

MLR Rebates – 2015 Update: What Sponsors of Insured Plans Need to Know

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Quick Summary

If an insurer's Medical Loss Ratio (MLR) for 2014 does not meet the Affordable Care Act's (ACA) MLR requirements, the insurer must pay MLR rebates to policyholders by September 30, 2015. For group health plans where the policyholder is the employer (plan sponsor), the employer must determine how much (if any) of the MLR rebate is "plan assets" and must pay that amount to eligible plan participants or reduce future premium amounts as soon as practicable and within three months of the date the MLR rebate check is received from the insurer. The MLR provisions apply only to insured health plans; they do not apply to self-funded health plans or to insurance policies for "excepted" benefits such as stand-alone dental or vision coverage.

Background on the MLR Rebate Provisions of the Affordable Care Act

The Medical Loss Ratio (MLR) Rebate provisions of the Affordable Care Act (ACA) require health 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** the MLR must be at least 85%.
- In the **small group and individual markets** the MLR must be at least 80%.

PPACA defines a small employer for this provision as one who employed an average of 1-100 employees on business days during the prior calendar year and had at least two employees on the first day of the plan year, but states have the option until 2016 to define a small employer as one who employs up to 50 employees. Employees include full-time, part-time and seasonal employees.

Calculation of Medical Loss Ratios

Each health insurer calculates its MLR and rebates based on aggregate data it files in each State, for each market segment (e.g., large group, small group, individual). Beginning in 2015 (for the 2014 "reporting" year) insurers must file MLR reports with HHS by July 31, reporting data for the prior calendar year. The rebate amount is calculated based on the average MLR (ratio) over the prior three years.

Note: 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 particular insurance product you purchased in your market size in your state qualifies for an MLR rebate.

Date by which Insurers Must Pay Rebates

Beginning in 2015 (for the 2014 “reporting” year), the date by which insurers must pay rebates to policyholders will be September 30 following the reporting year. Before 2015, the deadline was August 1. If a group health plan receives an MLR rebate, the rebate will be paid to the plan sponsor (employer) who is the group policyholder, and the employer must pay the portion of the rebate that is “plan assets” (if any) to eligible plan participants or reduce future premium amounts within three months of the date the rebate check is received from the insurer. (For an ERISA plan, the plan sponsor also may use the rebate amount for benefit enhancements.)

Who will Receive the MLR Rebates?

For insured group health 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 2014 and who also is enrolled in the plan when the insurer provides the rebate notice
- The insurer also may elect to—but is not required to—notify former participants 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. In fact, some insurers are sending the rebate letters to participants before sending a letter to the plan sponsor, so plan sponsors may get questions from employees before the sponsor receives the notice or rebate check.

Some Rules Apply Differently to ERISA Plans versus Non-ERISA Plans

The general MLR rebate rule applies to both ERISA plans and non-ERISA plans (such as non-federal governmental plans or church plans), but some differences apply. In 2011, HHS issued separate interim regulations for ERISA plans and non-ERISA plans (<http://www.gpo.gov/fdsys/pkg/FR-2011-12-07/pdf/2011-31291.pdf>).

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. (Of course, the MLR rebates apply only to insured plans.)

Group health plan sponsors are responsible to properly allocate the rebates among plan participants within a specific amount of time and in a specific way. Plan sponsors that receive MLR rebate checks from their insurers must make four determinations:

1. How much of the rebate must be paid to plan participants, and how much may the employer keep?
2. Must or should the rebate be allocated to both prior year and current year participants?
3. How may the rebate be used?
4. 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 an 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 for ERISA plans. The HHS interim regulations noted above provide guidance for non-ERISA plans.

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

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 2014 and participants paid 40%, then 60% of the MLR rebate for 2014 would belong to the plan sponsor and 40% would be plan assets that must be used for plan participants.

If the plan documents specify that participants pay a set dollar amount (e.g., \$80 per month) and the balance of the premium is paid by the plan sponsor (employer), then the rebate belongs to the plan sponsor up to the total amount it contributed, and the balance is plan assets. If the plan document specifies that the plan sponsor pays a fixed dollar amount, and participants pay the balance, then the rebate belongs to the participants up to the amount they contributed.

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.

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

The rules are slightly different for ERISA plans than for non-ERISA plans such as non-federal governmental plans and church plans.

- For non-federal government plans, the employer must allocate any rebate amount only among current-year participants.
- For ERISA plans, current-year participants *must* receive at least part of the rebate amount that is plan assets. Thus, the three categories to whom the plan sponsor might allocate the MLR rebate are:
 - Only current year participants;
 - Current employees who are current-year participants and were prior-year participants; or
 - Current employees who are current-year participants, and to all individuals who were prior-year employee participants (even if they are now former employees).

