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Compliance Insights | Guide to medical loss ratios

The federal healthcare reform law (The Affordable Care Act or ACA) requires health insurers, including health maintenance organizations (HMOs), to annually achieve minimum medical loss ratios (MLR) on insured medical contracts or return premium dollars to the policyholder.

By each Sept. 30, carriers will issue rebates to employers, based on the carriers' respective MLRs for the prior calendar year. In some cases, there are restrictions on how these rebates, or some portion of them, may be spent by employers. Carriers might not explain these potential restrictions to employers.

If an insurer does not attain the minimum loss ratio, it will send notices — which are somewhat ambiguous — to covered employees. These notices may prompt questions by some employees and by/to the employer/policyholder.

The purpose of this piece is to:

- **Explain how the MLR rules work.**
- **Explain how employers may be required to apply the rebates.**
- **Supply links to the HHS-prepared model notices that carriers will supply to covered employees.**
- **Supply a list of frequently asked questions regarding MLR rebates.**

Your Lockton account team also has several model documents that may prove helpful, including sample employee communication pieces explaining MLR rebates and model wrap plan amendments that supply language making it easier for employers to deal with MLR rebates.

Background

The ACA requires insurers and HMOs — on their fully insured business — to meet or exceed specific MLR thresholds or refund premium dollars to the policyholder. The MLR rules do not apply to self-insured plans, stop loss coverage or excepted benefits, such as stand-alone dental and vision coverage. The rules are applied to a carrier's book of business on a state-by-state basis and vary by market (large or small group) in the state. The grandfathered status (under health reform) of the plan or policy is irrelevant. The rules do not apply to insurers in the U.S. territories (U.S. Virgin Islands, Northern Mariana Islands, Guam, American Samoa and Puerto Rico).

"Medical loss ratio" refers to the percentage of each premium dollar that insurers must spend on paying direct medical costs and on improving healthcare quality for their customers. The remaining percentage goes to nonmedical expenses such as salaries, advertising, claims adjudication, profits, etc.

The ACA stipulates insurers must pay rebates (lump-sum cash payment or premium credit) to their policyholders if they have a loss ratio of less than 80% for individual health policies and small group health plans and less than 85% for large group health plans. For states with a higher MLR standard (e.g., 90%), the higher percentage applies to insurers in that state.

The U.S. Department of Health and Human Services (HHS) reports insurers' MLRs on its website. By July 31, health insurers must submit their annual reports for the prior calendar year. If an insurer failed to meet its loss ratio for the prior calendar year, it must provide rebates by Sept. 30 of the subsequent year. The MLR for expatriate coverage is separately calculated from the insurer's other health coverage and can be determined on a national basis. Expatriate coverage that qualifies under the Expatriate Health Coverage Clarification Act of 2014 is exempt from the MLR requirements.

The insurer's report to HHS will indicate whether not or it attained the minimum MLR for the calendar year for each market (individual, small group or large group) within each state it operates. The rebate is calculated based on that calendar year of reporting. The rebate calculation will be based on an average over the prior three years.

Communication from insurers & rebates to be paid by Sept. 30

The ACA requires health insurers to issue rebates to policyholders by Sept. 30 if the insurer failed to attain the minimum MLR for the prior calendar year. Prior to Sept. 30, health insurers must distribute a notice to policyholders and subscribers (e.g., enrolled employees) only if the MLR threshold was not satisfied for the prior calendar year and the plan is due a rebate. HHS does not require an insurer to issue a notice if it satisfied the MLR threshold and no rebate is due.

The HHS created model notices insurers must use. The instructions accompanying the notices indicate insurers cannot deviate from the notices' required content. The model notices are a bit vague and may generate questions from covered employees.

Navigating the maze

Lockton Compliance Services has developed model documents and tools to help employers navigate the potential issues related to MLRs, including:

- Model employee communication pieces (prepared by Lockton) for employers whose employees will receive MLR notices from insurers.
- Model wrap plan amendment language with an accompanying summary of material modification and resolution, to supply the plan sponsor with additional flexibility regarding what it may do with its carrier's rebate. Employers restating or putting in a new wrap plan through Lockton after 2012 should have the desired language in their wrap plan document.

