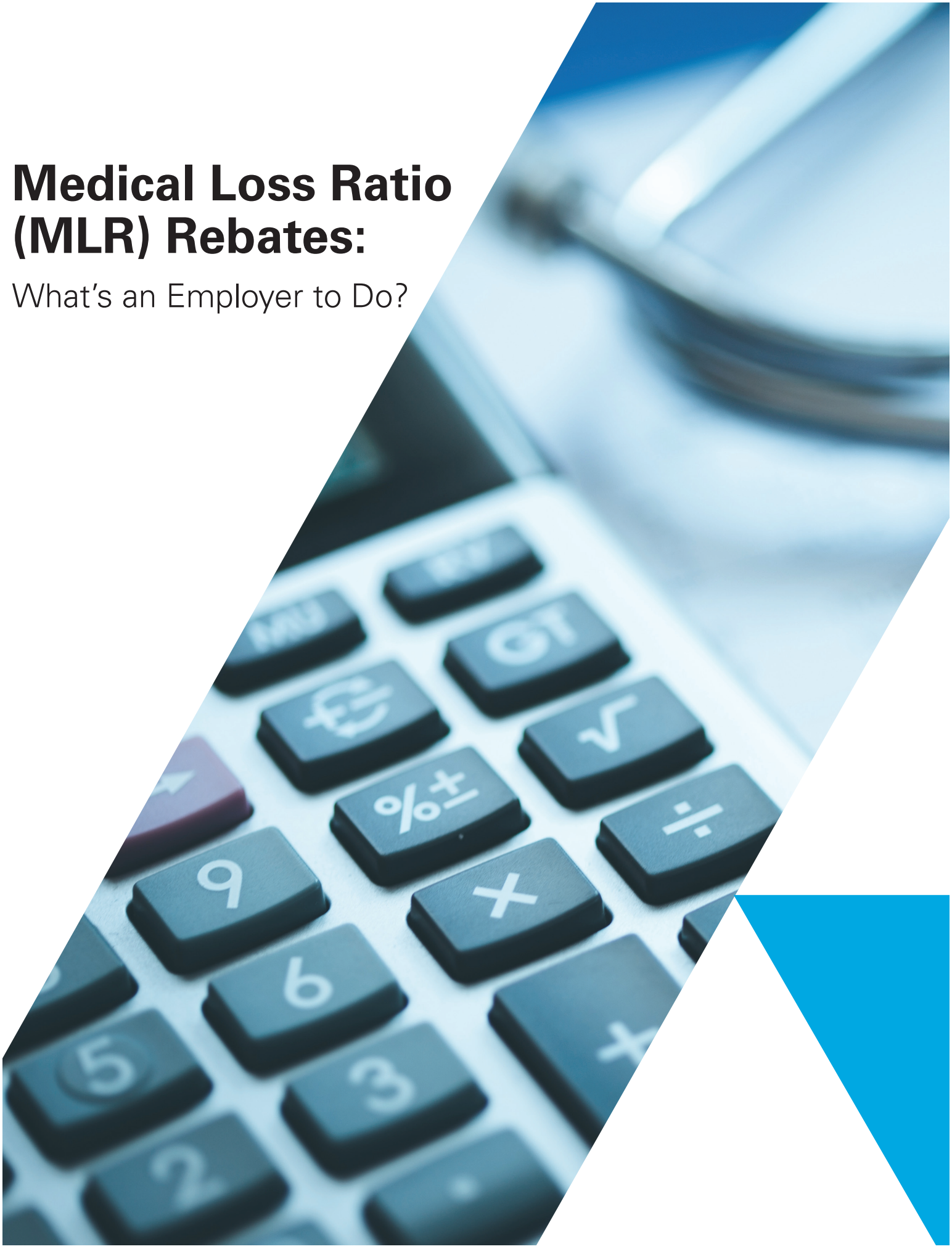
# Medical Loss Ratio (MLR) Rebates:

## What's an Employer to Do?



Under the Affordable Care Act (ACA) health insurers are required to spend a certain percentage of premium dollars on claims or activities that improve health care quality or provide a rebate in the form of a payment, premium credit or "premium holiday" (if a premium holiday is permissible under state law) to policyholders (e.g. the plan sponsor). The rules for what an employer may do with the MLR rebate it receives depends on whether the group health plan is an ERISA or non-ERISA plan, and if non-ERISA whether it's a non-federal governmental group health plan or a church plan.

