



## LEGISLATIVE BRIEF

### COBRA Requirements: FSAs and HRAs

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) requires that employers provide individuals who would otherwise lose group health benefits due to a qualifying event with an opportunity to continue group health coverage. In general, employers are aware of their COBRA obligations with respect to their health insurance plans. However, employers maintaining health flexible spending accounts (FSAs) and health reimbursement accounts (HRAs) also need to be aware of how COBRA applies to these plans.

Health savings accounts (HSAs) are **not** subject to COBRA coverage requirements. However, if an employer offers a high deductible health plan (HDHP) in connection with an HSA, the HDHP is required to comply with COBRA.

#### **FLEXIBLE SPENDING ACCOUNTS**

An FSA is a tax-favored account, most typically offered under a cafeteria plan, that pays for or reimburses the qualified medical expenses of an employee and/or his or her spouse and dependents.

#### ***Obligation to Offer COBRA Coverage***

In general, employers who offer FSAs to their employees are required to offer COBRA coverage to qualified beneficiaries who would otherwise lose their FSA coverage due to a qualifying event, ***subject to the special exception described below***. Many FSAs qualify for the special exception. FSAs that do not qualify for the special exception are required to offer COBRA coverage for the maximum coverage period applicable under COBRA. In this case, individuals electing COBRA coverage must be allowed to re-enroll for FSA coverage for subsequent plan years during open enrollment periods.

If COBRA coverage must be offered for subsequent plan years because the FSA does not qualify for the special exception, an employer's risk of loss increases due to the uniform coverage rule applicable to FSAs. Under the uniform coverage rule, an FSA must reimburse expenses up to the participant's remaining annual benefit, even if the reimbursements are in excess of the participant's year-to-date contributions.

#### ***Special Exception***

If an FSA satisfies all of the following criteria, the employer is not required to offer COBRA coverage to certain qualified beneficiaries, and may limit the duration of COBRA coverage for other qualified beneficiaries to the plan year in which the qualifying event occurs:

- The maximum annual benefit payable under the FSA to any participant does not exceed an amount equal to twice the participant's annual salary deferral election under the FSA (or, if greater, an amount equal to the participant's annual salary deferral election under the FSA, plus \$500);
- Other group health plan coverage is made available by the employer, other than HIPAA-excepted coverage (for example, limited-scope dental and vision coverage); and



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- The maximum annual benefit available under the FSA is less than the maximum COBRA premium for a year. Often, this criterion is satisfied because the COBRA premium will either equal the maximum annual benefit or will be equal to 102 percent of the maximum annual benefit.

If an FSA satisfies the three criteria outlined above, then (1) the employer is **not** required to offer COBRA coverage to qualified beneficiaries who have **"overspent"** their FSA accounts and (2) the employer must offer COBRA coverage to qualified beneficiaries who have **"underspent"** their FSA accounts, but the COBRA coverage may terminate **at the end of the year** in which the qualifying event occurs.

## *"Overspent" and "Underspent" FSA Accounts*

An employer determines whether a participant has "overspent" or "underspent" his or her FSA account by looking at: (1) the participant's maximum benefit for the plan year; (2) the amount of reimbursable claims submitted to the FSA for the plan year before the qualifying event; and (3) the maximum amount that the employer is permitted to charge for COBRA coverage under the FSA for the remainder of the plan year.

If the participant's maximum annual benefit minus the amount of submitted reimbursable claims is less than the maximum COBRA premium that can be charged for the rest of the year, then the FSA is "overspent." On the other hand, if the remaining annual benefit (participant's maximum annual benefit minus amount of submitted reimbursable claims) is more than the maximum COBRA premium that can be charged for the rest of the year, then the FSA is "underspent."

Consider the following example based on Internal Revenue Service (IRS) regulations:

Example: An employee's maximum annual benefit under an FSA for 2011 is \$2,400. The employee experienced a qualifying event that was a termination of employment on May 31, 2011. As of that date, the employee had submitted \$300 of reimbursable expenses under the FSA. Thus, the employee's remaining annual benefit is \$2,100. The maximum amount that the FSA can require to be paid for COBRA coverage for the remainder of 2011 is 102 percent times 1/12 of the applicable premium for 2011 times the number of months remaining in 2011 after the date of the qualifying event. In this case, the maximum amount that the FSA can require to be paid for COBRA coverage for 2011 is \$2,448. One-twelfth of \$2,448 is \$204. Because seven months remain in the plan year, the maximum amount that the FSA can require to be paid for the employee's coverage for the remainder of the year is seven times \$204, or \$1,428. Because \$1,428 is less than the employee's remaining annual benefit (\$2,100), the FSA is required to make COBRA coverage available to the employee for the remainder of 2011 (but not for any subsequent year).

