Professional Perspective

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The Hidden Risks of Having the Same Company Serve as TPA and Stop-Loss Insurer and How You Can Minimize Them

Contributed by Rhonda D. Orin and Terese M. Connerton

Businesses that self-fund their health benefit plans often have the same insurance company serve as both their third-party administrator ("TPA") and their stop-loss carrier. While there are obvious advantages to this structure, there are significant risks as well.

The advantages leap off the page, starting with the fact that it is easier to work with one company than two. They include that the TPAs will be incentivized to manage high-risk claimants carefully in order to minimize the number of stop-loss claims and that the TPA will be responsible for informing the stop-loss branch of the company when a claim nears the attachment point. Also, when a stop-loss submission is inevitable because payments exceed the attachment point, the TPA will know the claim history and the relevant details.

Less obvious are the substantial legal and financial risks that exist when one company wears both hats. The principal one is that a company can use its role as TPA to enable its stop-loss branch to avoid liability for stop-loss claims.

Such manipulation is frighteningly easy. Here is one example, drawn from a lawsuit that was tried before a jury in the Southern District of New York:

Company X had stop-loss coverage for its self-funded health plan with Alabaster Insurance Company, which also served as the plan's TPA. When the annual renewal approached, Company X was dissatisfied with Alabaster's renewal pricing and decided to make a change. It terminated Alabaster as both TPA and stop-loss carrier effective as of July 1 and moved its plan elsewhere. In the preceding months, however, a huge claim had been submitted to the plan for payment. Company X did not know about it because it had not yet been paid. If Alabaster as TPA paid it by July 1, then Alabaster as stop-loss carrier would be liable for the claim. So wearing the first hat, Alabaster avoided paying the claim before July 1. It "pended" the claim repeatedly on the purported ground that it continued to need more information. Alabaster did not pay the claim until after the July 1 termination date. Doing so enabled Alabaster's stop-loss division to deny the stop-loss claim.

Is this unusual? Unfortunately, no. This situation can arise whenever a plan undergoes a change in stop-loss carriers and/or TPAs or changes from a self-funded plan to a fully insured plan. Every insurance company that serves as both TPA and stop-loss carrier has a strong financial motive to engage in such conduct and the opportunity to do so. In fact, it can happen whenever there is a close relationship between an administrator and a stop-loss company even if they have no corporate relationship.

Can a business protect itself against such risks? To a certain extent, yes. A business can have some protection if it pays careful attention to the three contracts that are key to any self-funded plan: Summary Plan Descriptions ("SPDs"), Administrative Services Agreements ("ASAs"), and stop-loss insurance contracts. The contracts should, at the least, contain the following:

1. Timely Filing Requirements

Timing is essential to stop-loss policies because there always is a lag between when claims are incurred and when they are paid. Sometimes the lag can be lengthy, due to such matters as untimeliness in provider billing, incomplete claim submissions, and initial denials by the TPA. There also may be "coordination of benefits" issues when an employee is covered by more than one plan or health program, such as Medicare. It can take time to decide which plan pays first.

It is standard for stop-loss policies to establish a 12-month period within which claims to be incurred and paid in order to be eligible for stop-loss reimbursement. But because of the lag between the service date and the payment date, there is a risk of losing stop-loss coverage. A high-dollar claim that is incurred during one policy year, but not paid until the next, is capable of falling into an uncovered gap.

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To avoid this risk, every business that self-funds should negotiate extensions of these cut-off dates.

The most common solution involves "run-out" provisions. These provisions allow claims incurred during a policy year to be processed and paid after the policy year ends. That extension typically varies from three to six months. Most stop-loss companies that offer this protection require businesses to purchase and pay for it at the outset of the policy period. Businesses are rarely (if ever) allowed to add this protection retroactively, at the end of the policy period.

"Run-in" provisions can be purchased as well. These provisions require the new stop-loss company to provide coverage for claims that are incurred during the prior policy period, but not paid until the new company is on the risk. This type of extension is less common than run-out provisions, as the incoming stop-loss company will not be familiar with the existing risks. But if it is the only solution for a business that neglected to purchase run-out coverage, the cost may be worthwhile.

Timing requirements are also important in ASA agreements, which govern the relationship between a business and its TPA. Every ASA should contain a requirement for the TPA to process claims and either pay or deny them within a set period of time. Such requirements would, for example, make it harder for TPAs to "pend" claims in order to avoid liability for their stop-loss divisions.

The ASA similarly should require the TPA to disclose all large claims that have been submitted for payment to the business, its broker, and a third-party stop-loss carrier, when there is one. Such provisions would reduce the risk of a TPA avoiding disclosure of such claims on grounds that they were not paid.

Timing requirements play a role in SPDs as well. SPDs are the documents that set forth the coverage terms for the health benefit plan. Among other things, every SPD should set tight time limits for providers to submit claims for payment after services are rendered. Claims that are submitted outside of those time limits should not be paid unless special arrangements have been made in advance.

Timely submission is essential to prevent providers from stockpiling bills and then releasing them all at once, in amounts that could be unmanageable for the plan. Also, like the other protections discussions above, it too helps to reduce the risk of the payments being deferred until after the termination of the stop-loss period.

2. Legal Accountability for Claims-Handling Mistakes

It is common for ASAs to place ultimate responsibility for claims and appeal decisions on the businesses that sponsor the plans and affirmatively deny any liability on the part of the TPAs. But this approach is a fiction.