# ERISA Group Health Plans

Virtually all private-sector employers who establish or maintain a welfare benefit plan, fund or program for their employees are subject to the Employee Retirement Income Security Act (ERISA), a federal law that sets minimum standards and requirements for employee benefit plans. A person who manages employee benefits or controls plan assets is called a fiduciary. ERISA imposes obligations on the conduct of fiduciaries including how plan assets must be handled by those administering or managing the plan (i.e. fiduciary responsibilities).

Helpful Tools:

MLR Calculator

Medical Loss Ratio (MLR) FAQs

**Background -** ERISA's Fundamental Fiduciary Rules

Anyone who exercises any discretionary authority or control over a plan; exercises any authority or control over a plan's assets; has any discretionary authority in administering a plan, is deemed to function as a fiduciary under ERISA, even if not named as a fiduciary in the plan's governing documents.

Fiduciaries have important responsibilities and are subject to standards of conduct because they act on behalf of group health plan participants and their beneficiaries. These responsibilities include:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them;
- Carrying out their duties prudently;
- Following the plan documents (unless inconsistent with ERISA);
- Holding plan assets (if the plan has any) in trust; and
- Paying only reasonable plan expenses.

## How Do These Responsibilities Affect the Operation of the Plan?

### Employee Contributions

If a plan provides for salary reductions from employees' paychecks for contribution to the plan or participants pay directly, such as the payment of COBRA premiums, then the employer must make plan insurance premium payments or deposit the contributions in a plan trust, in a timely manner.

The law requires that participant contributions (i.e. plan assets) be deposited in the plan as soon as it is reasonably possible to segregate them from the company's assets, but no later than 90 days from the date when the employer withholds or receives them. If employers can reasonably deposit the contributions sooner, they must do so. For plans with fewer than 100 participants, salary reduction contributions deposited with the plan no later than the 7th business day following withholding by the employer will be considered contributed in compliance with the law.

For participant contributions to cafeteria plans (also referred to as Internal Revenue Code Section 125 plans), the Department will not assert a violation solely because participant contributions were not held in trust.

Other contributory health plan arrangements may get the same relief if the participant contributions are used to pay insurance premiums within 90 days of receipt.

If an employer withholds employee salary reductions but does not use the funds in a timely manner or misuses the funds (e.g. paying rent) this may be considered a "prohibited transaction" (i.e. what not to do with the Plan's assets) and breach of fiduciary duty.

### Insurance Company Rebates or Refunds

Distributions from insurance companies to employers for their employee benefit plans, take a variety of forms, including refunds, dividends, demutualization payments, rebates, and excess surplus distributions. To the extent that these distributions are considered to be plan assets, they become subject to fiduciary responsibility and prohibited transaction provisions of ERISA.

ERISA does not expressly define plan assets, however, there are regulations describing what constitutes plan assets with respect to participant contributions. In general, the portion of a refund that is attributable to participant contributions would be considered plan assets. Thus, if the employer paid the entire cost of the insurance coverage, then no part of the refund with respect to this particular policy would be attributable to participant contributions. However, if participants paid the entire cost of the insurance coverage, then the entire amount of the refund would be attributable to participant contributions and considered to be plan assets.

If the participants and the employer each paid a fixed percentage of the cost, a percentage of the refund equal to the percentage of the cost paid by participants would be attributable to participant contributions. There are also rules on what may be done with plan assets to ensure they are used for the exclusive benefit of plan participants and beneficiaries.

Six ways to use plan assets to benefit ERISA group health plan participants:

1. Employer paid nutrition counseling
2. Employer sponsored wellness fair
3. Employer sponsored flu shots
4. Offsetting annual premium increases from the carrier
5. Providing refunds
6. Premium holiday

*Examples:*
*AL Machine Shop offers Chopper Insurance health plan to their full-time employees. The employees who elect coverage pay 100% the cost of coverage pretax via their S.125 plan. There are 100 employees enrolled in health coverage. Chopper Insurance returned $5,000 of premium to AL Machine Shop in the form of a MLR Rebate. The employees contributed 100% of the premium, so 100% of the rebate would need to be used for the benefit of the employees. AL Machine Shop could decide to reduce each enrolled employee's pretax contribution the next pay period by $50.**

*Note: if an employee's pre-tax premium contribution is reduced one month, then their paycheck will be slightly higher that month. For example, if Al Machine Shop employee's monthly contribution is $150 but due to the rebate, it's only $100 one month, the extra $50 remains in the employee's paycheck and is subject to taxes and withholding.

