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Dealing With COBRA Premium Payment Shortfalls

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March 5, 2011 — One of the most recurring administrative challenges in dealing with COBRA premium payments is what to do when the amount paid by the qualified beneficiary does not match up with the amount owed.

Consider the following true story (which has happened more than once!):

A qualified beneficiary, who has always paid his COBRA premiums in full and on time, accidentally writes a check for $0.02 (two cents) less than the actual premium amount for a given month. Despite attempts by the COBRA administrator to notify the qualified beneficiary of the shortfall, the individual does not realize his error and does not pay the $0.02 until after the end of the applicable grace period. Therefore, in "strict compliance" with the law, the COBRA administrator cancels the qualified beneficiary's COBRA coverage. Because the qualified beneficiary's COBRA coverage was canceled, he is unable to receive lifesaving treatment for an illness.

Being two cents short and a day (or more) late happens all too often in COBRA administration and administrators need to understand their responsibilities when a premium check falls short.

General Rules

Under COBRA, qualified beneficiaries must pay their premiums in full and on time. If they don't, the plan administrator is within its rights, as a general rule, to terminate COBRA coverage. However, the COBRA regulations include a special rule that applies when a COBRA premium payment is short by an amount that is "not significant." An underpayment is deemed to be not significant if the shortfall is not greater than the lesser of:

- $50; or
- 10 percent of the COBRA premium required to be paid.

In such a case, the plan must choose between one of two options:

1. treat the payment (albeit less than the full amount) as if it were payment in full for COBRA coverage; or
2. notify the qualified beneficiary of the deficiency amount and grant him or her a reasonable period of additional time to pay the shortfall. The regulations provide that, as a safe harbor, a period of 30 days is deemed a reasonable period for this purpose.

Generally, plan administrators opt to provide a premium shortfall notice and give qualified beneficiaries a grace period of 30 days. It is unusual for a plan simply to accept the shortfall as payment in full; that tends to set a bad precedent and it is hard to make a determination as to what amount of a shortfall is sufficient for this purpose.

Separately, there is a COBRA rule that can come into play here. The general COBRA grace period is 30 days for each monthly COBRA premium payment. However, if the plan is insured and the insurer generally gives the employer more than 30 days to pay the premium for the plan coverage, then COBRA qualified beneficiaries get the same period to pay. Also, if employees or other non-COBRA qualified beneficiaries are given more than 30 days to pay, then so are qualified beneficiaries. The reason this rule is relevant in the case of an underpaid premium amount is that, if there is an underpayment, the qualified beneficiary would have a longer period within which to make the check good.

Consider ERISA Fiduciary Rules

In addition to the technical COBRA requirements, administrators need to consider the ERISA fiduciary rules where a group health plan is subject to ERISA. Under these rules, plan fiduciaries need to act in the best interest of participants and beneficiaries, including qualified beneficiaries. Therefore, if a plan fiduciary knows that a qualified beneficiary has elected COBRA coverage and needs the coverage (perhaps because the qualified beneficiary has paid the right amount and on time for months), it may be more appropriate to make sure that the qualified beneficiary understands the consequences of underpaid premiums. This is particularly important when a shortfall is more than insignificant. For example, there have been instances where a qualified beneficiary sent the electric bill payment (or payment for some other service) to the COBRA administrator and the COBRA payment to the electric company (or other vendor)! The good news is that the electric company won't shut off the lights due to an error like that; but the COBRA administrator will cut off the COBRA coverage due to nonpayment. Before it does that, however, the administrator should consider the possible ERISA implications and duties to inform a qualified beneficiary of the error, in addition to the normal COBRA rules.

Considering Normal Practices

With that as background, consider the normal practice of providing the shortfall notice with another 30 days to make up the shortfall. While the plan is waiting for the shortfall to be paid, the qualified beneficiary then might pay a regular COBRA premium that comes due within the 30-day shortfall period. Systems will typically apply the first dollars of a payment to the prior shortfall and then treat the new payment as being short and generating a new deficiency notice and 30-day period.

To see the confusion this can cause, consider this example (also based on a true story from several years ago):

A qualified beneficiary has always paid his COBRA premium (which was $164.09 per month) in full and on time. One month, she accidentally writes the check for $164.07 (two cents short). The plan sends her a deficiency notice showing she owes the plan two cents. She then sends another regular monthly COBRA premium check to the plan for $164.09. Although this is the correct amount for the COBRA premium, the plan takes the first $0.02 (two cents) and applies it to the prior month shortfall. That means that the current month's premium is short by two cents. Therefore, the plan sends another deficiency notice and provides another 30-day grace period for the insignificant underpayment. On and on it goes until the qualified beneficiary pays in full or pays too late.

