

MLR Rebates & How to Handle Them

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Employers sponsoring a fully-insured group health plan may soon be getting a check from their insurer. This check is a medical loss ratio (MLR) rebate that insurers are required to distribute to their plans when too large of a portion of the premiums charged in the previous year go toward the insurer's administration, marketing, and profit, rather than going toward paying claims and quality improvement initiatives. Insurers are required to distribute this check annually by September 30 (though some may choose to distribute it earlier). How an employer may use the rebate amount will depend on how coverage premiums are paid.

What can employers do with an MLR rebate?

This question requires answering another question: How is the coverage paid for? If the employer pays 100% of the premium for employees and any enrolled spouses or dependents, then any rebate belongs to the employer to do what they wish.

If participant contributions pay for any portion of the premium, then for any MLR rebate received by the policyholder, that same portion of the rebate is considered "plan assets," meaning that the funds belong to the plan as a whole and not the plan sponsor. ERISA restricts the use of plan assets to the exclusive benefit of plan participants. If there is *any* portion of the MLR rebate that is considered plan assets, then it must be treated as such. There is no 'de minimis' portion of the MLR rebate being a plan asset that would allow an employer or plan to ignore the plan asset implications.

How much of the rebate is considered plan assets?

If participant contributions paid for any portion of a plan's premium, the employer must then calculate how much of any MLR rebate should be considered plan assets (i.e., should be used strictly for the benefit of plan participants). Below are listed contribution strategies and whether (and how much of) MLR rebates will be considered plan assets in each:

| | Premium Payment Strategy | Plan Assets? |
|--------------------|---|--|
| Most Common | Employer and Employee pay a fixed percentage of the premium (e.g., 80/20%) | Percentage of MLR rebate equal to Employee's contribution percentage is plan assets |
| Less Common | Employee pays fixed amount and Employer pays remaining amount (e.g., Employee pays \$250 for single | None of MLR rebate is plan assets unless the rebate amount exceeds the amount paid by Employer |

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| | coverage under an age-rated plan and Employer pays the difference) | |
| Less Common | Employer pays fixed amount and Employee pays remaining amount | All of MLR rebate is plan assets unless the rebate amount exceeds total Employee contributions |
| Less Common | Employer pays entire premium | None of MLR rebate is plan assets |
| Uncommon | Employee pays entire premium | All of MLR rebate is plan assets |

It is also common that plans either have a combination of the above strategies, or utilize different fixed percentages or amounts based on different employee groups. To most easily determine the portion of the MLR rebate to be considered plan assets, upon receipt of an MLR rebate, the employer should calculate the percentage of total plan premiums paid to the insurer during the previous year that can be attributed to participant contributions. This includes employee payroll deductions, COBRA premiums, premiums paid during FMLA-protected leave, and any other premium payment made by a participant. The resulting percentage is then applied to the rebate to determine the portion that must be treated as plan assets.

Example

- Total group health plan premiums paid to a carrier for 100 covered employees during 2023 = \$1,000,000.
- Total employee payroll deductions + COBRA premium payments received during 2023 = \$250,000
- Employer receives a \$15,000 rebate from the carrier in 2024.

In this example, participant contributions made up 25% of total plan premiums for the year (\$250,000 / \$1,000,000), so a total of \$3,750 is considered plan assets (25% of \$15,000).

How is the plan asset portion calculated if there are multiple fully-insured plan options?

It may depend on how the insurer issues the rebate. If the insurer lumps all plan options together and issues a single rebate amount (without a way to know the portion of the rebate generated by each plan option), then it would generally be compliant to calculate (and distribute) the plan asset portion of the rebate across all medical plan options provided through that insurer. However, if the insurer issues separate rebates for each plan option or issues the rebate in a way that allows the plan sponsor to decipher how much of the rebate is generated by each plan option, then the plan asset portion should be calculated and distributed separately for each plan option.

What can employers do with rebate amounts that are plan assets?

Employers should first look to their plan document to answer this question. Some plan documents address how to handle the portion of the MLR rebate that is determined to be a plan asset. Including an MLR rebate provision in a plan document can make the whole process a bit smoother and may even allow employers to retain a larger portion of the rebate. However, most plan documents will not contain such a provision, in which case the

employer may do one of two things with the rebate: (1) improve plan benefits; or (2) return the appropriate amount to plan participants.

