The Perils of Self-Funding: What Your Advisors Don't Tell You

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ANDERSON KILL

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Rhonda D. Orin is the managing shareholder of the firm's Washington, D.C. office and co-chair of the firm's Climate Change and Disaster Recovery Group.

Rhonda represents policyholders in coverage cases nationwide. She is distinguished by her extensive experience as lead counsel in multiple multi-million-dollar insurance trials, both bench and jury. She has substantial appellate experience as well, having argued before the highest courts of several states, and appeared in two cases before U.S. Supreme Court. Rhonda is distinguished further by the unusual breadth of her substantive knowledge.

In addition to experience with first-party property damage and business interruption claims, third-party tort and environmental liability claims, directors & officers claims and errors & omissions claims, she also is knowledgeable about cyber liability, fidelity bonds, disability insurance policies and the myriad of health insurance and ERISA issues that arise in the context of modern healthcare.

Due to such achievements, Rhonda was named a **Fellow of the American Bar Foundation**, an honor reserved for less than 1% of attorneys. She is ranked in ***Chambers USA*** and ***The Legal 500***, named a **Fellow of the Litigation Counsel of America**, awarded "Star of the Bar" by the D.C. Women's Bar Association and continuously included in ***Best Lawyers in America*** and ***Super Lawyers***. She also writes extensively on insurance issues, including a book honored by *The Wall Street Journal*.

Terese Connerton

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Terry Connerton is a nationally recognized ERISA/employee benefits lawyer with over 40 years of experience. She specializes in ERISA litigation, qualified retirement plans, executive non-qualified plans and compensation, stock and other equity plans, health plans and welfare compensatory arrangements.

Terry started her career with the Department of Labor, litigating breach of fiduciary cases. She has been in private practice litigating breach of fiduciary claims (representing both plaintiffs and defendants), representing clients in Department of Labor and Internal Revenue Service audits, advising clients on the establishment and administration of their plans, and drafting employee benefit plans for employers.

Terry has served as an expert witness in several ERISA cases.

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John is a shareholder in Anderson Kill's New York office. He is Co-Chair of the firm's Financial Services Group and Biometric Liability Group.

He has recovered millions of dollars for policyholders in a full spectrum of insurance coverage matters, including disputes over business interruption losses, D&O and E&O defense and indemnity, general liability losses, and environmental liability.

He is a member of the firm's Corporate and Commercial Litigation Group and COVID Task Group.

