



HEALTH CARE REFORM – SPECIAL EDITION

MLR REBATES: What Sponsors of Insured ERISA Plans Need to Know

LEGISLATIVE BRIEF

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If you are the sponsor of an insured ERISA health plan, you might already have received a notice from your insurer that your plan will receive a Medical Loss Ratio (MLR) rebate before August 1. Plan sponsors who receive rebates must share with plan participants that portion of the rebate that constitutes “plan assets.” This Bulletin:

- Explains employers’ options,
- Summarizes the MLR and ERISA requirements and the tax consequences, and
- Answers the many questions plan sponsors have been asking

Background on the MLR Rebate Provisions of the Affordable Care Act

The MLR provisions of the Patient Protection and Affordable Care Act (PPACA) require insurers to pay rebates to policyholders if the insurers fail to meet specified MLRs. The MLR is the percentage of total premium revenue (not including taxes and fees) that is spent on medical claims and health care quality improvement activities (as opposed to administrative and marketing expenses and profits). The requirements are as follows:

- In the **large group market** insurers must spend at least 85% of premium revenue on medical claims and quality improvement activities. Large group is generally defined as employers with at least 100 employees, although in some states (such as California) large group is defined by state insurance law as 51 or more employees.
- In the **small group and individual markets** the MLR is 80%.

Calculation of Medical Loss Ratios

Each insurer calculates its MLR and rebates based on aggregate data for each type of contract (e.g., HMO, PPO, POS) that it files in each State, in each market segment (e.g., large group, small group, individual).

The rebates are not calculated separately for each employer group health plan’s experience. Even if your particular plan’s MLR was below the applicable required standard, you will not

receive a rebate unless the aggregate MLR for the insurance product you purchased in your market size in your state was below the required MLR.

Insurers who failed to meet the MLR standards for 2011 must pay rebates to policyholders by August 1, 2012.

Similar MLR rules apply to non-ERISA and non-federal government group health plans, and to individual health insurance policies, but this article focuses on insured group (or employer) ERISA plans.

Plans Subject To the Employee Retirement Income Security Act (ERISA)

A group health plan is subject to ERISA if it:

- Is established or maintained by a non-governmental, non-church U.S. employer or a union, and
- Provides medical benefits (including hospitalization, sickness, prescription drugs, vision, or dental) to employees and their families, and
- Pays benefits either directly by the employer, through insurance, reimbursement or other funding methods.

Who will receive the MLR Rebates?

For insured ERISA plans, insurers will send:

- Notices and the rebates to the group policyholder (plan sponsor), and also
- A notice to each of the employees who participated in the plan in 2011. (This includes terminated employees who no longer work for the plan sponsor.)

The notices will inform affected participants of the rebates, so plan administrators should be prepared to respond to questions and to proactively send their own notices to employees.

Even for products that *met or exceeded* the applicable MLR standards in 2011, insurers must send notices with *general* MLR information (but not the exact MLR percentage for that policy) to each policyholder and subscriber of a group health plan and to each subscriber in the individual market. (HHS final regulations, May 11, 2012).

This means even if your group health plan will not receive a MLR rebate, your plan participants will receive a MLR notice from the carrier, so you may get questions from confused participants.

What do ERISA Rules Require of Plan Sponsors?

Plan sponsors are responsible to properly allocate the rebates among plan participants.

ERISA plan sponsors that receive MLR rebate checks from their insurers must make four determinations:

- How much of the rebate must be paid to plan participants, and how much can the employer keep?
- Must or should the rebate be allocated to both prior year and current year participants?
- How may the rebate be used?
- When must the rebate be paid?

ERISA's prohibited transaction and exclusive benefit rules require that "plan assets" be used solely for the benefit of plan participants and beneficiaries. Thus, plan sponsors (ERISA fiduciaries) must first determine what part of any MLR rebate constitutes "plan assets." **Even if you receive a MLR rebate check from your insurer, do not assume you can use the entire**

amount for corporate purposes. Second, if any amount of the rebate is “plan assets” you must decide how to allocate that amount among current and/or former participants and how to use the money for the benefit of participants and beneficiaries (e.g., whether to pay rebates, reduce premiums or fund enhanced benefits). The Department of Labor issued Technical Release 2011-04 (December 2, 2011), which provides the following guidance on these issues:

How much of the rebate must be paid to plan participants, and how much can the employer keep?

