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MLR REBATE CONSIDERATIONS

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Because the guidance provided by the regulatory agencies has been fairly general, employers continue to have questions about how to handle the medical loss ratio (MLR) checks. Below are answers to some common questions, based upon either the guidance issued by the agencies regarding MLRs or how similar situations have been handled by the agencies. Employers should keep in mind that 1) there is no black-and-white answer as to how to calculate and distribute rebates to plan participants, and 2) any reasonably thoughtful and fair approach that returns participant contributions to participants in some manner should be acceptable.

Q1. As an employer, I pay most of the premium, and my contribution far exceeds the rebate. Can I just keep the rebate?

A1. With one exception, no. If participants paid part of the premium, the participants (as a whole) should get a pro rata share of the rebate. So, if the employer pays 80 percent of the premium, the employer must return 20 percent of the rebate to the participants.

The exception, which appears to not be available to church or government plans, applies if employees paid a fixed dollar amount and the employer paid the balance of the costs. In that case, if the employer's contribution equaled or exceeded the rebate, the employer could keep the entire rebate.

Q2. How do I, as an employer, determine the percentage I can keep?

A2. The percentage of the premium paid by the employer and the percentage paid by employees should be calculated on a representative date, such as the first day of the plan year. If the relative shares changed during the calendar year because of a renewal, the percentages likely should be averaged. If contribution percentages changed during a year because of a change in demographics (e.g., virtually all new hires elected family coverage, for which the employer pays a smaller share), recalculating does not seem to be needed.

Q3. How do I determine the employer percentage if the employer contributes different percentages for different groups? For example, if the employer pays 80 percent of the cost of employee only coverage and 50 percent of the cost of dependent coverage.

A3. All indications are that it is acceptable to look at the participant group as a whole, so you could use a blended contribution percentage. If the employer prefers to use different percentages for different classes, based on each class' actual contribution percentage, that is fine, but not required. An exception would be if the employer pays 100 percent of the cost of single coverage and nothing toward dependent coverage. In that case, those with single coverage would have no "overpayment" to be returned, and the rebate probably should be limited to those with dependent coverage.

Q4. The rebate is based on last year's results. Do I need to look at last year's contribution percentage? Do I need to pay part of the rebate to last year's participants?

A4. Most likely not. In similar situations in the past, the Department of Labor (DOL) has said, with respect to <u>plans sponsored by private employers</u>, that as long as the participant share is used to benefit the participant group as a whole, employers do not need to specifically apportion the payment to specific individuals based on each individual's contribution to the fund. (This is partly because it is so difficult to determine how much, exactly, any person did contribute, as participants come and go. Moreover, these MLR rebates are based on the block, not individual employer experience, so total precision seems impossible to achieve.)

The Department of Health and Human Services (HHS) has said, with respect to <u>local and state government plans</u>, that the rebate should be given to current or future participants.

Q5. How should I distribute the participants' shares of the rebate?

A5. There are different approaches for private and government plans.

<u>For private employer plans</u>, there are no detailed instructions. To the extent the rebate is "de minimis" ($50 - $75 per participant), applying the rebate to reduce future premiums in the current year (a "premium holiday") or to enhance benefits (e.g., moderating a planned increase in copays or the deductible or providing onsite, free flu shots to participants) should be an acceptable solution, to avoid excessive administrative costs and the potential tax consequences of providing a cash refund. If the per head rebate is very large (more than 90 days' worth of premium), consideration should be given to a cash refund. Note that the required participant notice -- provided by the carrier -- encourages employees to contact their employer for information on how the rebate will be used. Although it is not required, you should consider distributing a notice along the lines of the following:

> XYZ Company has determined that it is in the best interest of our participants to use the Medical Loss Ratio Rebate to provide a "premium holiday" for the month of September 2012. This means that your share of premium for September will be [zero] [reduced to $___]]
>
> OR
>
> XYZ Company has determined that it is in the best interest of our participants to return your share of the rebate to you in cash. The rebate will be added to your ______, 2012 pay as taxable income.

Private plans also need to understand that the DOL has interpreted ERISA to require that participant monies in private employer plans be put into a trust within 90 days after they are received. Very few insured plans operate through a trust, so it would be a burden to create a trust due to delays in dispensing the rebates. To avoid the 90-day rule, private plans should take steps to use or pay out the rebate within 90 days after it is received.

For state and local government plans, the rules are clearer. HHS has stated that the rebate may be used to:

- Reduce the next year's premium for all participants in group health plans sponsored by the employer
- Reduce the next year's premium only for the participants enrolled in the plan that received the rebate at the time the rebate is received
- Provide a cash refund to those who were participating in the plan that received the rebate at the time the rebate was received.

HHS also said that the premium reduction or cash refund can be based on whichever of these methods the employer chooses:

- Divided evenly among participants
- Divided based on each participant's actual contributions to premium
- Divided based on each participant's proportionate contribution to premium

Delaying application of the rebate until the next policy year, as appears to be the required approach for government plans, could result in a long delay for plans with spring and summer renewals. A case can be made, if the rebate is relatively small, that a current-year premium holiday makes more sense. Government employers who consider that option should be aware that the required participant notice -- supplied by the carrier -- will state that the rebate will be applied to the next year's premium, so further communication with participants may be needed if this approach is taken, and there is a small risk this approach would be challenged by HHS.

Church plans are encouraged to follow an approach similar to that prescribed for state and local government plans.

Q6. What can the employer do with its share of the rebate?

A6. Unless the insurance policy is part of a trust, the employer can use its share of the rebate however it sees fit. If the policy is in a trust, the entire rebate -- both the employer's and employees' share -- must be used to benefit plan participants (through reduced contributions or enhanced benefits).

Q7. The employer has two plans/policies. One received a rebate and one did not. How do I handle the rebate?

A7. Normally, the rebate is tied to the policy that received it, so only those covered by that policy would get a portion of the rebate. This is true even if those in the nonrecipient policy say they would have elected the receiving policy if they'd known the rebate would impact the cost.

Q8. Are there issues under my Section 125 plan if I give a premium holiday?

A8. As long as the plan recognizes a change in cost as a qualifying event, the premium holiday would not be a problem under the Section 125 plan. Because the amount the employee expected to pay on a pre-tax basis is now smaller, their taxable wages will increase.

Q9. If I decide to give rebates in cash, are those amounts W-2 or 1099 income?

A9. If the premium was originally paid on a pre-tax basis, the refund is taxable wages, which would be handled like any wages (i.e., subject to income tax, FICA and FUTA) and reported on the person's W-2. If the premium was paid with after tax dollars, there are no tax consequences (unless the employee claimed the premium as a deduction on their tax return).

Q10. Am I required to provide an explanation of my rebate distribution method to participants?

A10. An explanation is not required, but it likely will reduce questions and misunderstandings over the long run. (See Q5 for sample language.) Additionally, when making fiduciary decisions under ERISA (which is what a decision about applying participant monies is for a private employer's plan), the process is just as important as the result. Therefore, it would be a good idea to do a short memo to file explaining the basic method used and why it is used.

Q11. Why do I need to consider whether the DOL or HHS is giving the instruction?

A11. The DOL has authority over plans that are subject to ERISA. This includes all private employers -- i.e., employers that aren't a government or church -- whether they are privately or publicly held, and whether they provide benefits on a self-funded or fully insured basis.

HHS has authority over state and local government plans.

So private plans generally need to follow the DOL rules, and government plans need to follow the HHS rules. Unfortunately, the agencies' views, while similar, are not identical, so different types of employers will be implementing different responses.
