MLR REBATES

WHAT THEY ARE AND HOW THEY SHOULD BE HANDLED BY EMPLOYERS

Issue Date: October 5, 2021

BACKGROUND

Included in the Affordable Care Act (ACA) were new rules that required health insurance companies to disclose certain financial data. This includes the portion of medical plan premiums spent on paying claims and quality improvement initiatives and the portion that was spent on administration, marketing, and insurance company profit. These numbers make up the Medical Loss Ratio (MLR). There is an extensive formula to determine the MLR; however, an overly simplified way to think of and assist in understanding the MLR as a formula is below.

$$\frac{\text{(Dollar amount of premiums paid to the insurer that were used to pay for claims or quality improvement)}}{\text{(Total dollar amount of premiums paid to insurer)}} = \text{MLR \%}$$

For large group markets, MLR must be at least 85%; for small group markets, it must be at least 80%. If an insurer's MLR is below the requisite 80% or 85%, then the insurer must issue rebates to its customers – the customers being the actual policyholders including people with individual health insurance and employer sponsored plans.

Insurers must perform annual reporting to the U.S. Department of Health and Humans Services (HHS) by July 31 of their MLR and its calculation. Any resulting rebate must be paid to policyholders by the following September 30. Self-funded medical plans are not subject to MLR requirements.

WHAT CAN EMPLOYERS DO WITH REBATES RECEIVED FROM THE INSURER?

The answer to this question depends on what portion of the premium that the policyholder (generally the employer) covers for participants (employees).

If the employer pays for 100% of the premium, then any rebate belongs to the employer to do what they wish.

If participant contributions pay for any portion of the premium, then for any MLR rebate received by the policyholder, that same portion of the rebate is considered "plan assets," meaning that the funds belong to the plan as a whole and not the plan sponsor. ERISA restricts the use of plan assets to the exclusive benefit of plan participants.

HOW MUCH OF THE REBATE WOULD BE CONSIDERED PLAN ASSETS?

If participant contributions did pay for any portion of a plan's premium, the employer must then calculate how much of any MLR rebate should be considered plan assets (i.e., should be used strictly for the benefit of plan participants).

A current year's MLR rebate is based on premiums paid to the insurer for the previous year. Upon receipt of a MLR rebate, the employer should calculate the percentage of total plan premiums paid to the insurer during the previous year that can be attributed to participant contributions. This includes employee payroll deductions, COBRA premiums, premiums paid during FMLA-protected leave, and any other premium payment made by a participant. The resulting percentage is then applied to the rebate to determine the portion that must be treated as plan assets. Below is an example for determining how much of a MLR rebate should be considered plan assets:

- Total group health plan premiums paid to a carrier for a plan with 100 covered employees during 2019 = $1,000,000.
- Total employee payroll deductions during 2019 plus COBRA premium payments received by the employer = $250,000 (i.e. participants paid 25% of total plan premiums for the year).
- The employer receives a $15,000 rebate from the carrier in 2020.
- In this example, a total of $3,750 is considered plan assets (25% of the $15,000).

WHAT CAN EMPLOYERS DO WITH REBATES THAT ARE CONSIDERED PLAN ASSETS?

Employers should first look to their plan document to answer this question. Some plan documents include how to handle the portion of the MLR rebate that is determined to be a plan asset. However, the majority of plan documents will not contain such a provision, in which case the employer may do one of two things with the rebate: (1) improve plan benefits; or (2) return the appropriate amount to plan participants.

The first option of improving plan benefits can be difficult for a few reasons. Usually, the rebate amount is not substantial enough to make any benefit improvements. There is also no guarantee that there will rebates in subsequent years that would continue to pay for any improvement, meaning that the employer would have to cover the cost. Though regulations are not completely clear on how to handle a rebate used for benefit improvements, the Department of Labor (DOL) has given guidance that states any benefit improvement paid for by a MLR rebate should be specifically tied to the plan that received the rebate and should only be available to participants of that specific plan. Finally, ERISA contains certain requirements for plan assets to be stored in and handled through a trust. Once an employer receives a rebate, they have 90 calendar days in which to do something with the rebate before a trust will be necessary. It is very unlikely that any improvement of plan benefits would be achieved and paid for within 90 calendar days, therefore an employer using a rebate for improvement of plan benefits will likely have to create a trust.

The second and more popular option of returning an appropriate amount of the rebate directly to participants can be achieved by either a cash payment or a "premium holiday" that temporarily reduces the amount needed from participants to pay the premium.

COMPLIANCE ALERT

WHO SHOULD RECEIVE THE PARTICIPANT PORTION OF REBATES?

Decisions about how to allocate the participants' portion of the rebate are subject to ERISA's general standards of fiduciary conduct, which require that plan fiduciaries act prudently, solely in the interest of plan participants and their beneficiaries, in accordance with the provisions of the plan, and with impartiality to plan participants. When a plan provides multiple benefit options under separate policies, the participants' share of the rebate must be distributed to the participants and beneficiaries covered under the policy to which the rebate applies.

