MLR Rebate Considerations – Private Plans

Updated July 2019

Insurers with medical loss ratios (MLRs) that were below the prescribed levels on their blocks of business must issue rebates to policyholders. Since 2015, insurers must pay rebates to policyholders by September 30 following the reporting year. For example, insurers must pay rebates by September 30, 2019, for the 2018 reporting year. The rules for calculating and distributing these rebates are largely the same each year.

The guidance provided by the regulatory agencies about the way employers should distribute rebates has been fairly general, so employers have some discretion on calculating and distributing the employees' share. These general principles apply:

How should the rebate be divided?

Assuming both the employer and employees contribute to the cost of coverage, the rebate should be divided between the employer and the employees, based on the employer's and employees' relative share. Employers may divide the rebate in any reasonable manner – for example, the rebate could be divided evenly among the employees who receive it, or it may be divided based on the employee's contribution for the level of coverage elected.

Employers are not required to precisely determine each employee's share of the rebate, and so do not need to perform special calculations for employees who only participated for part of the year, moved between tiers, etc.

Using the example that the rebates are based on premiums paid to the carrier for calendar year 2018, the employer may pay the rebate only to employees who participated in the plan in 2018 and are still participating, only to current participants (even though the rebate relates to 2018), or to those who participated in 2018, regardless of whether they are currently participating.

Insurers must send a notice to all employees who participated in the plan in 2018 stating that a rebate has been issued to the employer. Employers who choose to limit rebate payments to those individuals who are currently participating should be prepared to explain why the rebate is only being paid to current participants. This might include the fact that since the rebate would be taxable income, or the amount involved does not justify the administrative cost to locate former participants and issue a check.

Are former plan participants entitled to a share in the rebate?

ERISA does not require plans to include or exclude former participants. However, the Department of Labor (DOL) states that a fiduciary may decide to distribute a rebate to only current participants if the fiduciary determines that the cost of distributing the rebate to former participants is approximately the rebate amount.

For non-federal governmental plans, an employer must aggregate any portion of a rebate that is based on former participants' contributions and use it for current participants.

For nongovernmental, non-ERISA plans, if the rebate is paid to the policyholder, then the policyholder must distribute the rebate to current participants.

How may the employer use the rebate?

The employer may pay the rebate in cash, use it for a premium holiday, or use it for benefit enhancements. The rebate must be applied or distributed within 90 days after it is received.

A cash rebate is taxable income to the employee if it was paid with pre-tax dollars.

A premium holiday should be completed within 90 days after the rebate is received (or the rebate needs to be deposited into a trust).

Benefit enhancements include reduced copays or deductibles (which may not be practical due to the timing requirements) or wellness-type benefits that the employer would not have offered without the rebate, such as free flu shots, a health fair, a lunch and learn on nutrition or stress reduction, or a nurse line.

How should the rebate be provided?

The employer should consider the practical aspects of providing a rebate in a particular form.

Generally, the larger the amount that would be due to an individual, the more effort the employer should make to directly benefit the person (either through a cash rebate or premium holiday). While benefit enhancements are permissible, a large rebate should be used to provide a direct benefit enhancement, such as a reduced copay, and not for a general benefit, such as flu shots.

The agencies have not provided any details as to what amount is so small that it does not need to be returned to the employee. (Insurers are not required to issue a rebate check to individuals if the amount is less than $5.00.) A cash rebate is taxable income if the premium was paid with pre-tax dollars, so issuing a check that is very small after taxes should not be necessary. If an employer knows it costs $2.00 to issue a check, issuing a rebate check for $1.00 should not be necessary. However, an employer cannot simply keep the rebate if it determines that cash refunds are not practical – it will need to use the employee share of the rebate to provide a benefit enhancement or premium reduction.

What does the plan state about how rebates should be used?

Many plans state how a rebate should be used. If the plan describes a method, that method must be followed.

The following Q&As provide additional details.

