



Medical Loss Ratio (MLR) Rebates for Employers with ERISA Plans

Each year, some employers with insured plans will receive rebates from carriers that did not meet the medical loss ratio (MLR) requirements for the prior calendar year.

The MLR is the percentage of premium dollars the carrier spent on medical expenses based on the experience of all of the carrier's policies broken out by state and market (i.e., individual, small group, or large group). The MLR is not based on a group's own claims experience. If the carrier spent less than 80% of premium dollars on medical expenses (or 85% for large groups with 51 or more employees), then the carrier must pay a rebate to policyholders by August 1st after the end of the calendar year.

For employer groups, the carrier will generally pay the rebate to the employer who may then be responsible for sharing a portion with employees. If a portion of the rebate is considered an ERISA plan asset, employers are obligated to handle the rebate according to ERISA rules.

Note: The MLR rebate rules are slightly different for governmental and church plans that are exempt from ERISA, as well as for insured plans with a trust. Contact your Keller consultant if you meet one of these scenarios.

How will employers know if they will receive an MLR rebate?

Each year, carriers must provide an MLR Notice to any employer who will be receiving a rebate and any employee who was covered during the MLR reporting year. The rebate itself may be provided separately from the MLR Notice.

Do employers have to share the rebate with employees?

If the rebate is considered a plan asset, employers must share the MLR rebate with employees proportional to their overall share of the cost of the plan. While employers may use their portion of the MLR rebate for any purpose, if the employee-portion of the rebate is a plan asset, then employers have a fiduciary responsibility to use it in a prudent and impartial way, "solely in the interest of the plan participants." Employers must determine the most reasonable, fair and objective method of allocating the rebate while also taking into account administrative costs. Since facts and circumstances vary by employer, there is not a single "right" way to share the MLR rebate with participants, but it must either be paid to employees as cash or as a reduction in premium contributions for their current coverage.

When is the MLR rebate considered a plan asset?

If the employer paid the entire cost of the insurance coverage, then the entire rebate with respect to this particular policy is an employer asset and not a plan asset. Conversely, if participants paid the entire cost of the insurance coverage, then the entire amount of the rebate is a plan asset. Likewise, if the participants and the employer each paid a portion of the cost, then the percentage of the rebate equal to the percentage of the cost paid by participants most likely would be a plan asset. However, if participants paid a portion of the cost, but the governing plan documents state that rebates and refunds are employer assets, then the rebate is an employer asset (as long as the rebate is less than the employer's total contribution during the relevant period).

Note: If your plan currently has a governing plan document or other written instrument, and you are unsure of whether such information is in the terms, or if your plan does not currently have governing documents and you would like to consider that option, please contact your Keller consultant.

Which employees must share in the MLR rebate?

Employers have a number of considerations to make regarding which participants should share in the MLR rebate.

- Participants in rebating plan only. A share of the MLR rebate may only be provided to individuals who participated, or who currently participate, in the rebating plan. For example, if an employer offers PPO and HMO benefit plan options and only the HMO plan qualifies for an MLR rebate, only participants in the HMO plan may receive a share of the MLR rebate. Similarly, the MLR rebate may not be provided to individuals who never participated in the plan (e.g. waivers or ineligible employees).

COBRA beneficiaries and retirees are plan participants just like any active employee participants; therefore, they could be eligible for a share of the MLR rebate. However, if the per-person rebate amount is small and it is cost prohibitive to include COBRA participants, the rebate may be distributed to active employees only.