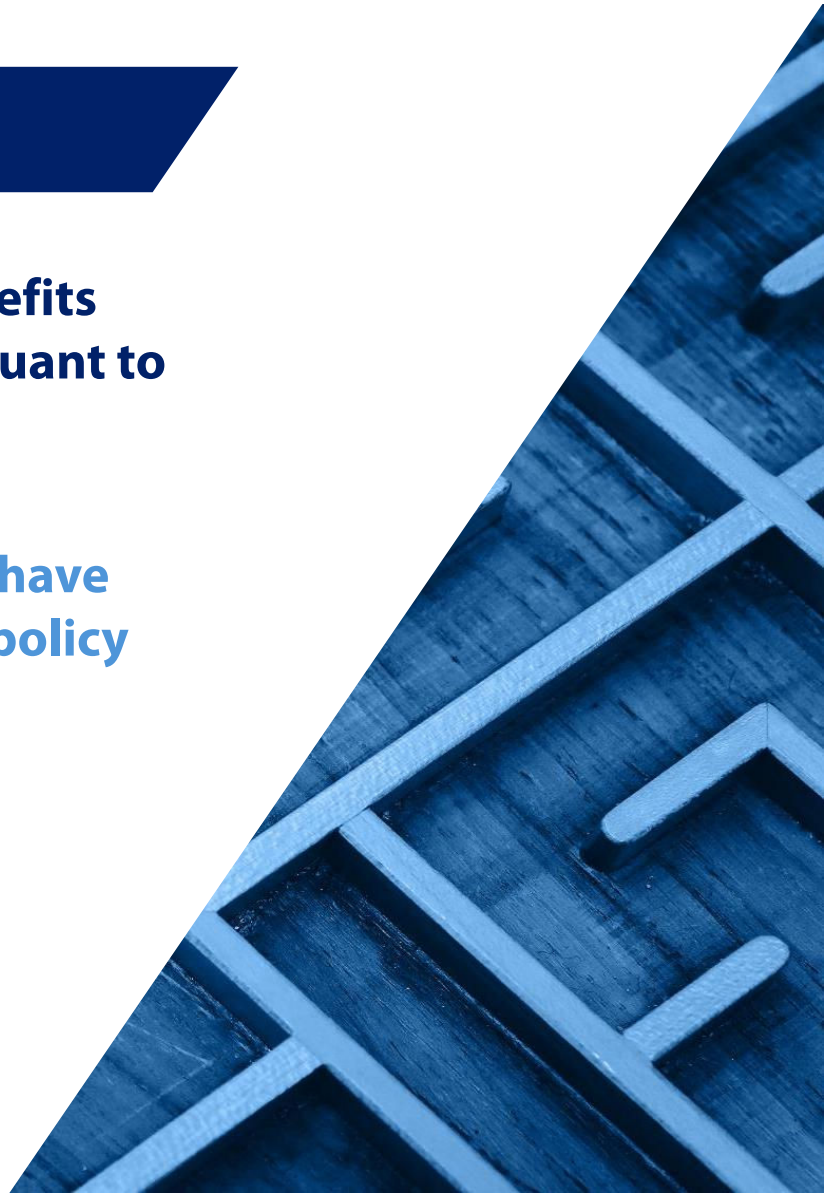
John has represented financial service providers, energy companies, municipalities, manufacturers, railroads, hospitality groups, and homeowners.

John is a seasoned litigator who counsels clients across a wide range of industries and insurance coverage programs.

Since 2018, John has been included on the **Super Lawyers Rising Stars** list for Insurance Coverage. In 2022, John was Recommended by **The Legal 500 US** for Insurance Recovery.