If the *plan or trust is the policyholder* (which is not the case for most ERISA plan sponsors), the entire rebate is plan assets, unless there is specific plan or policy language to the contrary. Plan assets must be used only for the benefit of plan participants and beneficiaries or to pay reasonable administrative expenses. The plan sponsor can keep none of the rebate for itself if the plan or trust is the policyholder

If the *plan sponsor is the policyholder* (as is the case for most ERISA plan sponsors), it must first review plan or policy language to determine what portion of the rebate is plan assets. If the documents are silent or unclear, the determination will likely be based on what percentage of total premiums were paid by plan sponsors and participants in the past. For example, if the plan sponsor paid 60% of total premiums in 2011 and participants paid 40%, then 60% of the MLR rebate for 2011 would belong to the plan sponsor and 40% would be plan assets that must be used for plan participants.

Must or should the rebate be allocated to both prior-year and current-year participants?

Technical Rel. 2011-04 provides that ERISA’s general standards of fiduciary conduct apply and that the plan fiduciary may allocate the MLR rebate only to *current* participants—and not to former participants—if the fiduciary finds that the cost of distributing amounts to former participants approximates the amount of the proceeds. *Note:* The employer is *not required* to pay part of the rebate back to *former* employees. The plan sponsor can decide, subject to ERISA fiduciary rules, to pay the rebate to:

- Only current year participants, or
- Current employees who are current-year participants and were prior-year participants, or
- Current employees who are current-year participants, and to all individuals were prior-year employee participants (even if they are now former employees)

If the employer decides to allocate the rebate only among current participants, the allocation must be based on a reasonable, fair, and objective allocation method. The Technical Release allows plan sponsors to divide the rebate or refund in any of the following three ways (which were listed in HHS guidance that was issued the same day as Technical Rel. 2011-04), so long as they meet ERISA fiduciary standards:

- Evenly among subscribers – this will be the easiest and most straightforward to calculate; or
- Based on each subscriber’s actual contributions to premium; or
- In a manner that reasonably reflects each subscriber’s contributions to premium.

How may the rebate be used?

Employers may find that reducing premiums for plan participants in 2012 is the easiest way to administer the rebates. Since the intent of the MLR provision is to return money to those individuals who paid premiums in the prior year, one obvious way to apply the rebate is to provide cash amounts to participants (either current year and/or prior year participants). Under the DOL Technical Release, the plan fiduciary is given discretion in applying the rebate, subject to ERISA fiduciary obligations. Specifically, if cash rebate amounts to individuals are *de minimis* or would result in tax consequences to participants or the plan, the fiduciary may use the rebate for other permissible plan purposes including applying it toward future participant premium

payments or toward benefit enhancements. As explained below in the Tax Consequences section, the type of rebate the plan sponsor provides does not affect the tax consequences.

When must the rebate be paid?

Plan fiduciaries should apply MLR rebates that are plan assets within three months of the date the MLR check is received from the insurer. ERISA generally requires that “plan assets” must be held in trust; however, an exception applies if the assets consist of insurance policies or if an insurance company holds the assets. Thus, a fully insured plan does not need a trust. The portion of the MLR rebate that constitutes “plan assets” technically should be held in a trust; however, Technical Release 2011-04 provides that the trust requirement will not be enforced if the MLR rebate is applied within three months. (DOL has applied a similar long-standing non-enforcement policy to employee pre-tax contributions paid via a cafeteria plan, which is why such plans are not required to hold employee contributions in a trust.)

Other Considerations for ERISA Plan Sponsors

Multiple policies under one ERISA plan

If an employer offers multiple policies under one ERISA plan, the plan might receive MLR rebates for some policies and not for others, or may receive different MLR rebate amounts for different policies. Technical Release 2011-04 directs plan fiduciaries to provide the MLR rebate to participants covered by the policy to which the rebate relates *provided doing so would be prudent and solely in participant interests* (according to general ERISA fiduciary standards). This seems to allow fiduciaries to decide whether to allocate rebates separately to participants under different policies, or to aggregate all MLR rebate amounts and allocate them among participants in the same ERISA plan who are covered under *different* policies if it would be too costly or would be an administrative burden to allocate only to participants covered by the specific policy. However, a fiduciary cannot use rebates from one ERISA *plan* to benefit participants under another *plan*. (Each ERISA plan has a separate plan number and Form 5500 filing. An employer has two separate ERISA plans if it files its POS policy as plan 501 and its’ HMO as plan 502; however, an employer has only one ERISA plan if it files both its POS and HMO policies under one Form 5500 as plan 501.)

