Captives, TPAs, Medical Sharing and Other Sources of Alternative Funding – the Risk vs Reward and Pitfalls to Avoid

Presented by:

Joshua Gertz, J.D.
Assistant Vice President, Compliance Consultant
Alliant Employee Benefits

Ross Carmichael, J.D.
Managing Director, Compliance and Operations
Higginbotham

September, 2019

This compliance corner is sponsored by the LPRT Committee

The View from the Top is Great….So are the benefits of being there!

Find out more on NAHU's website, search "LPRT"

Encouraging excellence in health and benefits insurance professionals since 1942

Sponsored by LPRT

What's the BIG deal?

- Profound Testimonial about YOU
- Distinguished
- Knowledgeable
- Successful
- The ELITE in your profession
- Motivation …

QUESTIONS?

You may ask your question in the questions box at any time. Any questions that we do not answer during the webinar will be posted on the compliance corner webpage in the coming weeks.

The information herein should not be construed as legal or tax advice in any way. Regulations, guidance and legal opinions continue to change. The preparer has gathered public information and has attempted to present it in an easily readable and understandable format. Situations vary, technical corrections and future guidance may vary from what is discussed in the presentation.

This is meant for informational content only. The presenter makes no warranty of any kind concerning this information. You should seek the advice of your attorney or tax consultant for additional or specific information.

This presentation is not to be duplicated or distributed.

TODAY’S PRESENTERS

Joshua Gertz

- Josh is a compliance consultant at Alliant Employee Benefits. As an attorney, Josh serves as a dedicated resource exclusively for clients and staff of the employee benefits practice, researching and writing many of their periodic compliance and topical communications regarding a variety of subjects in employment and labor law as well as tax law. He assists clients in meeting compliance standards and also assists institutional partners in their performance of benefits-related due-diligence for target companies. Internally, Josh leads educational initiatives ensuring staff remain aware of the latest developments in health care reform and its effect upon clientele. Josh earned a BA in economics and political science from the University of Illinois at Urbana-Champaign. He earned a JD from DePaul University and is a member of the Illinois State Bar. He is also a member of NAHU’s Principal Council and member of the Compliance Corner committee.

Ross Carmichael

- Ross Carmichael graduated from the University of California, Santa Barbara and attended Texas A&M University School of Law. He was an investigator with the Department of Labor’s Employee Benefits Security Administration, leading its Dallas Regional HIPAA and Affordable Care Act Compliance Project. In his time at the DOL, Carmichael received the Secretary of Labor’s Exceptional Achievement Award for his work on the Health Disclosure and Claims Issues Project. Since joining Higginbotham in 2012 has helped represent the firm on the National Association of Health Underwriter’s Principal Council and Legislative Counsel, and its Prescription Drug Task Force and Compliance Corner committees.

AGENDA

- Captives
  - What is a captive
  - How they be used for medical coverage
  - Compliance concerns with captives (i.e. plan assets & prohibited transactions)
    - How they are different from MEWAs
  - Different types of captives
  - Advantages to captives
  - Barriers to using a captive/potential pitfalls.
- TPAs
  - True Self Funded vs Level Funded
  - What's the difference, how can you tell?
    - Potential issues
  - Direct Stop Loss vs through an MGA/MGU
    - Potential issues
  - RBP
    - Potential issues
- Medical Sharing Plan
  - What are they?
    - Potential issues

• Captives

- A *bona fide* insurance company licensed under captive insurance statute of its place of domicile
  - Different from a mutual because it is both owned and operated by insured(s)
- Traditionally created by a parent company (other than insurance) to insure its own property and casualty risks
  - Called a “pure” captive or single-parent
  - Also group captive, cell, or rent-a-captive

• Captives

- Created as an alternative to commercial markets for several reasons
  - Unique risk
  - Wishes to avoid commercial market pricing volatility
  - Market capacity
  - Able to handle its own risks better than the market
  - Tax advantages