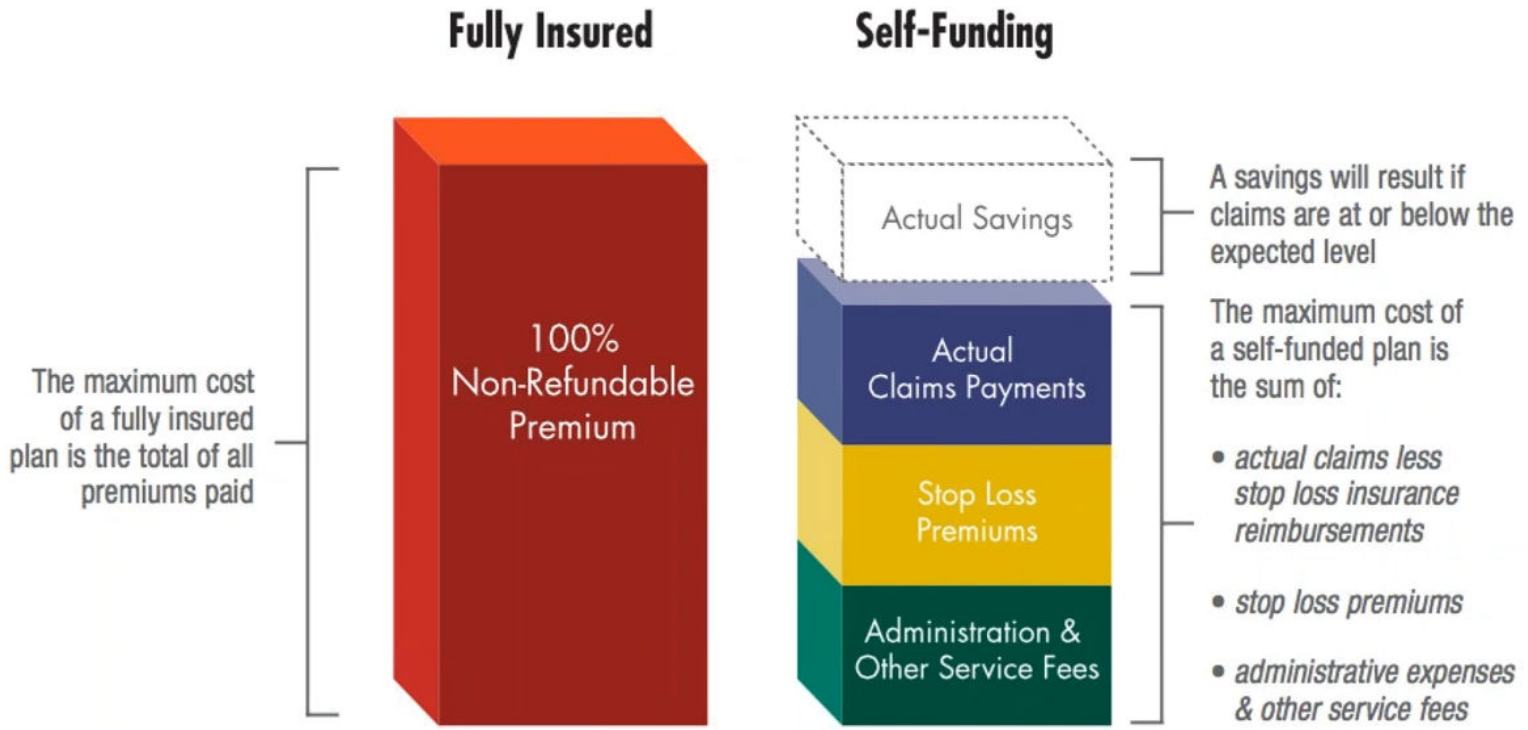
HERE'S HOW IT STARTS

- **Renewal time is approaching for the health benefits that you must provide for your employees, pursuant to the Affordable Care Act.**
- **You are a small (< 100 employees) or mid-sized employer (100-250 employees). Until now, you have met the mandate by buying a health insurance policy each year.**
- **Premiums for this year have "spiked." But your broker just offered you a "way to save money."**

