Provided by National Insurance Services, Inc.

How Employers Should Handle MLR Rebates

The Affordable Care Act (ACA) established **medical loss ratio (MLR) rules** to help control health care coverage costs and ensure that enrollees receive value for their premium dollars. The MLR rules require health insurance issuers to spend **80-85 percent** of premium dollars on medical care and health care quality improvement, rather than administrative costs.

Issuers that do not meet these requirements must provide **rebates to consumers**. Rebates must be provided by September 30 following the end of the MLR reporting year. For the 2017 reporting year, issuers are required to pay rebates by **Sept. 30, 2018**.

Employers that expect to receive rebates should review the MLR rebate rules and decide how they will administer the rebates. For assistance

LINKS AND RESOURCES

- On Dec. 1, 2010, the Department of Health and Human Services (HHS) issued interim final regulations implementing the ACA's MLR requirements.
- The Department of Labor (DOL) issued Technical Release 2011-4 (TR 2011-4) to explain how ERISA's fiduciary duty and plan asset rules apply to MLR rebates.

HIGHLIGHTS

OVERVIEW

The ACA requires health insurers to spend a minimum percentage of their premium dollars, or MLR, on medical care and health care quality improvement. This percentage is:

- **85 percent** for issuers in the large group market; and
- **80 percent** for issuers in the small and individual group markets.

EFFECTIVE DATES

The MLR requirements became effective for issuers in 2011.

- Issuers must report their MLR data to HHS by July 31 following the end of an MLR reporting year.
- Rebates must be provided by September 30 following the end of the MLR reporting year.
- For the 2017 reporting year, issuers must pay rebates by **Sept. 30, 2018**.

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with rebates, please contact your National Insurance Services, Inc. representative.

MLR REBATES

An issuer that does not meet its MLR standard must provide a rebate to the policyholder, which is typically the employer that sponsors the plan in the group health plan context. For current enrollees, issuers may provide rebates in the form of:

- A lump-sum payment; or
- A premium credit (that is, a reduction in the amount of premium owed).

Also, to avoid having to pay a rebate, an issuer may institute a **"premium holiday"** during an MLR reporting year if it finds that its MLR is lower than the required percentage. According to HHS, an issuer may use a premium holiday only if it is permissible under state law. Also, any issuers using premium holidays must meet certain other requirements, such as providing the holiday in a nondiscriminatory manner and refunding premium overpayments.

How an employer should handle any MLR rebate it receives from an issuer depends on the type of group health plan (an ERISA plan, a non-federal governmental group health plan or a non-ERISA, non-governmental plan) and whether the rebate is considered a plan asset.

ERISA PLANS

Most, but not all, group health plans are governed by ERISA. Employers with ERISA plans should not assume that they can simply retain an MLR rebate.

> Any rebate amount that qualifies as a plan asset under ERISA must be used for the **exclusive benefit** of the plan's participants and beneficiaries.

Is the Rebate a Plan Asset?

According to TR 2011-4, in the absence of specific plan or policy language addressing these types of distributions, whether the rebate will constitute a plan asset depends, in part, on the **identity of the policyholder** and the **source of premium payments**.

If the plan or its trust is the policyholder, the policy is an asset of the plan and the entire rebate must be treated as a plan asset. If the employer is the policyholder—as is most often the case—the portion of the rebate that must be treated as a plan asset depends on who paid the insurance premiums. For example:

- If the premiums were paid entirely out of **trust assets**, the entire rebate amount is a plan asset;
- **If the employer paid 100 percent of the premiums**, the rebate is not a plan asset and the employer can retain the entire rebate amount;

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- If participants paid 100 percent of the premiums, the entire rebate amount is a plan asset; and
- **If the employer and participants each paid a fixed percentage of the premiums,** the percentage of the rebate equal to the percentage of the cost paid by participants is a plan asset.

Also, if the employer was required to pay a fixed amount and participants were responsible for paying any additional costs, the portion of the rebate that does not exceed the participants' total amount of contributions for the MLR reporting period would be a plan asset. If participants paid a fixed amount and the employer was responsible for paying any additional costs, the portion of the rebate that does not exceed the employer's total amount of contributions during the MLR reporting year would not be a plan asset.

In any case, under the DOL's guidance, employers are generally prohibited from retaining a rebate amount greater than the total amount of premiums and other plan expenses paid by the employer.

How Should the Rebate Be Used?

