



For your information

Volume 35 | Issue 56 | August 7, 2012

## Medical Loss Ratio Rebates Require Employer Action

The medical loss ratio (MLR) requirements under health care reform require insurers to provide rebates to group health plans and individuals purchasing medical insurance if the insurer does not spend a minimum percentage of the premium on medical claims. The first rebates were to be paid by August 1, 2012. Sponsors of insured plans receiving rebates for 2011 must address a number of fiduciary and tax issues.

### Background

Beginning January 1, 2011, health insurers were required by the Affordable Care Act to spend at least 85% of premium dollars received from policies in the large group market (i.e., those that cover more than 50 employees) on a combination of medical care claims and activities to improve health care quality. (Individual and small group plans must spend at least 80% of premium dollars.) Effectively, the MLR provision limits the amount that insurers can spend on administrative expenses, overhead, profit, commissions and other non-claim expenses to 15% of premium dollars received. Insurance companies were required to pay rebates for 2011 by August 1, 2012.

Over the past year, the Department of Health and Human Services and the Department of Labor (DOL) issued guidance regarding how insurers are to distribute the rebates and how plan sponsors may use them. (See our December 23, 2011 [For Your Information](#).) The IRS also issued [Frequently Asked Questions](#) that explain the tax consequences for employees when a plan sponsor applies the rebates to reduce employee premiums or pays the rebate amounts to employees in cash.

The following discussion highlights some of the issues that plan sponsors need to consider in light of this guidance. While this discussion focuses on sponsors of plans subject to ERISA, similar rules apply to non-federal governmental plans and plans that are neither governmental nor subject to ERISA, (e.g., church plans).

### Treatment of Rebates as Plan Assets

Under ERISA, insurance rebates attributable to employee contributions are considered plan assets and must be used for a plan purpose and for the exclusive benefit of plan participants. Thus, when handling MLR rebates, an employer must determine the extent to which the amounts received must be treated as “plan assets” under ERISA. This determination will depend on a number of factors, including the terms of the governing plan documents and the insurance contract. [DOL Technical Release 2011-04](#)

provides that in the absence of a plan document provision prescribing how distributions from insurance companies will be treated, the following rules will apply:

- If the employer paid the entire cost of the coverage to which the rebate relates, none of the rebate is considered a plan asset and the entire rebate can be retained by the employer.
- If participants paid the entire cost of coverage, the entire amount of the rebate would be considered plan assets.
- If the employer and the participants each paid a fixed percentage of the cost of the coverage, a percentage of the rebate equal to the percentage of cost paid by participants would be considered plan assets.
- If participants paid a fixed amount of the cost of coverage and the employer was responsible for paying all other amounts, the portion of the rebate that exceeds the employer's total amount of contributions for the relevant period would be plan assets.
- If the employer paid a fixed amount of the cost of coverage and participants were responsible for paying all other amounts, then the rebate will be considered plan assets to the extent that it does not exceed the total amount contributed by participants during the relevant period.
- If the entire cost of the premium was paid out of trust assets, the entire rebate is a plan asset.

#### Insight

When the plan document is silent, the focus should be on how the employer determines the amount that employees will pay for the coverage. Once the contribution strategy is identified, the appropriate approach to apportionment can be determined.

#### Permissible Use of Rebates

As noted above, ERISA requires that plan assets be used for the exclusive benefit of plan participants. Technical Release 2011-04 provides that the portion of rebates that are plan assets may be distributed to plan participants in cash, used to enhance plan benefits, applied to reduce participant premiums or otherwise used in accordance with the terms of the plan, which could include payment of administrative expenses.

The Technical Release also provides the following guidance:

- Rebates may only be used for the benefit of participants in the plan that generated the rebates.
- In considering allocation approaches, the plan fiduciary may weigh the costs to the plan and the ultimate plan benefits and may allocate shares of the rebate among plan participants or classes of participants under any method that is "reasonable, fair and objective" under the circumstances. For example, the Technical Release notes that "if a fiduciary finds 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.”

**COMPLIANCE ALERT:** Although a plan fiduciary has some latitude in selecting an allocation method under the “reasonable, fair and objective” standard, it should be prepared to justify any method that does not simply refund the rebate to all individuals who participated in the option generating the rebate in 2011.

The Technical Release also provides that the DOL will not assert a violation of ERISA’s trust requirement against plans receiving rebates that do not otherwise maintain a trust, as long as the rebate is used to pay premiums or refunds within three months of receipt of the rebate. Alternatively, the trust requirement may be avoided if the plan sponsor directs the insurer to apply the rebate against future participant contributions or benefit enhancements.

#### Insight

**The short time frame for using the rebate proceeds will likely influence the approach taken by plan sponsors.**

### Income Tax Treatment of Rebates

Employers need to be aware of the tax implications of using the MLR rebates for the benefit of employees. The tax treatment will depend on whether the employee paid for the coverage with pre-tax or after-tax dollars.

**When an employee pays for coverage through a cafeteria plan.** Generally, if the employee paid for coverage on a pre-tax basis, the rebate will be taxable (i.e., subject to withholding and employment taxes). This is the case not only when the rebate is paid in cash but also when it is provided as a premium reduction (because the employee will use fewer pre-tax dollars to pay for the coverage and thus will have a corresponding increase in taxable wages).

**When an employee pays for coverage on an after-tax basis.** If the employee paid for coverage on an after-tax basis, the rebate will not be taxable to the employee or subject to employment taxes, even if paid in cash. If an employee previously deducted the premium on his/her tax return, the rebate is subject to federal income tax (but not employment tax) to the extent the employee received a tax benefit from the deduction.

## Insurer Notices to Enrollees

Insurers paying rebates must provide a notice to both the policyholder and affected enrollees when the rebate is distributed. In addition, insurers that satisfied the MLR standards in 2011 and do not have to pay rebates must include information about the medical loss ratio with the first plan documents they provide to enrollees on or after July 1, 2012. Thus, employers with insured health programs are likely to face questions from both current and former participants who receive insurer notices.

### Insight

Employers should consider preparing employee communications about the rebates. If the rebates are shared only with current plan participants, the employer should be prepared to address questions from former participants about why they are not benefiting from the distribution.

## Conclusion

Employers with insured health coverage that receive MLR rebates must act quickly to establish a process for sharing any rebates with employees. Buck's consultants are available to discuss these requirements in more detail and to assist in developing a compliance strategy.

### Buck Can Help

- Review plan asset issues arising in connection with rebates received by ERISA plans
- Develop a rebate allocation approach
- Review the impact of the new notice requirements
- Ensure compliance with the notice and rebate distribution, and with the communication requirements

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.  
© 2012 Buck Consultants®, L.L.C. All Rights Reserved