To: Our Clients and Friends **November 15, 2010**

Caution: Health Care Reform Puts the Brakes on Employer-Sponsored Insured Health Plans

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The rules of the road for employer-sponsored insured health plans have been changed dramatically by the Patient Protection and Affordable Care Act of 2010 (the "Act"). Effective for plan years beginning on or after September 23, 2010 (January 1, 2011 for calendar year plans), the nondiscrimination rules that currently apply to "self-funded health plans" will apply to "insured health plans." An employer that provides discriminatory coverage or benefits to executives through an insured health plan will face severe penalties under the Act.

This means that employers that offer better health care benefits and/or premium subsidies to executives and management than those provided to the general workforce will be under pressure to either extend those better benefits or premium subsidies to the workforce or stop providing them to executives/management. Furthermore, special health benefits provided to an executive or terminated executive under an employment or severance agreement may also be subject to the Act's expanded nondiscrimination rules.

Long before the Act, an employer's self-funded health plan could not discriminate in favor of its executives and other highly compensated individuals with regard to eligibility for coverage and availability of benefits. These nondiscrimination rules did not apply to insured health plans, thus allowing for the not uncommon practice of an employer providing executives/management with access to better health coverage or lower premiums.

If an employer's self-funded health plan is found to be discriminatory, the highly compensated individuals who receive the discriminatory coverage or benefits must include their benefits in taxable income with no penalty imposed on the employer. The Act did not change this rule for self-funded health plans. However, under the Act, as interpreted by the IRS, if an employer's insured health plan is found to discriminate in favor of highly compensated individuals, an excise tax of $100 per day for each individual discriminated against will be imposed on the employer. The executives are neither penalized nor are they required to include the benefits in their taxable income.

Under the Act's penalty provision, for example, an employer with 100 employees that provides discriminatory insured health benefits to three executives could face an excise tax penalty of $9,700 per day until it either drops the discriminatory benefit or provides such benefit to all members of its workforce at least to the extent that the health plan passes the nondiscrimination

tests. The employer's penalty is capped at the lesser of $500,000 or 10% of the employer's prior year's health plan costs. In addition to the excise tax, the employer faces the possibility of being named in a civil action under ERISA to compel it to provide similar benefits to its rank-and-file employees.

The new rules do not apply in all situations. Subject to future guidance on mandatory health plan aggregation, an employer's separate group health plan that exclusively covers retirees and/or former employees may be exempt from the nondiscrimination rules. Also, employer-sponsored health plans that existed on March 23, 2010, the so-called "grandfathered health plans," are exempt from certain provisions of the Act, including the nondiscrimination rules, but only for as long as such plans maintain their "grandfathered health plan" status.

If you sponsor an insured health plan or have negotiated employment or severance agreements with your executives containing special health care benefits, you should have them reviewed as soon as possible so you can develop a strategy for going forward without inadvertently triggering the Act's penalties.

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