Peanut's Candy Store offers Salud Insurance health plan to their full-time employees. The employees who elect coverage contribute 50% of the premium on a post-tax basis. There are 15 employees enrolled in health coverage. Salud Insurance returned $750 of premium t o Peanut's Candy Store in the form of a MLR rebate. 50% of $750 or $375 would need to be used for the benefit of plan participants. Peanut's Candy Store could decide to provide a $25 refund to each employee via their next paycheck. The refund is a return of contributions originally withheld from the employee's paycheck on a post-tax basis, therefore the refund provided to employees generally will not be subject to income taxes.

Determining whether any part of the refund is a plan asset, is based on factors such as the terms of the plan document and whether employees paid any portion of the premiums. If any part of the refund is a plan asset, the employer must decide, consistent with ERISA's fiduciary rules, how to allocate the refund, such as distributing to participants, enhancing plan benefits or reducing future participant premiums. Guidance suggests this allocation must occur within in three months of receipt, or the plan assets must be held in a trust

## What does your plan document say?

A plan document may be drafted in a way that allows the employer to retain any assets, refunds, or credits as long as they do not exceed the employer's contributions for the plan year.

If the plan documents do not include the necessary language allowing the employer to retain the rebate, the DOL requires plan sponsors (employers) to use the plan asset portion of the rebate for the sole benefit of plan participants (employees, COBRA beneficiaries) based on the percentage of premium attributed to participant contributions.

### Allocating the Employee's Share of the Rebate

Employers with more than one policy, must also ensure they are properly applying the rebate to the applicable policy and only benefitting the participants on that particular plan. The DOL makes it clear, using plan assets to benefit another plan's participants may be a breach of fiduciary duty.

Although, employers must adhere to ERISA's general standards of fiduciary conduct, they do have some discretion when allocating the rebate and in general, any "reasonable, fair, and objective" method of allocation likely would be respected upon audit.

For instance, if the rebate amount to each participant would be de minimis or have tax consequences to the participants, the employer may apply the rebate toward future premium payments or benefit enhancements. An employer may also "weight" the rebate so employees who paid a larger share of the premium (e.g. family coverage) receives a larger share of the rebate.

There is also some flexibility regarding returning the rebate to participants no longer enrolled in the plan. Most commonly the employer will:

1. Return the rebate to participants covered on the plan when the rebate is received.
2. Return the rebate to participants covered during the period of time the MLR corresponds with (i.e. the prior year) who are also currently participating in the plan.

DOL guidance states: *If [an employer] finds that the cost of distributing shares of a rebate to former participants approximates the amount of the proceeds, the fiduciary may properly decide to allocate the proceeds to current participants [only]…*

Employers should review all relevant facts and circumstances when determining how the rebate will be distributed.

### Consequences of Failure to Fulfill Fiduciary Duties

- Personal liability to make plan whole–restore plan losses
- DOL & IRS may assess civil penalties
- Fiduciary may be removed and barred from being a fiduciary

*Note: Any person who is a decision maker regarding a Plan, is an ERISA fiduciary. ERISA has a "functional" definition – it is not dependent on job title or documents. Many fiduciaries fail to understand that they can be held personally liable for a breach of fiduciary duty, even when the breach is unintentional.*

## Possible ERISA & IRS Consequences of Improperly Using Carrier Refunds

There is no de minimis exception to ERISA's fiduciary rules for the use of plan assets. Nor is it permissible to use plan assets to pay for expenses that are for the benefit of the employer, (e.g. tax consulting fees). An employer, upon audit, may have to substantiate how they determined which portion of the carrier refund was a plan asset and how these assets were allocated. Or participants, upon learning about a refund, may inquire about the status and sue for breach of fiduciary duties.

**Tip:**

Participants of plans that receive an MLR rebate will receive a letter from the health insurance carrier stating that their employer is receiving a refund. Regardless of how an employer decides to utilize the refund, a best practice would be for an employer to send a communication to employees explaining how it will be used. This will prevent employees from expecting a check in the mail and being disappointed or upset if they do not receive a check.

