GROOM LAW GROUP

On August 2, 2012, Cigna sponsored a webinar on Medical Loss Ratio rebates featuring Groom Law Group. This FAQ overview summarizes the question and answer session that followed.

Frequently Asked Questions about Medical Loss Ratio ("MLR") Rebates

I. ERISA and Tax Issues

Q1: Does the employer have to give all of an MLR rebate back to the employees, or can the employer keep part of it?

It depends on whether the rebate is a "plan asset." According to Department of Labor ("DOL") Technical Release 2011-04, one must look to the terms of the insurance policy and the governing plan documents to determine if any portion of the rebate may be retained by the employer. If the plan documents are silent as to who has an ownership interest in the MLR rebate, one must look to the source of premium payments for the policy to determine what portion of the rebate (if any) will be considered a "plan asset". According to the DOL guidance:

- If the premium is paid entirely out of *trust assets*, the entire rebate will be considered a plan asset;
- If *employees paid the entire cost of insurance coverage*, the entire rebate is a plan asset;
- If the *employer pays the entire cost of insurance coverage*, the entire rebate is *not* considered a plan asset;
- If the *employer and enrollees both contributed a percentage of the cost of insurance coverage*, the MLR rebate is a plan asset to the extent attributable to enrollee contributions and the balance is not a plan asset and may be retained by the employer.

Q2: What steps must an employer take to meet its ERISA fiduciary duty to not unduly profit from the rebates?

If the rebate is a "plan asset," it cannot be kept by the employer or used to pay corporate expenses. Instead, the rebate must be used consistent with ERISA and DOL guidance, in the following manner:

- Distributed in cash to participants;
- Used to reduce the participants' portions of future premiums under the plan; or
- Used to enhance benefits under the plan, such as the addition of a wellness program or dental or vision benefits.

Note: Different rules apply to governmental and church plans.

Q3: Must rebates be distributed in cash to participants?

The DOL guidance suggests that cash distribution of a rebate that is a plan asset is the preferred method, and that such amounts should be distributed to those who contributed to the cost of the plan that generated the rebate. However, the DOL guidance gives plan fiduciaries flexibility to apply rebates toward future premiums or benefit enhancements for the plan that generated the rebate if they deem it appropriate to do so because the cost of distributing the rebate as cash is too high or burdensome, or the amounts to be distributed would be "*de minimis*," or if a cash distribution would result in adverse tax consequences to rebate recipients. Regardless of how a plan fiduciary decides to apply the rebate, the allocation formula must be "reasonable, fair and objective" which is discussed below:

Q4: When do plan fiduciaries have to pay the funds back to participants?

For plans that have a trust or are funded through a VEBA, there is no specific date by which rebates that are "plan assets" must be distributed in cash (or otherwise applied to enhance benefits or reduce the participants' share of insurance premiums).

For an unfunded plan that is exempt from ERISA's trust and audit requirements, however, the DOL guidance requires that the rebate be (1) distributed in cash to participants or (2) used to offset the participants' share of future premiums – within *3 months* of the plan's receipt of the rebate (generally November 2012) to maintain that exemption. It is unclear if DOL will allow plans to apply an MLR rebate toward calendar year 2013 premiums, since the first such premium payment generally would not be due until January 2013 – which is more than 3 months *after* the rebate was received. It is possible that DOL might view a written and irrevocable commitment made prior to November 2012 – to apply the rebate toward 2013 premiums – as effectively "using" such rebates within 3 months of receipt, but there is no guidance from DOL on this point as of yet.

Q5: What are the tax consequences for an employee who receives these rebates if the employee's share of premium in 2011 was paid on a pre-tax basis?

If an employee paid his or her portion of the insurance premium on pre-tax basis (*e.g.*, through a cafeteria plan), then distribution of the rebate as cash will generally be taxable to the employee, and withholding rules will apply. Additionally, the amount of the rebate must be reported on a Form W-2 issued to the employee, given that the rebate distribution generally will be considered a supplemental wage.

If the rebate is used to offset the employee's share of a premium that is paid on a pre-tax basis, then the employee's taxable income will increase by the amount of the premium reduction

Q6: If an employer offers an HMO and PPO option, and receives a rebate for the HMO option, may the employer distribute the rebate among participants in each product, or must it go exclusively to those participants in the HMO product to which the rebate is attributable?

Rebates generally must be used to benefit participants in the option that generated the rebate.

II. Calculations

Q7: Must a plan fiduciary pick either 2011 or 2012 participants to refund?

No. As discussed above, the DOL guidance suggests that the "preferred" approach is to distribute the rebate in cash to plan participants who were covered by the plan that generated the rebate in 2011, so this would include people in the plan during 2011. However, if it is not cost-effective to track down former employees who are no longer covered by the plan, or if the amounts to be distributed are *de minimis*, such amounts may instead be allocated to *current* plan participants who are covered by the plan that generated the rebate when the rebate is received.

Q8: How should a plan fiduciary calculate the amount of a distribution paid to each participant, if this is the option that the plan decides to implement?

The DOL guidance applicable to ERISA plans (and HHS guidance for governmental and church plans) does *not* have a specific formula for how rebates are distributed or allocated. In the case of ERISA plans, the DOL guidance provides that a plan fiduciary must decide upon a "reasonable, fair and objective" allocation policy, which weighs the costs to the plan and plan benefits – as well as the "competing interests of plan participants and beneficiaries."

Importantly, the DOL guidance is clear that the allocation method does *not* need to exactly reflect the premium activity of participants. Accordingly, plan fiduciaries have flexibility to develop their own policies, looking to who contributed to the cost of coverage that generated the rebate – and the costs to the plan of divvying up the rebates.