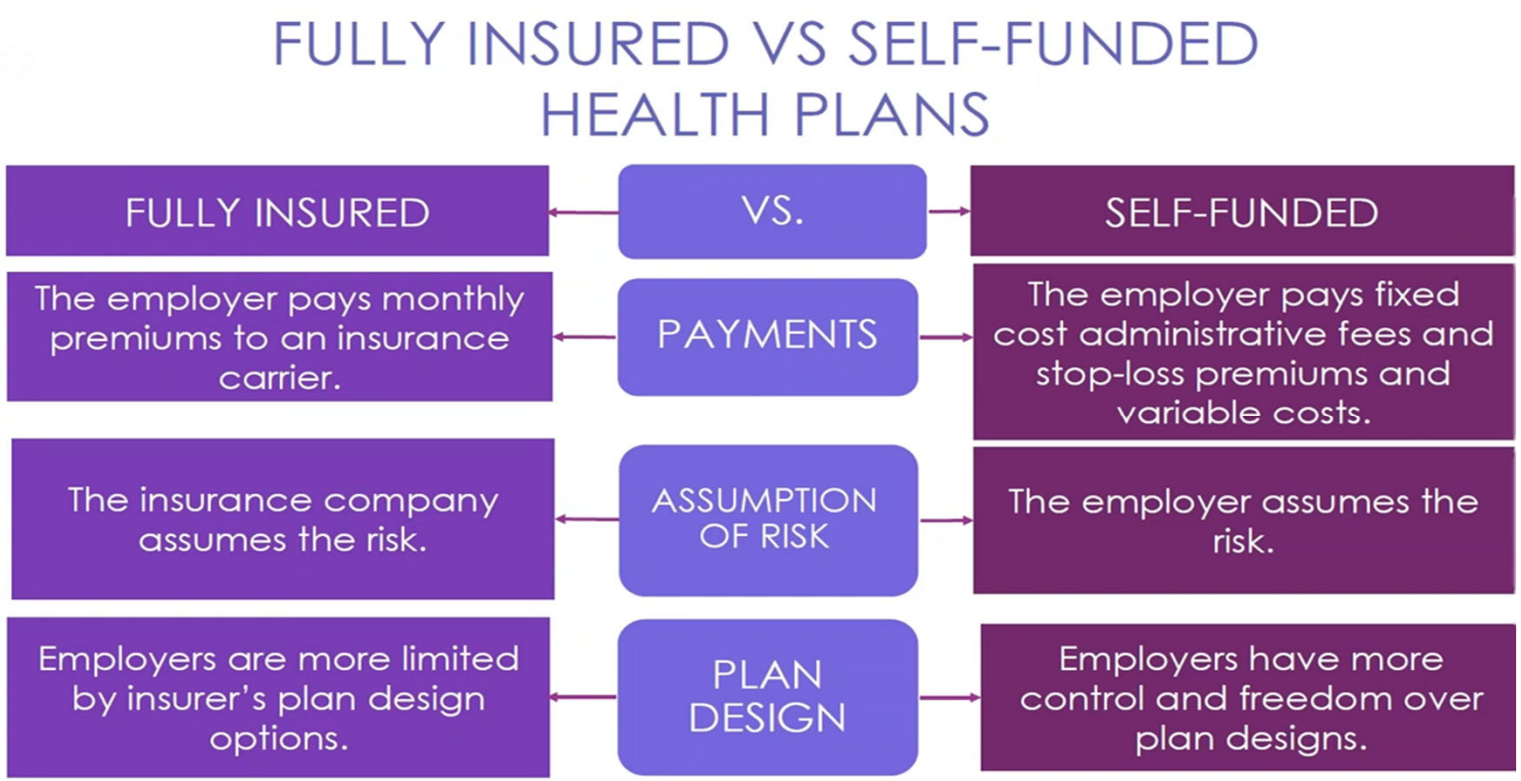


IT'S CALLED "SELF-FUNDING" -- AND EVERYONE IS DOING IT

SEE HOW MUCH MONEY YOU'LL SAVE?



AND *THIS* IS HOW YOU'LL SAVE IT



WHO IS SELF-FUNDED?

- 62 percent of all private corporations;
- 72 percent of public employers;
- 85 percent of multi-employer plans.

(2020 Employee Benefits Survey)

YES, THERE ARE BENEFITS

- **Practical: Cost-Savings**
  - No premiums
  - 90% reduction in taxes on stop loss premium taxes
  - Flexibility in design of plan

- **Legal: ERISA Preemption**
  - Jurisdiction only in federal court
  - Governed exclusively by federal law (no state mandatory-benefits)
  - Governed by ERISA and by regulations of U.S. Department of Labor (no punitive damages)

BUT ALL BENEFITS COME AT A PRICE

- **Do you fully understand the risks that you take on by self-funding?**
- **Let's unpack them.**

