

EMPLOYEE BENEFITS

Medical Loss Ratio (MLR) Rebates – Employer FAQ

September 2022

What is a Medical Loss Ratio?

Medical Loss Ratio (MLR) is the amount a health insurance issuer spends from premium revenue on claims and health care quality improvement costs as compared to the total amount of premium revenue received by the insurance issuer (excluding any taxes, fees, and payments for risk adjustment, risk corridors, and reinsurance paid by the insurance issuer).

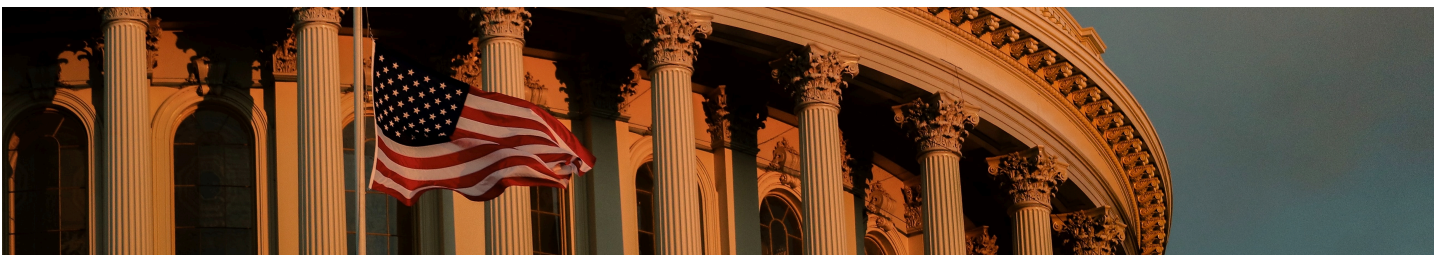
When is an MLR rebate required?

Under the ACA, a health insurance issuer must spend at least 80%-85% (depending on the market segment) of the premium dollars it receives on medical care and health care quality improvement (as opposed to overhead expenses). If an issuer fails to satisfy this obligation, it must provide a refund back to its customers/policyholders (referred to as a rebate), based upon the difference between what the insurance issuer should have spent on medical care/health care quality improvement (i.e., 80%-85% of total premium received) and what the issuer spent on those items (reflected as a percentage of total premium received). This functionally limits the insurance issuer from spending more than 15%-20% (depending on market segment) of its premium revenue on administrative expenses. See the following example of how issuers must calculate and provide the rebate.

Example:

An issuer uses 70 cents out of each premium dollar to pay customers' medical claims and improvement of its quality of health care, leaving 30 cents out of every premium dollar to pay salaries, administrative costs, agent commissions, marketing expenses, etc. The issuer's MLR is 70% because it is spending 70% of each premium dollar ($\$.70/\$1.00 = 70\%$) it receives to pay for medical claims/improvement in the quality of health care. This also means the issuer is using the remaining 30 percent ($\$.30/\$1.00 = 30\%$) of total premiums received on its administrative expenses. Since the issuer's MLR is 70%, which is less than the required MLR percentage of 80%-85% (depending on market segment) under the ACA, the issuer must provide a refund/rebate of 10% – 15% (depending on market segment) of total premiums received in the applicable MLR reporting year to each coverage enrollee, on a pro-rata basis. The rebate amount is calculated using the average MLR of the issuer over the previous three years.

Insurance issuers must report MLR data to the Department of Health and Human Services (HHS) by July 31 following the end of the reporting year and must provide any rebate owed to policyholders no later than September 30 following the end of the MLR reporting year.



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How is the rebate provided to a health plan/policyholder?

Issuers may choose to provide the rebate to a health plan/policyholder in the form of a premium credit (i.e., reduction in a premium owed), lump-sum check or if an enrollee paid the premium using a credit card or direct debit, by lump-sum reimbursement to the account used to pay the premium.¹

According to HHS guidance, if, during the MLR reporting year, the issuer determines that its MLR is lower than the minimum required percentage (depending on market segment), the issuer may institute a “premium holiday” to avoid having to pay the rebate so long as it’s permissible under applicable state law.²

Impact on Employer/Plan Sponsors and Group Health Plans

How do MLR rebates apply to employers/plan sponsors/group health plans?

MLR rebates from insurance issuers are provided to the policyholder. Depending on the organization, the policyholder would typically be the employer sponsoring the plan, a trust or the group health plan itself.

Application to Self-Insured Plans: Except under limited circumstances (e.g., level-funded products or plans changing from fully insured to self-insured), self-insured plans will not receive MLR rebates from insurance issuers. Nevertheless, self-insured ERISA plans must ensure they handle other plan assets per ERISA’s requirements.

What must be done with the rebate if the policyholder is a plan sponsor of a group health plan/trust?

It depends upon whether the plan is subject to ERISA, and whether those rebate/refund amounts are considered plan assets under ERISA.

