COMPLIANCE

Medical Loss Ratio Rebates: Background and Basics

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Background

Under the Affordable Care Act (ACA), health insurance issuers offering coverage in the group or individual markets must meet medical loss ratio (MLR) standards or provide rebates to policyholders. MLR standards measure the percentage of medical plan premium that is spent on claims and health quality improvement initiatives versus the amount spent on administration, marketing and retained as profits. MLR rules only apply to fully-insured plans, self-funded plans and excepted benefits are not subject to these requirements.

MLR Rebate Requirements

Under the MLR rules, insurers in the large group market must maintain a loss ratio of 85%, while insurers in the individual and small group markets must maintain a loss ratio of 80%. Rebates are required to be provided no later than September 30 following the end of each MLR reporting year. Insurers that fail to meet the applicable MLR standard must also send a notice to policyholders (e.g., employer sponsoring the plan) and participants (e.g., enrollees) explaining the purpose of the MLR rule, how much the insurance company missed the goal by, percentage of the premium being returned as a rebate, and that the total aggregate rebate for the group health plan is being provided to the employer. Although the obligations to calculate the MLR and issue rebates fall on insurers, in most cases the rebates will be paid to the employer, and employers will be required to determine how to use the rebates or refund them to plan participants.

Guidance on the Distribution of MLR Rebates

The Departments of Labor ("DOL") and Health and Human Services ("HHS") coordinated their efforts to provide guidance as to how different types of group health plans are required to handle MLR rebates. Specifically, the DOL issued Technical Release 2011-04, which applies to ERISA plans; while HHS issued an interim final rule that explains how non-federal governmental plans are to handle MLR rebates and provides guidance for non-ERISA, non-federal governmental plans (i.e., church plans).

Rebates for ERISA Plans

The DOL Technical Release addresses, among other things, plan asset rules, the exclusive benefit rule, and the ERISA trust requirement. Applying those rules to MLR rebates, the DOL noted that rebates may qualify as ERISA plan assets, in whole or in part, depending on various factors. Significantly, employee contributions towards the cost of coverage always constitute plan assets.

- If the employer paid 100% of the premiums, the rebate is not plan assets and the employer can keep the entire rebate.
- If the participants paid 100% of the premiums, the entire rebate amount is plan assets.
- If participants and the employer each paid a fixed percentage of the premiums, a percentage of any rebate equal to the premium percentage paid by participants would be plan assets, and the balance would belong to the employer.

Any portion of a rebate that constitutes plan assets must be used for the exclusive benefit of plan participants and beneficiaries. This will be limited to participants and beneficiaries (past or current) covered under the benefit option that generated the rebate. There is no requirement that former participants be included or excluded. If a plan determines that it is not cost-effective to include former participants, the employer may properly decide to allocate the rebate only to current participants. In choosing 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." Furthermore, if the cost of making refunds to participants is not cost-effective (e.g., payments would be of de minimis amounts or would create tax consequences to participants or the plan), the rebate may be used for other permissible plan purposes, such as reductions in future participant contributions or future benefit enhancements. The guidance does not define "de minimis" in this context, so the plan fiduciary would need to determine whether a payment is de minimis, based on the facts and circumstances.

The ERISA Trust Rule may also limit what a plan can do with the plan assets portion of a MLR rebate. ERISA generally requires that plan assets be held in trust. However, DOL Technical Release 92-01 generally excuses group health plans from the obligation to hold participant contributions in trust if the only plan assets at issue are employee contributions generally paid through a Cafeteria Plan. The exemption only applies if refunded plan assets are quickly distributed by the plan. To maintain trust exempt status rebates must be used within three months of receipt to offset premiums or paid out as refunds (premium holidays or rebate

checks). This requirement makes an immediate premium holiday to participants covered under the benefit option that generated the rebate the most practical approach.

Rebates for Non ERISA Plans (Church and Non-Federal Governmental Plans)

Group health plans maintained by non-federal governmental employers (such as state and local governments and some Indian tribal governments) and church plans are not subject to ERISA. These plans are required to use the portion of rebates attributable to the amount of premium paid by subscribers under the plan for the benefit of current participants (i.e., those who are participants at the time the rebate is received), including any portion of a rebate that is based on former participants' contributions. The regulations give the policyholder several options for allocation of rebates among the current participants:

- The plan may reduce participants' premiums in the next policy year by allocating the rebate among all participants covered under any option offered by the plan at the time the rebate is received,
- The plan may reduce participants' premiums in the next policy year by allocating the rebate among only the participants covered under the policy to which the rebate is attributable at the time the rebate is received, or
- The plan may make a cash refund to the participants covered under the policy to which the rebate is attributable at the time the rebate is received.

In addition, regardless of whether the policyholder chooses to reduce future premiums or make cash refunds, the policyholder has the further choice of dividing the rebate evenly among the participants who will receive it, dividing it based on each participant's actual contributions to the premium, or apportioning it in a manner that reasonably reflects each participant's contributions to the premium. Non-federal governmental and church plans are required to use the rebate for the benefit of subscribers no later than three months after receipt.

For church plans, regulations provide an insurer must receive written assurance from the policyholder that the rebates will be used in the same way that a rebate to a non-federal governmental plan could be used (see above). Without this written assurance, the insurer must pay the rebate directly to the plan participants covered by the policy during the year in which the rebate is based by dividing the entire rebate equally among all participants entitled to a rebate. Although this is administratively simpler, the plan sponsor forfeits any amount it could have otherwise retained.

Rebates for Terminated Plans

If a group health plan, regardless of whether it is subject to ERISA, has been terminated at the time of rebate payment and the insurer cannot, despite reasonable efforts, locate the employer, the insurer must distribute the entire rebate directly to the participants who were enrolled in the terminated plan during the year in which the rebate was calculated by dividing the rebate equally among the individuals entitled to a rebate. If an insurer is able to locate the employer with respect to a terminated ERISA plan, the employer would need to comply with ERISA's fiduciary provisions when handling any rebate.

Next Steps

Although the obligation to provide the rebate notice is on insurers, employers that sponsor group health plans may receive inquiries from employees who receive such a notice. For example, some employees may expect that they will receive checks reflecting their share of a rebate, or may want details on how the rebates are being allocated. Employers should be prepared for those questions, and may wish to provide their own notice to employees explaining how the rebate will be used, especially if the employer is not expecting to make cash refunds to employees. There will be many decisions that employers will have to make, keeping in mind their duties to act prudently, impartially, for the exclusive benefit of plan participants and beneficiaries, and in accordance with the terms of the plan.