In every practical sense, claims decisions are made entirely by the TPAs. Businesses have no choice but to rely on them entirely—and blindly. Businesses that are not in the health-care field do not have the ability to make claims decisions themselves. Such decisions require an expertise in the complex and byzantine world of health care. Also, most businesses lack the basic facts needed to make such decisions, such as the names of the employees seeking medical care and the nature of their conditions. Various employment, health, and privacy laws often deprive businesses of access to exactly this type of information.

The result is that it is extremely dangerous to accept contracts drafted by TPAs that contain language identifying the businesses as having decision-making power over claims and appeal decisions under the plans and the liability that accompanies such responsibilities. Businesses should always negotiate provisions in the ASAs that render TPAs liable for the duties that they assume (whether as fiduciaries or not) for abuse of discretion or negligent activities in carrying out their responsibilities for claims and appeals determinations.

Agency language is one example. Insurance companies that administer health benefit plans should be identified in ASAs as agents of those plans. While such affirmative language is not essential to establishing a legal relationship of agency, it can assist employers pursue the important goal of ensuring that the TPAs are legally accountable for their own mistakes.

While most TPA contracts contain language regarding the legal relationship between TPAs and businesses that sponsor the plans, these provisions vary greatly. The following two provisions, drawn from actual TPA agreements, illustrate how great the differences can be:

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Agency Relationship – [claims administrator], in performing its obligations under this Contract, is acting only as agent of the Contractholder and the rights and responsibilities of the parties shall be determined in accordance with the law of agency….

* * *

RELATIONSHIP OF THE PARTIES

In performing services under this [ASA], [the claims administrator performs all acts as an independent contractor and not as an officer, employee or agent of Employer or Plan Administrator (if other than Employer) or Plan. Nothing in this Agreement shall be construed to mean that Employer retains any control over the manner and means of how [the claims administrator] performs the services provided for herein.

A business is more likely to hold its TPA accountable under the first provision than under the second. Most states set high expectations for entities that agree by contract to serve as the agents of others. Among other things, agents owe fiduciary duties to their principals; they must put the interests of their principals before their own and disclose all important information to their principals.

3. Indemnification Provisions

Indemnification provisions are another useful protection for self-funded plans. Many ASAs contain such provisions, but they are not all equal and may not be mutual.

Indemnification provisions, at the very least, should be triggered by negligent conduct on the part of TPAs. Ordinary care, reasonable diligence and negligence are appropriate triggers, in light of the important role played by TPAs and the amount of exposure faced by employers who rely on them. The following form language is a good example:

(B) Performance Standard – [TPA] shall use that degree of *ordinary care and reasonable diligence* in the exercise of its powers and duties hereunder that an administrator of claims under an insured or uninsured employee benefit plan would use acting in like circumstances. [emphasis added]

(C) [TPA] Indemnity – [TPA] agrees to indemnify the Contractholder and hold the Contractholder harmless against any and all loss, liability, damage, expense, cost or obligation (including reasonable attorneys' fees) with respect to this Contract:

(1) resulting from or arising out of the dishonest, fraudulent or criminal acts of [TPA]'s employees, acting alone or in collusion with others, or

(2) for that portion of such loss, liability, damage, expense, cost or obligation that a court determines was the result of or arose out of the acts of [TPA]'s employees in providing services under this Contract not in compliance with (B) above.

Less favorable—but still useful--forms require the administrator to "[a]djudicate (exercising ordinary care and reasonable diligence) group benefit claims…," but require indemnification for gross negligence only:

Plan Supervisor agrees to indemnify and hold harmless Employer from any claim, liability, cost, loss, expense or damage (including reasonable attorney and accountant fees) which results from Plan Supervisor's *gross negligence, willful misconduct or fraud* … [emphasis added]

Indemnification provisions are especially valuable when they include reimbursement for legal fees.

4. Select A Broker Who Understands Self-Funded Plans

Self-funding is a highly specialized area involving the interplay between three different contracts. Purchasing and negotiating the agreements necessary for self-funded health plans is far more complicated than the simple purchase of a health insurance policies. Also, the attendant financial risks associated with self-funded plans (including stop-loss policies) to businesses that sponsor the plans may be huge.

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Self-funded businesses need the advice of skilled brokers, familiar with the peculiarities and quirks inherent to self-funding. Not all employers are good candidates for self–funding. The brokers need to realistically evaluate whether the employer has sufficient cash to be able to withstand large claims prior to reimbursement by the stop-loss carriers. Businesses should make sure that their brokers provide actual advice, rather than lists of options that businesses may or may not fully understand. Businesses also should make sure that they either follow the advice that they receive, or have a good reason – that they truly understand – for not doing so.

In one case, the business's broker actually served as the TPA's lead witness at trial. The dispute involved whether the TPA had kept the business properly informed of large claims prior to termination. The broker testified that he never made any recommendations to the business, but merely forwarded information from the TPA with lists of options. According to this broker, the business used the information to draw its own conclusions and make its own decisions, without his recommendations. The broker also explained how he dutifully had asked the TPA all the proper questions and had passed along all of the responsive information he received. The business was not able to point to any written advice from the broker. Thus, the TPA was able to use the broker's self-serving testimony to undermine the position of the business, which was the broker's client.

5. Retain a Specialized Auditor to Monitor the TPA

Self-funded businesses should be prepared to invest in specialists, as needed to advise them about legal or financial issues. Depending on the circumstances, such specialists may include attorneys or auditors who specialize in self-funding, and are prepared to recommend ways to protect the plans from baseless claims and methods of recovering against wrongdoers.

There is, for example, an entire industry of billing experts that examine the conduct of TPAs. They advise businesses whether the TPA is billing them properly, among other things. By being proactive and retaining such experts, businesses can avoid certain problems that have a tendency to snowball, if not caught early.

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