Health Reform

What do Employers do with MLR Rebates?

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Under health care reform, insurance carriers are required to satisfy certain medical loss ratio ("MLR") thresholds, meaning that carriers will be required to spend 80 to 85 percent of premium dollars on medical care and health care quality improvement. If these thresholds are not satisfied, rebates are available to enrollees. The MLR provisions are not applicable to self-insured plans. The rules regarding these rebates are complicated and employers should review them carefully with ERISA counsel. Upon receipt of a rebate by a carrier, employers will need to determine the following:

- Who is entitled to receive a rebate;
- What form should the rebate take;
- What are the tax impacts of the rebate on both the employer and participants; and
- What, if any, communication must be provided to participants regarding the rebate.

Below you will find helpful information regarding any employer action that may be necessary.

Does a Carrier have to Provide a Rebate?

Carriers determine MLR on a state basis by market segment and do not disaggregate by type of plan within these markets; they will need to let employers know the amount. Carriers do not have to provide a rebate to an enrollee if the total rebate owed is less than $20 per subscriber ($5.00 when a carrier pays the rebate directly to each subscriber). This rule only applies to the carrier and not to employers refunding amounts to participants.

Carriers can issue rebates as either a:

- premium credit (a reduction in premium owed);
- lump-sum payment;
- lump-sum reimbursement to the account used to pay the premium if an enrollee paid the premium using a credit card or direct debit; or
- "premium holiday" if this is allowed under state law.

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Rebates must be paid by August 1st each year. If a carrier fails to timely pay any rebate, it must pay the enrollee interest at the current Federal Reserve Board lending rate or 10% annually, whichever is higher, on the total amount of the rebate, accruing from the date payment was due.

Are there Notice Requirements for the Rebates?

Carriers must provide notice to the policyholder and each current enrollee who was enrolled in the MLR reporting year at the time any rebate is provided. Employers are not required to notify employees of the rebate; however, employers may want to address the notices that are distributed by the carriers. If employers wish to do so, they can use the following language, filling in the blanks as appropriate:

Employees should have received a notice of rebate from [carrier]. In a nutshell, [Employer] received a rebate check in the amount of $_______. Amounts attributable to participant contributions will be used to [reduce premium amounts] for [currently enrolled employees] in accordance with legal requirements. These amounts will be reflected in the [August] paychecks.

What Should Employers do with the Rebates?

Employers must give some or all of the rebates to participants, unless they paid 100% for all tiers of coverage. In general, carriers will send rebate checks to employers and employers must mete out any amounts attributed to employee contributions to employees and handle the tax consequences. Rebates must be made to participants as soon as possible following receipt and, in all cases, within 3 months of receipt.

Guidance has been provided to aid employers, but no one formula has been provided for their use. The options to consider are as follows:

- Reduce future premiums for current plan participants (administratively easy with limited tax issues with respect to participants).
- Cash payments to current participants (administratively burdensome and results in tax consequences to participants).
- Cash payments to former participants (administratively burdensome and results in tax consequences to former participants).

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Employers can also consider, with counsel, whether providing benefit enhancements or payment of reasonable plan expenses would be considered permissible.

The best method is probably for employers to reduce future premiums for current participants. If proceeds are to be paid to participants in cash, the DOL would likely require that payments go to those who participated in the plan at the time the proceeds were "generated," which may include former employees. An option that may be easier to administer is to keep the proceeds in the plan and provide a "premium holiday" (suspension of required premiums) or a reduction in the amount of employee-paid premiums.

ERISA plans

A plan that is subject to ERISA needs to assess whether rebate amounts are plan assets that can be used only for plan purposes. If the employer is the policyholder, determining the plan's portion, if any, may depend on provisions in the plan or the policy or on the manner in which the plan sponsor and the plan participants have shared in the cost of the policy. If rebates are attributable to participant contributions, they constitute plan assets and must be handled in accordance with the fiduciary responsibility provisions of ERISA. Generally, the plan fiduciary must distribute rebate amounts to participants, enhance benefits, or reduce future participant premiums. If the employer and participants each paid a fixed percentage of the cost, a percentage of the rebate equal to the percentage of the cost paid by participants would be attributable to participant contributions and considered to be plan assets. The regulations and guidance leave it up to the policyholder as to how to use the portion of a rebate that constitutes plan assets, subject to ERISA's general standards of fiduciary conduct. An allocation does not necessarily have to mirror the premium activity of policy subscribers. Instead, a plan fiduciary may weigh the costs to the plan and the competing interests of participants or classes of participants when fashioning an allocation method, provided the method ultimately proves reasonable, fair and objective.

There is no requirement for ERISA plans that former participants be included or excluded in distribution of the rebates. However, a DOL Technical Release provides that if the fiduciary finds that the cost of passing through the rebate to former participants would exhaust most of those rebates, the proceeds can likely be allocated to current participants.

The guidance does not address how to handle an MLR rebate where the amount is inconsequential (e.g., one dollar per participant). However, taking a cue from DOL Field Assistance Bulletin 2006-01, a fiduciary may be able to conclude, after analyzing the relative costs, that no allocation is necessary when the administrative costs of making correction far exceed the amount of the allocation.

Where a plan provides benefits under multiple policies, the fiduciary is instructed to 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, according to the Department of Labor, "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."

Where it is determined that MLR rebates are ERISA plan assets, the ERISA "trust" requirement will not apply if the rebate is used to pay premiums or refunds within 3 months of their receipt by the employer.

Non-Federal Governmental Plans

For plans sponsored by state or municipal governments for their employees, the interim final regulations require that rebates be used to reduce premiums for health plan options for subscribers covered when the rebate is received, to reduce premiums for current subscribers to the option receiving the rebate, or as a cash refund to current subscribers in the option receiving the rebate. In each case, the regulations allow the rebate to be allocated evenly or in proportion to actual contributions to premiums. Note that the rebate is to be used to reduce premiums for (or pay refunds to) employees enrolled during the year in which the rebate is actually paid (rather than the MLR reporting year on which the rebate was calculated).

Church Plans

For employers with a plan that is not subject to ERISA , nor a governmental plan (e.g., a church plan), carriers must obtain written assurance from the policyholder that rebates will be used for the benefit of current subscribers or otherwise must pay the rebates directly to subscribers. The interim final regulations provide that if the rebate is paid to the policyholder, the policyholder must allocate the rebate to current participants only. If the rebate is paid directly to participants by the insurer,

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the insurer must distribute the rebate equally among those who were participants during the MLR reporting year on which the rebate is based.

Federal Tax Implications to Employees and Employers

When employees pay their portion of the premiums for employer-sponsored health coverage on a pre-tax basis under a cafeteria plan, MLR rebates will be subject to federal income tax and wages. For rebates that are distributed as a reduction in premium (reducing an individual's pre-tax premium payment during the year), there is a corresponding increase to the employee's taxable salary that is also wages taxable for employment tax purposes. Rebates that are distributed as cash will result in an increase in taxable income that is also wages subject to employment taxes.

When employees pay their portion of the premiums on an after-tax basis, MLR rebates generally are not subject to federal income tax or employment taxes (assuming the individual does not claim a deduction on Form 1040 for insurance premiums). This applies when the rebate is provided as a reduction in premiums or as cash.

For employers, generally amounts used for benefits (e.g., to pay premiums with respect to insured plans) should not be taxable, but employers should review the tax implications of a rebate with tax advisors.

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