## ***Calculating the COBRA Premium***

In general, the maximum COBRA premium is 102 percent of the cost to the plan for similarly situated beneficiaries who have not experienced a qualifying event. The IRS has not issued much guidance on calculating COBRA premiums, especially with respect to FSAs and HRAs. However, IRS regulations indicate that the maximum COBRA premium for FSA coverage is based on the **annual coverage amount under the FSA**, which includes both employee and employer contributions.

Consider the following example based on IRS regulations:

Example: During an open enrollment period before the beginning of each calendar year, employees can elect to reduce their compensation during the upcoming year by up to \$1,200 per year and have that same amount contributed to the FSA. The employer contributes an additional amount to the account equal to the employee's salary reduction election for the year. Thus, the maximum amount available to an employee under the FSA for one year is two times the amount of the employee's salary reduction election for the year. The employer

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determined that a reasonable estimate of the cost of providing coverage for similarly situated non-COBRA beneficiaries for 2011 under this FSA is equal to two times their salary reduction election for 2011 and, thus, that two times the salary reduction election is the applicable premium for 2011.

## **HEALTH REIMBURSEMENT ACCOUNTS**

An HRA is a tax-favored, employer-funded arrangement that pays for or reimburses the qualified medical expenses of an employee and/or his or her spouse and dependents.

### ***Obligation to Offer COBRA Coverage***

In general, employers with HRAs are required to offer COBRA coverage to qualified beneficiaries who would otherwise lose their HRA coverage due to a qualifying event, even if the HRA includes a spend-down feature. Although HRAs sometimes qualify as FSAs, HRAs rarely meet the standards for the special exception described above that applies to the requirement to offer COBRA coverage under an FSA. Thus, employers with HRAs generally must offer COBRA continuation coverage beyond the current plan year for the maximum coverage period applicable under COBRA. However, unlike FSAs, HRAs are not subject to the uniform coverage rule. This significantly lessens an employer's risk of loss for an employee electing COBRA because the maximum amount of reimbursement under an HRA may be prorated during the year.

If an employee elects COBRA coverage for his or her HRA, the employee must have access to the unused balance as well as any additional accruals provided to similarly situated employees, less any year-to-date reimbursements.

### ***Calculating the COBRA Premium***

The maximum COBRA premium is 102 percent of the cost to the plan for similarly situated beneficiaries who have not experienced a qualifying event. As noted above, the IRS has not provided much guidance on calculating the COBRA premium, especially for FSAs and HRAs. The IRS provided limited guidance on calculating the COBRA premium for HRAs in Notice 2002-45. In this guidance, the IRS described an acceptable calculation method that uses a blended HRA premium as follows:

An HRA complies with the COBRA requirements for calculating the applicable premium ... if the applicable premium is the same for qualified beneficiaries with different total reimbursement amounts available from the HRA. For example, if the annual additional reimbursement amount credited under an HRA is \$1,000 and the maximum reimbursement amount remaining for two similarly situated qualified beneficiaries at the time of their qualifying events is \$500 and \$5,000, the applicable premium is the same for each individual.

The IRS has not provided any additional guidance on calculating a blended HRA COBRA premium. The IRS has also not addressed other methods for calculating the HRA COBRA premium, such as basing the premium off of individual account balances.

## **OTHER COMPLIANCE ISSUES**

COBRA compliance for FSAs and HRAs can be complicated. Although employers may be comfortable applying COBRA's rules to their group health insurance plans, the same COBRA rules may be difficult to apply to FSAs and HRAs given the lack of IRS guidance. In addition to the COBRA compliance issues discussed above, the following topics are also linked with COBRA coverage under FSAs and HRAs:

- Applying the uniform coverage rule under FSAs during COBRA coverage;
- Determining when spouses and dependents have independent COBRA election rights;

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- Calculating the remaining annual limit under an FSA; and
- Determining how to allocate continuing HRA accruals.

Employers sponsoring FSAs and HRAs should work with their advisors regarding COBRA compliance.