



# MEDICAL LOSS RATIO REBATES:

## What the Requirements Mean for Employers Who Sponsor Group Health Plans and Their Employees

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New requirements in the *Patient Protection and Affordable Care Act (PPACA)* affect employers who sponsor group health plans and their employees. Here's what to expect, and how to prepare.

Employers that sponsor group health insurance plans are beginning to receive notices regarding the medical loss ratio (MLR) requirements created by the *Patient Protection and Affordable Care Act (PPACA)*. For some plan sponsors, the law will result in a rebate from the insurance company for a portion of premiums paid in 2011. How a plan sponsor responds to the notice depends on a number of factors, including the type of employer, the cost-sharing arrangements of the plan, and whether the plan is subject to the *Employee Retirement Income Security Act (ERISA)*.

This document has been developed to help the employer that sponsors a group health plan to understand MLR rebates and the requirements for distribution of the rebates.

### THE GOAL: LIMIT ADMINISTRATIVE COSTS

MLRs are an effort by the federal government to ensure that health insurance consumers are getting the greatest value for their premium dollars, and that insurance companies are not spending too much on administration, marketing, and other activities that do not directly benefit consumers. The PPACA's MLR standard requires insurance companies in the individual and small group health insurance markets to spend at least 80 percent of premium dollars on medical care and quality improvement activities. This amount increases to 85 percent for insurance companies serving large groups.

### Who gets the notice and rebate?

Insurance companies that do not satisfy the MLR standards in 2011 must provide a rebate to their customers. But before issuing rebates, the insurance company must provide notice to:

- Subscribers in the individual market
- Group policyholders and plan participants who will receive a rebate
- Participants in a group plan who will receive the rebate directly from the insurance company

MLR requirements apply to insurance companies offering group or individual health insurance coverage, but they do not apply to self-funded group health plans or limited-scope dental or vision policies.

A notice to any of these groups must explain why the rebate is being given, how it is calculated, whether the rebate is being provided to the policyholder or plan participants, and how the rebate can be used.

Insurance companies that meet or exceed the MLR standards must also provide a one-time, basic notice for the 2011 MLR reporting year, informing policyholders and subscribers that the insurance company has met the minimum MLR standards. This notice must be sent to enrollees on or after July 1, 2012. The primary purpose of the notice is to educate consumers, and to direct them to the Department of Health and Human Services website ([www.hhs.gov](http://www.hhs.gov)) for additional information.

### Who gets the rebate?

For individual policies, the insurance company must provide the MLR rebate to individual enrollees. For group policies in both the large and small group markets, the insurance company must generally provide the rebate to the policyholder, who, in turn, must ensure that the rebate is used for the benefit of plan participants.

In general, an insurance company can provide MLR rebates to participants in the form of a premium credit, lump sum check, a refund to a credit or debit card, or as a pre-paid debit card.

### ALLOCATING THE REBATE

How the rebate amount is allocated depends on whether the plan is subject to ERISA, and whether the plan is a sponsored by a commercial entity, state or local government, or a church.

#### Rebates to ERISA plans

*Department of Labor (DOL) Technical Release 2011-04* states that, before sponsors of ERISA plans can allocate the MLR rebate, they must first consider whether the rebate is a plan asset. This is important because if the rebates are plan assets, the plan sponsors must comply with ERISA fiduciary requirements.

To determine whether rebates are plan assets, employers should first reference the language in their policy and plan documents. Generally, MLR rebates are considered plan assets unless there is specific plan or policy language to the contrary. If the documents are ambiguous, and the plan or its trust is the policyholder, then MLR rebates are plan assets.

If the employer is the policyholder, the source of the premium payments will determine what portion, if any, of the MLR rebates are plan assets:

- If the premiums are paid entirely out of trust assets, the MLR rebates are plan assets.

- If all or a portion of the premiums are paid by participants, the portion of the rebate that is attributable to participant contributions is considered a plan asset.

Here's an example: If an employer pays the entire premium, then no part of the rebate would be attributable to participant contributions. However, if participants pay all of the premiums, the entire amount of the rebate would be attributable to participant contributions and would be considered plan assets. If participants and the employer each pay part of the cost, the percentage paid by participants would be considered plan assets.

