

MLR Rebates—Compliance Steps for ERISA Plan Sponsors

The Affordable Care Act (ACA) established **medical loss ratio (MLR) rules** to help control health care coverage costs and ensure that enrollees receive value for their premium dollars. The MLR rules require health insurance issuers to spend at least 80 or 85 percent of their premiums on health care and health care quality improvement activities. Issuers that do not meet these requirements must pay rebates to consumers.

As the sponsor of an insured group health plan, you may have received an MLR rebate from your issuer. This ACA Overview includes compliance steps based on the DOL's guidance to help plan sponsors decide what to do with their MLR rebate.

Employers that expect to receive rebates should review the MLR rebate rules and decide how they will administer the rebates. For assistance with rebates, please contact your Valent Group, LLC representative.

LINKS AND RESOURCES

- On Dec. 1, 2010, the Department of Health and Human Services (HHS) issued [interim final regulations](#) on the MLR requirements.
- The Department of Labor (DOL) issued [Technical Release 2011-4](#) (TR 2011-4) to provide general guidelines on how ERISA plan sponsors should handle MLR rebates. TR 2011-4 explains how ERISA's fiduciary duty and plan asset rules apply to MLR rebates.

Overview

The ACA requires health insurers to spend a minimum percentage of their premium dollars, or MLR, on medical care and health care quality improvement. This percentage is:

- **85 percent** for issuers in the large group market; and
- **80 percent** for issuers in the small and individual group markets.

Effective Dates

The MLR requirements became effective for issuers in 2011.

- Issuers must report their MLR data to HHS by July 31 following the end of an MLR reporting year.
- Rebates must be provided by September 30 following the end of the MLR reporting year.

Compliance Steps for ERISA Plan Sponsors

2

STEP ONE—WHICH PLAN OR POLICY IS COVERED BY THE REBATE?

For employers that have multiple health plans, or provide benefits under multiple policies, you must determine which plan or policy is covered by the rebate. The issuer should include policy information as part of the rebate. If the issuer has not provided this information, or it is not clear, please contact your Valent Group, LLC representative for assistance.

STEP TWO—IS THE REBATE A PLAN ASSET?

Next, you must determine whether the rebate, or any portion of the rebate, is a **plan asset** under ERISA. This step is crucial because any rebate amount that qualifies as a plan asset must be used for the **exclusive benefit** of the plan's participants and beneficiaries. You, as the employer, cannot retain any portion of the rebate that is a plan asset.

Any rebate amount that qualifies as a plan asset under ERISA must be used for the exclusive benefit of the plan's participants and beneficiaries.

You should review your plan documents to see if there is any language regarding how to treat distributions (such as demutualization proceeds, refunds, dividends or rebates) from health insurance issuers. If your plan does not contain this type of specific language, whether the rebate is a plan asset, in whole or part, will generally depend on the:

- Identity of the policyholder; and
- Source of premium payments.

Unless you pay the entire cost of health insurance without any employee contribution, at least a portion of the rebate will typically be a plan asset.

Who Is the Policyholder?

To answer this question, you must first review the plan's documents to determine **who is identified as the policyholder**. You should determine whether you are identified as the policyholder, or whether the policyholder is the plan itself or a trust.

- In most cases, the **employer is the policyholder** of the group health plan. If you are the policyholder, you will need to answer the next question regarding who pays the health insurance premiums.
- However, if the **plan or trust is the policyholder**, then the entire rebate is likely a plan asset. You, as the employer, generally will not be able to retain any portion of the rebate. If this is the case, you can skip the next question and proceed to Step Three.

Who Pays the Premiums?

If you are the policyholder and the plan's documents do not clearly address how to handle distributions from the issuer, the portion of the rebate that must be treated as a plan asset depends on **who paid the insurance premiums** for the MLR reporting year. For example:

- If the premiums were paid entirely out of **trust assets**, the entire rebate amount is a plan asset.

Compliance Steps for ERISA Plan Sponsors

3

- If the **employer paid 100 percent of the premiums**, the rebate is not a plan asset and the employer may retain it.
- If **participants paid 100 percent of the premiums**, the entire rebate amount is a plan asset.
- If the **employer and participants each paid a fixed percentage of the cost**, the percentage of the rebate equal to the percentage of the cost paid by participants is a plan asset.