• Captives

- ERISA covers the provision of most employee benefit plans
- Health, life, disability…etc.
- Prohibits certain transactions with respect to plan assets with "parties in interest" to the plan
  - Specifically when dealing with "plan assets" being separated from the general account of the sponsor and held in trust
- Subsidiary of a parent entity is a related party
- Must apply for Prohibited Transaction Exemption (PTE) with the DOL

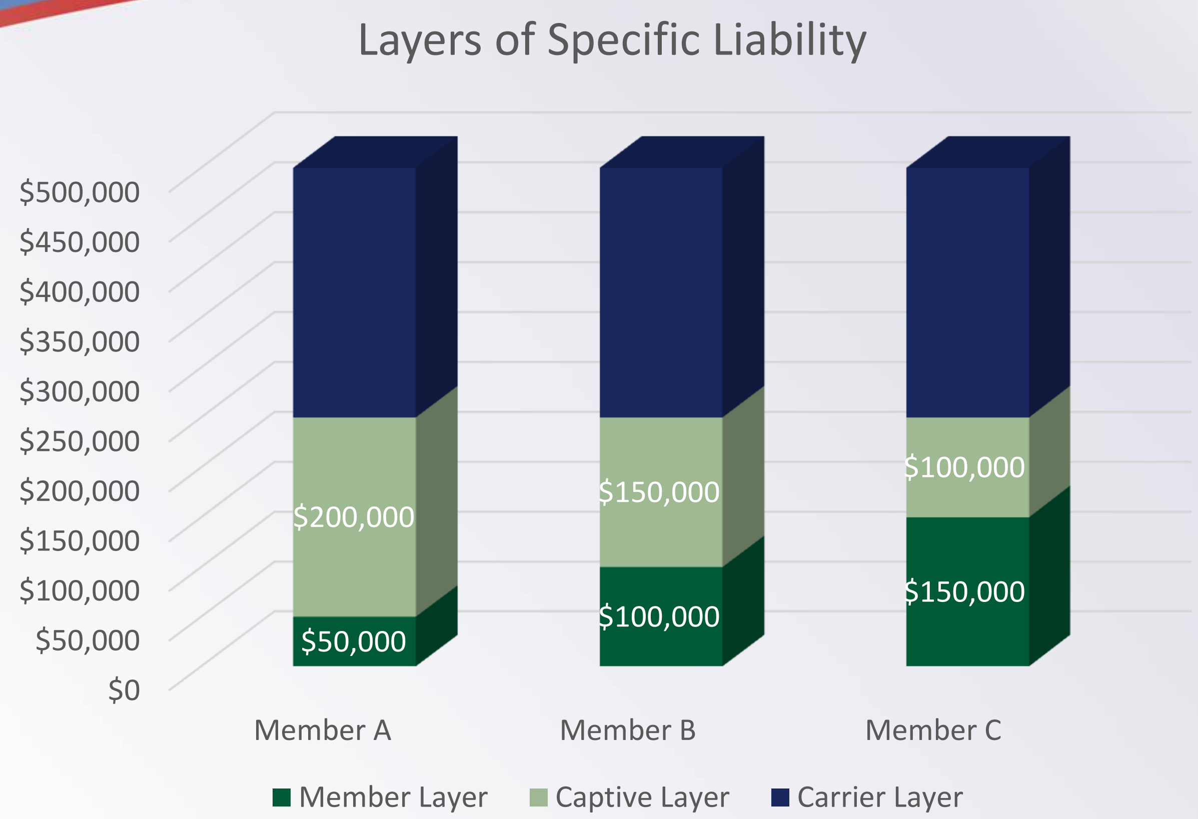
- **Captives**

- Must be fronted by a commercial insurer
- Captive meets licensing and financial examination conditions
- Plan pays no more than adequate consideration for contracts
- No commissions are paid by plans with respect to the direct sale of such contracts or reinsurance
- There will be an immediately and objectively determined to benefit the plan participants and beneficiaries in the form of increased benefits
- Subsequent years, must use reasonable formulas to charge premium with the same or better coverage than commercial market
- Plans contract with insurers with a rating of A or better from AM Best
- Captive retains a independent fiduciary to analyze transaction

