

Authors

R. Dean Conlin
312-443-0454
rdconlin@lockelord.com

Timothy S. Farber
312-443-0532
tfarber@lockelord.com

A Rose by Any Other Name...*Texas Court Classifies Medical Stop-Loss Coverage as "Reinsurance"*

In the latest battle over the appropriate classification of "medical stop-loss" or "medical excess loss" coverage, a Texas appeals court (the "Court") has ruled that such coverage is reinsurance and not direct insurance, a classification that is critical because the Texas Department of Insurance (the "Department") has only indirect regulatory authority over reinsurance, but has extensive authority over direct insurance, including the ability to impose certain fees and approve policy forms. In *American National Insurance Company et. al ("American National") v. Texas Department of Insurance* 2009 WL 4878676 (Tex.App. Austin), the dispute concerned the appropriate classification of medical stop-loss coverage issued in connection with self-funded medical benefit plans.

coverage is triggered when all claims paid during the plan year (excluding amounts reimbursed under the specific coverage) exceed an attachment point, which is generally expressed as an amount in excess of 120 percent (or other percentage) of anticipated annual claims, subject to the policy limit. Although self-funded medical benefit plans protected by stop-loss insurance always select specific coverage, some of these plans do not purchase aggregate coverage.¹

A medical stop-loss insurance policy is a contract between the insurer and the plan or the sponsoring employer; the stop-loss insurer has no contractual relationship with employees covered under the self-funded medical plan.

What are Self-Funded Medical Benefit Plans

The Court described a self-funded medical benefit plan as one that operates by maintaining a pool of funds that are contributed by an employer or its employees, or by both, from which the plan pays covered medical expenses of the employees and their dependents. The plan assumes the risk of paying covered employees' (and their dependents') expenses rather than shifting the responsibility for payment entirely to a third-party insurer. Many of these plans qualify as "employee welfare benefit plans" as defined by the Employee Retirement Income Security Act of 1974 ("ERISA").

The Texas Appeals' Court Decision**Self Funded Medical Plans are Considered Insurers Capable of Purchasing Reinsurance**

American National had always treated medical stop-loss insurance policies as reinsurance, but the Department claimed that such policies were direct insurance, not reinsurance, principally because of the Department's position that only insurers can purchase reinsurance, and the Department's view that self-funded plans are not "insurers" under Texas law. However, pursuant to the Texas statute requiring a license for any entity engaged in the "business of insurance," which is the linchpin of state insurance regulation, a self-funded medical plan qualifies as an "insurer." Although the Texas Insurance Code does not specifically define "reinsurance," it does provide a contextual definition by stating that "any insurer authorized to do the business of insurance in [Texas] may reinsure in any solvent assuming insurer, any risk, or part of a risk which both are authorized to assume...."

What is Medical Stop-Loss Insurance

The Court described medical stop-loss insurance as coverage that allows a self-funded medical plan to shift some of its (or the sponsoring employer's) risk to an insurance carrier. Such policies often contain both specific and aggregate coverage. With specific coverage, when a claim exceeds the specific attachment point (often called a specific deductible expressed as an amount per covered life per plan year), the stop-loss insurer reimburses the plan or the sponsoring employer for the amount of the claim that exceeds the specific deductible. Aggregate

American National contended that self-funded medical plans meet the definition of "insurer" engaged in the "business of insurance" under the Texas Insurance Code and qualify under the contextual definition above to buy reinsurance as any other insurer. Therefore, American National argued, it is permitted to classify medical stop-

www.lockelord.com

This *Client Alert* is provided solely for educational and informational purposes. It is not intended to constitute legal advice or to create an attorney-client relationship. Readers should obtain legal advice specific to their enterprise and circumstances in connection with each of the topics addressed.

If you would like to be removed from our mailing list, please contact us at either unsubscribe@lockelord.com or Locke Lord Bissell & Liddell LLP, 111 South Wacker Drive, Chicago, Illinois 60606, Attention: Marketing. If we are not so advised, you will continue to receive *Client Alerts*.