Refunds & ERISA employers

In instances when the carrier provides a cash rebate, the employer will need to determine what part of the rebate, if any, is considered to be a plan asset under ERISA that must be used for the benefit of plan participants. The answer depends on what, if anything, the plan documents say about who may keep the rebate, and (if the plan is silent) who paid the premiums for the medical coverage.

Plan documents describe who is entitled to the rebate

Where the plan documents describe who is entitled to the MLR rebate, the employer should follow the terms of the plan. Some plan documents don't address the question of MLR refunds. In those cases, the plan should be amended or restated to ensure appropriate language is in the document. If the employer adopts (before the rebate is received) such an amendment or restatement, it has a better argument that none of the rebate is a plan asset if the amount of the rebate is less than the amount of employer's contributions for that year (which will almost certainly be the case). Under this scenario, we think the employer may retain the entire amount of the rebate and use it for expenses unrelated to the medical insurance program, but employers may wish to discuss that issue with their ERISA counsel.

Plan documents don't describe who is entitled to the rebate

In this case, the answer to the question, "Who gets a piece of the rebate and how large a piece?" turns on four different factual scenarios, distinguished by who pays the premium for the medical coverage:

EMPLOYER PAY-ALL

Employer may keep the entire rebate.

EMPLOYEE PAY-ALL

All of the rebate must be used to benefit participants.

EMPLOYEES PAY A FIXED PORTION & THE EMPLOYER PAYS THE REST

(e.g., Under a cost-plus or minimum premium contract where the employer's liability is potentially open-ended). Employer may keep the entire rebate.

EMPLOYER & EMPLOYEES EACH PAY A FIXED PERCENTAGE OF PREMIUM

A percentage of the rebate — equal to the percentage of premium paid by employees — must be used to benefit participants, and the employer may keep the balance.

If the ERISA employer determines some or all of the rebate is a plan asset, that portion of the rebate must be used within three months to pay employee premiums, provide benefit enhancements or be disbursed to plan participants in cash. Otherwise, the employer must establish a trust to hold the rebate for the future benefit of plan participants. Most employers will want to use up the plan's share of the refund within three months. Establishing a trust would make the underlying medical plan "funded" for purposes of ERISA, requiring an outside auditor's report to accompany the annual Form 5500 filing if the plan has 100 or more participants.

As a practical matter, providing cash refunds to participants may be burdensome. Typically, the refund will be taxable and the employer would be responsible for paying its share of FICA taxes on the amounts disbursed. There would also be the practical problem of trying to find former enrollees. A more tax-efficient approach would be to provide current enrollees with a premium credit or "holiday."

In instances when the carrier provides a premium credit (e.g., applies the rebate against the plan's future premium payment obligation), employers will need to instruct the insurer when and how to apply the credit. If the employer adopts the wrap plan amendment, it has an argument that the entire rebate may be used to offset the employer's share of the premium payment (and not the employees' share) if the rebate is less than the amount of the employer's contributions for the year. Employers will need to carefully consider whether they will provide former employees, such as COBRA beneficiaries and retirees, with a premium credit. Doing so may be more burdensome and hassle-prone than it's worth.

Refunds & governmental employers

For the year to which the MLR refund applies, the plan sponsor must determine the portion of premiums paid by participants (say, 30%). The same portion (e.g., 30%) of the MLR refund must be used in one of three ways, as the plan sponsor may decide:

01 Reduce participant contributions for the subsequent policy year.

02 Reduce participant contributions for the subsequent policy year, but only for those participants who made premium payments in the year to which the refund relates (for example, if the MLR refund is made in 2018 for the 2017 policy year, the sponsor may reduce contributions to be made by those participants who made premium payments in 2017).

03 Pay a cash refund to those participants who made premium payments in the year to which the refund relates.

It appears a governmental employer with a calendar year policy would need to use up the MLR refund by Dec. 31 of the year in which it is paid. This will require careful planning because a premium holiday will be limited to the remaining months in the calendar year.

