



IN THE BUSINESS OF YOUR SUCCESSSM

HEALTH CARE REFORM

Eye on Washington

MEDICAL LOSS RATIO REBATES

The first rebates under the Medical Loss Ratio (MLR) rule applicable under the Patient Protection and Affordable Care Act (ACA; also known as Health Care Reform), are payable this August. Under the MLR rule, health plan insurers are required to spend a certain percentage of the premiums that they receive on health care services and activities to improve health care quality. If a health plan insurer does not satisfy the MLR rule, the insurer owes a MLR rebate.

For most insured group health plans, health plan insurers will provide the rebate owed to the policyholder of the plan, which is usually the employer sponsoring the plan. *Employers who receive a MLR rebate from a health plan insurer will need to decide how the rebate will be used and distributed. Insurers must distribute rebates by August 1st of each year. The first round of MLR rebates are due by August 1, 2012 and are based on the insurer's 2011 MLR.* Since the MLR rule only applies to health plan insurers, a MLR rebate will not apply to self-insured health plan benefits.

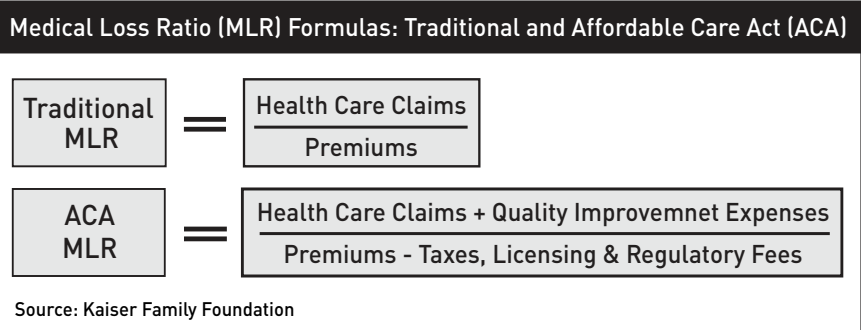
How Is the MLR Rebate Calculated?

The MLR rules require that an insurance carrier whose MLR is less than 85% in the large group market or 80% in the small group market provide a rebate to policyholders. Under the MLR rules, the large group market is defined to include "any employer with an average of 101 or more employees during the preceding calendar year." Until 2016, States have the option of defining large employers as those having 51 or more employees, and small employers as those having 50 or fewer employees during the preceding calendar year.

MLRs are calculated by dividing health care claims and quality improvement by the carrier's premium income (minus taxes and regulatory fees). The chart below illustrates the difference between the traditional MLR formula and the MLR formula under the ACA. The traditional MLR formula has been utilized by insurance carriers and regulators on a product by product basis to evaluate the financial viability of a particular insurance product.

Carriers must generally calculate MLR based on three criteria:

- State (based on policies issued in the State);
- Market segment (i.e., large group, small group and individual); and
- Carrier's legal entities (i.e., carriers' HMO and PPO filings may be under different entities)





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How Much?

On June 1, 2012, health plan insurers nationwide submitted their annual MLR reports for coverage provided in 2011 to the U.S. Department of Health and Human Services (HHS). Based on this data and according to HHS, health plan insurers that didn't meet the MLR rule will provide more than \$1.1 billion in MLR rebates this year for plans covering nearly 12.8 million Americans. According to HHS, that will be an average rebate of \$151 per covered household.¹

How Does an Insurer Provide the Rebate?

The health plan insurer can provide the group health plan MLR rebate to the employer/plan sponsor by one of the following methods:

- a reduction in the premium due from the employer/plan sponsor to the insurer (i.e., a reduction in the 2012 premium); or
- a reimbursement to the employer/plan sponsor.

An insurer can avoid paying a MLR rebate by providing a "premium payment holiday" (if allowed by State law and offered to employers on a non-discriminatory basis) during which time premiums will not be due.

ERISA Considerations

For group health plans governed by the Employee Retirement Income Security Act of 1974 (ERISA), health plan insurers will provide the MLR rebate to the policyholder of the plan, which is usually the employer sponsoring the plan. For ERISA-governed group health plans, rebate payments to the policyholder/employer may have plan asset, fiduciary responsibility, and prohibited transaction implications under ERISA. To the extent that MLR rebates constitute plan assets of an ERISA-governed group health plan, the MLR rule indicates that decisions regarding the allocation and the handling of the rebate would have to be made by a plan fiduciary. To help employers/plan sponsors comply

with ERISA, the U.S. Department of Labor (DOL) has issued guidance as discussed below.

DOL Guidance

The DOL has issued guidance to help employers/plan sponsors and other fiduciaries of ERISA-governed group health plans understand what their duties are relating to the MLR rebates. The DOL guidance addresses issues concerning the status and the handling of rebates when they are provided to the policyholder/employer of such a group health plan. Among other things, the guidance covers plan asset issues, plan fiduciary considerations, determining the plan participants' portion of the rebate and plan trust considerations. The DOL guidance is located at <http://www.dol.gov/ebsa/newsroom/tr11-04.html>.

Federal Taxes

The Internal Revenue Service (IRS) has issued a set of FAQs describing the federal income tax and federal employment tax consequences for MLR rebates. For employer-sponsored group health plan coverage, refer to Section C (for employee after-tax premium payments) and Section D (for employee pre-tax premium payments) in the FAQs. Under both sections, the federal tax consequences are described for premium reductions and cash distributions to the employee/group health plan participant. The FAQs are located at <http://www.irs.gov/newsroom/article/0,,id=256167,00.html>. Although federal tax guidance has been provided, an employer will also need to determine if and how State taxes apply.

Notices

A health plan insurer is required to send out a MLR notice. If the insurer meets or exceeds the MLR requirement (i.e., is not required to provide a MLR rebate), the insurer must send a MLR notice to each policyholder (typically the employer) and the subscriber



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(typically the employee) of the insured group health plan. This notice only applies for the 2011 MLR and must be provided in the first plan document (e.g., open enrollment materials) that the insurer provides to enrollees on or after July 1, 2012. The federal government has provided a model MLR notice for use by insurers.

If the insurer is required to provide a MLR rebate, the insurer must send a MLR notice to each policyholder and subscriber of the insured group health plan. For the 2011 MLR, this MLR notice is due by August 1, 2012. The federal government has also provided a model MLR notice for use by insurers. In addition to other information required to be included in the model notice, the notice directs employees to contact their employer or plan administrator for information on how the MLR rebate will be distributed.²

Some Employer and Group Health Plan Sponsor Considerations

Employers and group health plan sponsors that provide insured health benefits may want to contact their insurance brokers, health insurance companies and professional legal, tax and ERISA advisors as soon as possible and in advance of any potential MLR rebate distributions from health plan insurers to ensure the proper handling, use and distribution of the rebate. Employers will also need to consider how they will distribute any rebate to subscribers and the tax treatment of such distributions.

¹ <http://www.healthcare.gov/law/resources/reports/mlr-rebates06212012a.html> . For additional information about the MLR filing requirements and other MLR information, see ***“Medical Loss Ratio: Getting Your Money’s Worth on Health Insurance”*** at <http://www.healthcare.gov/news/factsheets/2010/11/medical-loss-ratio.html>.

² To review the Model MLR Notices and Instructions, see <http://cciio.cms.gov/resources/other/index.html>.

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