Example of MLR Refund Allocation			
	Insurance Premium		
	Employer pays 80%	Employee pays 20%	Total
Employee 1	\$3,200	\$800	\$4,000
Employee 2	\$1,600	\$400	\$2,000
Employee 3	\$4,800	\$1,200	\$6,000
<b>Total</b>	<b>\$9,600</b>	<b>\$2,400</b>	<b>\$12,000</b>
	MLR Rebate Allocation (Employer 80%, Employee 20%)		
	Employer	Employee	Total
Employee 1	\$267	\$67	\$334
Employee 2	\$133	\$33	\$166
Employee 3	\$400	\$100	\$500
<b>Total</b>	<b>\$800</b>	<b>\$200</b>	<b>\$1,000</b>

Any portion of a rebate that is considered a plan asset must be handled in accordance with ERISA's general standards of fiduciary conduct. It can be distributed to participants, applied toward future participant premium payments, or applied toward benefit enhancements. In deciding on an allocation method, the plan fiduciary may consider the costs to the plan, the ultimate plan benefit, and the interests of participants or classes of participants.

Rebates that are plan assets should be held in trust. However, if the rebate is used to pay premiums or is refunded to participants within three months of when it was received, the Department of Labor (DOL) will not

assert a violation of ERISA's requirement that a trust be established. Plan sponsors can avoid the need for a trust by directing the insurance company to apply the rebate toward future participant contributions or benefit enhancements.

#### **Rebates to state and local government plans**

Rebates to state and local government plans must be distributed to the policyholder, which must use the amount of the rebate that is proportionate to the premiums paid by employees to either:

- Reduce the employee portion of premiums in the subsequent policy year
- Provide a cash refund to employees

The premium reduction or cash refund can be divided evenly, based on each employee's actual contributions, or apportioned to reflect each employee's contribution to the premium. The premium reduction only applies to those employees who pay premiums in the year the rebate is applicable.

**"How the rebate amount is allocated depends on whether the plan is subject to ERISA, and whether the plan is a sponsored by a commercial entity, state or local government, or a church."**

#### **Rebates to church plans**

Rebates to church plans that are exempt from ERISA may only be provided to the policyholder if the insurance company receives a written assurance from the policyholder that the rebates will be used to reduce premiums or provide refunds to current plan participants. If no written notice is received, the insurance company must distribute the rebate to current plan participants by dividing the entire rebate into equal amounts and distributing equal payments to all participants.

#### **Rebates to terminated plans**

If an insurance company cannot locate the policyholder of a terminated plan, the company must distribute the rebate directly to plan participants by dividing the entire rebate into equal amounts for all participants. If the issuer identifies the policyholder of a terminated ERISA plan, the policyholder must comply with ERISA, including reviewing the plan document to determine how assets

are to be allocated upon termination. If the plan document does not have instructions, the policyholder may need to determine if it is cost effective to distribute the rebate to former participants.

#### **FEDERAL TAX CONSEQUENCES FOR EMPLOYEES**

If employees pay premiums on a pre-tax basis, an MLR rebate is subject to federal income and employment tax, regardless of whether the rebate is in the form of a premium reduction or a cash distribution. If employees pay premiums on an after-tax basis, an MLR rebate (whether cash or a premium reduction), is generally not subject to federal income or employment tax.

There is one exception: If the employer only provides the rebate to employees who participated in the group health plan in the year the premiums being rebated were paid and in the year the MLR rebates are paid, and an employee deducted the prior premium payments on Form 1040 in the year the premiums were paid, the MLR rebate is taxable to the extent the employee received a tax benefit from the deduction (but it is not subject to employment taxes).

#### **NEXT STEPS**

Rather than waiting for employees to ask about the notices they are receiving, employers can take steps to address MLR rebate requirements, and streamline the distribution process.

- Notify employees that they will be receiving a notice from their insurance company
- Determine if an MLR will be due, based on information from the insurance company
- Determine if a rebate is a plan asset
- Review 2011 year-end payroll records for annual employee contributions
- For each plan receiving a rebate, calculate the portion of premiums paid by participants
- Determine which participants will receive a rebate and how much they will receive
- Draft an employee communication to explain what the rebate is, why they are receiving it, and the amount they are receiving
- Distribute the rebate to participants using a fair and objective allocation method, either as a premium credit, a lump sum payment, a refund to a credit or debit card, or as a pre-paid debit card
- Consult legal counsel to determine if plan documents should be revised for the future

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## ADDITIONAL GUIDANCE

### ***DOL Technical Release 2011-4***

(<http://www.dol.gov/ebsa/newsroom/tr11-04.html>)

### **IRS FAQs on tax treatment of rebates**

(<http://www.irs.gov/newsroom/article/0,,id=256167,00.html>)

### **U.S. Department of Health and Human Services' MLR information**

(<http://cciio.cms.gov/programs/marketreforms/mlr/index.html>)

## CONTACTS

Anita Baker is a managing partner for CliftonLarsonAllen's employee benefit plans group.

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