

employee benefits lawflash

August 14, 2012

**Medical Loss Ratio Rebates: The Clock Is Ticking**

*Rebates that are considered plan assets must be used within three months or placed in trust.*

The Patient Protection and Affordable Care Act of 2010 (ACA) requires health insurers to issue rebates to policyholders if less than a specified percentage of the premium dollars collected is used to provide medical care. Under the ACA, rebates must be paid if the medical loss ratio (MLR) exceeds 85% for the large group market or 80% for the small group and individual market (some states have even stricter MLR requirements). The first MLR rebates were due by August 1. Employer plan sponsors who received MLR rebates must decide, in short order, what to do with them. If the rebates are considered plan assets, employers must take action within three months in order to comply with the trust and fiduciary requirements applicable to employer plans under the Employee Retirement Income Security Act of 1974, as amended (ERISA). Many employers will recall receiving demutualization proceeds from insurers in prior years; the requirements for handling MLR rebates are similar.

**Who Owns the Rebate?**

If an employer receives an MLR rebate, the employer must first determine who owns the rebate. If the plan or a trust is the policyholder under the insurance contract, the rebate generally will be considered a plan asset and must be used for the benefit of plan participants. If the employer is the policyholder, the employer must look to the plan language to determine how the rebate may be used. If the plan language can be fairly read to provide that some or all of the MLR rebate belongs to the employer, then the employer may retain such amount and use it for any purpose. For cases where the plan is silent or the language is unclear, the Department of Labor (DOL) has provided guidance in Technical Release 2011-04<sup>1</sup> to help employers determine appropriate uses for MLR rebates.

The DOL guidance directs employers to look to the premium cost-sharing arrangement under the health plan for the year to which the MLR rebate relates to determine whether the rebate is owned by the plan, the employer, or both, as shown in the following chart.

Premium Cost-Sharing Arrangement	MLR Rebate Determination
Employer paid entire premium	Employer may retain entire rebate
Employees or trust paid entire premium	Entire rebate is a plan asset
Employer and employees each paid a fixed percentage of premium	Use percentage paid by employees to determine portion of rebate that is a plan asset
Employer paid a fixed dollar amount, and employees paid remainder of premium	Rebate is a plan asset, except to the extent amount exceeds total premium paid by employees

1. Dep't of Labor Tech. Release 2011-04 (Dec. 2, 2011), available at <http://www.dol.gov/ebsa/pdf/tr11-04.pdf>.

Employees paid a fixed dollar amount, and employer paid the remainder of premium	Rebate may be retained by employer, except to the extent amount exceeds total premium paid by employer
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As a practical matter, some employers are taking the easy route by choosing to return 100% of the MLR rebate to participants, even where the employers have subsidized the coverage and could legally retain all or a portion of the rebate. This approach assures compliance with ERISA's fiduciary requirements and also presents an opportunity for employers to communicate positive news to employees in an otherwise tight compensation and benefits environment.

## How Should the Rebate Be Used?

If some or all of the rebate is considered a plan asset, then such portion of the rebate must be used to benefit plan participants and must be handled in accordance with ERISA's general standards of fiduciary conduct. Employers may weigh the costs and benefits to the plan, as well as the interests of participants or groups of participants, as long as their methods are reasonable, fair, and objective. However, a rebate must always be used to benefit those participants covered under the insurance policy with respect to which the rebate was issued; it may not be spread among plan participants covered under other policies or coverage options.

Technical Release 2011-04 provides that MLR rebates may be distributed to plan participants. If an employer finds that the cost of making such distributions to former participants approximates the amount of the proceeds, the employer may reasonably choose to allocate the rebate among only active participants. Further, if distributions to active participants are not cost-effective because the amounts are very small or the distributions will give rise to tax consequences for participants (which will always be the case if premiums were paid with pre-tax dollars, as discussed below), the employer may instead choose to apply the rebate to reduce future participant contributions or to enhance plan benefits.

## By When Must the Rebate Be Used?

Under ERISA, plan assets, including participant contributions, generally must be held in trust for the benefit of plan participants. However, many group health plans take advantage of an exemption from the trust requirement (and its related audit and reporting requirements) that is available to plans that do not hold such amounts for more than three months. The DOL guidance makes clear that, if such a plan receives an MLR rebate that is considered a plan asset, the rebate must be used within three months of receipt in order for the plan to continue to rely on the exemption. As a result, time is of the essence for many employers in considering how they will use MLR rebates received from insurers.

Although the DOL guidance does not specifically address the point, it appears that rebates must be used *to benefit plan participants* within three months. For example, an employer that decides to distribute the rebate to plan participants must actually issue the amounts, whether through its regular payroll or separate checks, within three months of the employer's receipt of the rebate. Likewise, an employer that decides to use the rebate to reduce required participant contributions must adjust its payroll deductions for affected participants within three months. Current DOL guidance does not appear to permit a calendar-year plan that receives a rebate on August 1 to wait until the next plan year begins on January 1 to adjust premiums, although this undoubtedly would be easier administratively.

## Do These Rules Apply to All Plans?

Special rules apply to plans sponsored by non-federal governmental employers (e.g., state and local governments) and plans not covered by ERISA. For example, non-federal governmental employers may use the MLR rebate to reduce employee premiums for the upcoming plan year for participants covered under any coverage option offered under the employer's plan—an option not available for ERISA-covered plans. Further, because the ERISA trust requirement discussed above does not apply to such plans, these employers have more time to decide how they will use any MLR rebates received from their insurers.