Q1. If an employer pays most of the premium, and its contribution far exceeds the rebate, can it 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 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 does an employer determine the percentage it 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 (such as, virtually all new hires elected family coverage, for which the employer pays a smaller share), recalculating does not seem to be needed.

Q3. How does an employer 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. It is acceptable to look at the participant group as a whole, so an employer 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. How should an employer distribute the participants' shares of the rebate?

A4. The agencies have not provided detailed instructions on the way to distribute rebates. The primary options are to pay the rebate in cash, use it to reduce future premiums in the current year (a "premium holiday") or apply it to enhance benefits (such as moderating a planned increase in copays or the deductible, or providing onsite, free flu shots to participants). The Department of Labor (DOL) recognizes that because of the administrative costs of cutting checks and the tax consequences that may follow a cash refund, it may make more sense to provide a premium holiday or to provide a benefit that otherwise would not have been offered. If the per head rebate is more than 90 days' worth of premium, however, serious consideration should be given to a cash refund.

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.

Q5. The rebate is based on last year's results. Does an employer need to pay part of the rebate to last year's participants?

A5. The DOL has not specifically addressed whether plans sponsored by private employers should or should not pay rebates to former participants. In similar situations, the DOL has said 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 difficult to determine exactly how much each person contributed 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.)

Q6. Should a rebate be paid to COBRA participants?

A6. The agencies have not issued anything that specifically addresses this question. However, in many situations COBRA participants are considered plan participants, so the most conservative approach would be to include individuals currently on COBRA or in the COBRA election period in the rebate. If former active participants are given a rebate, a person who was a COBRA participant during that time also should receive a rebate. It should be acceptable to use the standard method of allocating the rebate amount (even though the individual may have paid the full cost of coverage).

Q7. The employer has two policies. One policy received a rebate and one did not. How does the employer handle the rebate?

A7. Normally, the rebate is tied to the policy that received it, so only those individuals covered by that policy would get a portion of the rebate. This is true even if the individuals in the non-recipient policy say they would have elected the receiving policy if they had known the rebate would affect the cost.

Q8. Are there issues under the Section 125 plan if the employer gives 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 the employer decides 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 (that is, 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).

See the IRS FAQ on taxation of rebates for more information: [Medical Loss Ratio (MLR) FAQs](#).

Q10. Is the employer required to provide an explanation of its rebate distribution method to participants?

A10. An explanation is not required, but it likely will reduce questions and misunderstandings over the long run, particularly since if a rebate is paid the insurer is required to send a notice to those who participated in the plan in 2018 stating that a rebate is being paid. The insurer notice that will be sent when the rebate is paid to the employer is available at: http://www.cms.gov/CCIIO/Resources/Files/Downloads/mlr-notice-2-group-markets-rebate-to-policyholder.pdf.

An employer's explanation does not need to be detailed; something like this may be enough:

> 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 2019. 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 ______, 2019 pay as taxable income.

Also, when making fiduciary decisions under ERISA, the process is just as important as the result. As a best practice, the plan administrator should draft a short memo to the file explaining the basic method used and why it is used.

Q11. What can the employer do with its share of the rebate?

A11. Unless the insurance policy is part of a trust, the employer can use its share of the rebate in any way 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).

Q12. Are grandfathered plans eligible for rebates?

A12. Yes.

Q13. Are self-funded plans eligible for rebates?

A13. No.

Q14. How are rebates determined?

A14. Medical loss ratios (MLRs) are based on the cost of claims and health care quality improvements as a percentage of total premium (federal taxes and assessments are excluded from the premium). All of the insurer's policies in a market, in each state, are combined when calculating its MLR. A policy issued in the large group market is eligible for a rebate if its medical loss ratio (MLR) is less than 85 percent. A policy in the small group or individual market is eligible for a rebate if its MLR is less than 80 percent.

Q15. If the employer has employees in several states, how is the rebate determined?

A15. The rebate is based on the state in which the policy was issued. It should be shared with all participants, regardless where the participant lives.

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