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What to do with insurance premium refunds and discounts

Insurance carriers will soon issue 2023 Medical Loss Ratio (MLR) rebates to fully insured policyholders, as mandated by the Affordable Care Act (ACA). While money back is always useful for employer plan-sponsors, there are rules governing what employers are able to do with these amounts. This Alert distinguishes between different types of premium refunds and discounts applicable to fully insured health and welfare plans and addresses what employers can do with these amounts. We will also briefly discuss how the rules differ for refunds and discounts related to self-insured group health plans.

This Alert is relevant for all employers sponsoring group health plans, but it is most relevant for employers with fully insured medical plans.

Background

Medical loss ratio rebates are premium refunds

The ACA's MLR standards limit the extent to which health insurance carriers can use premium dollars to cover their internal administrative and overhead expenses, requiring health insurance carriers to spend a minimum percentage of premiums on health care services and activities that can improve the quality of care. If a carrier does not meet the MLR standards (85% in the large group market; 80% in the small group market), it must provide rebates to the policyholders – the employer in the group market and individuals in the individual market.

Each year, insurance carriers calculate their MLR across their market segment books of business and issue rebates to policyholders if the money spent on health care and quality care activities is less than the required MLR standard. A report containing those calculations is due to CMS by July 31st of the following year (e.g., July 31, 2024, for 2023) and rebates must be paid to policyholders by September 30th each year.

An MLR rebate is a premium refund. If participants pay some or all of the insurance premiums (known as a "contributory plan"), the same proportion of the MLR rebate is considered a "plan asset" and should be distributed to plan participants or otherwise used for their benefit.

Highlights

Overview

- The ACA's MLR standards require insurance carriers to issue rebates to policyholders each year by September 30th if money spent on health activities falls below certain thresholds.
- This Alert is most relevant to employers sponsoring fully insured medical plans who receive these annual rebate checks from carriers.
- If participants pay any portion of insurance premiums, the same proportion of the MLR rebate is a "plan asset" and should be refunded to participants or used for their benefit within 3 months.

Employer Action

- MLR rebates only apply to fully-insured plans – they do not apply to self-insured, or level-funded plans (although level-funded plans must still generally treat premium refunds similar to MLR rebates).
- MLR rebates are refunds, but employers need to determine whether other types of premium relief are a refund or a discount and determine how to use the portion of the refund that is a plan asset for the benefit of plan participants.

(Providing a premium holiday is the most commonly used method of distribution)

Other insurance premium refunds or discounts

As mentioned earlier, insurance carriers may offer employers premium refunds or discounts on fully insured health coverage due to lower than expected claims experience for a given year. Insurance carriers tend to position this relief as a goodwill gesture to employers, although carriers who do not provide relief for medical coverage in the current year may owe large MLR rebates the following year. Most dental and vision coverage is not subject to the MLR standards, so relief provided by dental and vision carriers is more an act of goodwill on their part (unless a state standard similar to the MLR rules applies).

Unlike MLR rebates, insurance carriers have some flexibility to determine how to provide other premium relief and seem to favor providing relief in the form of a discount to a future premium invoice.

What's in a name? Refunds versus Discounts

The label used by an insurance carrier may not be that helpful. When we use the term "refund" or "discount" in this Alert, we mean the following:

- Refund – A refund is a return of premiums already paid for a prior period. All refunds are subject to plan asset rules and employers should generally treat them like an MLR rebate.

- Discount – A discount is a reduction of a future premium. Since discounts are reductions to premiums not already paid, they are not subject to the plan asset rules. Employers can generally keep discounts but cannot charge the employee more than actual premium for coverage.

"Disguised refunds": A future credit based upon premiums already paid in a prior period is really a refund. For example, a credit on the August invoice equal to 50% of the premiums paid in April is really a 50% refund of April premiums and not an August discount.

What about self-insured health coverage?