• Captives

- If DOL's application for Prohibited Transaction Exemption (PTE) is a non-starter, other options
  - Stop-loss coverage isn't subject to ERISA (usually)
  - Can be written directly or with a fronting carrier
- In group captive, each employer buys stop-loss coverage from a reinsurer
- With a fronting arrangement, the carrier issues a separate policy to each plan sponsor (not the plan)
  - Carrier collects premium for policy as normal
  - Captive reinsures the carrier for a layer of coverage (i.e. specific from $50,000 - $250,000) and carrier allocates a portion of the premium to that risk that has been ceded to the captive
  - At the end of the year, any underwriting gains (or losses) are allocated accordingly for the captive layer and the carrier

• Captives



Layers of Specific Liability
$500,000
$450,000
$400,000
$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$0
$200,000
$50,000
$150,000
$100,000
$100,000
$150,000
Member A
Member B
Member C
Member Layer
Captive Layer
Carrier Layer

Captives

- If an ERISA covered plan provides welfare benefits to employees of 2 or more employers that are not part of the same controlled group, this creates a Multiple Employer Welfare Arrangement (MEWA)
  - MEWAs are subject to federal and state scrutiny and are outlawed in many states or require burdensome registration and regulatory oversight
- When dealing with pooled risk, there is a concern whether a plan, fund, or program is the "provider" of the benefits to the employees
  - Want to distinguish between the captive/insurer's relationship to each individual plan sponsor from each plan sponsor's relationship with its welfare plan(s)
  - Stop-loss reimburses the sponsor for excessive losses in operating a plan (casualty product)

• Captives

- Captive is a business and can decide with whom it wishes to engage/interact
- Can create underwriting guidelines/requirements for member admission
- May require extensive wellness programs as a barrier to entry
- Attempts to only accept “healthy risk”
- Outlined in subscription agreement or contract as part of forming captive/joining captive
    - As a company, members/owners vote to change or adopt new procedures and requirements
    - May also decide upon investment of the captive’s reserves, whether or not to issue a dividend to owners in a given year, or require additional capital contribution
        - Typically assisted by a captive manager

• Captives

- 831(b) is a provision in the tax code that sets requirements for certain small insurance companies
- These insurance companies are given advantages to increase competition amongst insurers
  - Only required to pay federal income tax on investment income, not underwriting gains
- Cannot receive more than $2.3 million (in 2019) in gross premium per year
  - Adjusted to inflation and may change annually
- Subject to abuse and heightened scrutiny from IRS
  - Considered part of the “dirty dozen” of tax abuses, if used for illegitimate intergenerational wealth transfer or tax avoidance
- Even w/o 831(b), captives still give members the advantage of deductions for all premiums paid and capital gains for investment assets

• Captives

- Due to money being invested and held, many states compete to attract captives and business
  - Do so through tax incentives
  - Administrative assistance from regulators
  - Clearly-defined requirements and enforcement procedures
  - Low retention levels for reserves
  - Low licensing fees
- Favorable states:
  - Vermont – 3rd largest captive domicile in the world
  - Utah
  - Delaware
  - Tennessee

Captives

- Must conduct a feasibility analysis
  - Ensure everyone on the same page from a risk management standpoint
  - Requires a commitment and capital to enter/exit; not as easy as cancelling FI policy
- Draft reinsurance agreement for allocating losses/gains to the captive
- If captive holds reserves and uses fronting carrier, carrier will want a guarantee of solvency
  - Usually letter of credit; may require trust agreement/captive agreement
- Will need manager, accounting, actuary/analytics, legal, trustee
  - Many services recommended/referred by captive manager
  - Additionally, each plan will still need all elements to run their own GHP
    - TPA, PBM, network…etc.

