Medical Loss Ratio Rebate Checks

An Overview for Advising Employer Group Clients

A provision in the Patient Protection and Affordable Care Act known as the medical loss ratio (MLR) requirement mandates that health insurance carriers spend 85 percent of their premiums (large group) and 80 percent of their premiums (individual and small group) on direct medical care. Health insurers that do not meet this standard in any calendar year beginning on January 1, 2011, will be required to issue rebates to their policyholders. The first MLR rebates for 2011 have been calculated, and official word on how much they will be and who they will go to was released by the Department of Health and Human Services (HHS) on June 21, 2012. Affected health insurance carriers are required to distribute their rebates by August 1, 2012, along with an accompanying notice to impacted group and individual policyholders. Even if an insurer meets the MLR requirements, it must notify subscribers that no rebate will be issued. This notice must be included with the first plan document provided to enrollees on or after July 1, 2012.

MLR rebates will be issued to approximately 12.8 million people in individual and employer-sponsored plans nationwide. According to the official numbers from HHS, the average rebate will be $151 per family, or about $12.50 a month. Some people, particularly those in individual insurance plans, could receive up to several hundred dollars more, and many individuals, particularly those in employer-sponsored plans, will receive far less. While less than 10 percent of the country's private health insurance consumers will receive a rebate, group plan recipients will be relying on their health insurance agent, broker or consultant to help them understand if and how they must distribute rebate checks to employees.

The Basics
Group health insurance MLR rebates only affect fully insured major medical plans. Both grandfathered and non-grandfathered plans may be eligible for a rebate. Self-funded plans are not subject to MLR requirements, so employers who operated a fully or partially self-funded plan in 2011 or employees that were in a self-funded plan in 2011 will not get a rebate. Rebates also are not applicable to stand-alone vision or dental plans or any plans that would fall under the definition of HIPAA excepted benefits.

The MLR rebates currently being issued are based on the 2011 calendar year, even if the employer plan is not a calendar year plan. The MLR calculation is determined for each specific market (individual, small group and large group) and is based on the carrier’s entire book of business within the state. So even if a specific group’s MLR calculation exceeds the rebate threshold, the group will not necessarily receive a rebate. Carriers will send impacted group policyholders notification if they are due a rebate, and they are also required to send **current** plan participants a notice that their employer group plan was issued a rebate by August 1, 2012. Upon receipt of the funds, it is the group policyholder’s responsibility to distribute the rebate to plan beneficiaries as applicable. If the overall rebate is small—$20 or less for a group health plan—the insurer does not need to issue the rebate at all.

Employers only have to distribute rebates to current employees who participated in the affected plan during the prior calendar year. Employers do not have to track down prior employees and attempt to provide them with a rebate if they find that the cost of calculating and distributing shares of a rebate to the former participants approximates (or exceeds) the amount of their share of the rebate. If the employer decides not to provide a share of the rebate to past employees, the employer should aggregate the portion of the rebate that is attributable to former employees' contributions and use for the aggregated funds for the benefit of current employees in the group health plan.

Employers must divide and distribute any rebates received based on who paid the premiums. If the premiums were paid partly by the employer and partly by the employees, the rebate must be split according to the contribution formula. However, employers can distribute rebates in a variety of ways, including providing impacted employees with a direct payment, using the rebate funds for future premium reductions or providing benefit enhancements. Furthermore, the employer can decide that premium reductions or cash refunds may be evenly divided evenly among the employees who contributed their own funds toward the cost of premiums or divided based on a weighted average using the amount each individual employee specifically paid (i.e., single rate versus family rate).

Guidelines for Employers Who Receive a MLR Rebate

The first steps for an employer who receives a MLR rebate are to figure out who is the actual group policyholder and who paid the premiums in 2011. The employer should review their plan documents to determine the policyholder, which could be the group health plan, a trust, the employer directly or another entity. If the policyholder is the group health plan or an ERISA trust, then the ERISA plan rules described below must be followed with regard to the distribution of the rebate funds.

If the premiums were paid completely by one party, the rebate distribution is rather straightforward. If they were paid by an ERISA plan trust, then any rebate must be deposited in the trust and used in accordance with the trust agreement. If they were paid completely by the employer, the employer can retain 100 percent of the rebate and use the rebate funds for any purpose the employer wishes. If premiums were entirely paid by the employees, the employer must return 100 percent of rebate funds to participating employees. However, if the group plan premiums were paid partly by the employer and partly by the employees, the rebate distribution is slightly more complicated. The group policyholder oversees the distribution of the rebate, which must be done according to specified rules and generally must follow the contribution formula.

In ERISA plans, while the employer may do what it wishes with its portion of the MLR rebate check, the group policyholder must consider the portion of the rebate attributable to what the employees paid as "plan assets." Whatever portion of the rebate constitutes “plan assets” must be handled in accordance with ERISA’s general standards of fiduciary conduct.

