adult dependents will tend to remain on the plan in which they first enroll. Hundreds of scientific studies have established that even if more attractive options are available to a person, they will tend to stick with their first decision. This is known as Status Quo Bias and a couple of examples will express its impact. A

Key Concept:
Due to Status Quo Bias
Dependents will tend to
persist on the plan in
which they are enrolled

study of Harvard University health plan enrollees found that once employees were enrolled in a particular health plan, they very rarely switched to other plans.¹¹ Even though the majority of new employees chose the more attractive plan option, existing employees persisted in the decision they made when they first enrolled. Another example of this bias is from a study of over half-a-million 401(k) enrollees. Financial professionals indicate that the mix of stocks, bonds, and other investment vehicles should change over the life of an individual to maximize returns and minimize risk. If rational decisions were made by the enrollees they would change their asset mix a few times during their career. However, when enrollees chose an asset allocation percentage during their initial enrollment, over half of the participants made zero changes throughout their entire professional career. The study also found that many of those who joined the plan before they were married still had their mothers listed as their beneficiaries.¹² These two examples illustrate the power that an individual's first decision has during subsequent years.

Employers need to understand the power of the Status Quo Bias as they formulate strategies for containing the cost of the expanded dependent coverage requirements. The plan in which dependents are

¹¹ Status Quo Bias in Decision Making, *Journal of Risk and Uncertainty*, 1:7-59

¹² Nudge - Improving Decisions About Health, Wealth, and Happiness, Thaler and Sunstein

enrolled prior to each of the three time periods discussed below will have a large impact in predicting which employer will shoulder the cost burden for the dependent in the subsequent time period.

Three Time Periods Require Three Different Approaches

Employers will be impacted by the legislation for years to come. But there are three distinct periods of time that employers need to consider as they determine how to protect themselves from this revolutionary change in how dependents are treated within the employer-based health care marketplace.

Plan Years Beginning Before 9/23/2010

According to the legislation, no changes regarding dependent eligibility will become effective for plan years beginning before 9/23/2010, but employers need to take action right away to shield themselves from increased cost over the following periods.

Key Concept:
Employers need to be vigilant in protecting their plan due to employee confusion regarding health care reform

Pay Close Attention to the Eligibility of Dependents Enrolling During This Timeframe - Plan years that fall into this timeframe will function much as before with respect to dependent coverage from a legislative standpoint. The President, along with most of the major news outlets, have showcased the provision to extend dependent coverage for dependents age 25 and younger. As noted above most of this coverage has been at a very high-level and has led many employees to believe that they have the right to enroll their dependents right away. Confusion is very high at this point and the likelihood of ineligible dependents enrolling in employers' plans is increased.

Make Sure That the Plan Remains In Compliance With Current Law - ERISA requires that administrators run the plan as it was designed. Allowing ineligible dependents on the plan for any period of time would not be in compliance with federal law. If an employer currently has a student requirement it is still very important to enforce it from both a cost and compliance perspective. Employers shouldn't assume that adult dependents who are not eligible because of their non-student status will re-enroll in the plan in 2011. If an employer follows the recommendation in the next time period and implements a verification process to determine whether adult dependents have an offer of coverage from their own employer, many of these dependents will not rejoin the plan. As previously discussed, a large number of adult dependents have access to coverage by virtue of their own employment. Employers who enforce their current plan provisions will not only reduce plan costs right away, but will also maintain the group health plan's compliance.

Avoid Any Changes That Could Threaten the Grandfathered Status of the Plan - Regulations will hopefully clarify exactly what is required to maintain a plan's grandfathered status. The bill is clear that renewing a plan will not cause a plan to lose its grandfathered status. However, it is still unclear what types of plan changes will be allowed while still maintaining a plan's grandfathered status. Employers should consult their attorneys and watch for regulatory updates when considering any changes that may impact their status as a grandfathered plan.

Key Concept:
Maintaining the grandfathered status of the group health plan will be critical over the next few years

Watch for the Regulations That HHS Will Issue Regarding the Definition of a Dependent - How the HHS decides to define a dependent will be a critical factor in determining the impact to employers' health plans. Employers should keep a watchful eye towards the HHS for more guidance on this topic. It is important that the HHS issues this detailed guidance in time for employers to make changes to their plan design and eligibility language for plan years beginning after 9/23/2010.

Don't Forget the Tendency for Dependents to Remain On the Plan In Which They Are Enrolled - Actions taken by employers during each one of these time periods will have a significant impact on their costs in the following years. Beginning in 2011 some small employers will receive tax credits for providing coverage to their employees. This should increase the number of employers offering coverage in the short term. This means that any dependents who are not currently offered coverage by their own employer may receive an offer during the next open enrollment. *See the commentary regarding Status Quo Bias for more information about this topic.*

Key Concept:
Employers need to continue with any eligibility verification processes or audits being conducted this plan year

Be Proactive in Communicating What Health Care Reform Does and Doesn't Mean to Employees - Confusion regarding health care reform among the general public is very high. Employers that proactively address health care reform with their employees will reduce the administrative costs and employee anxiety associated with these misconceptions. Employers should incorporate guidance in any health plan communications they are currently communicating to their employees.

