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Proposed Rule Addresses Variety of Health Plans Arrangements

On July 7, 2023, the Departments of Health and Human Services ("HHS"), Labor ("DOL"), and the Treasury (collectively, "the Departments") released a notice of proposed rulemaking ("NPRM") that aims to:

- Revise the conditions for hospital fixed indemnity or other fixed indemnity insurance to be considered an excepted benefit;
- Clarify that payments from an employer-provided fixed indemnity plan are not excludable from gross income if the amounts are paid without regard to the actual amount of incurred expenses and impose a substantiation requirement;
- Modify the definition of short-term, limited-duration insurance ("STLDI"); and
- Solicit comments regarding specified disease excepted benefits coverage and level-funded plan arrangements.

The Departments issued this NPRM to support the goals of the Affordable Care Act ("ACA") by increasing access to affordable and comprehensive coverage, strengthening health insurance markets, and promoting consumer understanding of coverage options.

If finalized "as is," these rules would impact employers offering hospital indemnity and other fixed indemnity insurance. In addition, the guidance suggests additional rulemaking may be forthcoming as it relates to level-funded plans and specific disease-related coverage.

The Departments are accepting written comments through September 11, 2023.

Below are some of the highlights from the NPRM:

Fixed Indemnity Insurance – Excepted Benefit

Hospital and fixed indemnity excepted benefits coverage is exempt from the ACA market reforms, as these products generally provide income replacement as opposed to comprehensive medical coverage.

It is important to note that if a fixed indemnity policy does not meet the definition of an excepted benefit, it will likely be considered a group health plan. If it does not comply with the ACA market reforms penalties of $100/day per individual affected may apply.

Under the existing rules, to qualify as an excepted benefit, the hospital or other fixed indemnity coverage must meet the following requirements:

- The benefits are provided under a separate policy, certificate, or contract of insurance (self-funded arrangements will not meet this definition);
- There is no coordination between the provision of the benefits and an exclusion of benefits under any group health plan maintained by the same plan sponsor;
- The benefits are paid with respect to an event without regard to whether benefits are provided with respect to the event under any group health plan maintained by the same plan sponsor; and
- The insurance must pay a fixed dollar amount per day (or per other period) of hospitalization or illness (for example, $100/day) regardless of the amount of expenses incurred or the type of service.

The Departments are concerned about reports of troubling marketing and sales tactics and the creation of new benefit designs that mislead consumers to believe hospital indemnity or other fixed indemnity insurance constitutes comprehensive coverage.

In response, the NPRM reinforces that to qualify as an excepted benefit, the fixed indemnity coverage must pay benefits as a fixed dollar amount per day (or per other time period) of hospitalization or illness regardless of the amount of expenses incurred and affirm that benefits cannot be paid on any other basis (such as on a per-item or per-service basis).

Benefits paid under fixed indemnity excepted benefits coverage must be paid regardless of the actual or estimated amount of expenses incurred, services or items received, severity of illness or injury experienced by a covered member, or any other characteristics particular to a course of treatment.

A fixed indemnity policy that merely adds “per day” to its definition would not satisfy the excepted benefit definition.

The NPRM would require a new notice in at least 14-point type to be affixed to marketing, application, and enrollment materials (including on a website advertising or offering an opportunity to enroll in fixed indemnity excepted benefits coverage). The NPRM provides model language.

These proposed changes would take effect as follows:

- For coverage sold on and after the effective date of the final rule, the rules apply as of the effective date of the final rules.
- For coverage sold before the effective date of the final rule, the rules apply to plan years that begin on or after January 1, 2027.
- The notice requirement would take effect when final rules are issued.

Fixed Indemnity Insurance and Specified Disease or Illness Coverage – Tax Treatment

The Treasury and IRS have expressed concern around certain arrangements that claim to avoid income and employment taxes by characterizing cash benefits as amounts paid for reimbursement of medical care, even though those amounts are paid without regard to the actual amount of any incurred, and otherwise unreimbursed, medical expenses.

The NPRM clarifies the tax treatment of payments made to individuals under fixed indemnity excepted benefits or any plan that pays an amount regardless of medical care expenses actually incurred (e.g., some specified disease or illness coverage). Specifically, if the premiums for the coverage are paid on a pre-tax basis, the benefit received by the individual is considered income to the individual if the benefit is paid without regard to the amount of medical expenses incurred. For any amount to be excluded from income, the payment or reimbursement must be substantiated.

It is important to note that if an employee pays for the fixed indemnity or similar coverage on an after-tax basis, the reimbursement should remain tax-free.

These proposed changes would take effect as of the later of:

- The date the final rule is published; or
- January 1, 2024.

Short-Term, Limited-Duration Insurance

STLDI is a type of health insurance coverage primarily designed to fill temporary gaps in coverage and is not subject to the ACA requirements and protections. STLDI may be useful when, for example, an individual is transitioning from one plan or coverage to another. It is not usually an employer-sponsored plan.

The NPRM:

- Reduces the length of an initial STLDI contract period to no more than 3 months (from 12 months) and the maximum coverage period to no more than 4 months (from 36 months), including renewals or extensions.
- Prohibits an STLDI issuer from issuing multiple STLDI policies to the same policyholder within a 12-month period, although an individual could secure STLDI coverage from a different carrier within this time period.
- Requires a notice to be prominently displayed in the contract and in any application materials provided in connection with enrollment in STLDI, in at least 14-point font.

These proposed changes would take effect as follows:

- For coverage sold on and after the effective date of the final rule, the rules apply as of the effective date of the final rules.
- For coverage sold or issued before the effective date of the final rule, individuals may keep their coverage for the full duration allowed under current rules (up to 36 months, including renewals and extensions), to the extent permitted by applicable state law.
- The notice requirement would take effect when final rules are issued.

Comments Sought

Specified Disease Excepted Benefit Coverage: The Departments are not proposing any changes to specified disease coverage although they are seeking comments to better understand typical benefit designs and whether the proposed changes to the fixed indemnity rules would have unintended consequences for specified disease coverage.

Level Funded Plan Arrangements: With the increase in the number of level-funded plans, the Departments have heard concerns and received questions from interested parties related to level-funded arrangements' status as self-funded health plans.

The Departments are seeking comments to better understand the prevalence of level-funded plans, such plans' designs, and whether additional guidance or rulemaking is needed to clarify a plan sponsor's obligation with respect to coverage provided through a level-funded plan arrangement.

Employer Action

The NPRM is in a proposed format and no immediate action is required.

However, if the rule is finalized "as is," employers offering fixed indemnity insurance may need to consider some changes. In the meantime, employers that are offering fixed indemnity insurance should review their policies to understand whether they will be viewed as excepted benefits and prepare for changes to the tax treatment of the benefits paid from fixed indemnity policies or certain specified disease or illness policies that are paid for on a pre-tax basis. The tax changes could be effective as early as January 1, 2024.

We anticipate further guidance from the Departments on level-funded plans and specific disease coverage.