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What To Do With Your Medical Loss Ratio Rebate

Plan sponsors of self-funded medical plans: This UPDATE does not apply to you.

Once again, plan sponsors of fully insured group health plans may receive a Medical Loss Ratio ("MLR") rebate if the group health plan insurance carrier fails to meet specified MLR requirements for the 2018 calendar year as required under the Affordable Care Act ("ACA"). In general, group health plans subject to ERISA will need to ensure that plan participants benefit from the rebate in accordance with Department of Labor ("DOL") fiduciary standards. In addition, the Internal Revenue Service ("IRS") has provided information concerning how potential rebates, either in the form of cash or premium reduction, will be taxed. Plan sponsors who receive a rebate should carefully review the guidance issued by the DOL (Technical Release 2011-04) and IRS (MLR FAQs), both of which have remained unchanged since the inception of the MLR requirements, as well as review options with qualified tax and/or legal advisors.

Medical Loss Ratio

Beginning January 2011, insurance carriers must spend a certain percentage of premiums collected each calendar year on medical services (such as claim payments) and activities that improve health care quality as follows:

- 80% in the individual and small group markets, and
- 85% in the large group market.

Carriers must report the annual aggregate MLR results by state for the policies it issues, separately in the large group, small group, and individual markets. Carriers that fail to meet these targets must issue a rebate to plan sponsors by September 30 of the following calendar year. Insurance carriers must also issue notices to plan sponsors and individual participants to explain the MLR and the rebate being provided. If the plan is subject to ERISA, the notice to plan sponsors and participants should contain an explanation that the employer may have obligations under ERISA's fiduciary responsibility provisions with respect to the handling and allocation of the rebate.

Employer Responsibilities

In general, employer-sponsored plans may need to treat the portion of the rebate attributable to employee contributions as plan assets subject to ERISA fiduciary provisions, unless plan documents state otherwise, the employer paid the full cost of coverage, or the plan is not subject to ERISA. The plan sponsor needs to ensure that the rebate is used to benefit covered employees such as reducing employee contributions, providing benefit enhancements, or paying individual rebates.[1] Plan sponsors who pay premiums out of general assets (and do not utilize a trust arrangement) would need to "distribute" the rebate to participants *within three months* of receipt, in order to avoid the DOL "trust requirements".

IRS FAQs (last updated April 2, 2012) offer guidance and describe the tax implications for handling rebates:

- A rebate issued to the group policyholder (plan sponsor) as a premium reduction will generally not be considered taxable income to the plan sponsor as the rebate is merely offsetting the amount of premium due in the current period.
- Determine the portion of the rebate attributable to employee contributions, generally based on the overall employee contribution schedule.
- Determine the employee population who will benefit from the rebate. The rules allow flexibility in this regard as employers may either identify those employees who participated in the plan for both the coverage and rebate year (i.e. 2018 and 2019) or, consider employees who participate in the plan during the year the rebate is issued (i.e.2019) regardless of whether they participated in the plan during the coverage year (i.e. 2018). This alternative may be more administratively viable as opposed to reviewing prior and current year enrollment.

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- In general, individual cash rebates or premium holidays issued to employees who participate in the plan and pay for group health coverage ***on a pre-tax basis*** will be considered taxable income to the employee and subject to federal employment taxes in the year received.
- Cash rebates or premium holidays issued to employees who participate in the plan and pay for group health coverage ***on a post-tax basis*** will NOT be considered taxable income to the employee and will NOT be subject to federal employment taxes in the year received.

Next Steps

- Plan sponsors should weigh the costs and administrative issues associated with issuing individual rebates either as cash or as a reduction in future required contributions.
- Employers should pay close attention to those employees who cover a domestic partner (or other non-federally recognized tax dependent) and pay for coverage on both a pre-tax and post-tax basis.
- Sponsors of church and non-federal government plans are basically subject to similar requirements, even though not subject to ERISA.
- All plan sponsors receiving a rebate should carefully review options with qualified tax and/or legal advisors.

[1] *From Technical Release 2011-04: Decisions on how to apply or expend the plan's portion of a rebate are subject to ERISA's general standards of fiduciary conduct. Under section 404(a)(1) of ERISA, the responsible plan fiduciaries must act prudently, solely in the interest of the plan participants and beneficiaries, and in accordance with the terms of the plan to the extent consistent with the provisions of ERISA. With respect to these duties, the Department notes that a fiduciary also has a duty of impartiality to the plan's participants... An allocation does not fail to be impartial or "solely in the interest of participants," for purposes of ERISA section 404(a)(1), merely because it does not exactly reflect the premium activity of policy subscribers. In deciding on an allocation method, the plan fiduciary may properly weigh the costs to the plan and the ultimate plan benefit as well as the competing interests of participants or classes of participants provided such method is reasonable, fair and objective. For example, if a fiduciary 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 based upon a reasonable, fair and objective allocation method. Similarly, if distributing payments to any participants is not cost-effective (e.g., payments to participants are of de minimis amounts, or would give rise to tax consequences to participants or the plan), the fiduciary may utilize the rebate for other permissible plan purposes including applying the rebate toward future participant premium payments or toward benefit enhancements.*

Where a plan provides benefits under multiple policies, the fiduciary should allocate or apply the plan's portion of a rebate for the benefit of participants and beneficiaries who are covered by the policy to which the rebate relates provided doing so would be prudent and solely in the interests of the plan according to the above analysis. However, the use of a rebate generated by one plan to benefit the participants of another plan would be a breach of the duty of loyalty to a plan's participants.