The situation is different when we are talking about self-insured coverage. First, MLR rebates do not apply to self-insured coverage (or level-funded plans written as self-insured products). Second, an employer usually pays plan benefits from its own general assets. An employer may feel some pressure to return employee contributions if they exceed actual paid claims, but the employer usually has no legal obligation to do so.[1] The excess contributions theoretically remain in the employer's general assets and are available to pay future claims. If a third-party administrator (TPA) refunds fees that were included in the plan's premium equivalent rates, a proportion of the refund is a plan asset, but it can also theoretically remain in the employer's general assets to pay future claims.

[1] This assumes the self-insured plan premium equivalent rates were set using sound actuarial principles. The employer must also consider the plan year's claims experience when determining the premium equivalent rates for the next plan year.

If the plan pays benefits through a trust, an employer may want to consider reducing excess contributions to avoid overfunding for tax reasons, particularly if the trust is a VEBA trust.

Caveat for level-funded plans: Even though level-funded plans are self-insured plans and not subject to the ACA's MLR standards, the same principles apply under ERISA's exclusive benefit and plan asset rules. When a level-funded plan receives a refund that relates back to prior premiums collected, the portion of the refund attributable to employee premium contributions are plan assets and must be used for the exclusive benefit of those participants. As a result, plan sponsors of level funded plans should generally follow the MLR rules when determining how to handle premium refunds.

Who gets the money?

Determining who gets the money can be challenging. The Employee Retirement Income Security Act of 1974 (ERISA) requires any amounts attributable to "plan assets," such as employee contributions, to be returned or used for the exclusive benefit of participants. Similar state level rules apply to prevent the misuse of funds attributable to participant contributions for non-ERISA plans.

If the premium relief provided by an insurance carrier involves plan assets, some of the relief may belong to plan participants and the employer cannot simply keep all of the money. Determining whether plan assets are involved and what amount may belong to plan participants requires a multi-step analysis described below.

Multiple employer plans: This Alert focuses on single employer plans. Multiple employer plans may maintain their own rules for the distribution of plan assets and likely require additional analysis to determine plan participant proportional shares.

Step 1: Categorize the type of premium relief

Employers must first determine whether the premium relief is a refund or just a discount. If the premium relief is a discount, please skip to Dealing with Discounts. If an insurance carrier issues the employer a check or wire transfer, as is the case with MLR rebates, it is easy to classify the payment as a refund. If the premium relief is a refund, please proceed to Step 2.

Step 2: Identify source of premiums

The employer needs to determine if any portion of the refund/rebate is a "plan asset". Plan assets belong to the participants and may not be kept by the employer or used to pay its expenses. The relevant plan documents should indicate the source of the premiums paid to the insurance carrier and might describe the ownership interest in rebates or refunds of premiums received by the plan.

In most instances, the plan documents will not resolve ownership interests, and the employer will need to rely on the sources and relative ratios of paid premiums in order to determine what portion of the refund is a plan asset and proceed to Step 3.

Step 3: Designate portion of refund that is plan assets

Assuming the plan documents do not resolve ownership interests (and they likely do not), the employer needs to determine what portion of the refund is a plan asset.

How Premiums are Paid	Plan Asset	Who Receives the Refund
100% from the plan's trust assets	Yes	100% belongs to the trust and must be used for the benefit of participants
100% by participants	Yes	100% belongs to participants
100% by the employer	No	100% belongs to the employer and may be used for any purpose
Employers and participants each pay a fixed % of the premium (Example: Employer pays 70% and participants pay 30%)	Yes, partially	A % of the refund belongs to participants equal to the % of the total premium paid by participants The remainder of the refund belongs to the employer and may be used for any purpose
Employer pays a fixed dollar amount toward coverage and participants pay the rest (Example: The employer pays up to $6,000/year toward any tier of coverage and the employee pays the balance)	Yes	The amount of the refund up to participant contributions are plan assets Any portion of the refund that exceeds participant contributions belongs to the employer and may be used for any purpose
Participants pay a fixed dollar amount toward coverage and the employer pays the rest (Example: Participants pay up to $6,000/year toward any tier of coverage and the employer pays the balance)	Possibly	The amount of the refund up to the employer's contributions belongs to the employer and may be used for any purpose Any portion of the refund that exceeds the employer's contributions are plan assets

Step 4: Decide how to use refund

Finally, employers must determine how to use the portion of the refund allocated to plan participants, addressed below under Dealing with Refunds.

