MLR REBATES: A GUIDE FOR EMPLOYERS

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The ACA requires medical insurance companies ("insurer" or "insurers") to pay annual Medical Loss Ratio (MLR) rebates to policyholders by each September 30 if the insurer spent less than a specified minimum percentage of the premium on medical claims and certain healthcare quality improvement initiatives in the prior calendar year. The MLR provision is intended to limit the amount of money that insurers can allocate to administrative expenses and profits.

Employers that receive MLR rebates have compliance obligations regarding the use of the rebates, which may include time-sensitive requirements to distribute to eligible plan participants (potentially including former participants) any portion of the rebate that constitutes a plan asset. This publication provides an overview of the administration of MLR rebates for fully insured employer-sponsored group health plans that are subject to ERISA. It offers information regarding **Is the Rebate a Plan Asset?** (Appendix A) and includes a **Sample Employee Communication** for notifying employees about applicable rebates (Appendix B). It also includes a section on the administration of MLR rebates received by non-ERISA plans (see under Special Rules for Church and Non-Federal Governmental Plans).

MLR rebates do not apply to self-insured plans or to non-medical health plans such as stand-alone dental or vision plans, which are considered "excepted benefits" that are not subject to the ACA's rules. However, any premium credits or refunds issued by an insurer to an employer in connection with excepted benefits, or issued in connection with ACA-covered benefits in a manner that does not constitute a true MLR rebate, may nonetheless include amounts that may be considered ERISA plan assets. In such cases, an employer's receipt of such premium credits or refunds triggers the same fiduciary duties that apply to MLR rebates. For further information about the treatment of discretionary or non-MLR premium credits, see the NFP publication **Compliance Considerations on Insurance Carrier Refunds in the COVID-19 Environment**. For general information about ERISA, see the NFP publication **ERISA Compliance Considerations for Health and Welfare Benefit Plans**.

OVERVIEW OF MEDICAL LOSS RATIO REBATES

Effective for 2011, with the first rebates distributed in 2012 and then annually thereafter, insurers are required to issue MLR rebates if the percentage of premium revenue the insurer spent on patient care (claims) and quality of care improvements for its aggregated book of business in a state was less than 85% (for large group policies) or less than 80% (for small group and individual policies) in the prior calendar year. States may apply a higher MLR on insurers or define "small group" as less than 100 employees (versus the standard ACA 50-employee definition). The insurer's MLR calculation is based on the requirements of the state that regulates the insurance contract between the insurer and the employer purchasing the policy, regardless of where the employer or its plan participants are located.

Insurers report their respective large group and small group MLR factors to the US Department of Health and Human Services (HHS) and then calculate the MLR rebate

for each employer (as the policyholder) by applying the relevant factor to the premium paid by each insured group in the prior calendar year (the "reporting year"). Whether an MLR rebate is owed to a particular employer is not affected by the employer's unique experience or the particular claims of any of its participants. An employer that has an ERISA plan year other than a calendar year, and that changed plans or carriers during the reporting year (i.e., the previous calendar year), may receive MLR rebates on more than one plan or from more than one insurer.

Generally, MLR rebates will be issued by insurers by September 30 following the end of the MLR reporting year. Insurers that issue rebates must provide notice of such action to the employer as well as to plan participants who were enrolled in the plan during the reporting year. Insurers are not required to send any notice to policyholders who are not entitled to a rebate.

Depending on the employer and plan type, insurers will issue MLR rebates in the form of a premium credit or reduction (sometimes through a so-called "premium holiday"*), or a lump-sum premium refund (via cash or check). Employers must then determine the proper use of an MLR rebate, which often requires distribution of a pro rata share of the rebate to eligible plan participants within three months of the employer's receipt of the rebate from the insurer.

The following sections provide guidance on determining the use of an MLR rebate and the tax treatment of any amounts paid to eligible plan participants. Because of the multitude of legal and fiduciary liabilities that may arise with respect to MLR rebates, employers are encouraged to consult their tax advisor or legal counsel for advice on the use of MLR rebates and the tax consequences of distributions to plan participants.

EMPLOYERS' USE OF MLR REBATES

Generally, the proper use of an MLR rebate depends on the plan type and form of payment. This publication focuses primarily on employer-sponsored plans that are subject to ERISA. It assumes that the employer is the policyholder and that employer contributions toward employees' coverage are paid from the company's general assets (rather than from a trust). It further assumes that any participant contributions toward medical premiums, whether made on a pre-tax or post-tax basis, constitute plan assets and therefore must be used for the benefit of the plan participants. Lastly, it assumes that the ERISA plan document does not contain specific rules for the treatment of MLR rebates (as is typically the case). Where the plan document includes specific MLR rebate rules, it is understood that the employer will follow the controlling plan document, regardless of other options that are available under the DOL guidelines.

