COMPLIANCE ALERT

Proposed Rule on Short-Term Limited Duration Insurance & Fixed Indemnity

August 1, 2023

Quick Facts

- The Departments recently issued proposed rules for short-term limited duration medical insurance and fixed indemnity plans.
- The proposed rules would once again limit the time period for short-term limited duration medical policies to three months.
- The proposed rules clarify the tax treatment of pre-tax fixed indemnity benefits and change how fixed indemnity plans can provide payment.
- The Departments are requesting comments on the proposed rules.

Background

The Department of Labor (DOL), Department of Health and Human Services (HHS), and the Internal Revenue Service (IRS), (collectively, "the Departments") recently released **proposed rules** significantly changing coverage that can be provided by a short-term limited duration medical insurance (STLDI) and addressing the definition of, and tax treatment of, fixed indemnity plans, such as hospital indemnity. The Departments are also requesting comments related to possible additional regulation of level-funded plans and disease-specific plans.

Short-Term Limited Duration Insurance

Individual STLDI plans are not subject to the same requirements as comprehensive individual health insurance plans and notably are allowed to exclude coverage for pre-existing conditions. For many years STLDI plans were limited to a three-month maximum duration of coverage. In 2018, the Trump Administration issued new rules, expanding STLDI plans to allow for coverage to last up to 12 months, with two renewals allowed, effectively allowing for a maximum coverage period of up to 36 months. Note however that many states impose more stringent limits on, or even prohibit, STLDI plans.

Proposed Rules

The proposed rules released in July return STLDI plans to a maximum of three months of coverage, with a one-month extension allowed in some cases. Additionally, a newly expanded notice to individuals who purchase STLDI plans is required.

For STLDI sold or issued on or after the effective date of the final rule, the proposed changes apply for new coverage starting on or after the effective date of the final rules.

For existing coverage, the proposed regulations allow individuals enrolled in STLDI sold or issued prior to the effective date of the final rules to 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. However, the new consumer notice, if finalized, would apply to notices provided in connection with the renewal or extension of existing STLDI policies on or after the effective date of the final rules.

Hospital and Fixed Indemnity Plans

Hospital indemnity and fixed indemnity insurance plans pay a fixed amount for an occurrence of a specific condition and do not coordinate benefits with other insurance plans. Their original purpose was to provide additional income or income replacement to individuals experiencing certain medical events. Under current rules, these plans are treated as an "excepted benefit" and are not subject to many of the rules and regulations that apply to comprehensive group or individual health insurance plans. Regulators are concerned that some fixed indemnity-type plans are being designed, and sold, to appear to consumers as if they are providing comprehensive coverage. The new rules put additional restrictions on what types of plans can be treated as an excepted benefit.

Proposed Rules

To be treated as an excepted benefit, indemnity plans are only allowed to pay on a "per period" basis (such as per day of hospitalization) and are not allowed to pay on a per service basis. This change is designed to address plans that are being sold as excepted benefit indemnity plans but contain a significant list of "per service" payments that make them look more like comprehensive fee-for-service health insurance plans.

The proposed rules also clarify that indemnity plans cannot be offered in conjunction with another medical plan in a manner that makes the indemnity plans' payments contingent on the individual having other health coverage. This change targets the proliferation of "preventive-only minimum essential coverage (MEC) + indemnity coverage" plans that are marketed as alternatives to comprehensive group health coverage. The rules also require that a newly expanded notice be provided to participants.

The proposed amendments related to group or individual market fixed indemnity excepted benefits coverage apply to new coverage that is sold or issued on or after the effective date of the final rules with respect to plan years that begin on or after such date.

The proposed amendments related to group market fixed indemnity excepted benefit coverage apply to existing coverage that is sold or issued before the effective date of the final rules with respect to plan years that begin on or after January 1, 2027. Provisions related to the notice would apply for plan years beginning on or after the effective date of the final rules.

Certain other technical amendments and a severability provision apply to new and existing group market fixed indemnity excepted benefits coverage beginning on the effective date of the final rules.

Tax Treatment Proposed Rules

The proposed rules also include an amendment to existing IRS regulations regarding the tax treatment of indemnity plans offered to employees pre-tax through their employer's section 125 cafeteria plan. These regulatory changes clarify, and reflect, the IRS' existing interpretation of taxation of indemnity plans that has been communicated in internal memos and sub-regulatory guidance.

The regulatory change clarifies that if an employee pays for coverage using pre-tax payroll deductions, any payments from the fixed indemnity plan that were paid without regard for an actual

213(d) medical expense incurred by the employee should be treated as taxable compensation for income and payroll tax purposes.

The effective date of these changes will be the later date of publication of the final rules or January 1, 2024.

Additional Requests for Comments

Level-funded health insurance plans are principally offered to small employers and are treated as self-funded plans. As a self-funded plan, level-funded plans are exempt from most state insurance rules and regulations, and other rules that apply to fully insured small group health insurance. There is some concern that level-funded plans do not provide the same protections to employers as participants of fully insured small group health plans. The Departments are asking for comments on potential new federal rules that would apply to level-funded plans.

Summary

Comments on the proposed rules will be accepted for 60 days, until September 11, 2023. Employers will need to reconsider the practice of allowing employees to pay for fixed indemnity plans using pre-tax payroll deductions through the employer's Section 125 plan. This practice will create significant tax consequences for both the employer and the employee.

Another significant impact of these proposed rules will be on employers who offer one of the hybrid MEC/fixed indemnity-type plans. Some of these plans may need to be changed to meet the new requirements and retain their excepted benefit status. Employers must also provide new notices to participants in these plans.

EPIC Employee Benefits Compliance Services

For further information on this or any other topic, please contact your EPIC benefits consulting team.