Attorney Advertising

© 2009 Locke Lord Bissell & Liddell LLP

loss coverage sold to self-funded medical plans as reinsurance.

The Court agreed that self-funded medical plans are “insurers” because, among other activities, these plans engage in the business of insurance by making insurance contracts, receiving insurance applications, receiving premiums as consideration for insurance and delivering insurance contracts. Because the self-funded medical plans are “insurers,” by purchasing stop-loss coverage they were purchasing reinsurance. The Court also concluded that nothing in the Texas Insurance Code limited the purchase of reinsurance to “authorized insurers.” The statute quoted above was merely permissive, giving authorized insurers the right to purchase reinsurance without prohibiting self-funded medical plans from doing the same. Moreover, the Court ruled that self-funded ERISA plans do not need the state’s permission to reinsure, and any attempt to prevent them from doing so would be preempted under ERISA.

Medical Stop-Loss Insurance is Appropriately Classified as Reinsurance

In buttressing its conclusion that medical stop-loss coverage is reinsurance, the Court noted the following two facts. First, under Texas statutes, health maintenance organizations, which are not licensed as health insurers by the Department, are specifically permitted to purchase “reinsurance;” and second, medical stop-loss insurance meets the definition of reinsurance as the insurance coverage issued by American National had the classic characteristics of reinsurance: (i) American National has no contact with the individuals insured by the plans; (ii) all losses are handled by the plans and then sent to American National for indemnification; (iii) American National does not make coverage decisions with respect to individuals insured by the plans; and (iv) American National has no contractual relationship with the individuals insured by the plans and cannot be sued by them.²

Future Action

It is unclear whether the Department will appeal this decision as a spokesman for the Department has stated that it is “currently reviewing the Court’s decision and will make a determination about possible next steps at the appropriate time.”

Analysis of the Court’s Decision

The Court cited decisions from other courts it claims are in accord with its decision, including *Brown v. Granatelli*, 897 F.2d 1351 (5th Cir. 1990), which analyzed the substantially similar predecessor to current Texas law and determined that stop-loss insurance purchased by a self-funded plan was not direct accident or sickness insurance, but rather reinsurance; *United Food & Commercial Workers & Employers Ariz. Health & Welfare Trust v. Pacyga*, 801 F.2d 1157, 1161 (9th Cir. 1986) (holding stop-loss insurance is not equivalent to direct health insurance); *Cuttle v. Federal Employees Metal Trades Council*, 623 F.Supp. 1154, 1157 (D. Me. 1985) (“Stop-loss insurance is not group health insurance providing insurance to individuals through a sponsor group. Rather, it is insurance obtained to protect self-insurers from risks . . .”).

However, the Court fails to mention contravening authority in other jurisdictions that have found stop-loss coverage is direct insurance and not reinsurance. For example, in 2008, the Seventh Circuit Court of Appeals agreed with the Wisconsin Department of Insurance in holding that stop-loss insurance is not reinsurance. *Edstrom Industries, Inc. v. Companion Life Insurance Co.*, 516 F.3d 546 (7th Cir. 2008). The Seventh Circuit reasoned that a contrary “[i]nterpretation would not only strip the purchasers of stop-loss insurance, even when they are small companies, of the extensive protections that Wisconsin law provides to insureds...but it would disrupt the Wisconsin Health Insurance Risk Sharing Plan. The [Wisconsin Health Insurance Risk Sharing Plan] provides health insur-

ance to persons who cannot obtain private coverage, and finances the program by imposing fees on health-insurance companies including companies that sell stop-loss insurance to employers who sponsor self-funded employee welfare benefit plans.”