It's not clear how the rule applies to policies not operating on the calendar year, such as a policy that renews every July 1. In this example, we think the refund would need to be used by the end of the policy year in which the rebate was received.

Refunds & church employers

An insurer that owes an MLR refund to a non-ERISA, nongovernmental plan (such as a church plan) should pay the entire amount over to the plan sponsor, but only after receiving assurances from the plan sponsor that it will use the money to benefit participants.

MLR FAQs

1. If we decide to allocate the plan's share of the rebate to the employees in cash refunds, do we only have to consider current and active participants?

For ERISA employers, the Department of Labor (DOL) says determining how to allocate the rebate dollars is a fiduciary function. Basically, the employer should consider the cost associated with trying to find former participants and whether the cost associated with distributing the rebate to last year's participants exceeds the cost of the rebate. For example, the DOL says:

In 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. For example, if a fiduciary 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 based upon a reasonable, fair and objective allocation method.

Our general sense is that trying to track down former participants and then dealing with the tax implications of the rebate distribution often will not be practical. But we suppose the plan sponsor should at least think about it, and if it concludes it's not practical (given the amount of the rebate, the number of former participants, the cost of distributing the rebate to last year's class of participants, the tax issues associated with the distribution to former employees, etc.), then make a note of that decision.

2. With respect to the plan's share of the rebate, may we allocate the same amount to each employee regardless of their enrollment in or contribution to the plan (employee vs. family coverage)?

We think so. Here, too, the DOL has provided some general, but still helpful, guidance:

Decisions on how to apply or expend the plan's portion of a rebate are subject to ERISA's general standards of fiduciary conduct … the responsible plan fiduciaries must act prudently, solely in the interest of the plan participants and beneficiaries, and in accordance with the terms of the plan … An allocation does not fail to be impartial or "solely in the interest of participants," … merely because it does not exactly reflect the premium activity of policy subscribers.

In short, it appears to us that the DOL has no problem with a per capita distribution method or any other reasonable method.

3. What do we do about COBRA enrollees? They paid into the pool; do they get some of the plan's share of the rebate?

Reasonable minds can differ on this, and to some extent, employers may reach different conclusions depending on several factors, such as whether they administer COBRA or outsource it, whether the COBRA participant is currently making COBRA payments (note that some COBRA payees have their COBRA premiums automatically deducted from a checking account and would have to alter the amount for a month or more) or their COBRA coverage terminated during the prior year or early this year (before the rebate arrived), what amount the COBRA participant would receive, and what the costs and hassles associated with making the payments are.

There is no consensus here, regarding how to deal with COBRA participants. But the factors listed above should be considered. Any reasonable decision based on those factors should be acceptable.

4. How should we handle retirees who are paying for retiree medical coverage?

The issues here are similar to those employers face with respect to COBRA enrollees. However, any portion of the rebate that is returned to retirees would be tax-free because they contribute post-tax for their coverage. An employer granting a premium holiday to retirees would be faced with the same administrative issues the employer will face with COBRA enrollees.

5. What if a current enrollee was not on the plan in the year to which the rebate relates? Do they get any of the plan's share of the rebate? What about terminated employees from the year to which the rebate relates … do we need to find them?

See the answer to the first question above. Most employers are concerning themselves only with the current group of participants. But it's not an issue to which there is a black-and-white answer. It's a little grayer than that and requires at least a quick weighing of the various factors.

6. An employer uses a VEBA for its medical plan, and the VEBA is the owner of the insurance contract. How does this impact the analysis?

In most cases, the VEBA would be entitled to the entire rebate. The DOL guidance indicates the following concerning trusteed plans (which would include VEBAs):

For group health plans, a distribution such as the rebate will be a plan asset if a plan has a beneficial interest in the distribution under ordinary notions of property rights. Under ERISA section 401(b)(2), if the plan or its trust is the policyholder, the policy would be an asset of the plan, and in the absence of specific plan or policy language to the contrary, the employer would have no interest in the distribution.

See additional information from the DOL.