ERISA's general fiduciary standards apply to the employer's decision-making process. DOL Tech. Rel. 2011-04 provides that the allocation does not have to exactly reflect the amount of premiums each participant paid, and "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." If the fiduciary finds that the cost of distributing MLR rebate amounts to former participants "approximates the amount of the proceeds, the fiduciary may properly decide to allocate the proceeds to current participants based upon a reasonable, fair and objective allocation method."

Thus, an employer can probably allocate rebate amounts only among current-year participants, unless the rebate amounts are significant, or there are relatively few prior-year participants and they are easily located, or there are other compelling factors. An example might be if currently only a handful of highly-compensated employees remain and are closing down the company, and the MLR rebate is mostly attributable to premiums paid last year by a lot of rank-and-file employees who have since been terminated. Keep in mind, however, that prior-year participants will be aware the employer received the rebate, because the insurer is required by law to send a notice to all employees who were enrolled in the group policy during the MLR reporting year (i.e., 2014) from which the rebate is derived.

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. HHS guidance (issued the same day as the DOL Technical Release) allows non-ERISA plan sponsors to divide the rebate or refund in any of the following three ways. ERISA plan sponsors also must 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.

3 How may the rebate be used?

Permissible uses of rebates varies depending on whether or not the plan is subject to ERISA:

- *Reducing premiums for plan participants in 2015.* This option is available for ERISA and non-ERISA plans and will often be the easiest way to administer the rebates.
 - This often may be a partial-month “premium holiday” for current participants, depending on the amount of the rebate.
- *Paying the rebate as cash amounts to current year participants.* This option is available for ERISA and non-ERISA plans, but will have tax consequences for participants if premiums originally were paid pre-tax.
- *Paying the rebate as cash amounts to current and prior-year participants.* This is only an option for ERISA plans, not for non-ERISA plans.
- *Paying for benefit enhancements.* This option is only available to ERISA plans.
 - The DOL Technical Release specifically provides that 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 (the “premium holiday” noted above) or toward benefit enhancements.

4 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 give fiduciaries the flexibility 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. For example, an employer has two separate ERISA plans if it files its PPO policy as plan 501 and its HMO as plan 502; however, an employer has only one ERISA plan if it files both its PPO and HMO policies under one Form 5500 as plan 501.)

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

No, there is no *de minimis* amount for plan sponsors and employers. HHS rules apply to determine whether or not an insurer/carrier must pay rebates, but these same rules do not apply to plan sponsors/employers who receive a MLR rebate.

If the insurer pays a rebate to the policyholder (employer), and all or part of the rebate is “plan assets,” the employer is required to return the appropriate amount to participants in one of the methods outlined earlier, no matter how small the amount is, even if the amount the employer must pay to each participant is less than the \$5 amount noted below for insurers.

The HHS rules that apply to insurers/carriers 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.

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 paid 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 (2014) and the year in which it is issued (2015), the tax consequences vary:
 - 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 taxes in the prior year.
 - 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 taxes in the prior year (this would normally apply to self-employed individuals, including partners of a partnership).

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).
- Document your decisions above, in case you are later audited by the Department of Labor. (We think there is a high likelihood that employers who receive MLR rebates will eventually be audited by the DOL.) Ask your Leavitt advisor for a 2015 MLR rebate documentation form to complete and keep in your files.
- If not already done last year, 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 in 2014 (for the 2013 reporting year).
- 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

- MLR Final regulations for health insurance issuers under the Public Health Service Act: <https://www.federalregister.gov/articles/2012/05/16/2012-11753/medical-loss-ratio-requirements-under-the-patient-protection-and-affordable-care-act> (5/16/12)
- The MLR implementing regulations : <http://www.cms.gov/cciiio/resources/regulations-and-guidance/index.html#Medical Loss Ratio>
- Frequently Asked Questions on the Federal Tax Consequences of MLR Rebates
- Model notices insurers must provide to policyholders: <https://www.cms.gov/cciiio/Resources/Forms-Reports-and-Other-Resources/index.html#Medical%20Loss%20Ratio>
- Medical Loss Ratio (MLR) Interim Final regulations on Rebate Requirements (20 pages): <http://federalregister.gov/a/2011-31291>. For non-federal governmental plans.
- CMS, MLR Fact Sheet: <http://cciiio.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
- HHS interim regulations for non-ERISA Plans: [76 Fed Reg. 76596](http://www.gpo.gov/fdsys/pkg/FR-2011-12-07/pdf/2011-31291.pdf) (Dec. 7, 2011). At <http://www.gpo.gov/fdsys/pkg/FR-2011-12-07/pdf/2011-31291.pdf>