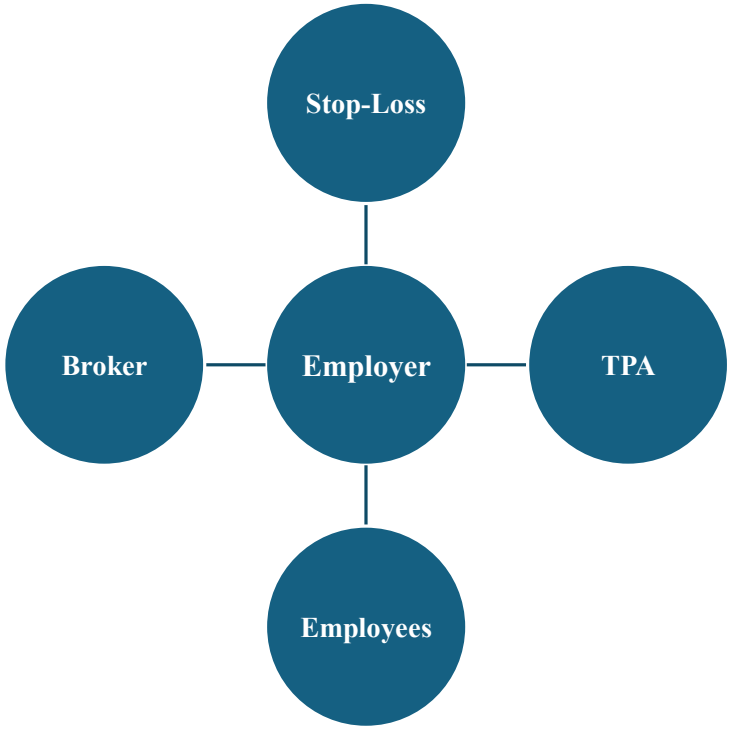
FIRST: PLAIN ENGLISH

- **FULLY INSURED**
  - You pay insurance premiums to an insurance company.
  - You collect the premiums from your employees and send premiums to the insurance company.
  - A health insurance policy is issued to your company.
  - The policy provides health insurance to your employees and their dependents.

MORE PLAIN ENGLISH

- **SELF-FUNDING**
  - YOU replace the insurance company (no insurer).
  - YOU collect "contributions" (no premiums).
  - YOU decide the benefits that will be offered under the Plan.
  - YOU provide a "summary of benefits" (no policy).
  - The employees submit their health claims to YOU or to the TPA retained by you to pay claims under the Plan.
  - YOU retain the fiduciary duty to deny claims and bear ultimate authority for the administration of the Plan.

SECOND: THE BASIC STRUCTURE OF EVERY SELF-FUNDED PLAN



ROLES OF THE PARTIES

- **Employer**
  - Contracts with TPA to process & pay your employees' health claims.
  - Buys stop-loss insurance.
  - Relies heavily on its broker.
- **TPA (Third-Party Administrator)**
  - Usually does everything a health insurer does, but does not assume the financial risk for claim payments.
  - Pays claims from a "checkbook" established by employer.
  - May not be liable for its own mistakes.

ROLES OF THE PARTIES (cont'd)

- **Stop Loss Insurance Company**
  - The policy usually contains two components:
    - Specific attachment point or "retention level" that protects against large claims; and
    - Aggregate attachment point that protects employer against paying more than a certain amount in claims in a year.
- **There are insurance companies everywhere -- yet employer is "self-funded."**

THE ANDERSON KILL PERSPECTIVE:

THIRD: THE INEXPERIENCE FACTOR

- **Self-funding arrangements are complicated and most employers who self-fund are persuaded by the potential savings, but not advised on the potential risks.**
- **They don't understand the spreadsheets and other documents that they are given by TPAs**
- **They can offer no alternatives to the "solutions" that insurance companies propose for their problems.**

SO -- WHAT COULD GO WRONG?

1. **TPAs could fail to pay health claims timely or correctly.**
   - Employer would be liable to the providers
   - Employer would violate ERISA
   - Employer would violate the ACA mandate
   - Employer would have disgruntled employees
   - Employer could lose its stop-loss coverage

SO -- WHAT COULD GO WRONG? (cont'd)

2. **Stop-loss insurers** could rescind or terminate stop-loss coverage, substantially increase premiums during the contract year, insist on "laser specific" attachment points for certain high-claim employees, and audit the TPA's claims payments (and seek reimbursement of coverage previously provided) due to the discovery of TPA mistakes.
3. **Employers** – when changing plans – could accidentally leave gaps (e.g., run-out and run-in claim issues).
4. **Regulators** could fine employers for COBRA, HIPAA and other violations.
5. **Employees** could sue employers.

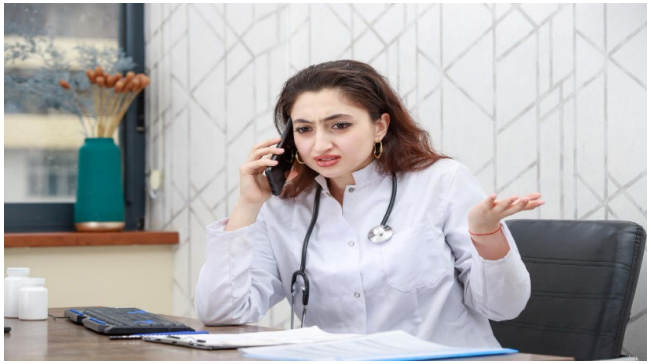
RISK OF LAWSUITS? YES.