• TPAs

- Third Party Administrator is a term that is often used to describe multiple different things:

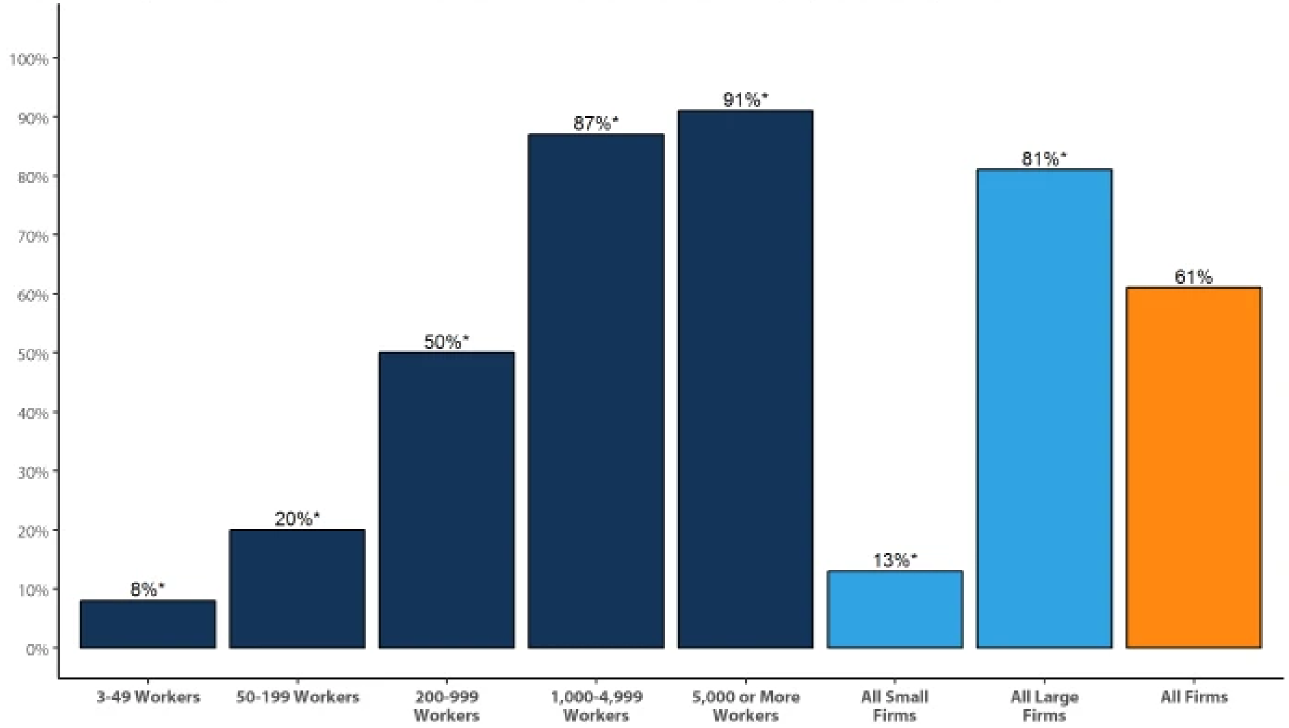
  - TPA
  - ASO
  - Captive Manager
  - Claims Administrator
  - PBM Manager
  - Third Party Vendor (COBRA, FSA, etc.)

• TPAs

- What's the big deal?

Figure 10.1

Percentage of Covered Workers Enrolled in a Self-Funded Plan, by Firm Size, 2018



* Estimate is statistically different from estimate for all other firms not in the indicated size category (p < .05).

NOTE: Figure includes covered workers enrolled in partially or completely self-funded plans. See the glossary at the end of Section 10 for definitions of self-funded, fully-insured, and level-funded premium plans. Small Firms have 3-199 workers and Large Firms have 200 or more workers.

SOURCE: KFF Employer Health Benefits Survey, 2018

• TPAs

- TPA vs. ASO
  - TPA = Third Party Administrator
  - ASO = Administrative Service Only

Administrative Services Only (ASO)	Third-party Administrator (TPA)
A service offered by a traditional insurance carrier that provides administrative support to a company that is looking to migrate a to self-funded insurance option.	A self-funded organization hires an outside company to manage their health insurance including processing claims, overseeing wellness programs and performing administrative services.

