



Compliance Alert

How Employers Should Handle Medical Loss Ratio (MLR) Rebates

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Quick Facts:

- Health insurers must spend the majority of their premiums on medical care.
- Medical loss ratio (MLR) means the percentage of premium spent on medical care. The minimum federal MLR standards are 80% for small group policies or 85% in the large group market.
- Insurers, including HMOs, must rebate (refund) any excess premiums to the policyholder by August 1 of the following year.
- Employers that receive MLR rebates must handle the funds in accordance with federal regulations.

The Affordable Care Act (ACA) requires health insurers and HMOs to spend at least a certain percentage of the total premium they collect on medical care (i.e., claims, clinical services and quality-improvement activities). The minimum required percentage – called the medical loss ratio or MLR – is **80%** for small group insurers or **85%** for insurers in the large group market. States may adopt higher MLR standards, although the majority of states (including California) use the federal standards. The MLR rule does not apply to self-funded health plans or stop-loss insurance policies.

Insurers that fail to meet the MLR standard must rebate (refund) the excess premiums to their policyholders. Rebates are not case-specific and do not reflect any one employer's policy results; instead rebates are based on the insurer's total policies in a market segment for the calendar year. Insurers may provide rebates as cash refunds or as a credit on the employer's premium statement.

Employers that receive a rebate must handle the funds appropriately, based on whether its plan is an ERISA plan, a non-federal governmental group health plan, or a non-ERISA church plan.

ERISA plans

Group health plans sponsored by employers are ERISA plans (unless the employer is a governmental entity or certain churches). The Department of Labor (DOL) issued Technical Release 2011-4 to explain how ERISA's fiduciary duty and plan asset rules apply to MLR rebates. Any rebate amount that qualifies as a plan asset under ERISA must be used for the exclusive benefit of the plan's participants, including employees and COBRA beneficiaries.



Is the rebate a plan asset?

According to Technical Release 2011-4, in the absence of specific plan document or policy language addressing these types of distributions, whether the rebate is a plan asset depends on the identity of the policyholder and on 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. In this case:
 - If the premiums were paid entirely out of trust assets, the entire rebate amount is a plan asset;
 - If the employer paid 100% of the premiums, the rebate is not a plan asset and the employer can retain the entire rebate amount;
 - If participants paid 100% of the premiums, the entire rebate amount is a plan asset; and
 - If the premiums were paid partly by the employer and partly by the participants, the percentage of the rebate equal to the percentage of the cost paid by participants is 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. DOL Technical Release 2011-04 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 give rise to tax consequences to the participants, the employer may utilize the rebate for other permissible plan purposes, such as applying the rebate toward future participant premium payments or toward 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?

Fortunately, DOL Technical Release 2011-4 provides relief from the general trust requirement for MLR rebates. Amounts that are plan assets do not have to be held in a trust provided that the funds are used within three months of receipt.

In addition, directing an insurer to apply the rebate toward future participant premium payments or toward benefit enhancements adopted by the plan sponsor appear to avoid the need for a trust.

Employers that decide to take this approach should coordinate with their insurance carrier to establish the process for handling rebates.

Non-federal governmental plans

Group health plans maintained by non-federal government employers (e.g., state and local governments, public school districts) are not governed by ERISA's fiduciary standards. HHS interim final regulations on the MLR rules address how rebates for non-federal governmental plans should be handled.

Under the HHS regulations, employers must use the portion of the rebate attributable to the amount of premium paid by employees in one of the following ways:

- To reduce participants' portion of the annual premium for the subsequent policy year for all participants covered under any group health policy offered by the plan;
- To reduce participants' portion of the annual premium for the subsequent policy year for only those participants covered by the group health policy on which the rebate was based; or
- To provide a cash refund only to participants that were 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 participants 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 participants, divide it based on each participant's actual contributions or apportion it in a manner that reasonably reflects each participant's contributions to the premium.



Non-ERISA church plans

HHS also addressed rebates for church plans that have not opted to be covered under ERISA. In this case, the insurer 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 participants using one of the options described above for non-federal governmental plans. Without this written assurance, insurers must pay the rebate directly to employees covered under the policy during the MLR reporting year. If a church plan is covered by ERISA, however, the standard rules for ERISA plan assets apply.

Tax Treatment of Benefits

The Internal Revenue Service (IRS) issued a set of frequently asked questions (FAQs) addressing the tax treatment of MLR rebates. In general, a cash refund to an employee would create a taxable event (unless the worker had previously contributed the funds on an after-tax basis). For this reason, employers should avoid issuing cash refunds to participants except upon advice of legal counsel.

Additional Guidance

A copy of DOL Technical Release 2011-4 is available at: www.dol.gov/ebsa/pdf/tr11-04.pdf. A copy of HHS guidance for non-federal governmental employers is available at: www.gpo.gov/fdsys/pdg/fr-2011-12-07/pdf/2011-31291.pdf. A copy of the IRS FAQs is available at: [www.irs.gov/uac/medical-loss-ratio-\(mlr\)-faqs](http://www.irs.gov/uac/medical-loss-ratio-(mlr)-faqs).

Kristina Beale, Senior Compliance Consultant, EPIC Employee Benefits.

For further information on this or any other topics, please contact your EPIC benefits consulting team.

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