# Non-ERISA Group Health Plans

- Non-Federal Governmental Plans (e.g. state and local governments): There is no legal framework set forth in Federal law governing the use of rebates received from an issuer under the MLR regulations. However, under Public Health Service (PHS) Act, CMS has direct authority over non-Federal governmental plan, and the interim final rule directs that issuers of such plans to distribute the entire rebate to the group policyholder and the group policyholder is required to use the portion of rebates attributable to the amount of premium paid by subscribers of non-Federal governmental plans for the benefit of subscribers, ensuring that enrollees in such plans receive the benefit of rebates.

The policyholder has the option to use the rebate in one of the following ways:

1. To reduce subscribers' portion of the annual premium for the subsequent policy year for all subscribers covered under any group health policy offered by the plan;
2. to reduce subscribers' portion of the annual premium for the subsequent policy year for only those subscribers covered by the group health policy on which the rebate was based; or
3. to provide a cash refund only to subscribers that were covered by the group health policy on which the rebate is based.

In all three options, the rebate is used to reduce premiums or is paid to subscribers enrolled during the year in which the rebate is actually paid, rather than the MLR reporting year on which the rebate was calculated. This results in administrative simplicity as it does not require tracking former enrollees or determining who was covered by which issuer the prior year.

- For example, if an employer receives a MLR rebate in the amount of $20,000, if the non-Federal governmental plan's subscribers paid 40 percent of the total premium, then the policyholder must use 40 percent of the rebate, or $8,000, for the benefit of the subscribers.

The regulations also require group policyholders of non-Federal governmental plans to use the subscribers' portion of the rebate for the subscribers' benefit within 3 months of receipt of the rebate

by the group policyholder. Plans are able to use the rebate to reduce the subscribers' portion of premium for the subsequent policy year (including by spreading it over the 12 months of the policy year) as long as the subsequent policy year commences within 3 months of receipt of the rebate by the group policyholder. If the subsequent policy year commences outside this 3-month window, the group policyholder of a non-Federal governmental plan must distribute the subscribers' portion of the rebate within 3 months in the form of a cash refund or by applying a mid-policy year premium credit to the subscriber's portion of the premium.

Non-Federal governmental group health plans that do not apply or distribute rebates within 3 months of receipt will be required to pay interest on the rebates.

- Church Plans: The final rule establishes separate standards for plans that are neither covered by ERISA nor are governmental plans (for example, church plans which are established or maintained by a church (or by a convention or association of churches) primarily for the benefit of employees of a Church (or their beneficiaries) that have not made an irrevocable election under IRC §410(d), by which the plan specifically subjects itself to the requirements of ERISA Title II.) Under HHS final regulations, an issuer may make a rebate payment to the policyholder (generally, the employer sponsoring the plan) if the issuer receives written assurance from the policyholder that the rebate will be used for the benefit of current subscribers using one of the options prescribed for non-Federal governmental plans (above) within three months of when the rebate is received. Without such written assurance, the issuer must directly pay the policyholder's subscribers covered by the policy during the MLR reporting year on which the rebate is based. Similarly, if the group health plan has been terminated, the issuers must distribute the entire rebate directly to the subscribers.

# Income Tax Considerations for All Group Health Plans

Employers should keep in mind, when refunding premiums to employees the tax consequences depending on whether the salary reductions were made on pre-tax basis through a Section 125 plan, or post-tax.

- **Employee Pre-Tax Payments –** if premiums were paid by employees through a Section 125 plan on a pretax basis, the rebate whether provided in cash or to reduce future premiums generally will be taxable to employees (i.e. increase the employee's taxable wages) and subject to employment taxes.
- **Employee After-Tax Premium Payments –** if premiums were paid by employees on a post-tax basis, the rebate whether provided in cash or to reduce future premiums generally will be not be subject to employment taxes, nor federal income tax (unless deducted on the employee's federal income tax return.

# Communication with Employees

In addition to providing the MLR rebate to the plan sponsor, carriers are required to provide a notice to the participant (e.g. Notice of Health Insurance Premium Rebate). Although the notice will not include the amount of the rebate, it does notify them that the rebate was sent to the employer and that a portion may be provided to participants.

If an employer has decided they will not be returning a portion of the refund directly to employees, they may want to consider proactively communicating with employees how they intend to use the plan asset portion of the refund for the employee's benefit. The employer may also want to share in the communication the per-participant amount the rebate equates to, so employees do not incorrectly believe they are entitled to a significant refund based on the carrier letter. This may help alleviate employee relations issues arising when employees learn about carriers providing MLR rebates to employers.

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