Plan Years Beginning on or After 9/23/2010 to 12/31/2013

This time period contains the first direct impact of the extension of dependent coverage to employer-based coverage. The actions employers take during this time period will not only have an extensive impact on the cost increase during this timeframe, but also from 1/1/2014 forward.

Avoid Any Changes That Could Threaten the Grandfathered Status of the Plan - Regulations will hopefully clarify exactly what is required to maintain a plan's grandfathered status. The bill is clear that renewing a plan will not cause a plan to lose its grandfathered status. However, it is still unclear what

types of plan changes will be allowed while still allowing a plan to maintain its grandfathered status. Employers should consult their attorneys and watch for regulatory updates when considering any changes that may impact their status as a grandfathered plan.

Establish a Process for Verifying Whether Adult Dependents Have Coverage Available Through Their Own Employer -

Employers who maintain their status as a grandfathered group health plan have a very effective tool at their disposal for reducing the cost impact of the new dependent requirements. Affidavit processes have been used very effectively by Chapman Kelly to enforce provisions regarding surcharges or exclusions for spouses that have health coverage available by virtue of their own employment. The language within the health care reform legislation regarding adult dependents and access to coverage through their own employer would allow grandfathered plans to leverage this same cost saving tool for their adult dependents. Obtaining documentation to establish the base eligibility factors of dependents will continue to be very important, but an affidavit process for adult dependents provides an additional check point to make sure that only eligible dependents join an employer's plan. Employers should begin planning how they will implement this affidavit process as soon as possible.

Key Concept:
Establish an affidavit process to make sure that adult dependents don't have access to health coverage by virtue of their own employment

Incorporate the Regulations that HHS Will Issue Into the Dependent Eligibility Language of the Plan -

How the HHS decides to define a dependent will be a critical factor in determining the impact to employer's health plans. Employers should keep a watchful eye towards the HHS for more guidance on this topic. *When the HHS issues the regulations this guidance will be updated with strategies that incorporate the upcoming regulations.*

Key Concept:
Employers with solid dependent verification processes during this time period will significantly reduce their cost right away and for plan years beginning after 1/1/2014

Don't Forget the Tendency for Dependents to Remain On the Plan In Which They Are Enrolled - Actions taken by employers during each one of these time periods will have a significant impact on their costs in the following years. However, an employer's dependent eligibility controls during this period will have a tremendous impact on whether or not a dependent enrolls in their plan after 1/1/2014 as well. The legislation requires that employers with over 200 full-time employees automatically enroll their employees in their health care coverage for plan years beginning after 1/1/2014.¹³ These employees will be able to opt out of this coverage. Since a large majority of adult dependents between 19 and 25 work in full-time or part-time jobs, they will be

¹³ PPACA - Sec. 1511. Automatic Enrollment for Employees of Large Employers

offered coverage during this process. As discussed earlier, if these adult dependents are on an employer's plan as a dependent, they will likely stay on it. If they are not on a plan as a dependent and are automatically enrolled through their own employer, Status Quo Bias indicates that they will "choose" to stay on their own employers plan. During the next time period grandfathered employers will lose the ability to conduct an affidavit process to verify that adult dependents do not have an offer of coverage by virtue of their own employment. The controls the employer has put in place during this period will have lasting effects. *See the commentary regarding Status Quo Bias for more information about this topic.*

Plan Years Beginning After 1/1/2014

Many of the keys to reducing the cost impact of dependents joining an employer's plan have taken place before this time period. Employers who follow the guidance given for previous plan years will be in a much better position than employers who did not. Employers will still want to maintain plan compliance and reduce costs by making sure that only eligible dependents join their plan. The regulations issued during the next year will provide a better picture of what employers should expect regarding minimum coverage, subsidies to health exchanges, and the cost of providing health care coverage to their employees and their dependents. *When the final regulations are issued regarding what employers should expect for plan years after 1/1/2014, this guidance will be updated accordingly.*

Employers should act now to protect themselves from the increased cost-burden that will be shouldered as a result of health care reform. Although there are still many unknowns, employers who take action now to review the eligibility of dependents on their plan will be placing themselves in a superior competitive position with regard to health care costs over the next 5 years.

Chapman Kelly's audit clients include 35 Fortune 500 companies, over 300 school districts, and numerous other private and public employers. Dependent Eligibility Audits represent over 85% of the firm's revenue. During the last 6 months of 2009 Chapman Kelly processed over 2 million dependent verification documents. The professionals at Chapman Kelly have been asked by various well respected magazines and publications to author and/or contribute to articles on the Dependent Audit process including the following: Employee Benefit News, Employee Benefits Advisor, Benefits Selling, The Henry J. Kaiser Foundation Health Policy Report, and The School Administrator.