Is there a *de minimis* amount, under which rebates need not be paid to participants?

No, there is no *de minimis* amount for plan sponsors. HHS rules apply to determine whether or not an insurer must pay rebates, but these same rules do not apply to plan sponsors who receive a MLR rebate. The HHS rules that apply to insurers are:

- Group market: Insurer is not required to pay the rebate if the rebate amount is less than \$20 for the combined policyholder and subscriber portion of the rebate.
- Individual market or if insurer pays rebate directly to each subscriber in a group: Insurer is not required to pay the rebate if the rebate is less than \$5 per subscriber.

If the insurer pays a rebate to the policyholder, and all or part of the rebate is “plan assets,” the policyholder is required to return the appropriate amount to participants in one of the methods outlined earlier.

Federal Tax Consequences and Why That Might Affect How Sponsor Chooses to Allocate Rebates

On April 2, 2012, the government issued guidance on the federal tax consequences for participants in insured group health plans who receive an MLR rebate (in the form of either a premium reduction or cash rebate). The primary points in these FAQs are:

- If participants pay their share of the premium on a pre-tax basis, then any MLR rebate will be subject to income and employment taxes in the year the rebate is received.
- If participants paid their share of the prior-year premium on an after-tax basis, and rebates are paid only to employees who were participants in **both** the year on which the rebate is

calculated (2011) and the year in which it is issued (2012), the tax consequences vary depending on whether a particular participant did or did not deduct the premium payment on their Form 1040 for that year:

- The MLR rebate will not be subject to income or employment taxes in the year the rebate is received if the participant did not deduct the premium on his/her 2011 Form 1040.
- The MLR rebate will be subject to income and employment taxes in the year the rebate is received if the participant did deduct the premium payment on his/her 2011 Form 1040.
- However, if rebates are paid to all employees participating in the plan in the year in which the rebate is paid (2012) regardless of whether or not they also participated during the prior year, then any MLR rebate will not be subject to income or employment taxes, regardless of whether the employee deducted his/her 2011 premiums on the 2011 Form 1040.

Next Steps for Plan Sponsors of Insured ERISA Plans

Consider the options described above (e.g., allocating the rebate to current-year and prior-year participants or only to current-year participants).

Amend your written plan document and summary plan description to specify how the plan assets portion of the rebate will be determined (e.g., the percentage of any rebate that will be “plan assets” is the same percentage of total premiums that were paid by participants), the methods by which rebates may be provided (e.g., cash payments or premium reductions), and/or whether the plan assets portion can or will be applied toward plan administrative expenses paid by the employer.

Notify your plan participants as soon as you receive notice from your carrier as to whether or not your plan will receive a MLR rebate for 2011.

Implement the method you have selected (e.g., cash rebates, premium reductions or benefit enhancements) within 90 days after you receive the MLR rebate from the carrier.

Government Guidance on MLR Reporting and Rebates

Frequently Asked Questions on the Federal Tax Consequences of MLR Rebates

Links to model notices insurers must provide to policyholders

Medical Loss Ratio (MLR) Interim Final regulations on Rebate Requirements (20 pages):
<http://federalregister.gov/a/2011-31291>

MLR Final regulations (78 pages): <https://s3.amazonaws.com/public-inspection.federalregister.gov/2011-31289.pdf>

CMS, MLR Fact Sheet: <http://cciio.cms.gov/resources/factsheets/mlrfinalrule.html>

DOL Technical Release 2011-04 (on MLR rebates) (Guidance for Rebates on Group Health Plans Paid Pursuant to the Medical Loss Ratio Requirements of the Public Health Service Act) :
<http://www.dol.gov/ebsa/newsroom/tr11-04.html> ;

HCR law: section 2718(b) of the PHS Act

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