7. The insurance coverage that generated the MLR has been canceled. What happens to the rebate?

HHS guidance indicates that if the carrier cannot locate the policyholder (the employer, typically), the insurer must distribute the entire rebate (both the employer's and the plan's share) directly to the participants who were enrolled in the terminated plan during the MLR reporting year on which the rebate was calculated by dividing the rebate equally among the individuals entitled to a rebate.

If an insurer is able to locate the policyholder (the employer, typically) with respect to a terminated ERISA plan, however, DOL guidance indicates the policyholder would need to comply with ERISA's fiduciary provisions when handling any rebate. Despite the fact the coverage has been terminated, the plan document should be consulted and its terms followed. If the plan document does not provide direction (it usually won't), the DOL suggests the policyholder may need to determine whether it is cost-effective to distribute the plan's portion of the rebate to the relevant former participants in the plan.

8. An employer has a wrap plan that includes insured and self-funded plan options. Does it have to use the plan's share of the MLR rebate solely for the benefit of the participants in the insured option, or may it be used for the self-funded program too?

The conservative approach would be to use the MLR rebate for the current participants in the insured program. But because the insured program and self-funded program are contained within the same ERISA plan, it should be permissible to use the rebate for all the plan participants (e.g., those employees enrolled in the insured and self-funded options), if you wish to do that.

9. How do we handle the plan's share of an MLR rebate for employees who are covered under the Service Contract Act (SCA)?

The fiduciary issues for ERISA employers with employees covered by the SCA are the same as they are for other employers. If the employer wants to apply the plan's share of the rebate toward the SCA fringe rate, it would have to be used in a manner consistent with SCA rules for bona fide fringe benefits (e.g., purchase of insurance or paid into an irrevocable trust). Your legal counsel should be consulted on these issues.

10. Do you have a sample response to a former employee who asks why they didn't receive a cash rebate?

"The rebate paid by [insurer] is attributable partly to premiums paid by [employer], and partly to premiums paid by participants in the health plan. With respect to the portion of the rebate attributable to participants' premium payments, these funds are considered assets of the health plan and U.S. Department of Labor guidelines leave it to the plan's fiduciaries to decide how best to allocate those funds; that is, whether to use them to supply additional plan benefits, to reduce premiums for the current year or refund those assets in cash.

"Where a refund is considered, the plan's fiduciaries are permitted to decide whether to allocate the refund among those who were participants in the plan last year, those who are participants this year, those who are participants this year and who were also participants last year, or in any other reasonable method. Where the amounts are modest and where the cost and administrative burdens of tracking down former participants (and dealing with the tax issues that will result from distributing a portion of the rebate to them) makes it more appropriate to simply credit the refund to this year's participants, the plan is permitted to do that.

"After considering all these issues and related administrative burdens and costs, the fiduciaries of the plan have determined to use the portion of the rebate belonging to the plan to [insert course of action] …"

11. Can you provide an example of how the employer would determine how it uses the MLR rebate?

Sure. Let's assume Sample Company's MLR refund is $20,000, and the share attributable to employee contributions is 25%, or $5,000. Sample Company may keep $15,000 of the refund and do with it as it pleases. Sample's health plan documents do not address how Sample Company should allocate the plan's share of the refund. There are 150 enrollees on the Sample Company health plan and 12 COBRA participants. There are 18 individuals who were enrolled employees in the year to which the rebate relates who are no longer active employees or COBRA enrollees.

The per capita share of the employee portion of the MLR refund is $27.77, considering the former employees and COBRA enrollees. Sample Company concludes that the additional cost and administrative burdens associated with locating and paying a rebate to the former employee and COBRA enrollees exceeds the $27.77 rebate they would otherwise receive. Sample Company concludes that the most reasonable course of action is to provide a premium credit, through payroll deduction, for the employees currently enrolled on the plan.

Sample Company is not required to adjust any individual's share of the rebate to account for the fact that the individual may have paid or is paying a larger premium (e.g., for family coverage as opposed to employee-only coverage).

Sample Company divides $5,000 by 150 participants, for a per-capita share of $33.33, and reduces each participant's premium payment for a month by $33.33. Each participant's taxable pay therefore increases by $33.33 for that applicable payroll run.

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