What if the plan is subject to ERISA?

Only governmental and church health plans are considered ERISA exempt. All other group health plans are subject to ERISA. Plan sponsors of ERISA health plans have a fiduciary obligation to ensure that they properly handle plan assets of a given health plan on behalf of the plan participants. Therefore, a plan sponsor that receives an MLR rebate must determine whether a rebate or a portion thereof, constitutes plan assets.

If a portion of the MLR rebate constitutes plan assets under ERISA, the plan sponsor’s decisions on applying or using the rebate will be subject to ERISA’s general standards of fiduciary conduct and the exclusive benefit rule.

- **Fiduciary Duty Rule** - Under ERISA’s fiduciary duty rules, the fiduciary must act in the sole interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits under the plan and defraying reasonable expenses of administering the plan.³
- **Exclusive Benefit Rule** - Under the closely related exclusive benefit rule, plan assets must be used for the sole purpose of providing benefits to participants (and their beneficiaries) in the plan and for covering the costs of administering the plan. Any plan assets may not inure to the plan sponsor’s benefit.⁴

To the extent that any portion of the MLR rebate constitutes plan assets, ERISA’s fiduciary rules will apply, and the amounts must be used for the exclusive benefit of the plan participants and beneficiaries.



¹ 45 CFR § 158.241(a)(1).

² CCIO Technical Guidance (CCIO 2012-002): Questions and Answers Regarding the Medical Loss Ratio Regulation, Q/A-30

³ ERISA §404(a)

⁴ ERISA §403(c)(1)

When is the MLR rebate/a portion of the MLR rebate considered plan assets under ERISA?

As discussed in the Department of Labor's (DOL's) [Technical Release 2011-04](#), whether MLR rebates constitute plan assets may depend on several factors, including the policyholder, the participants' share in the cost of the policy and the group health plan's governing documents.

- **Plan or Trust Is Policyholder** – In the absence of specific plan/policy language to the contrary, the entire MLR rebate will constitute plan assets.⁵ If the plan/policy language addresses ownership of the rebate, the portion that constitutes plan assets will depend on the specific language.
- **Employer/Plan Sponsor Is Policyholder** – The portion of the MLR rebate that constitutes plan assets will depend on plan/policy language and the share of premiums paid by participants.
 - » Examples of allocation of plan assets when policyholder is employer/plan sponsor:
 - Plan/policy language gives employer ownership of rebate = to the extent plan language provides, the rebate will not constitute plan assets.⁶
 - Premiums are paid entirely from plan assets with no applicable plan/policy language = 100% of the rebate constitutes plan assets.
 - Premiums paid 100% by employer (no plan/policy language) = the rebate does not constitute plan assets.
 - Premiums paid 100% by participants (no plan/policy language) = 100% of the rebate constitutes plan assets.
 - Premiums shared by employer and participants based on fixed percentage = Plan assets equal the share of premiums paid by participants.
 - If employer pays fixed amount of premiums and participants are responsible for paying any additional costs = portion of the rebate that does not exceed the participants' total amount of prior contributions during the relevant period would be plan assets.
 - If participants pay fixed amount of premiums and the employer is responsible for paying any additional costs = the portion of the rebate that did not exceed the employer's total amount of prior contributions during the relevant period would not be attributable to participant contributions.

In all cases, according to TR 2011-04, ERISA prohibits plan sponsors from keeping an MLR rebate/portion of an MLR rebate in an amount greater than the total amount an employer has paid towards its health plan's insurance premiums and other related plan expenses. Therefore, any rebate that exceeds the employer's contribution towards its health plan's insurance premiums must be held in trust for the exclusive benefit of participants and beneficiaries.⁷



⁵ Technical Release No. 2011-04

⁶ If the governing plan/policy document gives ownership of the rebate to the employer, the employer should seek legal advice prior to retaining the rebate.

⁷ *Id.*

How must employers use MLR rebates?

Once an employer calculates the appropriate amount of plan assets to provide back to health plan participants, the DOL guidance under TR 2011-04 states that employers may “weigh the costs to the plan and the ultimate plan benefit as well as the competing interests of participants or classes of participants” in deciding how to allocate and distribute the plan assets from its MLR rebate(s) back to plan participants. Specifically, the DOL guidance includes two allocation methods available to employers:

- 1. Distribution to participants using a reasonable, fair and objective allocation method.** Typically, plan assets from MLR rebates should be distributed proportionately to all participants in the plan for the applicable MLR rebate year. The DOL does not directly address how former health plan participants should receive their share of the MLR rebate. However, under DOL guidance, if the plan fiduciary finds that the cost of distributing shares of the rebate to former participants “approximates the amount of the proceeds, the fiduciary may properly decide to allocate the proceeds to current participants based upon a reasonable, fair and objective allocation method.”⁸
- 2. Plan participants may receive future premium cost reductions or benefit enhancements.** If the plan fiduciary determines that distributing shares of the rebate to participants of the plan during the applicable MLR rebate year is not cost-effective “(e.g., payments to participants are of de minimis amounts, or would give rise to tax consequences to participants or the plan), the fiduciary may utilize the rebate for other permissible plan purposes including applying the rebate toward future participant premium costs or benefit enhancements.”⁹

Note that the DOL guidance does not define “de minimis” or provide specific examples of benefit enhancements for purposes of rebate distribution. Plan fiduciaries are encouraged to consult with their legal counsel for specific advice on allocating rebates.

