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ERISA Group Benefits Alert

August 2012

Health Care Reform:

Do You Know How to Handle Medical Loss Ratio Rebates?

The Patient Protection and Affordable Care Act (commonly known as Health Care Reform), requires health insurance companies to spend a certain percentage of the premiums they collect on claims and related expenses. The percentage is known as the medical loss ratio ("MLR"). Insurance companies that do not meet these requirements must pay MLR rebates to policyholders. The first round of MLR rebates were due to policyholders by August 1, 2012. As policyholders have begun receiving these rebates, it is important that plan fiduciaries know how to properly use the rebates, as a portion or all of the rebates may be subject to ERISA fiduciary responsibility requirements. This newsletter addresses issues that a plan fiduciary must consider in determining how to properly disburse the rebates.

Is any portion of the MLR rebate "plan assets?"

First, plan fiduciaries must determine which portion, if any, of the MLR rebate constitutes "plan assets" because plan assets must be handled in accordance with ERISA fiduciary responsibility requirements. Plan assets must be kept separate from regular corporate assets and must be used for the exclusive benefit of plan participants and beneficiaries. Generally, if the plan is the policyholder, or the premium is paid entirely out of plan assets, then, unless the plan or insurance policy language specifies to the contrary, the entire rebate constitutes plan assets, and the sponsoring employer has no right to treat the distribution of the rebate as a corporate asset. On the other hand, if the employer is the policyholder, then, unless the plan document or insurance policies provide specific instructions (and they are consistent with ERISA's fiduciary standards), then generally the source of the premium payments will determine which portion of the rebate constitutes plan assets. The Department of Labor (DOL) has issued detailed rules (Technical Release 2011-04) for determining which portion of the rebate constitutes plan assets. The disposition of the rebate depends on how the premium payments are

arranged. In addition, different rules apply to professional employer organizations (PEOs).

What to do with the portion of the MLR rebate that is a plan asset?

When a portion of an MLR rebate is a plan asset, the plan fiduciary must determine how to use the rebate in accordance with ERISA fiduciary requirements. In the process of making its determination, the plan fiduciary may weigh the costs to the plan and the ultimate plan benefit as well as the competing interests of participants or classes of participants, provided that such method is "reasonable, fair and objective." Examples of allocation methods include (1) refunds to participants, (2) reductions in future participant contributions and (3) benefit enhancements. One method may be more appropriate than the other, depending on all facts and circumstances. Thus, a plan fiduciary may wish to seek advice from legal counsel in assessing the appropriateness of the chosen method.

What if your plan is not subject to ERISA or your plan is terminated?

For non-federal governmental group plans, church plans that are exempt from ERISA and terminated plans, the DOL has provided separate instructions regarding how to properly handle the MLR rebates. You may wish to contact your legal counsel for details if you maintain one of these plans.

What are the tax consequences to employees?

Generally, if employees pay health insurance premiums on a pre-tax basis, then any MLR rebate they receive is subject to federal income and employment taxes. If employees pay premiums on an after-tax basis, then an MLR rebate is generally not subject to federal income or employment taxes (however, there are exceptions to this general rule).



Please note that this *Benefits Alert* only highlights the most significant changes in the law. The details of these changes are complex and beyond the scope of this Alert. We look forward to discussing these changes and how they may impact your plans with you. Please do not hesitate to contact any of the following members of our Employee Benefits and Executive Compensation Practice if you have any questions or if you would like additional information.

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