Employers that receive an MLR rebate should follow the following four-step process to determine the proper use of that rebate:

Step 1: Employers must determine the plan(s) to which the MLR rebate applies.

- MLR rebates generally apply only to a specific plan option (such as an HMO, PPO or an HDHP). The insurer's MLR rebate notice will specify the plan(s) to which it applies, and only the participants who contribute(d) to the cost of the named plan option(s) should benefit from the rebate. If a rebate relates to two or more separate plan options with different MLR rebate factors, then the rebate should be applied separately by the employer based on the separate plan-specific calculations of the insurer. Remember that using an MLR rebate generated by one plan for the benefit of another plan's participants or for the benefit of non-participants is likely a breach of fiduciary duty.

Step 2: Employers must determine the portion of the rebate that relates to employee contributions versus employer contributions toward the plan's premium.

- The portion of the MLR rebate that relates to employee contributions is generally considered an ERISA plan asset (see Appendix A). Generally, ERISA plan assets may only be used for the benefit of plan participants (and any related administrative expenses). So, for example, if plan participants contribute 30% of the premium, then 30% of the rebate must be used for the benefit of plan participants. Employers may keep the portion of the rebate that relates to employer contributions; the employer portion of the rebate is simply returned to the employer's general assets.

Step 3: Employers must determine the participants to whom they will distribute the rebate.

- The guidelines for determining which participants are eligible for a portion of an MLR rebate are set forth in DOL Technical Release 2011-04 (T.R. 2011-04), with reference to Technical Release 1992-01 (T.R. 1992-01). The DOL guidance gives employers some discretion when allocating the rebate among plan participants, provided employers follow ERISA's general

*With respect to a premium holiday, there are state law restrictions on the insurer that must be considered. According to Technical Guidance CCIIO 2012-002: "Questions and Answers Regarding the Medical Loss Ratio Regulation," premiums are established and collected in accordance with state law. In addition, the terms of the policy or contract, where required, are filed with the applicable state regulatory agency. Thus, whether a premium holiday is permissible is a matter of state law. If a state allows insurers to provide a premium holiday, and the insurer chooses to do so, the premium holiday must be provided to employers in a non-discriminatory and consistent manner. Employers may then pass the premium holiday on to their plan participants.

standards of fiduciary conduct. In determining whether to distribute the MLR rebate to all participants who contributed to the plan during the reporting year or only to current plan participants, and whether to weight the rebate ratably according to each participant's actual contribution amount or to distribute the rebate in equal dollar amounts to all eligible plan participants, employers can follow these general guidelines:

A. The allocation method must be reasonable, fair and objective (but does not have to reflect each participant's actual contribution cost). This means that employers can choose to rebate a flat dollar amount to each participant or a uniform percentage of each participant's actual contribution, so long as the method is reasonable, fair and objective.

B. If the administrative cost of distributing rebates to former participants approximates or exceeds the amount of the rebate, employers may limit rebates to current participants only. The DOL guidelines do not specify what constitutes an administrative cost. It is generally accepted that these costs include only "hard costs" (such as the cost of producing a check and the related postage and handling) and do not include the effort to track down former participants. Note that the opportunity to exclude participants from MLR rebate actions based on a cost/benefit analysis pertains only to former participants and does not also apply to current participants.

Step 4: Employers must determine the method for distributing the rebate to plan participants.

- MLR regulations provide four possible methods for distributing the rebate to plan participants:
  - Premium reductions for plan participants
  - Benefit enhancements to the plan (adding a benefit or service)
  - A refund back to plan participants, either through cash or check
  - A premium holiday (either by employers passing along the insurer's premium holiday or creating their own)
- If it is not cost effective to distribute refunds to participants (both current and former) because the refund amounts approximate the distribution costs or would result in a taxable event to the participants, employers may use the plan asset portion of the MLR rebate for other permissible plan purposes, such as making near-future premium reductions, premium holidays, or benefit enhancements to the plan. Note that any such benefit plan enhancements must be implemented in full within the three-month time limit for using MLR rebates.

  There doesn't appear to be any guidance on how to treat MLR rebates for deceased former participants – that is, whether the individual's estate would have any rights to the rebate. Given the lack of clear guidance, employers should consult with legal counsel as needed.
- Overall, employers should document the method they used for administering MLR rebates according to the four steps outlined above or per the controlling ERISA plan document, as applicable. They should maintain records of all per-participant premium reductions or refunds according to their record retention policy. In general, records related to ERISA plans should be retained for eight years.

