Handling Medical Loss Ratio (MLR) Rebates

PARKER | SMITH | FEEK

May 2012

What is the issue?

Under the Affordable Care Act (ACA), health insurers are required to disclose the percentage of medical plan premium that is spent on claims and health quality improvement initiatives versus the portion spent on administration, marketing and insurance company profits. Under the Medical Loss Ratio (MLR) rules, insurers in the large group market (100+ employees) must maintain a loss ratio of no less than 85%, while insurers in the individual and small group markets must maintain a loss ratio of no less than 80%. Keep in mind that the MLR rules only apply to fully-insured plans. Self-funded medical benefit plans are not subject to these requirements.

Starting in 2012, insurers must report their prior year MLR data to the Department of Health and Human Services by June 1st and if the minimum standards described above are not satisfied, premium rebates must be provided to policyholders no later than August 1st.

So what happens to these rebates once they are received by the policyholders? In the case of individual policies the answer is simple - the money flows directly into the pocket of the policy owner, which is typically the individual insured under the contract. With group insurance plans, however, the answer is a bit more complex.

It's a matter of plan assets.

ERISA's prohibited transaction and exclusive benefit rules require that plan assets be used solely for the benefit of plan participants and their beneficiaries. So, to the extent that MLR rebates are deemed to be plan assets, they immediately become subject to these rules. In situations where the benefits are paid through a trust and either the plan or the trust is the policyholder, the entire MLR rebate will be a plan asset and flow directly back into the trust for the benefit of plan participants.

However, if there is no trust involved and the employer is the policyholder (which is the case for the vast majority of employer-sponsored health plans), the rebate's status becomes more difficult to determine. In these situations the DOL has ruled that only the portion of the rebate that is attributable to participant contributions will be considered plan assets.

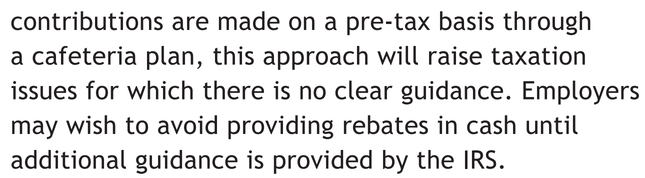
This means plan sponsors will need to calculate the percentage of total plan cost contributed by employees and then apply this same percentage to the rebate received, in order to determine the portion of the rebate that must be treated as plan assets. Similar rules will need to be followed by the fully-insured plans of state and local governments and by fully-insured church plans even though these plans are not subject to ERISA.

Although employers will need to exercise care in determining the portion of the rebate that is considered plan assets (and therefore used for the exclusive benefit of plan participants), the guidance provided by the DOL does allow employers some flexibility in this regard. For example, employers may use the rebate for the benefit of current participants rather than former participants (on whose contribution the calculation was based) where the cost of identifying and locating former participants is deemed unreasonable.

So how can an employer use the rebate?

The portion of the rebate that is determined to be a plan asset can be used in a number of ways as long as the method ultimately selected is consistent with ERISA fiduciary standards. Perhaps the most popular use will be to offset future participant contributions - a so called "premium holiday." (Note: when applying a rebate to reduce future premiums, care must be taken to assure that the participants realize the full cost reduction; otherwise a portion of the rebate could be deemed to be to the benefit of the employer, therefore a prohibited transaction under ERISA.) Alternatively, the rebate might be used to enhance the benefits available under the plan.

Technically, the portion of the rebate due to employee contributions could also be distributed in cash to plan participants. However, where



contributions are made on a pre-tax basis through a cafeteria plan, this approach will raise taxation issues for which there is no clear guidance. Employers may wish to avoid providing rebates in cash until additional guidance is provided by the IRS.

Additional guidance issued by the Department of Labor can be found in Technical Release 2011-04 at http://www.dol.gov/ebsa/newsroom/tr11-04.html.