For example, if an employer paid 60 percent of the premiums and employees paid 40 percent during the MLR reporting year, the employer may retain 60 percent of the rebate. The remaining 40 percent of the rebate is a plan asset that must be used for the exclusive benefit of the plan's participants and beneficiaries.

Also, if the employer was required to pay a fixed amount and participants were responsible for paying any additional costs, the portion of the rebate that does not exceed the participants' total amount of contributions for the MLR reporting period would be a plan asset. If participants paid a fixed amount and the employer was responsible for paying any additional costs, the portion of the rebate that does not exceed the employer's total amount of contributions during the MLR reporting year would not be 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.

STEP THREE—HOW SHOULD THE REBATE BE USED?

Any portion of a rebate that is a plan asset must be used for the exclusive benefit of the plan's participants and beneficiaries. Plan sponsors have a few different options for applying the plan asset portion of a rebate. The following questions and answers address these options.

Can I Distribute the Rebate to Participants?

Yes, the rebate can be distributed to participants under a reasonable, fair and objective allocation method. An allocation does not fail to be impartial merely because it does not exactly reflect the premium activities of participants.

Will I Need to Distribute the Rebate to Former Participants?

If you find that the cost of distributing shares of a rebate to former participants approximates the amount of the proceeds, you may decide to limit rebates to current participants. Former participants are those who participated in the plan for the MLR reporting year, but are not participating in the plan when you receive the rebate.

What Are the Tax Consequences of Rebate Distributions?

The rebate's tax consequences largely depend on whether employees paid their premiums on a pre-tax or after-tax basis.

- If premiums were paid by employees on a **pre-tax basis** under a cafeteria plan, the rebate will generally be taxable income to employees in the current year and will be subject to employment taxes.

Compliance Steps for ERISA Plan Sponsors

4

- If premiums were paid by employees on an **after-tax basis**, the rebate will generally not be taxable income to employees and will not be subject to employment taxes. However, if an employee deducted the premium payments on his or her prior year taxes, the rebate is taxable to the extent the employee received a tax benefit from the deduction.

How Much Time Do I Have To Distribute the Rebate?

To the extent a rebate qualifies as a plan asset, ERISA would generally require the amount to be held in trust. Most employers with insured plans do not maintain trusts for their health plans. The DOL has provided relief from the trust requirement for rebates that are used within **three months** of their receipt. Thus, employers who decide to distribute the rebate to participants should adhere to this three-month time limit.

What Are the Other Options for Using the Rebate?

If distributing payments to participants is not cost-effective (for example, the amounts are small or would give rise to tax consequences for the participants) you may utilize the rebate for other permissible plan purposes, such as applying the rebate toward **future participant premium payments** or toward **benefit enhancements**.

Directing an issuer to apply the rebate toward future participant premium payments or toward benefit enhancements would avoid the need for a trust and may, in some circumstances, be consistent with ERISA's fiduciary responsibilities. Also, employers may find the premium reduction (or premium holiday) approach to be administratively easier than sending out checks and calculating the additional taxes.

When employee premiums are paid on a pre-tax basis, a premium holiday will reduce the amount that the employee can contribute to the cafeteria plan on a pre-tax basis. There will be a corresponding increase in the employee's taxable salary and wages subject to employment taxes.

How Do I Allocate the Rebate If I Have Multiple Plans or Policies?

When you receive a rebate, you must determine which plan or policy is covered by the rebate. The issuer providing the rebate should give this information to you.

- Where a plan provides benefits under multiple policies, the employer should allocate or apply the plan's portion of the rebate for the benefit of participants who are covered by the policy to which the rebate relates, provided this would be prudent and solely in the interests of the plan.
- Using a rebate generated by one plan to benefit the participants of another plan would be a breach of ERISA's duty of loyalty to a plan's participants.

What Information Must Be Provided to Participants About the Rebate?

Under the MLR rules, issuers are required to provide participants with a notice describing the MLR rebates. This notice explains why a rebate is required under the MLR rules, and it provides that the employer may be obligated under ERISA to use all or a portion of the rebate for the benefit of plan participants. You should also consider explaining to participants how you are using the plan asset portion of the rebate for their benefit.