SPECIAL RULES FOR CHURCH AND NON-FEDERAL GOVERNMENTAL PLANS

Generally, group health plans sponsored by a church or non-federal governmental plan are exempt from ERISA. Thus, the requirements associated with plan assets and fiduciary duties would not apply. However, the MLR regulations contain special rules for the treatment of rebates issued to church and non-federal governmental plans (and similar rules under state law or organizational policies may also apply).

In the case of a church plan, before distributing the rebate to the church policyholder, the insurer will request written confirmation from the church policyholder that the church will follow the four-step ERISA rules, as outlined above. If the insurer does not receive such assurance, the insurer will distribute the entire rebate amount directly to the previous year's participants rather than to the policyholder.

Regarding non-federal governmental plans, the portion of the rebate attributable to employee contributions must benefit current participants only (that is, it must exclude prior year participants who are no longer enrolled as of the distribution date). Such employers have two options for using the rebate:

- They can reduce employee premium contributions in the next plan year. (Unlike ERISA plans, governmental employers may choose to apply the MLR rebate to all then-available plan options or only to the respective plan option for which the rebate was received.)
- They can distribute the rebate amount as a cash refund to current participants.

The option of using the MLR rebate toward a benefit enhancement is not available to governmental employers.

TAX TREATMENT OF MLR REBATES

For both employers and employees, the tax consequences of receiving an MLR rebate depend on whether the employees paid premiums on a pre- or post-tax basis.

If employees paid their portion of the premium on a pre-tax basis, the MLR rebate (whether distributed as a reduction of premium cost or as cash) is subject to federal income tax and employment taxes in the year that the rebate is received. Consequently, employees who receive a rebate in either of these forms will have an increase in taxable earnings equal to the amount of the rebate.

If employees paid their portion of the premium on a post-tax basis, the MLR rebate (whether distributed as a reduction of premium cost or as cash) will generally not be subject to federal income tax. But rebates relating to premium payments deducted on the employee's federal income tax return are subject to federal income tax. In either case, because the MLR rebate is a return of amounts that have already been subject to federal employment taxes, the rebate will not be subject to employment taxes.

To the extent that COBRA participants (as current plan participants) may be eligible for MLR rebates, employers should take care to differentiate between COBRA premiums that were self-paid by the participant with after-tax dollars and COBRA premiums that may have been partially or fully subsidized by the employer for some or all of the reporting year. Likewise, employers that allow employees to enroll domestic partner parties (a domestic partner or the child(ren) of a domestic partner) as eligible dependents on the group medical plan should ensure that the tax treatment of any corresponding MLR rebate amount allocates the taxable and non-taxable portions of the rebate according to the underlying imputed income calculations. For information about imputing income for domestic partners, see the NFP publication **Domestic Partner Benefits: A Guide for Employers**.

TIME LIMIT FOR USING MLR REBATES

To the extent that an MLR rebate qualifies as a plan asset, ERISA generally requires the amount to be held in trust. However, as expressed in T.R. 2011-04 and T.R. 1992-01, the DOL provides relief from the trust requirement for premium rebates used within three months of their receipt. (The DOL also provides relief from the trust requirement to employers that direct an insurer to apply the MLR rebate amount toward future participant premium payments or toward benefit enhancements, provided the employer has not yet received the MLR rebate. This option is rarely exercised and would require close coordination with the insurer to establish the process for handling the rebate.)

SUMMARY

Employers should consult with insurers to determine what, if any, MLR rebate will be received by the employer. Employers should consider the above guidance, including reliance on the controlling ERISA plan document, as applicable, to determine the proper use of any MLR rebate received from an insurer. Employers should maintain a record that describes how the rebate payable to eligible plan participants was determined and to whom it was distributed. Finally, employers should engage outside counsel to assist in the process of determining the appropriate use of MLR rebates received from insurers.

To discuss your MLR rebate compliance obligations and other aspects of your employee benefits program, or for copies of NFP publications, contact your NFP benefits consultant. For further information regarding NFP's full range of consulting services, see **NFP.com**.

RESOURCES

MLR Final Regulations

DOL Technical Releases 2011-04 and 1992-01

IRS MLR FAQs

CCIIO Technical Guidance (CCIIO 2012-002)

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APPENDIX A

ERISA-Covered Plans: Is the Rebate a Plan Asset?

In considering the appropriate use of a rebate for an ERISA plan, the first step is to determine whether the rebate constitutes a plan asset. This determination is important since ERISA fiduciary requirements restrict the use of ERISA plan assets.