According to the Department of Labor, plan assets must be distributed for the exclusive benefit of participants and beneficiaries in the following three ways:

- The rebate can be paid to the participants under a fair and equitable allocation method, such as a cash payment to the employees. What is “fair and equitable” is undefined, giving the employer the ability to decide if any premium reduction or cash refund should be divided evenly among the employees based on the actual total premium payment or divided based on a weighted average using the amount each individual employee paid (i.e., single rate versus family rate).

- The employer can apply the rebate toward future participant premium payments by reducing the impacted employee's salary reduction contributions for a specified period.
- The employer can use the rebate to provide enhanced benefits for the participants. Enhanced benefits are not defined, but it they are generally believed to mean an improvement to the group health plan's benefits or providing an enhanced health related benefit to beneficiaries.

When deciding how to pay employee rebates, the plan fiduciary should consider the overall cost to the plan and what may be in the overall plan's best interest. The DOL **suggests** that the second and third options should be used only if distributing payments to participants is not cost effective or would result in tax consequences for them. The plan administrator needs to weigh what is both most reasonable cost-wise for the plan, but also what is the fairest means of distribution for all plan participants and what is in the ultimate best interest for the plan.

If an employer gets rebates from multiple policies, or only gets a rebate from certain policies if employees have multiple plan choices, then the employer has to be extremely careful regarding rebate distribution. Rebates may only be distributed to the plan participants who were covered by the policy affected by the rebate during calendar year 2011. According to the DOL, using the rebate generated by one plan to benefit the participants of another plan is a fiduciary breach under ERISA.

Since the employee's share of any rebate is a plan asset, the employee's share should technically be held in trust. However, the DOL has stated that it will not enforce violations of ERISA's trust requirement as long as the rebate funds are either used to pay future premiums or the amount is refunded to participants within three months of receipt of the rebate. So to avoid the trust requirement, one thing a plan administrator can do is apply the rebate money toward future participant premium costs. Another way would be to use the rebate funds to enhance the benefits of the group plan, such as by adding a covered service or reducing cost-sharing for a covered service. If the employer elects to provide impacted employees with a direct rebate payment instead, the employer must be sure to distribute the rebate within three months to eliminate the need for a trust account.

HHS has established similar rules for plans that are not bound by ERISA, such as state and local government plans and "church plans." These plans must use the employee premium share of the rebate to benefit of the employees in one of the following ways:

- To reduce employees' premium payments for the subsequent policy year for all employees covered under any option offered under the group health plan at the time the rebate is received by the governmental entity;
- To reduce employees' premium payments for the subsequent policy year for those employees who are covered, at the time the rebate is received, under the group health plan option for which the insurer is providing a rebate;

- Or provide a cash refund to employees enrolled in the group health plan option, at the time the rebate is received, for which the insurer is providing a rebate.

Regarding non-ERISA and non-governmental plans, such as "church plans," the HHS guidance specifies that rebates may be released to the employer-plan directly only if the insurer obtains a written statement from the group policyholder that the rebate will be used for the benefit of current beneficiaries and distributed via one of the three options listed above. Otherwise, the rebate must be paid directly to the individual current participants in the group plan.

If the employer plan terminated coverage with the insurance company before a rebate due was paid, then the insurer must use reasonable efforts to locate the former group policyholder and provide them with the rebate. If the group policyholder is located and provided with a rebate, then the employer still has a fiduciary responsibility under ERISA with regard to handling rebates that it receives for the terminated plan using the plan documents as a guide. If the plan documents do not provide direction, the group policyholder may determine if it is cost-effective to distribute the plan's portion of the rebate to the relevant former participants in the plan.

Tax Treatment of MLR Rebates

The tax treatment of MLR rebates was addressed in a frequently asked questions document issued by the IRS in April 2012. For **individual market consumers** who purchased their coverage with after-tax dollars, a rebate is not taxable income. However, if an individual deducted the prior year's premium payments on their Form 1040 Schedule A, then their MLR rebate is subject to federal income tax.

With regard to employer-sponsored coverage, if the employee's share for the impacted premium year was paid for entirely with after-tax dollars, the rebate is not federal taxable income. However, if the employee paid their share using pre-tax dollars, such as through a Section 125 plan, it is taxable income. This is true whether the employee gets a future premium credit or a cash payment. For example, if the employee normally contributes $100 per pay period towards plan premiums via a salary reduction and the employer elects to reduce that contribution to $50 to accommodate a rebate, the employee's taxable salary would correspondingly rise and be taxed. If the employer decides to give impacted employees a cash payment, that payment is also subject to employment taxes.

Official Resources on the Distribution of MLR Rebates

- HHS Report on MLR rebates by market and state
- Guidance from the Department of Labor on the distribution of MLR rebates to employer-sponsored health plans
- Answers to frequently asked questions about the tax treatment of MLR rebates from the Internal Revenue Service
- The HHS interim final rule on the MLR which addresses rebate distribution for non-ERISA plans
- Guidance from HHS to insurers on the MLR rebate notices that must be sent to beneficiaries (includes link to template rebate notice)
- Guidance from HHS on MLR reporting and rebate requirements