- **Disputes with TPAs over wrongful denials, wrongful payments, defective record-keeping, misuse of funds.**
- **Disputes with stop-loss insurers over failure to pay claims.**
- **Disputes with brokers/agents/consultants over divided loyalties, poor advice.**

AND MORE LAWSUITS . . .

- Disputes with providers over alleged payment errors.
- Disputes with employees over alleged wrongful denials.
- Disputes with employees over alleged discriminatory terminations.
- Actions against employers by U.S. Department of Labor.

ALL OF A SUDDEN – THIS!



CASE STUDIES

- **The jury trial in *Aetna Life Insurance Co. v. Esselte Corporation* (Intentional alteration of "Large Claimant Report")**

- **The behind-the-scenes resolution for the "ABC" Corporation (Dysfunctional TPA)**

HOW CAN YOU PROTECT YOUR COMPANY?

- **Understand the employee benefits structure offered under the Plan.**
- **Get as much insurance protection as possible and understand what you and the TPA need to do to ensure full recovery from stop-loss.**
- **Don't self-fund unless you are prepared to take on unexpected obligations and risks, and understand how the aggregate monthly accommodations/advance funding loan agreement works.**
- **Understand the cost implications of moving to a self-funded plan.**
- **Negotiate a contract with a TPA which details the services to be provided by the TPA.**

THE ROOT OF THIS STRUCTURE

- **ERISA Basics:**
  - Pre-emption Clause
  - Saving Clause
  - Deemer Clause

PREEMPTION CLAUSE

- **"[ERISA shall] supercede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."**
- **Section 514(a), 29 U.S.C. § 1144(a)**

SAVINGS CLAUSE

- **"[Nothing in ERISA] shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking or securities."**

- **Section 514(b)(2), 29 U.S.C. § 1144(b)(2)(B)**

DEEMER CLAUSE

- **"[No employee benefit plan, with certain exceptions] shall be deemed to be an insurance company or to be engaged in the business of insurance or banking for purposes of any law of any state purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies."**

- **Section 514(b)(2)(B), 29 U.S.C. § 1144(b)(2)(B)**

THE REGULATORY STRUCTURE

- **Self-Funded plans are *not* subject to state insurance laws, but must comply with ERISA, HIPPA and ACA's applicable provisions.**
- **If TPAs make a mistake, the employer will be responsible.**
- **Stop-loss insurance policies are not subject to ERISA, but rather state insurance laws. State laws vary.**

THE REGULATORY STRUCTURE (cont.)

- **Stop-loss insurance companies have no direct contractual obligations to the Plan's participants and beneficiaries.**
- **Some states treat stop-loss as a health insurance line; other states as a casualty line. A few states treat it as casualty insurance, but also authorize health insurers to write policies.**
- **Stop-loss insurance may be used to take advantage of more favorable regulatory treatment. Depending upon how low the attachment points are, it functions like a group health insurance.**

THE REGULATORY STRUCTURE (cont.)

- Many ACA Requirements do not apply to self-funded plans -- *e.g.*, rating restrictions, EHB requirements and state mandated benefit laws.
- **But remember, the self-funded employer remains legally responsible to pay claims. Employers are the Plan's fiduciaries and can be personally liable if they fail to fulfill their fiduciary obligations under ERISA.**
- The employers may be liable under ERISA if they know, or should have known, of any breach of a co-fiduciary. If the employers delegate fiduciary responsibilities to a TPA, the employers must monitor the TPA.

CONSIDERATIONS IF YOU NEED COUNSEL

- **We may be the only law firm that sees self-funding as a "policyholder v. insurance company" issue.**
- **Most policyholder firms stick with property/casualty insurance and avoid life/health issues.**
- **The law firms that set up self-funded plans generally do ERISA-related work on behalf of the insurance companies.**

Questions?

THANK YOU

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