Many qualified beneficiaries wonder why the plan administrator cannot just accept the shortfall and move on. They don't realize the challenge of COBRA administration and ensuring the benefits are administered on a uniform and compliant basis. For example, if the plan accepts a two-cent shortfall, how about a $2 shortfall? Or a $20 shortfall? How will the plan make these arbitrary distinctions? Although it might seem confusing for qualified beneficiaries who paid the shortfalls, the COBRA regulations are clear on what the rules are and administrators generally need to follow those rules.

So, what steps can an administrator take to ensure compliance? Admittedly, each employer and COBRA administrator has to consider appropriate actions, together with counsel, based on the specific facts at hand. Also, this is not a new issue, so many employers and administrators might already have procedures that just need to be reviewed. For example, a 1992 informal survey of 364 employers with plans covering from 10 to 250,000 participants indicated that the vast majority had procedures in place to deal with payments not received on time, bounced checks and incomplete payments. Most employers even then struggled with various procedures to manage these issues including: (1) instituting a fee for bounced checks; and (2) allowing individuals to make checks good but requiring a certified or cashier's check for the future. Although many did not provide special notice of nonpayment and only allowed reinstatement within the normal COBRA grace period, this aspect of COBRA administration has, no doubt, changed since issuance of IRS and DOL regulations in more recent years.

Key Steps to Remember

To help think through these issues and develop a compliant COBRA premium payment system, see the box below for a few steps that plan administrators may wish to consider.

Admittedly, some of these suggestions may seem to be more protective of qualified beneficiaries' rights than required by a literal application of the law. Nevertheless, they are worthy of consideration by administrators because of the cost and expense involved in lawsuits and benefit claims or challenges by qualified beneficiaries who feel their premium shortfall was handled incorrectly. It is a balance — on the one hand, providing COBRA coverage is expensive and if a plan administrator can permissibly terminate that coverage, it will want to do so. On the other hand, terminating a qualified beneficiary's COBRA coverage when the administrator knows the person wants the coverage (evidenced by the partial premium payment and, perhaps, a history of prior payment) could lead to the expense of benefit claims, lawsuits and adverse publicity. This is why plan administrators need to review their premium payment policies with counsel and determine the best overall approach for their specific situation.

Key Steps to Remember for COBRA Premium Payments

1. **Carefully review all COBRA notices, letters and premium payment coupons (if any).** Make sure they are as clear as possible regarding COBRA deadlines and premium amounts — emphasizing that COBRA coverage will terminate for any qualified beneficiary who fails to strictly adhere to the premium payment policies and that, once coverage is terminated, it cannot be reinstated. In addition, administrators that frequently experience partial payments may wish to modify their summary plan descriptions and plan documents to include similar language. That way, if the administrator cancels a qualified beneficiary's coverage in the case where the premium payment was "a day late and a dollar short," the documentation will support the administrator's action.
2. **Consider sending COBRA notices and letters regarding insufficient payments via certified mail or other similar means that can verify mailing and (perhaps) receipt.** Qualified beneficiaries may be less likely to throw away or ignore these communications. In some of the actual payment shortfall cases, the qualified beneficiaries claimed never to have received the shortfall notices and that they were more than willing to pay the shortfall amounts. By sending the notices with proof of mailing, the plan might be able to deflect this argument.
3. **In addition to mailing COBRA notices and letters regarding insufficient payments (whether via certified mail or otherwise), administrators might call or e-mail certain qualified beneficiaries who have made insufficient payments.** Again, qualified beneficiaries are less likely to ignore a phone call and also maybe be more likely to understand the urgency of the problem when it is explained in a phone call rather than given only in a written communication. This may not work for big plans; but it might be helpful for small plans or unique situations. If this is done, a clear record or communication log should be kept documenting that the call or e-mail was provided.
4. **Administrators may wish to provide qualified beneficiaries who have an established history of making COBRA premium payments in full and on time with some sort of one-time premium shortfall forgiveness opportunity.** For example, if a qualified beneficiary has regularly paid premiums in full and on time for several months, the plan might consider forgiving a*de minimis* underpayment. In that case, the plan should make it clear that no further shortfalls will be forgiven.
5. **Administrators should consider the ERISA fiduciary requirements for plans subject to ERISA.** Will there be procedures in place to elevate cases where special consideration is required (such as a clearly mistaken payment after months of paying the correct amount)?

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