Employee Benefits Alert

Willis

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Ineligible Dependents: Solving an Expensive Problem

Situation One:

A new employee completes an enrollment form requesting coverage for herself and for her husband. They are duly enrolled in the plan and pre-tax payments for the coverage are taken from the employee's pay. A year later, she asks to drop her husband from the coverage. The HR representative explains that the employee cannot drop her husband's coverage in the middle of the year unless there has been a divorce. The employee explains that she should be able to drop him because they were only "common law" married and they are no longer together. Further questioning makes clear that she was *never* married (common law or otherwise) to the individual enrolled as her spouse and that she knew he was not her spouse at the time she enrolled him. She explains that when she enrolled him they were "practically" married, and he needed coverage.

Situation Two:

An employee has had coverage under the plan for himself and his spouse for several years. One morning he notified HR that he had recently married and wanted to enroll his new spouse in the employer's group health plan. When questioned about the spouse he already had covered under the plan, the employee noted the that the person who was already enrolled was his ex-spouse, and he now wanted to enroll his new spouse. Further questioning revealed that the employee divorced the ex-spouse two years earlier, but he never notified the employer of the divorce. The employee explained that he was ordered by the divorce court to continue to provide medical coverage for the ex-spouse so he believed that he was not allowed to drop her from the employer's plan.

Situation Three:

An employee's child is in a serious automobile accident and incurs $350,000 in medical expenses for treatment of his injuries. After paying the first $100,000 in bills, the TPA notes that one of the bills records the child's age as 26 — the limiting age for coverage under the plan — three months before the accident occurred. Further questioning results in the employee explaining that he was aware of the plan's age limit on dependents, but he thought it was okay to leave the child on the plan because no one had asked him to take the child off the plan.

As the cost of health coverage increases, employers are encountering more situations like those described in the blue field shown above. Some employers believe that these situations amount to criminal fraud. Other employers regard them as mere administrative nuisances. As the cost of health care coverage increases, however, more employers are taking these situations very seriously.

Anecdotal evidence suggests that as many as 25 percent of the dependents enrolled on an employer's health plan may be ineligible, so auditing for and removing ineligible dependents can have an immediate and beneficial cost impact. In addition, employers that are subject to ERISA are obligated to administer their plan according to its terms, including its eligibility provisions.

When an employer finds an ineligible dependent, several questions often arise.

- Can the plan terminate the dependent's coverage retroactively? Should it do so?
- Can the plan recover claims payments? Should it do so?
- Should the plan refund premiums?
- Is the plan required to offer COBRA to the dependent?
- Can the employer terminate the employee who enrolled or failed to remove the ineligible dependent?

- If the employee is terminated, is the plan required to offer COBRA to the employee?

Answers to these questions are not always clear and will vary depending on plan terms, the employer's past practices and other factors. The employer's answers to these questions can result in significant liability under COBRA, ERISA and other applicable compliance authorities, so employers have tended to tread lightly when addressing these issues. This is particularly true when a dependent's ineligibility is discovered long after the fact, or after the ineligible dependent has incurred significant expenses.

This *Alert* explains what documentation and procedures employers should put in place so that they can avoid these situations to the extent possible and, if they do arise, respond to them consistently in order to minimize exposure to liability resulting from that response.

Explain Eligibility Rules Clearly

For the plan to enforce eligibility rules, the rules must be explained clearly in the plan's SPD. Unfortunately, many SPDs generated by carriers and other vendors do not explain eligibility rules clearly. Because the employer is primarily responsible for determining which of its employees are eligible for coverage, the employer should take particular care in reviewing the eligibility provisions in its SPD and revising them to match the employer's actual practice.

Whether the employer does this for an insured plan or a self-insured plan with stop loss coverage, it is important to review the revised provision with the carrier to ensure that it will provide coverage for the individuals described. Employers should also include a statement that the SPD is the exclusive statement of plan eligibility and that statements by HR representatives and others will not be given effect and should not be relied upon in making decisions about coverage.

Make the Employee Responsible

The next step in addressing these situations is to set a clear plan policy, making each employee responsible for knowing the plan's dependent eligibility rules and ensuring that he or she does not enroll or retain ineligible dependents under the employer's plan. To do this, we suggest drafting an explanatory statement describing this rule and featuring it prominently in all plan communications, especially enrollment materials. When introducing this concept to employees, it may be helpful to point out that the employer is taking this action so that the plan remains as affordable as possible for employees and their eligible dependents.

State the Consequences

Employers can choose to address these situations in a number of different ways.

- Retroactive termination of the ineligible dependent's coverage, with no refund of premium.

- Denial of COBRA to dependents who were never eligible, and to dependents who were retained on the plan after becoming ineligible if their ineligibility is not reported to the plan on a timely basis.