Q9: When determining how much of the rebate to distribute to participants covered by the policy, is it based on the amount paid by an employee for employee-only coverage, or should the plan take into account amounts contributed by an employee toward family coverage?

As discussed above, the DOL guidance does not set forth a specific formula for allocating rebates among participants. Instead, the DOL guidance provides that a plan has discretion to develop its own allocation methodology, provided that such method is "reasonable, fair and objective." Importantly, the DOL guidance specifically notes that the allocation method does not need to exactly reflect the premium activity of subscribers.

Q10: Employers are asking if applying the rebate toward participants' future premiums is more advantageous than distributing the rebate in cash. Can an employer reduce the amount of premium taken from an upcoming paycheck?

Yes, if the fiduciary determines that a distribution as cash is not appropriate (e.g., the amount of the rebate to be distributed is *de minimis*, or the cost to plan of distributing such amounts is too high, or if a cash distribution would impose adverse tax consequences on plan participants). An alternative to reducing the participants' share of future premiums is to enhance benefits under the plan that generated the rebate.

Q11: How much is a "*de minimis*" rebate?

The DOL guidance does not define a *de minimis* rebate, although other MLR rules applicable to insurers define a *de minimis* amount as a rebate of $20 or less that is owed to the group policyholder. Given the lack of a binding definition, it appears that plans have flexibility to set their own standard, within reason. In setting a *de minimis* standard, many plans are looking at things like: (1) how much would be distributed to employees after income tax withholding, (2) the cost of mailing the rebate check and (3) the administrative costs of manually cutting checks.

Q12: If I determine a rebate amount is *de minimis*, what can I do with the money? Can the employer just keep it?

No, an employer may not keep *de minimis* amounts if the rebate is a plan asset. If a distribution as cash to former participants is not feasible because the amounts are *de minimis*, the plan fiduciary may allocate such amounts to current enrollees in the plan that generated the rebate. And, if a cash distribution to current enrollees is not feasible because the distributed amounts would be *de minimis* (or would impose adverse tax consequences), the plan may use the rebate to offset premium payments or enhance benefits for current participants in the plan.

Q13: Does an employer need a rebate policy in place based on the DOL guidelines? What documentation should the employer and plan retain to show how the rebate was used?

A rebate allocation policy is not required as a matter of law, but it is prudent to have a written policy in case of a DOL audit. At a minimum, employers and plans should retain documentation concerning decisions as to the following matters:

- Whether the MLR rebate is a "plan asset," and the supporting documentation for that decision (e.g., copies of relevant insurance policies, plan documents, trust agreements, summary plan descriptions, etc.);
- If the rebate (or a portion thereof) is determined to be a plan asset, the plan's "reasonable, fair and objective" methodology for allocating the rebate among participants covered by the policy that generated the rebate, including whether any amounts were distributed to former employees, and whether any *de minimis* amounts were allocated to current participants;
- If the rebate is applied toward a benefit enhancement or as an offset to participants' share of future premiums, verification of the additional benefit or how the premium offset will be applied (*e.g.*, will there be a one-time premium holiday, or will the participants' share of premiums be reduced over a period of months);
- If the trust is unfunded, verification that the rebate was, within 3 months of the plan's receipt of the rebate, either distributed in cash or used to reduce the participants' share of future premiums.

Q14: An employer has employees in multiple states but received a rebate indicating that only one of the states was eligible for a rebate. How does that happen? Does that rebate need to be used for the benefit of all employees or just the employees in that state?

When the insurer is calculating the experience, it is not doing that on a plan-by-plan basis. If employees reside in different states, federal regulations require the insurer to put all of those employees into one state's pool based on where the contract is issued. As for use of the rebate, it applies to all employees regardless of where they are located.

While a group insurance policy ordinarily covers people in multiple states, HMO coverage is typically limited to a particular state (single state HMOs). An employer may sponsor a group health plan that is funded by contracts with multiple HMOs — one in each state where employees are located. That might explain why for a single group health plan a rebate may be payable by HMOs in some states but not others.

Q15: Will Cigna adjust commissions since the rebate is a return of premium?

No. An MLR rebate does not result in any adjustment to commissions already paid.

III. Terminated Employees/COBRA Beneficiaries

Q16: What happens if an employer cannot locate an ex-employee it had in 2011 that technically should be getting part of a rebate back?

If a former employee cannot be located, amounts otherwise attributable to him or her may be allocated to other former and current participants based on a fair and reasonable method.

Q17: What is an employer's responsibility to people on the plan because of COBRA – do COBRA participants share in a rebate distribution/allocation?

COBRA beneficiaries are plan participants and generally should be considered when deciding on an allocation method. (COBRA beneficiaries are usually different from simply terminated employees with whom the plan no longer has contact).

IV. Benefit Enhancements and Wellness Programs

Q18: How is "benefit enhancement" defined?

The DOL has not defined a "benefit enhancement." Applying a plain reading of the term suggests that a benefit enhancement would include adding to the plan that generated the rebate coverage for items or services not previously covered. Dental/vision coverage and wellness programs are all examples of products or services that would likely be considered as benefit enhancements.

Q19: If a rebate is used to add a wellness program, must all enrollees in the plan that generated the rebate participate?

The DOL has not issued guidance regarding the use of MLR rebates to add wellness programs, although, as discussed above, it is likely that a wellness program would be viewed as a benefit enhancement. In discussing benefit enhancements, the DOL does not require that all enrollees covered under the plan actually utilize the additional benefit.

Q20: Can we use the rebate to buy treadmills for our onsite wellness center?

If the rebate is a plan asset, the DOL may not look favorably upon the use of the rebate to buy treadmills, given that the treadmills would likely be available for use by any employees (regardless of whether they were covered by the plan that generated the rebate). Additionally, it would be difficult to argue that treadmills have a connection to the health coverage offered under the plan that generated the rebate.