The most obvious decision the employer must make concerns what group of participants should receive the rebate. The most commonly chosen options are:

+ Returning the rebate to current participants covered by the plan in the year in which the rebate is received (current plan year participants, including COBRA participants), or;
+ Returning the rebate to current participants in the plan in the year in which the rebate is received, and to former participants from the year used to calculate the rebate.

"Former participants" refers to previous plan year participants, not COBRA participants or former employees.

DOL guidance points out that it will usually not be necessary to distribute rebates to former plan participants. DOL guidance states: *If [an employer] finds that the cost of distributing shares of a rebate to former participants approximates the amount of the proceeds, the fiduciary may properly decide to allocate the proceeds to current participants [only]...* In most cases, the amount of the rebate, on a per participant basis, will be so small that the administrative cost of distributing it to former participants will exceed the value of the rebate.

HOW SHOULD THE PARTICIPANT PORTION OF REBATES BE ALLOCATED AMONG PARTICIPANTS?

As plan sponsors develop an allocation method, many questions are sure to arise. Should participants who are not required to contribute to the plan (e.g. employer-provided, employee-only coverage) share in the rebate? Should participants with family coverage receive a larger rebate than participants with employee-only coverage?

Fortunately, the distribution allocation method is not required to exactly reflect the premium activity of individual plan participants. DOL guidance states, *In deciding on an allocation method, the plan fiduciary may properly weigh the costs to the plan and the ultimate plan benefit as well as the competing interests of participants or classes of participants provided such method is reasonable, fair and objective.* In many situations a reasonable and objective method of allocation may be as easy as dividing the rebate evenly over all current plan participants, even if those participants made different contributions to the plan or were not even participants in the previous year that the rebate is for.

WHEN SHOULD THE PARTICIPANT PORTION OF REBATES BE DISTRIBUTED?

As mentioned above, ERISA generally requires that insured plans hold their plan assets in a trust. For any portion of a MLR rebate that is considered plan assets, if it is not distributed to participants within 90 days of the employer's receipt of the rebate from the insurance company, then it will be necessary for the employer to set up a trust in which to hold the portion of the rebate considered plan assets. To avoid having to take those extra steps, employers should aim to distribute participant portions of the MLR rebate within 90 days of receipt.

WHAT WILL THE REBATE DISTRIBUTION LOOK LIKE ON THE PARTICIPANTS' TAXES?

The Internal Revenue Service (IRS) published a set of Frequently Asked Questions (FAQs) related to the tax treatment of various forms of MLR rebate distribution. According to the IRS guidance, if participant contributions were made on a pre-tax basis, the rebate portion that is returned to the participant as cash or a premium holiday must be treated as taxable income. On the other hand, for contributions made on an after-tax basis, the rebate will not be taxable as the rebate is essentially a return of amounts that have already been subject to taxation.

For the pre-tax participant contributions, if the rebate is distributed as cash, it will be taxable because of the participants' income increasing by the amount of the rebate. If the rebate is distributed as a reduction in current-year contributions, it will be "effectively" taxable; because the amount of the participants' pre-tax contribution toward current year benefits will decrease, their taxable income will increase by a like amount.

ARE THERE ANY NOTICE REQUIREMENTS?

Employers are not required send a specific notice regarding the MLR rebate to employees; however, the insurer is required to send notices of the MLR rebate to participants in the plan. The amount of the rebate is not included in the notice sent by insurers, but it will state that the rebate was sent to the employer and there may be a portion that is distributed to participants.

Though not required, it is a good idea for employers to communicate with participants about whether, and how, they may expect to receive their portion of the rebate. Employers may also want to point out that the rebate will usually be a relatively small amount on a per-participant basis. Employees may incorrectly assume that they will be receiving a significant rebate based on only the information included in the carrier notices.

DO THE MLR REBATE DISTRIBUTION REQUIREMENTS APPLY TO NON-ERISA PLANS?

HHS has issued similar rules that apply to non-federal governmental entities such as state and local governments and some Indian tribal governments that are not subject to ERISA. Specifically, these employers are required to us a portion of rebates that is attributable to the amount of premium paid by subscribers. They may generally do this by: 1) reducing future premiums, or 2) making a cash refund to participants covered under the policy to which the rebate is attributable at the time the rebate is received.

If an employer chooses to reduce future premiums, it may do so by:

+ Allocating the rebate among all participants covered under any option offered by the plan the time the rebate is received; or
+ Allocating the rebate among only participants covered under the policy to which the rebate is attributable.

If the employer chooses to provide a cash rebate, it may provide it to the subscribers enrolled in the plan option at the time the employer receives the rebate, or may choose to provide it to the subscribers who were enrolled in the plan option during the MLR reporting year that generated the rebate.

Regardless of what distribution method the employer chooses, it may divide the rebate evenly among participants, divide it based on actual contributions, or apportion it in a manner that reasonably reflects each participant's contributions.

Under these rules, non-federal governmental employers must use the rebates within 3 months of receipt.

With respect to Non-ERISA, non-governmental plans (e.g., some church plans), the rules provide that insurers may only make rebate payments to the policyholder if the insurer receives written assurance that rebates will be used in the same way that rebates issued to non-federal governmental plans may be used. In the absence of such written assurance, the insurer must issue rebates directly to plan participants.