In T.R. 2011-04 and T.R. 1992-01, the DOL concludes that rebates paid pursuant to the MLR provisions may constitute ERISA plan assets if a plan has a beneficial interest in the distribution under ordinary notions of property rights. To determine property rights, it is helpful to determine which entity is the actual policyholder. If the plan or its trust is the policyholder, in the absence of specific plan or policy language to the contrary, the entire rebate would constitute plan assets, and the policyholder would be required to comply with ERISA's fiduciary provisions regarding the handling and use of any rebates it receives. This would be the case, for example, where the premiums are paid entirely out of trust assets. In contrast, if the employer is the policyholder (which is much more common), the determination of the portion of the rebate that constitutes plan assets, if any, may depend on language in the plan or policy, or on the manner in which the plan sponsor and plan participants have shared in the cost of the policy.

The general rule, as described in T.R. 2011-04 and T.R. 1992-01, is that if the plan documents and other extrinsic evidence do not resolve the allocation issue, the portion of a rebate that is attributable to participant contributions would be considered plan assets. For example, if the employer paid the entire cost of the insurance coverage out of the general assets of the company, then no part of the rebate would be attributable to participant contributions, and therefore no part of the rebate would constitute plan assets. Conversely, if participants paid the entire premium cost, then the entire amount of the rebate would be attributable to participant contributions and therefore would be considered plan assets.

There are other considerations if there are fixed percentage or dollar costs associated with employer and employee contributions. If the participants and the employer each paid a fixed percentage of the cost, the percentage of the rebate that equals the percentage of the cost paid by participants would be considered attributable to participant contributions, and would thus constitute plan assets. If the employer was required to pay a fixed dollar amount and participants were responsible for paying any additional costs, then the portion of the rebate that did not exceed the participants' total dollar amount of contributions during the reporting period would constitute a plan asset. Similarly, if participants were required to pay a fixed dollar amount and the employer was responsible for paying any additional costs, then the portion of the rebate that did not exceed the participants' total dollar amount of contributions during the reporting period would constitute a plan asset.

Plan Asset Rules

Factors	Is the Rebate a Plan Asset?
Policy issued to plan or trust; no specific plan or policy language	Yes, 100%
Specific plan or policy language addressing ownership or division of rebates or refunds	Yes, to the extent provided by the plan or policy language
Policy issued to employer; plan or policy language can fairly be read to give employer ownership in some or all of a refund or rebate	No, to the extent the plan or policy language gives employer ownership
Premiums paid entirely from plan assets; no specific plan or policy language	Yes, 100%
Policy issued to employer; no specific plan or policy language; and:	
• Premiums paid 100% by employer	No
• Premiums paid 100% by participants	Yes, 100%
• Premiums shared by employer and participants by fixed percentage (e.g., employer pays 60%, participant pays 40%)	Yes, for percentage paid by participants; percentage paid by employer is not a plan asset
• Employer pays fixed amount of premiums, participants pay balance (e.g., employer pays $5,000/year toward coverage; participant pays any balance)	Yes, up to total amount paid by participants; amount paid by employer is not a plan asset
• Participants pay fixed amount of premiums, employer pays balance (e.g., participant pays $5,000/year toward coverage; employer pays any balance)	Yes, up to total amount paid by participants; amount paid by employer is not a plan asset

APPENDIX B

Sample Employee Communication

Note to Employers: This sample communication is drafted as an All Employees memo to avoid the extra work of communicating exclusively with the subset of employees who may be eligible for an MLR rebate while the work of identifying those employees is underway. **Importantly, the Distribution Date in the third paragraph must be within three months of the date the insurer issued the MLR rebate.**

TO: All Employees

FROM: Human Resources Department

RE: Medical Loss Ratio Rebates for Calendar Year [YYYY]

We are writing regarding the correspondence you may have recently received from [Name of Medical Carrier] about Medical Loss Ratio (MLR) rebates. The carrier memo addresses rebates that may be owed to plan participants in connection with cost-share contributions to medical premiums for calendar year [YYYY].

If you participated in our group medical plan and contributed toward the premium for one or more months in the above-referenced calendar year, you may be entitled to a portion share of the MLR rebate that we received. The amount of your rebate may vary depending on your coverage tier and the number of months for which you were enrolled.

We will process MLR rebates to eligible plan participants by no later than the pay period ending [MM/DD/YYYY]. You may receive this as a cash refund or as a premium contribution.

NOTE: You do not need to take any action to receive this rebate.

If you have any questions, please contact [Name of Employer Contact] at [Contact telephone and/or email].