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What to do with Insurance Premium Refunds and Discounts

Insurance carriers will soon issue 2019 Medical Loss Ratio (MLR) rebates as mandated by the Affordable Care Act (ACA). In addition to this recurring refund, insurance carriers have been offering – and continue to offer – employers premium refunds and discounts on fully insured health coverage due to lower-than-expected claims experience during 2020. While money back is useful for employers, there are rules affecting what employers may be able to do with it resulting in another headache for beleaguered HR personnel to sort out. This Alert distinguishes between refunds and discounts, and it addresses what employers can do with them.

Background

Medical Loss Ratio Rebates

The ACA's MLR standards require 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 the individuals in the individual market.

Each year, insurance carriers calculate their MLR across 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 generally due to CMS by July 31st of the following year (e.g. July 31, 2020 for 2019), but the 2019 reporting deadline was extended until August 17, 2020. CMS is allowing carriers to prepay their 2019 rebates to policyholders prior to submission of that report.[1]

An MLR rebate is a premium refund. If participants pay all or a portion 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.

COVID-19 and Other Insurance Premium Refunds or Discounts

As mentioned earlier, insurance carriers have been offering – and continue to offer – employers premium refunds and discounts on fully insured health coverage due to lower-than-expected claims experience during 2020 caused by the COVID-19 pandemic. Although a pandemic lowering expected claims experience sounds counterintuitive, this is a result of limited access to health care providers due to office and facility closures, individuals staying away from providers out of fear of exposure to COVID-19,

[1] See June 12, 2020 CMS Insurance Standards Bulletin

postponements and cancellations of elective procedures, and reduced covered participation under health coverage because of layoffs.

Insurance carriers have largely positioned this relief as a goodwill gesture to employers, although carriers who do not provide relief for medical coverage in 2020 will likely owe large MLR rebates in 2021. 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).[2]

Unlike MLR rebates, insurance carriers have some flexibility to determine how to provide other premium relief and seem to favor providing COVID-19 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 terms "refund" or "discount" in this Alert, we mean the following:

- **Refund –** A refund is a return of premiums already paid for a prior period. 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 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 and should be treated like one. 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. 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.[3] The excess contributions theoretically remain in the employer's general assets and are available to pay future claims. If a third party administrator 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.

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.

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[2] COVID-19 premium relief began through dental and vision coverage.
[3] 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.

Who Gets the Money?

Determining who gets the money can be challenging. The Employee Retirement Income Security Act of 1974 (ERISA) requires that any amounts attributable to "plan assets," such as employee contributions, 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 the 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 is 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

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

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. Please proceed to Step 3.

Step 3

If the plan documents do not resolve ownership interests, 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 as a plan asset and must be used for the benefit of participants
100% by participants	Yes	100% belongs to the participants

How Premiums are Paid	Plan Asset	Who Receives the Refund
100% by employer	No	100% belongs to the employer and may be used for any purpose
Employer 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 the participants equal to the % of the total premium paid by the participants.[4] The remainder of the refund belongs to the employer and may be used for any purpose
Participants pay a fixed dollar amount and the employer pays the balance	Possibly	The portion of the refund that exceeds the employer's contributions is plan assets The remainder of the refund belongs to the employer and may be used for any purpose

Step 4
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.

1. **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.[5] For example, if the plan option that generated the refund was replaced, it should be reasonable to use those funds for participants in the plan option(s) that replaced it.

[4] If the fixed percentage of premiums paid vary by tier of coverage, an employer could choose to use a single average percentage rate for all tiers or determine a weighted average percentage rate for each tier.
[5] In theory, this could extend to all participants in benefits incorporated under the same ERISA plan number, but we generally recommend against this.

2. **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 or educational presentations.

> **Note:** We do not support the use of refunds to fund opportunities for a relatively few 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.

3. **Tax Consequences –** If the 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

4. **Timing –** The employer must generally distribute or use the participant’s portion of the refund within three months of receipt.

Dealing with Discounts

Since the plan asset rules do not apply, employers are not generally 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.

1. **Employee deductions vs. premium amounts –** 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 discount, employers must pass the discount through to the participating employees.

2. **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).

3. **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 regained.

4. **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.

5. **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.

6. **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.

Note for Small Group (and Individual Plans): ACA market rules generally prohibit carriers in the small group and individual markets from reducing premiums, however on August 4, 2020, the Centers for Medicare & Medicaid Services (CMS) issued a temporary policy of relaxed enforcement allowing premium credits to be issued in 2020 subject to certain conditions.

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