

Coming Up a Little Short: How to Handle Insignificant Premium Underpayments

By Rich Glass, JD

If you wanted to purchase something at the store that costs \$1.00, it would be unreasonable to expect to pay 95 cents and take the item. And yet, this occurs for some employers when it comes to COBRA administration.

It need not be the case.

In final COBRA regulations, the IRS outlined what employers should do if they receive a COBRA premium payment that is less than the required amount. The rule, in one subsection of these regulations, distinguishes between underpayments that are significant and insignificant. An underpayment is insignificant if it is less than \$50 or 10 percent of the required payment, whichever is less. The rule basically states that an employer must either accept the insignificant underpayment or send a notice to the qualified beneficiary, requesting payment within a reasonable period of time.

This rule is familiar to anyone with COBRA experience. Insignificant underpayments typically happen in two situations:

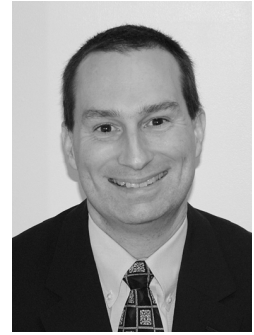
- 1) the first month of a new determination period in which there is a premium increase; and
- 2) the initial premium payment.

Although the rule is straightforward, employers should consider several twists. Some difficulty lies in the fact that there are not any reported cases or additional guidance on this issue.

Consideration 1: Address Insignificant Underpayments in COBRA Procedures

Employers should address insignificant underpayments in their COBRA administrative procedures. All too often, the employer's policy on this issue will not be clearly

See *Underpayments*, p. 14



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Three-step Analysis for Employers to Conduct for Short Initial Payments

- **Determine the total premium due by the end of the initial payment period.**

Example 1. If the loss of coverage date was Feb. 28, the election occurred on April 30 and the monthly premium was \$150, the 45-day deadline would be June 14, with three months due at that time (March, April and May). The total premium due on June 14 would be \$450.

- **Determine whether the underpayment is insignificant.**

Example 2. Using Example 1 above, if the qualified beneficiary sent a check for \$430 on June 14, the underpayment would be insignificant because \$20 is less than 10 percent of \$450 (\$45). A \$400 underpayment would be significant.

- **Take appropriate action.**

Example 3. Using the example of the \$430 payment, the employer should apply \$300 to March and April and send an insignificant underpayment notice for \$20 for May. If the May deficit is not corrected within the timeframe given, coverage would be terminated as of April 30. On the other hand, using the example of a \$400 payment, the employer should apply \$300 to March and April, terminate coverage as of April 30 and refund the remaining \$100 to the qualified beneficiary. If the qualified beneficiary later pays the June payment in a timely manner, that payment should be refunded because he or she no longer had coverage after April 30. 🏠

Underpayments (continued from page 13)

documented. This can result in inconsistent handling of insignificant underpayments and unnecessary acceptance of underpayments. Employers need to make two determinations:

- *Whether to accept insignificant underpayments as payment in full or insignificant underpayments below a certain threshold (for example, \$2).* If so, savvy qualified beneficiaries will routinely underpay their premiums. If not, the employer will want to send the insignificant underpayment notices promptly because a second grace period begins when the insignificant underpayment notice is sent.
- *Whether to notify affected participants either in the plan's summary plan description (SPD) or the election notice.* The model notice in final COBRA regulations from the U.S. Department of Labor (DOL) does not include such language. The DOL's SPD regulations arguably do not require inclusion either, even though they require "information concerning qualifying events and qualified beneficiaries, premiums, notice and election requirements and procedures, and duration of coverage." Again, to the extent that a savvy qualified beneficiary is

SPD (continued from page 12)

For planning purposes, however, it is better to ensure that plan and SPD documents clearly explain the differences between alternative coverage options and how to make elections under either option. (See ¶1264.)

Another important planning point is that plan administrators should not orally try to explain how their benefit plans work. In this case, the HR director tried to explain how the various options worked and how a COBRA election related to a later ability to elect retiree coverage. Without knowing exactly what the HR director said, it is enough to point out would have been no need for the HR director to say anything (misleading or otherwise) if the SPD and other plan documents clearly explained that a participant's election of retiree health options had to be made independently of any COBRA election. Then, the HR director simply could have referred Fitzpatrick to the relevant SPD sections.

Once again, the bottom line is that employers and plan administrators must review their documents and verify that the terms of any summary are accurate and complete. Once that is the case, administrators should resist the urge to explain how the coverage rules work in a manner that is different from the written documentation. 🏠

aware of such procedures, he or she may routinely underpay premiums.

Consideration 2: Remember the Safe Harbor Period

The IRS regulations provide a safe harbor of 30 days as a reasonable period for making up the shortfall. But, as the preamble to those regulations indicates, there could be some, but not all, situations where a period of less than 30 days is reasonable. Employers should determine what situations, if any, would require less time to correct the underpayment.

Consideration 3: What if Notice Is Ignored but Other Premiums Are Fully Paid?

What should employers do if a qualified beneficiary ignores the insignificant underpayment notice but continues to pay the subsequent monthly premiums in full? Does the employer apply the next month's premium to make up for the previous month's underpayment? The regulations don't address this issue. The conservative approach would be to continue coverage and issue another insignificant underpayment notice for the subsequent month. A more aggressive approach would be to include language in the insignificant underpayment notice that states the employer will not credit underpayment amounts with future months' payments and will terminate coverage if the underpayment amount is not paid by the applicable deadline.

Consideration 4: Consider the Initial Premium Payment

Regarding the initial premium payment, simply do the math: an employer has 30 days to notify the plan administrator of a qualifying event, the plan administrator then has 14 days to send the election notice, the qualified beneficiary has 60 days to elect coverage and then 45 days from the election to make the first payment. As a result, most initial payments cover several months of coverage. That means as many as 149 days may pass before the initial payment is due. However, the DOL regulations also make clear that a qualified beneficiary can pay for coverage in monthly increments. Thus, a qualified beneficiary need not elect coverage for the full retroactive period.

What should an employer do if the initial payment is short? See the sidebar on page 13 for a three-step analysis.

The insignificant underpayment rule is a short and practical one that has some variations to consider. Prudent employers should review their procedures in this area to ensure correct and consistent application of this rule. 🏠