• TPAs

- TPA vs. ASO
  - Generally, both:
    - Adjudicate and pay claims
    - Determine and report eligibility for enrollment
    - Communicate and provide customer service for employees
    - Assist with stop loss coverage
    - Allow for more control over plan/plan design

• TPAs

- ASO
  - Generally has higher admin fees
  - May/may not have better network discounts
  - Normally take a “bundled” approach
    - Stop Loss
    - PBM

• TPAs

- TPA
  - Generally has lower admin fees
  - May/may not have better network discounts (“rental networks”)
  - Offer multiple payment methods
    - Self-funded
    - Level funded
    - Direct contracting/RBP/bundled payments/centers of excellence
  - Normally take an “unbundled” approach
    - Stop Loss
    - PBM
    - Data Analytics
    - Wellness

• TPAs

- TPA
  - Self Funded vs. Level Funded
  - <u>Self Funded:</u>
    - Mix of fixed + variable costs
    - Fixed costs include administrative fees, any stop-loss premiums
    - Variable costs are health care claims
  - <u>Level Funded</u>:
    - Level funding generally provides the security of a fully insured plan while offering the potential cost savings and flexibility of a self-insured plan.
    - Employer pays a “level” fee each month to a carrier covering claims, administrative fees, and stop-loss insurance.
    - TPA will handle facilitating the health plan, including paying out claims.

- **TPAs**

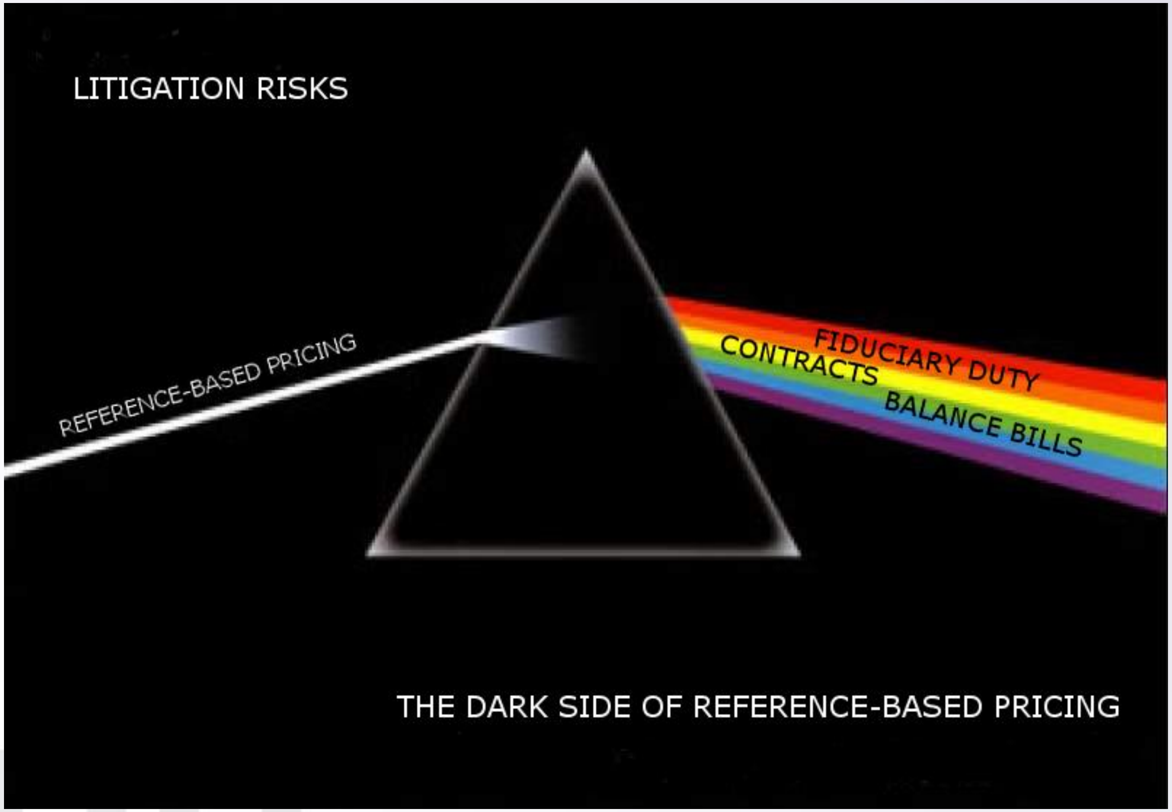
• TPAs

- Contracts

  - The devil is in the details
    - It is really level funded or self-funded
    - What are the SL limits? Are the accommodations or advances made?
    - Who is the SL carrier? Is it an MGA/MGU?
      - Rating/Financial strength/carrier relationships
      - Additional layers
    - Have you created a TPA/MGA/MGU Vetting Questionnaire?