Once an employer determines that all or a portion of an MLR rebate is a plan asset, it must decide how to use the rebate for the exclusive benefit of the plan's participants and beneficiaries. DOL TR 2011-4 identifies the following methods for applying the rebates:

- The rebate can be **distributed to participants** under a reasonable, fair and objective allocation method. If the employer finds that the cost of distributing shares of a rebate to former participants approximates the amount of the proceeds, the fiduciary may decide to limit rebates to current participants. Also, an allocation does not fail to be impartial merely because it does not exactly reflect the premium activities of participants.
- If distributing payments to participants is not cost-effective because the amounts are small or would cause tax consequences for the participants, the employer may utilize the rebate for other permissible plan purposes, such as applying the rebate toward **future participant premium payments** or **benefit enhancements**.

If a plan provides benefits under multiple policies, the employer must be careful to allocate the rebate for a particular policy only to the participants who were covered by that policy. **According to the DOL, using a rebate generated by one plan to benefit another plan's participants would be a breach of fiduciary duty**.

Is There a Time Limit for Using Rebates?

To the extent a rebate qualifies as a plan asset, ERISA would generally require the amount to be held in trust. However, most group health plans receiving rebates do not maintain trusts because their premiums are paid from the employer's general assets (including employee payroll deductions). In TR 2011-4, the DOL provides relief from the trust requirement for premium rebates that are used within **three months** of their receipt.

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In addition, directing an issuer to apply the rebate toward future participant premium payments or toward benefit enhancements adopted by the plan sponsor would avoid the need for a trust and, in some circumstances, may be consistent with the employer's fiduciary duties. Employers that decide to take this approach should coordinate with their insurance issuers to establish the process for handling rebates.

NON-ERISA PLANS—NON-FEDERAL GOVERNMENTAL PLANS

Group health plans maintained by non-federal government employers (for example, state and local governments) are not governed by ERISA's fiduciary standards. HHS' interim final regulations on the MLR rules provide that employers must use the portion of the rebate attributable to the amount of premium paid by employees to:

- Reduce subscribers' portion of the annual premium for the subsequent policy year for all subscribers covered under any group health policy offered by the plan;
- Reduce subscribers' portion of the annual premium for the subsequent policy year for only those subscribers covered by the group health policy on which the rebate was based; or
- Provide a cash refund only to subscribers covered by the group health policy on which the rebate is based.

In all three cases, the rebate is used to reduce premiums or is paid to subscribers enrolled during the year in which the rebate is actually paid, rather than the MLR reporting year on which the rebate was calculated. Whichever method is selected, the policyholder may choose to:

- Divide the reduction or refund evenly among the subscribers;
- Divide it based on each subscriber's actual contributions to the premium; or
- Apportion it in a manner that reasonably reflects each subscriber's contributions to the premium.

HHS' final 2016 Notice of Benefit and Payment Parameters changed the MLR rules to require that participants of non-federal governmental or other group health plans not subject to ERISA receive the benefit of MLR rebates within **three months** of receipt of the rebate by their group policyholder, just as participants of group health plans subject to ERISA do.

NON-ERISA, NON-GOVERNMENTAL PLANS (CHURCH PLANS)

HHS also addressed rebates for non-governmental group health plans that are not subject to ERISA, such as church plans. Under HHS final regulations, an issuer may make a rebate payment to the policyholder (typically, the employer sponsoring the plan) if it receives the policyholder's written assurance that the rebate will be used for the benefit of current subscribers using one of the options described above for non-federal governmental plans. Without this written assurance, issuers must pay the rebate directly to employees covered under the policy during the MLR reporting year.

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Also, HHS proposed requiring that participants in non-ERISA plans receive the benefit of the MLR rebate within three months of when the rebate is received by the plan sponsor. If a church plan is covered by ERISA, the standard rules for ERISA plan assets will apply.

TAX TREATMENT OF REBATES

The IRS issued a set of frequently asked questions (FAQs) addressing the tax treatment of MLR rebates. In general, the rebates' tax consequences depend on whether employees paid their premiums on an after-tax or a pre-tax basis.

After-tax Premium Payments

If premiums were paid by employees on an after-tax basis, the rebate will generally not be taxable income to employees and will not be subject to employment taxes. This tax treatment applies if the rebate is paid in cash or if it is applied to reduce current year premiums. However, if an employee deducted the premium payments on his or her prior year taxes, the rebate is taxable to the extent the employee received a tax benefit from the deduction.

Pre-tax Premium Payments

If premiums were paid by employees on a pre-tax basis under a cafeteria plan, the rebate will generally be taxable income to employees in the current year and will be subject to employment taxes. This is the case whether the rebate is paid in cash or is applied to reduce current year premiums. A premium reduction in the current year will reduce the amount that an employee can contribute on a pre-tax basis. Thus, there is a corresponding increase in the employee's taxable salary that is also wages subject to employment taxes.

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