- Requirement for the employee to repay any claims the plan paid during the period of ineligibility.

- Potential for termination of the employee's employment, with denial of COBRA for gross misconduct.

One key to minimizing the liability of whatever "consequences" the employer chooses to apply is to state (in writing) the result of enrolling or retaining ineligible dependents. To do this, we suggest adopting an explanatory statement describing the policy and its consequences and including it prominently in all plan communications — especially enrollment materials.

Follow Through

It is tempting when choosing consequences to overstate the sanctions that will be applied in hopes of discouraging employees from violating the rules. In order to minimize exposure to liability, however, employers should draft their materials to reflect only those consequences that it will actually apply when these situations arise. It is particularly important to apply these consequences consistently in similar situations and, if they are not applied, to document how the situation differed from other cases.

With a clearly stated eligibility provision and carefully worded communications contained in other plan materials, an employer who finds an ineligible dependent should be able to proceed as follows:

- Terminate the ineligible dependent's coverage back to the date of enrollment or the date the dependent became ineligible.

- If the dependent was ineligible when enrolled, and has not been eligible since, communicate ineligibility for COBRA when coverage terminates. If such an individual provides a notice of a divorce or dependent ineligibility, respond with a notice that COBRA coverage is unavailable.

- If the dependent was previously eligible, but the employee failed to remove the dependent when he or she became ineligible, do not offer COBRA unless the employee or the dependent child provides notice of the divorce or loss of qualification as a dependent child within 60 days after the later of the date of that event or the date coverage was lost because of it (e.g., if coverage would continue until the end of the month in which the divorce occurred). If an individual provides untimely notice of one of these events, respond with a notice that COBRA coverage is unavailable. Note that it will not be possible to refuse COBRA due to the lack of notice if the plan does not have reasonable notice procedures (as required by the Department of Labor's COBRA notice regulations), or has not disclosed those procedures in both the SPD and the initial ("general") notice of COBRA rights.

- Recover from the employee reimbursement for any claims paid on behalf of the ineligible dependent. If COBRA is available, explain that the employee can avoid the repayment obligation if the ineligible dependent elects and pays for COBRA coverage.

- Where it appears that the employee acted intentionally (as in the cases noted above), terminate the employee's employment for his or her attempt to defraud the plan and deny the employee COBRA coverage because of the employee's gross misconduct. Although COBRA does not define "gross misconduct" (and we typically recommend that employers err on the side of not asserting gross misconduct), theft, lying, and fraud represent the types of behavior that courts generally have characterized as gross misconduct. In addition, if an employer defines a particular activity as gross misconduct, in advance, and makes employees aware of that definition, a court is likely to agree with a decision to deny COBRA to an employee who engages in that activity.

If an employer chooses to terminate the employee in this way, some other steps also should be taken.

- The employer should treat the employee as terminated "for cause" for all purposes, including severance and unemployment compensation.

- The employer should report the employee's fraud to the police and the insurance carrier.

Some employers that have elected to adopt a stricter health plan eligibility policy have first offered an "amnesty" period, during which employees can drop their ineligible dependents from their coverage with no consequences. Such an employer might then follow that amnesty period with an audit of eligibility that involves asking employees to provide documentation showing that each of their enrolled dependents is eligible (marriage certificate, birth certificate, student transcript, etc.).

Conclusion

Employers should be relieved to recognize that, by taking a few reasonable and well communicated steps to tighten up plan administration and documentation, many potentially sticky situations (which often involve very sympathetic potential plaintiffs) can be successfully avoided.

U.S. Benefit Office Locations

Anchorage, AK (907) 562-2266	Atlanta, GA (404) 224-5000	Austin, TX (800) 861-9851	Baltimore, MD (410) 527-1200
Birmingham, AL (205) 871-3871	Boise, ID (208) 340-0645	Boston, MA (617) 437-6900	Cary, NC (919) 459-3000
Charlotte, NC (704) 376-9161	Chicago, IL (312) 621-4700	Cleveland, OH (216) 861-9100	Columbus, OH (614) 766-8900
Dallas, TX (972) 385-9800	Denver, CO (303) 218-4020	Detroit, MI (248) 735-7580	Eugene, OR (541) 687-2222
Farmington, CT (860) 284-6137	Florham Park, NJ (973) 410-1022	Ft. Worth, TX (817) 335-2115	Grand Rapids, MI (616) 954-7829
Greenville, SC (864) 232-9999	Houston, TX (713) 625-1023	Jacksonville, FL (904) 355-4600	Knoxville, TN (865) 588-8101
Las Vegas, NV (702) 562-4335	Long Island, NY (516) 941-0260	Los Angeles, CA (213) 607-6300	Louisville, KY (502) 499-1891
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