In supporting its conclusion in *Edstrom Industries*, the Seventh Circuit cited a number of cases, including *Kitchell v. Public Service Co. of New Mexico*, 972 P.2d 344, 348 (N.M. 1998); *South Carolina Property & Casualty Ins. Guaranty Ass’n v. Carolinas Roofing & Sheet Metal Contractors Self-Insurance Fund*, 446 S.E.2d 422, 424-25 (S.C. 1994); *Stamp v. Department of Labor & Industries*, 859 P.2d 597, 540-44 (Wash. 1993); *Iowa Contractors Workers’ Compensation Group v. Iowa Ins. Guaranty Ass’n, Inc.* 437 N.W.2d 909, 914-16 (Iowa 1989); *Zinke-Smith, Inc. v. Florida Ins. Guaranty Ass’n, Inc.*, 304 So.2d 507 (Fla. App. 1974); and Tennessee Department of Commerce and Insurance, “Regulation of Excess Stop-Loss Coverage,” *Tenn. Ins. Bulletin* 7-1-94 (1994). A New York Office of General Counsel Opinion (OGC Op. No. 09-04-08) last year also reaffirmed that medical stop-loss insurance is not reinsurance and thus is subject to New York state insurance regulation.

Uncertainty as to whether medical stop-loss coverage is direct insurance or reinsurance can be eliminated by a precise definition in state insurance codes. For example, the Illinois Insurance Code defines “stop-loss insurance” as “insurance against the risk of economic loss issued to...an employee welfare benefit plan as described in 29 U.S.C.10001 *et seq.*”³ However, where state insurance codes are not clear, the ultimate determination will be left to state insurance commissioners and the courts to conduct their own analysis and draw their own conclusions. The analysis can be complex and the conclusions from one state to the next can seem inconsistent.⁴

Offices

Atlanta

Austin

Chicago

Dallas

Houston

London

Los Angeles

New Orleans

New York

Sacramento

San Francisco

Washington DC

A Rose by Any Other Name... (cont'd.)

We will continue to follow recent developments in this area and assist clients in dealing with these critical, and sometimes complex, determinations.

Endnotes

- 1 Stop-loss coverage generally can be described as contractual indemnification and is not a group health policy that is subject to state mandated benefits and other required state insurance code provisions that apply to group health insurance.
- 2 In Illinois, stop-loss insurance can be issued by both property and casualty (p&c) and accident and health (a&h) insurers. However, most states allow stop-loss coverage to be issued by only one type of insurer.
- 3 However, in Illinois medical stop-loss insurance issued to a self-funded intergovernmental cooperative, which is not subject to regulation by the Illinois Department of Insurance, is classified as reinsurance pursuant to the Intergovernmental Cooperation Act.
- 4 Whether a particular coverage is considered medical stop-loss insurance or direct health insurance can also depend on whether the attachment points are too low. For example, a low attachment point (substantially the same as deductibles under group health insurance) be seen as an attempt by employers to circumvent state insurance requirements and makes the product look more like direct health insurance. See, e.g., *Brown v. Granatelli*, 897 F.2d 1351 (5th Cir. 1990), where the court suggested that a plan with low attachment point stop-loss coverage would more likely be considered insurance subject to state insurance regulation. See also *Bricklayers Local No. 1 Welfare Fund v. La. Health Ins. Ass'n*, 771 F. Supp 771, 774 (E.D. La. 1991); *Associated Indus. of Missouri v. Angoff*, 937 S.W.2d 277, 283 (Mo. Ct. App. 1996); *American Med. Sec., Inc. v. Bartlett*, 915 F. Supp. 740, (D. Md. 1996), later hearing at *American Med. Sec., Inc. v. Larsen*, 31 F. Supp. 2d 502, (1998), *affd.* by 111 F.3d 358 (4th Cir. 1997).

About the Authors

R. Dean Conlin is a partner at LLB&L. Mr. Conlin has more than 30 years of experience in a wide range of insurance regulatory and corporate matters for domestic and alien insurers and reinsurers.

Timothy S. Farber is an associate at LLB&L. He practices in the area of corporate law, where his practice focuses on general corporate law, mergers and acquisitions, securities and insurance regulatory matters. Mr. Farber has experience representing issuers and underwriters in debt and equity financing matters for both public and private companies.