

MEMORANDUM OF LAW

DATE: July 2, 1993

TO: D. Cruz Gonzalez, Risk Management Director

FROM: City Attorney

SUBJECT: Dependent Health Coverage

Issue

You have requested a legal opinion regarding whether prepaid dependent health insurance premiums must be refunded when an employee retires and payment for dependent health insurance premiums are picked up by deductions from the former employees retirement benefits.

Analysis

Specifically, a City employee retired effective January 5, 1993. However, because health insurance premiums are prepaid, the employee's and his dependent's coverage were paid through the end of February. Nevertheless, the retirement system deducted health premiums for the employee and his dependent from his January 1993 benefit check. The employee had, therefore, paid double premiums for the month of February and is asking that Risk Management refund his prepaid premiums for the month of February.

The Flexible Benefits Plan summary indicates that health benefit coverage ceases at the end of the month in which an individual leaves City employment. Pursuant to the plan rules, the employee's City benefits ended on the last day of January. Voluntary termination of employment, including retirement, is a qualifying event for purposes of the Consolidated Omnibus Budget Reconciliation Act ("COBRA"). Under COBRA rules, the City must offer health care coverage to a former employee and his or her dependents for at least eighteen (18) months after a qualifying event. Certain events may extend COBRA coverage up to a maximum of thirty-six (36) months. In this case, COBRA regulations are not an issue because the employee opted to enter the retiree health care system. However, when an employee retires and opts to use COBRA benefits, the issue of double premium payments again arises because current City policy requires a former City employee to pay COBRA benefits immediately, even if he or she still has a prepaid premium and even though the COBRA coverage is with the same provider.

California Insurance Code section 481 addresses the issue of prepaid premiums and provides in pertinent part:

Section 481. Return of premium;
Cancellation or
rescission

(a) Unless the insurance contract otherwise provides, a person insured is entitled to a return of premium if the policy is canceled, rejected, surrendered, or rescinded, as follows:

(1) To the whole premium, if the insurer has not been exposed to any risk of loss.

(2) Where the insurance is made for a definite period of time and the insured surrenders his policy, to such proportion of the premium as corresponds with the unexpired time, after deducting from the whole premium any claim for loss or damage under the policy which has previously accrued. The provisions of Section 482 apply only to the expired time.

The language of the statute clearly indicates that an insured is entitled to a refund of unused premiums upon cancellation of an insurance policy. Exceptions to the refund of premiums are statutorily allowed for specific types of insurance, such as life insurance, where premiums are not designed to cover a predetermined period of time as are automobile and health insurance policies.

However, this section of the California Insurance Code conflicts with the Internal Revenue Service ("IRS") regulations which govern the City's cafeteria plan. IRS regulation section 1.125-1 question and answer 8 states:

Q-8: What requirements apply to participants' elections under a cafeteria plan?

A-8: A plan is not a cafeteria plan unless the plan requires that participants make elections among the benefits offered under the plan. A plan may provide that elections may be made at any time. However, benefit elections under a cafeteria

plan should be made in accordance with certain guidelines (see Q&A-15) in order for participants to qualify for the protections of the section 125 exception to the constructive receipt rules.

An election will not be deemed to have been made if, after a participant has elected and begun to receive a benefit under the plan, the participant is permitted to revoke the election, even if the revocation relates only to that portion of the benefit that has not yet been provided to the participant. For example, a plan that permits a participant to revoke his election of coverage under a dependent care assistance program or of coverage under an accident or health plan after the period of coverage has commenced will not be a cafeteria plan. However, a cafeteria plan may permit a participant to revoke a benefit election after the period of coverage has commenced and to make a new election with respect to the remainder of the period of coverage if both the revocation and new election are on account of and consistent with a change in family status (e.g., marriage, divorce, death of spouse or child, birth or adoption of child, and termination of employment of spouse). (Emphasis added.)

Conclusion

Pursuant to the regulation once an individual has made an election, that election may not be changed, absent a change in family status, until the next open enrollment period. To allow an individual a refund of a prepaid premium would essentially be a change in elections from dependent health care to a cash option. Failure on the part of the City to adhere to the provision precluding election changes could jeopardize the tax qualified status of the City's cafeteria plan. Refunds of unused premiums should, therefore, not be made.

JOHN W. WITT, City Attorney

By

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cc Val VanDeweghe

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