- **Improve Plan Benefits:** The first option of improving plan benefits can be difficult for a few reasons. Usually, the rebate amount is not substantial enough to make any benefit improvements. There is also no guarantee that there will be rebates in subsequent years that would continue to pay for any improvement, meaning that the employer would have to cover the cost or potentially take it away. In addition, it may be hard to argue that the plan assets were distributed within 90 days as required to avoid having to hold such funds in a trust.
- **Distribute Amounts to Plan Participants:** The second and more popular option of returning an appropriate amount of the rebate directly to participants can be achieved by either a cash payment or a “premium holiday”. The cash payment can be distributed by check or cash directly to participants or via payroll, while a premium holiday temporarily reduces the amount needed from participants to pay the premium. Either way, the taxability of the rebate amount distributed to participants remains the same: if participant contributions were made on a pre-tax basis, the rebate portion that is returned to the participant as cash or a premium holiday must be treated as taxable income. On the other hand, for contributions made on an after-tax basis, the rebate will not be taxable as the rebate is essentially a return of amounts that have already been subject to taxation.

How quickly must the participant portion of the rebate be distributed?

ERISA generally requires that insured plans hold their plan assets in a trust. For any portion of an MLR rebate that is considered plan assets, if it is not distributed to participants within 90 days of the employer’s receipt of the rebate from the insurance company, then it will be necessary for the employer to set up a trust in which to hold the portion of the rebate considered plan assets. To avoid having to take those extra steps, employers should aim to distribute participant portions of the MLR rebate within 90 days of receipt.

Which participants should receive the participant portion of the rebate?

Decisions about where to allocate the participants’ portion of the rebate are subject to ERISA’s general standards of fiduciary conduct, which require that plan fiduciaries act prudently, solely in the interest of plan participants and their beneficiaries, in accordance with the provisions of the plan, and with impartiality to plan participants. When a plan provides multiple benefit options under separate policies, the participants’ share of the rebate must be distributed to the participants and beneficiaries covered under the policy to which the rebate applies.

In deciding which group(s) of participants should receive the rebate amount, the most common options are:

- Returning the rebate to current plan participants in the year in which the rebate is received (current plan year participants, including COBRA participants); or
- Returning the rebate to current plan participants in the year in which the rebate is received and to former participants from the year used to calculate the rebate.

TIP – Former Plan Participants

DOL guidance points out that it will usually not be necessary to distribute rebates to former plan participants. DOL guidance states: *“If [an employer] finds that 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 [only].”* In most cases, the amount of the rebate, on a per participant basis, will be so small that the administrative cost of distributing it to former participants will exceed the value of the rebate.

Former participants” refers to previous plan year participants, not COBRA participants nor former employees.

How should the participant portion be allocated among the chosen group of participants?

Even after plan sponsors choose the group of participants that the rebate will be distributed to, there are more questions that may arise. Should participants who are not required to contribute to the plan (e.g., employer-provided, employee-only coverage) share in the rebate? Should participants with family coverage receive a larger rebate than participants with employee-only coverage?

Fortunately, the distribution allocation method is not required to exactly reflect the premium activity of individual plan participants. DOL guidance states, *“[i]n deciding on 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.”* In many situations, a reasonable and objective method of allocation may be as easy as dividing the rebate evenly over all current plan participants, even if those participants made different contributions to the plan or were not even participants in the previous year that the rebate is for.

Are there any notice requirements that employers need to abide by?

No. Employers are not required to send a specific notice regarding the MLR rebate to employees; however, the insurer is required to send notices of the MLR rebate to participants in the plan. The amount of the rebate is not included in the notice sent by insurers, but it will state that the rebate was sent to the employer and that there may be a portion that is distributed to participants. Though it is not required, it may be a good idea for employers to communicate with participants about whether, and how, they may expect to receive their portion of the rebate. Employers may also want to point out that the rebate will usually be a relatively small amount on a per-participant basis. Employees may incorrectly assume that they will be receiving a significant rebate based on only the information included in the carrier notice.

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