• TPAs - RBP

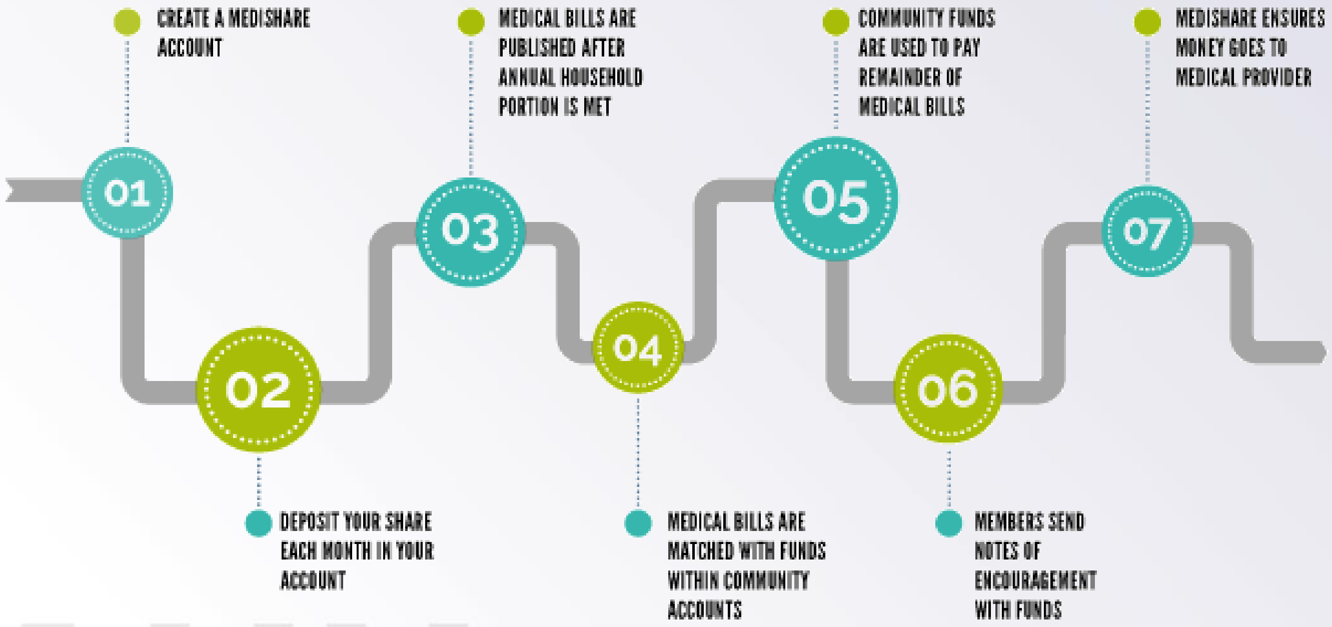
- RBP
  - Still requires very thorough vetting and research



Source: Maestro Health

• MediShare

- Sometimes call Healthcare Sharing Ministries/MediShare Programs
- Cost-sharing program among members
- Some offer group/employer provided options



MediShare

- <u>Possible Issues:</u>
  - Is NOT insurance
    - May not be covered by E&O
    - There have been some issues with various vendors lately and state insurance departments.
      - Strict liability in most states
  - Usually have pre-x clauses and annual/lifetime limits

QUESTIONS?

You may ask your question
in the questions box at any time.
Any questions that we do not answer during the webinar will be posted on the compliance corner webpage in the coming weeks.