- Participants in the MLR reporting year (2018), or in the year rebate paid (2019)? Employers will have to evaluate whether to share the rebate only with employees who participated in 2018 (the MLR reporting year), only with employees who participated in 2018 who are currently participating in 2019 (when the MLR rebate is paid), or with individuals who are currently participating in 2019 regardless of whether or not they participated in 2018.
- Participants enrolled at any time during the year, or enrolled on a specific date (i.e. snapshot)? For whichever year of participation is selected, the rebate may be shared with any participant during that year or just the participants as of a certain date (i.e. snapshot in time). The snapshot method will be the most administratively efficient option for the majority of employers given the amount of enrollment changes throughout a year. For example, employers could use the snapshot method to select all participants enrolled when the employer receives the MLR rebate (e.g., September 1, 2019) or all participants enrolled on the last day of the MLR reporting year (e.g., December 31, 2018). Employers may select other snapshot dates that are reasonable based on facts and circumstances such as the end of the plan year.
- Current participants only, or former participants also? For whichever group of participants is selected by the methods above, the resulting group may include individuals who, when the rebate is distributed, are no longer enrolled in the plan. Employers may be able to exclude these former participants from sharing in the rebate if, according to the DOL, the “cost of distributing shares of a rebate to former participants approximates the amount of the proceeds.” If so, the employer may instead allocate the rebate among current participants only.

Be aware that regardless of which participants you appropriately select to receive the rebate, the carrier is supposed to send a notice to all participants in the rebating plan during the MLR reporting year stating that a rebate has been issued to the employer. The notice directs participants to the employer for questions regarding how the MLR rebate is being distributed.

How do you calculate the employer and employee share of the rebate?

Employers should determine the employee share of the rebate based on participant contributions during the MLR reporting year (calendar year), regardless of the employer’s plan year. Rebates may be allocated on an aggregate basis for all participants, or separately by class of participant (e.g. employees, COBRA participants, enrollment tier). An individual participant’s share of the rebate does not need to exactly match the actual dollars he or she paid. Your plan’s contributions and participant population should be used to determine the most “reasonable, fair and objective” allocation method.

How should the rebate be distributed to employees?

Employers have two options for distributing the MLR rebate to employees: cash rebate or premium holiday/reduction in future premiums. Employers should consider administrative feasibility, cost effectiveness, and potential tax reporting. If the rebate is distributed in payroll and not as a reduction in premium, there could also be an implication to salary reductions and employer matches in a retirement plan. Note that the DOL guidance allows for the rebate to be returned to employees in the form of a benefit enhancement, but this is only permitted if the plan has a trust in place.

Is the rebate taxable to participants?

Taxation of the rebate depends on the method of distribution and how the employee contribution was originally taxed (see the IRS MLR FAQs).

- Pre-Tax Employee Contributions (Cafeteria Plan): The majority of employee contributions are made on a pre-tax basis through a cafeteria plan. According to the IRS, since the original employee contributions were not taxed, any cash rebate will be taxable to the employee. If the MLR rebate is provided as a premium reduction, the employee’s taxable income will increase by the amount of the premium reduction. Therefore, paying the rebate in cash or reducing premiums both have the same net tax impact to employees. See IRS MLR FAQs for additional details.

- After-Tax Employee Contributions: If the rebate is provided as a premium reduction to employees who made after-tax contributions, it will not be taxed again.

If the rebate is provided as cash, it will also not be taxed, unless it is distributed based on MLR reporting year participation (2018) and the employee deducted the original after-tax contributions on his/her 2018 personal tax return. Since employers cannot know an employee's personal tax situation, employers may determine that the most administratively feasible option is to distribute any rebates to after-tax participants as premium reductions instead of as cash.

- Individuals who no longer participate in the plan: For employers that elect to provide rebates to individuals who no longer participate in the plan, we recommend that you evaluate the facts and circumstances and determine the most cost effective and administratively feasible means of distributing the rebate to these individuals. The only mechanism available for distributing the rebate to these individuals is a cash rebate, which will generally be taxable to the individual. It is unclear whether providing cash rebates to non-employees would create additional employment tax or Form 1099 reporting liability.

When must the rebate be distributed to participants?

Regardless of the rebate distribution mechanism utilized, employers must distribute the rebate to participants within three months of receipt of the funds.

As always, contact your tax or legal advisers for additional guidance.