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CONFIDENTIAL – ATTORNEY CLIENT COMMUNICATION

MEMORANDUM

TO: Colorado Health Care Association

DATE: May 28, 2010

RE: Financial Responsibility Under the Health Care Availability Act (“HCAA”) for Colorado Health Facility Licensing

FROM: Kevin D. Peters of Miles & Peters, P.C., and
Jeff Kassal of Arthur J. Gallagher Risk Management Services, Inc. (303) 889-2530

This memorandum will address the financial responsibility requirements of the HCAA (§ 13-64-301 *et seq.* C.R.S.), as recently amended by House Bill 10-122, for health care facilities licensed by the Colorado Department of Public Health and Environment, Health Facilities Division (“DPHE”), as now interpreted by DPHE and the Division of Insurance (“DOI”). Recent changes to DPHE’s policies followed by amendment to the HCAA requiring DOI review have created uncertainty for health care facilities seeking licensure or renewals of their licenses, effective on or after March 1, 2010. Long-term care providers are concerned about these changes because their commercial insurance coverage or insurance platforms are generally maintained and renewed on an annual basis, but the timing does not necessarily coincide with the licensing renewals of their Colorado facilities so that commercial insurance coverage or insurance platforms are already in place at the time of the license renewal process. Mid-stream changes to these insurance plans and/or insurance platforms can be costly. This memorandum will not address customized insurance platforms that are often used by multi-facility operators,

which may include an off-shore self insurance plan, as each platform is tailored for the specific organization and must be analyzed based upon its specific attributes.

We anticipate that the process and possibly the policies of the DOI in reviewing a health care facility's financial responsibility requirements may develop over a period of time, but this memorandum reflects the DOI's current view of its obligations under Colorado law. We will start with some history of how we got to where we are today.

The HCAA was added to Colorado law as part of the 1988 tort reform legislation, and requires all Colorado health care facilities to maintain, as a condition of licensure, commercial professional liability insurance coverage with a minimum indemnity amount of \$500,000 per incident and \$3,000,000 annual aggregate per year, or in the alternative, obtaining approval for an alternative plan of financial responsibility from the Commissioner of Insurance in the form of (i) a surety bond, (ii) deposit of cash or cash equivalents, or (iii) other acceptable security, including an approved self-insurance plan. The Colorado Department of Public Health and Environment ("DPHE") requires each applicant for a health care facility license to provide evidence of insurance (usually a certificate of insurance) during the licensure or re-licensure process.

In the summer of 2004, DPHE required applicants for a health care license or license renewal with a commercial professional liability insurance policy subject to a deductible¹ or self-insured retention² ("SIR") to meet their financial responsibility requirements by executing an

¹ A "deductible," is an agreement between the insured and the insurance carrier that the insured will pay a certain amount of any claim. It is usually distinguished from an SIR by virtue of the requirement that the carrier is fully liable to the claimant for the entire amount of the claim. The insurance carrier then seeks reimbursement from the insured.

² A self insured retention means that insurance carrier does provide coverage until the SIR amount has been incurred and paid by the insured. In other words, the insured is responsible for any first dollar coverage for claims or costs (continued on next page)

affidavit affirming that the applicant has met the professional liability insurance coverage requirements under the HCAA. Alternative plans of responsibility, as listed above, still had to be reviewed and approved by the Commissioner of Insurance.

At the end of 2009, DPHE no longer accepted the affidavit of compliance to meet the financial responsibility requirements and adopted a new policy for all insurance applications received on or after January 1, 2010 for all licenses issued on or after March 1, 2010. The new policy requires adherence to the requirements of the HCAA, but adds that if an applicant's commercial professional liability insurance policy has a deductible or an SIR, it must be reviewed by the DOI and the deductible or SIR must qualify as an alternative financial arrangement under the HCAA. DPHE's new policy was added to the statutory language in HCAA with the passage of House Bill 10-1227, which was signed into law in April, 15th effective as of that date.

This language remains unclear and leaves questions as to how the new law will be interpreted. Kevin Peters of our office and Jeff Kassal with Arthur J. Gallagher met with representatives of the Division of Insurance, that included Raymond Akers, Financial Analyst, Cindi Hathaway, Financial Examiner, and Valerie Esters, Financial Examiner, to discuss the new requirements and any interpretative policies that may have been adopted by the DOI to review the insurance policies or alternative financial arrangements under the HCAA. Valarie Esters was transferred to the DOI specifically to review health care facility insurance policies and insurance platforms, as required by these changes.

