PSA
A Hilb Group Company

Benefit Minute

Volume 6 | 2023

Agencies Propose New Rule for Fixed Indemnity Insurance

Overview

Hospital indemnity or other fixed indemnity insurance provides fixed, cash payments upon the occurrence of a health-related event. Payments under fixed indemnity insurance must be made as a fixed dollar amount per day or per other time period of hospitalization or illness (for example, $100 per day of hospitalization). Benefits are paid regardless of the amount of expenses an individual incurs. Fixed indemnity insurance has traditionally been used as a form of income replacement, and it is not a substitute for medical coverage.

Fixed indemnity coverage must meet the following criteria to be an excepted benefit (i.e. not subject to HIPAA, ACA and other federal requirements or consumer protections that apply to health insurance coverage):

- issued under a separate policy
- not coordinated with exclusions in other health benefits provided by the same employer
- pay benefits regardless of whether other coverage offered by the same employer pays for the same event
- pay a fixed dollar amount per day (or other time period) of hospitalization or illness, regardless of the amount of expenses incurred

Certain policies that are sold as fixed indemnity insurance pay a fixed dollar benefit when medical services are received. For example, a policy may pay $50 for each blood test or $100 per office visit. The benefit might also be structured as a fixed amount for each day a medical service is received (e.g. $100 per office visit per day). This type of fixed indemnity policy has characteristics of medical coverage, but the benefits are much more limited. In response to this, the Departments of

Treasury, Labor, and Health and Human Services have proposed a new regulation for fixed indemnity insurance.

Standard for Fixed Indemnity Policies

The proposed regulation would adopt a specific standard for payment of benefits under a fixed indemnity policy in order for it to remain an excepted benefit. It would require a fixed payment amount per day or other time period, regardless of:

- The actual of estimated expenses incurred
- The services or items received
- The severity of the illness or injury experienced by the covered person
- Any other characteristic particular to a course of treatment

A fixed indemnity payment would not be permitted on any other basis (such as per service, or per service per day). Even if a participant uses the fixed indemnity payment to pay medical expenses, the payment is not for medical expenses as long as the amount of the payment is not tied to the service and the individual is entitled to keep any benefit payment in excess of the incurred expense.

The proposed rule would also require fixed indemnity insurers to provide a consumer notice that states the coverage is not comprehensive health insurance and does not have to include most federal protections for health insurance.

If non-compliant coverage is offered once the rule is final, the coverage will not qualify as an excepted benefit, and a plan sponsor could be subject to excise tax penalties of $100 per day per affected individual for offering coverage that does not comply with ACA requirements.

Fixed Indemnity Insurance Paired with Minimum Essential Coverage

The proposed rule would also broaden the standard of what constitutes coordination with exclusions in other health coverage (as described above, non-coordination is one of the requirements for a fixed indemnity policy to be an excepted benefit). One impact would be to prohibit pairing an offer of fixed indemnity insurance with an offer of minimum essential coverage (MEC). MEC provides ACA-required preventive services and satisfies an applicable large employer's obligation to make an offer of coverage under the ACA, but does not meet the ACA's minimum value standard. Some employers offer fixed indemnity insurance alongside MEC because the fixed indemnity policy pays a benefit based on occurrence of a health-related event or receipt of a medical service not covered by the MEC plan.

However, the agencies have taken the position that the fixed indemnity policy is coordinated with exclusions under the MEC plan when both are offered and have stated this coordination will not be permitted if the proposed rule is finalized as is.

The proposed changes would take effect for new fixed indemnity policies issued after the effective date of the final regulation. For existing fixed indemnity policies, most changes would apply to plan years beginning on or after January 1, 2027; however, the notice requirement would apply to plan years beginning after the regulation is finalized.

Tax Treatment of Fixed Indemnity Benefits

Section 105(b) of the Internal Revenue Code excludes from gross income amounts received by an employee to reimburse expenses for medical care. The exclusion does not apply to amounts the employee would be entitled to receive without regard to whether expenses for medical care are incurred, or when the amount received exceeds the medical expense.

However, there continues to be confusion about how the exclusion from income applies when the benefits are not directly related to a medical expense incurred by an employee, for example, whether payments from a fixed indemnity or specified disease policy are excluded because they are paid upon the occurrence of a health-related event.

The proposed rule states that any benefit amounts paid under an employer-provided fixed indemnity plan, or any plan that pays amounts regardless of the amount of medical expenses actually incurred, are not payments for medical care and **are included in the employee's gross income when the premium is paid by the employer or by the employee on a pre-tax basis.** The proposed rule also appears to make the employer responsible for withholding income and payroll taxes. These requirements will apply as of the publication date of the final rule or January 1, 2024, whichever is later.

From an employer's perspective, the practical solution is to have employees pay for fixed indemnity and similar coverage on a post-tax basis (or impute income if employer-paid).

Other Items

The proposed rule also address possible changes to short-term limited duration health insurance policies by lessening the initial contract term from 12 months to 3 month, and lessening the maximum duration from 36 months to 4 months, among other changes. The agencies have also requested comments on specific disease insurance and level-funded health plans.