Dealing with refunds

Employers have a few considerations when dealing with refunds such as who it should go to and how.

Plan participants

The employer may determine it is reasonable to use the refund for current plan year participants and not the exact participants from the plan year for which the rebate applies. This includes current COBRA participants. Factors used to make this determination can include the cost and administrative difficulty of locating former employees and/or whether a large number of the same individuals are participants in both plan years.

The available guidance prefers using the refund for participants in the same insurance policy (or policies) that generated it, but it should be reasonable to share the refund with participants in the employer's other medical coverage depending upon the facts and circumstances. For example, if the employer replaced the plan option that generated the refund, it should be reasonable to use those funds for participants in the plan option(s) that replaced it.

Preferred methods

The most common approaches are to pay the refund in cash, use it to reduce future premiums in the current year (a full or partial "premium holiday"), or apply it to enhance benefits. Enhanced benefits might include HSA contributions or additional wellness benefits. For small refunds or small remainders of larger refunds, an employer could use the funds to pay for flu shots, educational presentations, or other similar expenses.

Note: We do not support the use of refunds to provide opportunities for a relatively small number of participants to win prizes, such as through a raffle. This conflicts with the policy that employers should provide a reasonable, fair, and objective rebate allocation method that benefits the entire class of participants.

Tax Consequences

If participants pay premiums on a pre-tax basis through an Internal Revenue Code Section 125 cafeteria plan, a refund returned as cash or as a cash equivalent is taxable income. There is a myth that premium holidays provide participants with a "tax-free" benefit while cash refunds are taxable, but the net tax effect to employees is actually the same. The employee's taxable take-home pay will increase because the amount withheld from the employee's paycheck will decrease, as demonstrated below.

$50 Refund as Taxable Cash	Step	$50 Refund as Premium Discount
$3,000	Monthly Base Compensation	$3,000
$50	Cash Refund	-
$3,050	Subtotal	$3,000
($100)	Less Monthly Premium	($50)
$2,950	Taxable Compensation	$2,950
$885	Tax @ 30%	$885

Timing

The employer must generally distribute or use the participants' portion of the refund within three months of receipt to avoid ERISA's trust requirement.[2] Because of this distribution deadline, using the refund to subsidize benefit enhancements often is not an available option if the enhancements would take effect at the policy's annual renewal.

Dealing with discounts

Since the plan asset rules do not apply to discounts, employers are generally not required to share discounts with covered employees. While this frequently allows employers to keep the value of the discount for their own benefit, there are a few things for employers to consider.

- <u>Employee deductions vs. premiums amounts</u>: Employers cannot charge employees more than the actual premium paid to the insurance carrier. If the plan is 100% employee paid and the insurer gives a temporary premium, employers must pass the discount through to participating employees.

[2] Employers with plans that are not subject to ERISA are also required to use the rebate for the benefit of participants, per guidance from the U.S. Department of Health and Human Services (HHS).

- COBRA: A temporary reduction in the overall premium for a fully insured plan during the plan year is also a good argument to reduce the corresponding COBRA premium (even though the reduction is only temporary).

- ACA grandfathered status: If an insurance carrier provides a premium discount on an ACA "grandfathered" medical plan option, not sharing the discount means the participant contribution percentage toward one or more tiers of coverage increases. This may cause a loss of grandfathered status even though the contribution percentage increase is only temporary. Once grandfathered status is lost, it cannot be restored.

- Future refunds (including MLR rebates): Not sharing the discount with participants means their share of overall premium contributions increases. This can affect the participants' share of a future refund of paid premiums for that plan year, such as an MLR rebate. In other words, not sharing the discount today means the participants' share of a potential future return of plan assets should be larger.

- Contractual obligations: Although rare, there may be instances where a client is contractually obligated to provide a certain percentage toward contributions or some similar obligation. For example, this might exist in a collective bargaining agreement.

- Participant noise: It is also worth a mention that not sharing the premium discount with participants may generate some "noise" if they learn about it.

About the author

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