Guidance on the Medical Loss Ratio Provision

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The Patient Protection and Affordable Care Act (the "PPACA") provides that insurance carriers are required to satisfy certain medical loss ratio ("MLR") thresholds, otherwise they are required to provide rebates to enrollees. Beginning in 2011, carriers will be required to spend 80 to 85 percent of premium dollars on medical care and health care quality improvement. On November 22, 2010, the Department of Health and Human Services issued an interim final regulation on the MLR provision of the PPACA.

The intent behind the regulation is to hold insurance companies accountable and increase value for consumers. While these rules apply to insurance carriers, and not employers, it is important for plan sponsors to understand their impact.

Reporting Requirements

Insurance carriers will be required to publicly report on how they spend premium dollars. The reported information will clearly demonstrate how much money goes towards actual medical care and activities to improve health care quality versus how much money is spent on administrative expenses like marketing, advertising, underwriting, executive salaries and bonuses. Carriers are required to submit their MLR reporting by June 1 of 2012 for the 2011 year.

How is the MLR calculated?

For larger employers (51 or more employees in most states, including NY, NJ, PA), the amount an insurance carrier spends on medical care and quality improvement activities must be at least 85% of the premiums received; for small employers (1-50 employees), the amount must be at least 80%. States are permitted to provide for higher ratios and New York has already set a threshold of 82%. A carrier's MLR must be calculated separately for each market in each state as well as each different license under which the carrier conducts business. The rebate must be provided to enrollees when less than the target premium is attributed to claim costs. It is important to note that workforce salaries and benefits, agent and broker fees and commissions, and general and administrative expenses are not included in a carrier's incurred claims plus expenditures. A carrier, however, is not required to provide a rebate to an enrollee if the total rebate owed to the policyholder and the subscribers is less than $5 per subscriber covered by the policy for a given MLR reporting year.

Example

ABC insurance company collects $20,000,000 in premiums from its small employer pool in a particular state. It spent $15,000,000 in qualifying medical expenses. The remaining $5,000,000 covers non-claim expenses, including operating expenses, administrative costs and profit. The MLR for this pool of ABC insurance company would be 75%, and the company would be required to rebate 5% (i.e.,$1,000,000) of the premium paid by or on behalf of the enrollee on a pro-rated basis to the enrollees, after subtracting federal and state taxes and licensing and regulatory fees. If an enrollee paid $2,000 in premiums for the MLR reporting year and the federal and state taxes and licensing and regulatory fees are $150 for a $2,000 premium, ABC insurance company would subtract $150 from the premium revenue for a base of $1,850 in premium. The enrollee would be entitled to a rebate of 5% of $1,850, or $92.50.

Employer involvement

Carriers are required to make the first rebates to consumers in 2012 (based upon their 2011 MLR) and rebates must be paid to enrollees by August 1 each year. There are three ways for enrollees to receive rebates: (1) by having their premiums reduced, (2) by receiving a rebate check, or (3) if premiums were paid by credit or debit card, by receiving a lump-sum reimbursement to that account. Rebates made to former employees must be made in lump-sum by check or by using the same method for payment of the premium, such as credit or debit card. In some instances, where employers paid premium on behalf of employees, the rebate may go to the employer.

In any event, regardless of whether a carrier provides rebates to enrollees directly or indirectly through the employer, the carrier must ensure each enrollee receives a rebate that is proportional to the premium amount paid by that enrollee (the employer may not retain more of the rebate than is proportional to the amount of premium it paid). When a rebate is provided by a carrier, the carrier must provide each enrollee receiving a rebate an explanatory notice.

Carriers may request that employers administer rebates on their behalf to plan participants, however, employers are not required to do so. At first glance, employers may not want to be burdened with this responsibility, but in order to ensure receipt of their share of the rebate, it may be necessary for them to take on this function. In such a case, the carrier and employer should enter into a contract regarding this administration. One thing to note is that, while the carrier is permitted to delegate its rebate distribution functions to the employer, the carrier remains liable for complying with all of its obligations under the statute.

Penalties

If an insurance carrier violates the reporting and/or rebate requirements, it may face a civil monetary penalty for each violation that may not exceed $100 for each day for each individual affected by the violation, in addition to any other penalties prescribed or allowed by law.

Action to Take

Employers are not required to take any action to comply with the MLR rules. Employers may, however, be asked to enter into written agreements to administer the rebates on behalf of the insurance carriers. Employers should also be aware that carriers may soon decide to bill employers a service fee, rather than automatically deduct commissions and remit them to brokers. Although this interim rule is effective on January 1, 2011, HHS is seeking comments and will issue further guidance, as well as a final rule later this year. We will continue to keep you apprised of any further developments.