Mr. Akers advised us that the DOI would look at the commercial professional liability policies differently depending upon whether they had a deductible or an SIR. For those policies

associated with the insurance claim up to the amount of the SIR. The insurance carrier is then liable for payment of claims and costs incurred in excess of the SIR amount.

with deductibles, if the policy does not specifically state that the insurance company will pay all claims within the deductible amounts and seek reimbursement from the insured the DOI will require a deductible endorsement from the insurance carrier that includes such language. Jeff Kassal has indicated that most policies with true deductibles should include this language or will provide it in the deductible endorsement. Mr. Akers confirmed that all of the major insurance carriers to date have agreed to provide such endorsements. However, for policies with an SIR (or presumably a non-qualifying deductible), the DOI would require an alternative financial arrangement as described under the DOI's regulation 2.1.1. , Section 4, for the amount of the SIR which requires review and approval of an alternative plan of financial responsibility in the form of (i) a surety bond, (ii) deposit of cash or cash equivalents, or (iii) other acceptable security, including an approved self-insurance plan.

In accordance with the Department's regulations, if a surety bond is used, the amount of the bond must be sufficient to fund the applicant's minimum requirements of \$500,000 per claim and \$3,000,000 in the aggregate per location plus any remaining liability for prior years' coverage. If cash or cash equivalents are used, they must also be sufficient to fund the applicants minimum requirements described above. If the applicant does not desire, or is unable, to post a surety bond or deposit cash or cash equivalents, the non-qualifying deductible or SIR must meet requirements of a self insurance plan.

To establish alternative financial responsibility under a self insurance plan pursuant to DOI regulation 2.1.1., Section 4. F., each health care facility location must still meet the minimum required coverage limits. The applicant must submit to the DOI for review at least 60 days prior to the expiration of the qualifying financial responsibility arrangement, the following:

1. A detailed explanation of the overall plan of operation, list of health care facilities included in the plan, whether coverage is on an occurrence or claims made basis,

- administrative procedures, expertise in administration, actuarial and claims analysis, and copies of all contracts and subcontracts.
2. An actuarial certification and report prepared by a qualified actuary. This requirement may be waived, but the period between such reports can be no more than two years.
 3. An affidavit executed by a knowledgeable officer stating whether or not the amount in the actuary opinion has been stated on the institution's financial statements.
 4. Audited financial statements not to exceed 3 years for any entity that is liable for the self-insurance exposure risk.
 5. An organizational chart for all related corporate entities.
 6. Actuarial studies, reports, projections, feasibility studies, or justifications which demonstrate the adequacy of the self-insurance program.

The applicant may establish a Trust as the funding mechanism, but the trust agreement must be approved by the DOI and must be established by an authorized trustee in a chartered bank, saving and loan association, credit union, or trust company under the supervision of the State Bank or Financial Services Commissioner or a national banking association, federal credit union, or federal savings and loan association.

The new requirement to show alternative financial responsibility under one of the mechanisms described above for an a commercial insurance policy with an SIR seems onerous if the SIR is a lower amount (for example \$25,000 to \$50,000), but the DOI will not accept the SIR without review of other financial resources to meet the alternative financial responsibilities requirements of the DOI's regulations. In other words, the applicant must use a surety bond, cash deposits or the DOI will review all documentation required by regulation 2.2.1, Section 4.F. to show compliance by a self-insurance plan.

For CHCA's members, we make the following observations.

1. In assessing the provider's current insurance platform, we recommend that in the event the professional liability insurance requirements are met through a commercial insurance policy with a deductible, that the provider review the policy to determine whether it contains language stating that the insurance carrier will pay any and all claims covered the deductible and will seek reimbursement of the deductible amount directly from the insured. If it does not, the provider should seek to have a deductible endorsement placed on the policy.

2. For arrangements with a non-qualifying deductible or an SIR, the provider must (i) provide a surety bond to the Commissioner of Insurance, (ii) deposit cash or cash equivalents with the Commissioner of Insurance, or (iii) prepare the necessary documentation required under the Division's 2.2.1, Section 4.F for review by the DOI at least 60 days prior to the license renewal date.

3. For multi-facility operators using an insurance platform with a self-insurance plan component, we recommend submission of your plan documentation well in advance of your Colorado facilities' license renewal dates and be prepared to adjust your insurance platform to meet the minimum HCAA licensure requirements. The DOI will consider loss history of the Colorado facilities under the plan, financial resources of the company and the use of dedicated resources to satisfy the HCCA aggregate requirement of \$3 million per location.

For specific questions, please give Jeff Kassal or Kevin Peters a call.