⁸ *Id.*
⁹ *Id.*

Are former plan participants entitled to a share of the MLR rebate?

For plans subject to ERISA, the regulations do not require that former participants be included or excluded. The plan fiduciary must determine whether the cost of including former participants approximates the rebate amount and should make a prudent decision based on all relevant facts and circumstances.

What if the plan provides benefits under multiple policies?

The portion of the rebate should only be allocated to the participants and beneficiaries covered by the policy to which the applicable MLR rebate applies. According to DOL guidance, ERISA’s fiduciary rules prohibit using a rebate generated by one plan to benefit participants/beneficiaries of another plan.



Is there a time limit for employers to allocate the MLR rebate?

To avoid the requirement to hold plan assets in trust, policyholders subject to ERISA must use the portion of the MLR rebate attributable to plan assets within **three months** of receipt. Plans not subject to ERISA’s trust requirement may consider the cost of creating a trust when deciding how to use rebates.

What if the ERISA group health plan has been terminated before the policyholder’s rebate is paid?

If the insurance issuer can locate the policyholder, the DOL’s guidance under TR 2011-04 states that the policyholder subject to ERISA must comply with ERISA’s fiduciary provisions in the handling of MLR rebates, including a review of the plan document to determine how plan assets are to be allocated upon plan termination.



How do the MLR rebate requirements apply to non-ERISA plans?

- *Non-Federal governmental plans.* HHS requires policyholders to use the amount of the rebate that is proportionate to the total amount of the premium paid by all subscribers under the policy for the benefit of the subscribers in one of the following ways:
 - » Reduce subscribers' portion of premiums for the subsequent policy year for all subscribers covered under any option offered under the group health plan at the time the rebate is received;
 - » Reduce subscribers' portion of premiums for the subsequent policy year for only subscribers covered under the applicable policy to which the rebate is received at the time the rebate is received; or
 - » Make a cash refund to subscribers of the group health plan option for which the issuer is providing a rebate, who were enrolled in the group health plan option either during the applicable MLR reporting year that resulted in the issuer providing the rebate or at the time the policyholder receives the rebate.¹⁰
- *Church plans.* HHS regulations state that issuers may only provide rebates to non-ERISA, non-governmental policyholders (e.g., church plans) if the issuer receives written assurance from the policyholder that the rebates will be used in the same way that a rebate to a non-federal governmental plan could be used (as outlined above). If written assurance is not provided, the issuer must distribute the rebate directly to the subscribers of the group health plan covered by the policy during the MLR reporting year on which the rebate is based by dividing the entire rebate, including the amount proportionate to the amount of premium paid by the policyholder, equally to all subscribers entitled to a rebate without regard to how much each subscriber paid toward premiums.¹¹

Are employers required to provide any notices or disclosures to participants concerning MLR rebates?

No. However, for each MLR reporting year, health insurance issuers that issue rebates to policyholders must provide the policyholder and plan participants notice of the rebate when the rebate is provided.¹² The notice issued by issuers to plan sponsors subject to ERISA must include a statement that the policyholder may have additional obligations under ERISA's fiduciary rules concerning the handling of rebates.

Although employers are not obligated to provide notice of the rebate to participants, employers should nevertheless be prepared to answer questions from employees who receive the notice from the issuer. Employers may therefore choose to provide their own notice to participants explaining how the rebates are being allocated.

How are MLR rebates treated for federal tax purposes?

Following the HHS' final rules on MLR rebates, the IRS issued [Medical Loss Ratio \(MLR\) FAQs](#) providing information on the federal tax consequences of MLR rebates to health insurance issuers and policyholders, which are summarized below.

- *Pre-tax premiums.* The IRS guidance provides that if the employee portion of the premium is paid on a pre-tax basis under an IRC Sec. 125 cafeteria plan, the portion of MLR rebates distributed in cash or as a reduction of the employee premium cost will be subject to federal income tax and treated as wages subject to employment taxes in the year it's distributed.
- *After-tax premiums.* The guidance provides that where employee premiums are paid on an after-tax basis, the portion of MLR rebates distributed in cash or as a reduction of the employee premium cost is generally not considered taxable income to the employee and will not be subject to employment taxes.

¹⁰ 45 CFR § 158.242(b)(1)

¹¹ 45 CFR § 158.242(b)(3)

¹² 45 CFR §158.250



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