## Tax Consequences

The Internal Revenue Service issued guidance in the form of a set of frequently asked questions (FAQs)<sup>2</sup> addressing the tax treatment of MLR rebates. The guidance confirms that, if employees paid their insurance premiums on a pre-tax basis, rebates distributed to employees will be subject to income and employment tax withholdings. Premium holidays will also serve to increase employees' taxable income because pre-tax payroll deductions will be reduced. Rebates of premiums paid by employees on an after-tax basis are not subject to tax withholding.

## Employee Communications

By now, plan participants have received communications from insurers informing them that an MLR rebate has (or has not) been issued with respect to their plan. Based on these communications and what they may have heard in the media, participants may be expecting rebate checks to arrive in the mail any day. Employers should communicate directly with their employees regarding how rebates will be used in order to manage expectations.

Employers who have received 2011 MLR rebates that are considered plan assets must act swiftly to use such amounts to benefit plan participants. It remains to be seen whether this will become an annual exercise, or if the issuance of MLR rebates will decline in future years. Insurers may adjust their spending, or even refrain from increasing insurance premiums, to ensure that they do not have to issue rebates for 2012 and beyond.

## Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

### Chicago

Andy R. Anderson	312.324.1177	<a href="mailto:aanderson@morganlewis.com">aanderson@morganlewis.com</a>
Brian D. Hector	312.324.1160	<a href="mailto:bhector@morganlewis.com">bhector@morganlewis.com</a>
Marla J. Kreindler	312.324.1114	<a href="mailto:mkreindler@morganlewis.com">mkreindler@morganlewis.com</a>
Julie K. Stapel	312.324.1113	<a href="mailto:jstapel@morganlewis.com">jstapel@morganlewis.com</a>

### New York

Craig A. Bitman	212.309.7190	<a href="mailto:cbitman@morganlewis.com">cbitman@morganlewis.com</a>
Gary S. Rothstein	212.309.6360	<a href="mailto:grothstein@morganlewis.com">grothstein@morganlewis.com</a>

### Palo Alto

S. James DiBernardo	650.843.7560	<a href="mailto:jdibernardo@morganlewis.com">jdibernardo@morganlewis.com</a>
Zaitun Poonja	650.843.7540	<a href="mailto:zpoonja@morganlewis.com">zpoonja@morganlewis.com</a>

### Philadelphia

Robert L. Abramowitz	215.963.4811	<a href="mailto:r Abramowitz@morganlewis.com">rabramowitz@morganlewis.com</a>
Brian J. Dougherty	215.963.4812	<a href="mailto:bdougherty@morganlewis.com">bdougherty@morganlewis.com</a>
I. Lee Falk	215.963.5616	<a href="mailto:ilfalk@morganlewis.com">ilfalk@morganlewis.com</a>
Amy Pocino Kelly	215.963.5042	<a href="mailto:akelly@morganlewis.com">akelly@morganlewis.com</a>
Robert J. Lichtenstein	215.963.5726	<a href="mailto:rlichtenstein@morganlewis.com">rlichtenstein@morganlewis.com</a>
Joseph E. Ronan, Jr.	215.963.5793	<a href="mailto:jronan@morganlewis.com">jronan@morganlewis.com</a>
Steven D. Spencer	215.963.5714	<a href="mailto:sspencer@morganlewis.com">sspencer@morganlewis.com</a>
Mims Maynard Zabriskie	215.963.5036	<a href="mailto:mzabriskie@morganlewis.com">mzabriskie@morganlewis.com</a>
David B. Zelikoff	215.963.5360	<a href="mailto:dzelikoff@morganlewis.com">dzelikoff@morganlewis.com</a>

### Pittsburgh

Lisa H. Barton	412.560.3375	<a href="mailto:lbarton@morganlewis.com">lbarton@morganlewis.com</a>
John G. Ferreira	412.560.3350	<a href="mailto:jferreira@morganlewis.com">jferreira@morganlewis.com</a>

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2. The MLR FAQs were last revised on April 2, 2012. They can be accessed at <http://www.irs.gov/newsroom/article/0,,id=256167,00.html>.

# Morgan Lewis

Lauren B. Licastro  
R. Randall Tracht

412.560.3383  
412.560.3352

[llicastro@morganlewis.com](mailto:llicastro@morganlewis.com)  
[rtracht@morganlewis.com](mailto:rtracht@morganlewis.com)

## Washington, D.C.

Althea R. Day  
David R. Fuller  
Havilah L. Gebhart  
Mary B. "Handy" Hevener  
Gregory L. Needles

202.739.5366  
202.739.5990  
202.739.5774  
202.739.5982  
202.739.5448

[aday@morganlewis.com](mailto:aday@morganlewis.com)  
[dfuller@morganlewis.com](mailto:dfuller@morganlewis.com)  
[hgebhart@morganlewis.com](mailto:hgebhart@morganlewis.com)  
[mhevener@morganlewis.com](mailto:mhevener@morganlewis.com)  
[gneedles@morganlewis.com](mailto:gneedles@morganlewis.com)

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