

# IMPLICATIONS UNDER HIPAA FOR SALES OF HEALTH INSURANCE BUSINESS

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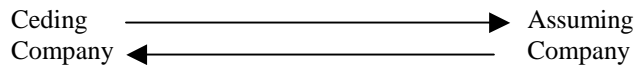
A person or entity seeking to acquire existing health insurance or HMO business generally may pursue this objective through the acquisition of either (1) the insurance or HMO entity, or (2) the insurance assets from the insurance company or HMO that owns the book of business. An asset purchase is generally accomplished by an assumption or portfolio reinsurance transaction involving some or all of the insurer=s existing book of business. Purchases of insurance or HMO books of business were very common in the 1990s. The adoption of the Health Insurance Portability and Availability Act by Congress in 1996 and of similar statutes by state legislatures raise several interesting issues affecting these types of transactions. The Texas Health Insurance Portability and Availability Act (AHIPAA@) is found in Chapter 26 of the Texas Insurance Code, and references made herein are to that statute.

The following paragraphs describe the most common approaches to effecting acquisitions of insurance assets.

## *Assumption Reinsurance*

This transaction transfers the insurance coverage to a new insurer/HMO, which then assumes all direct obligations to the original insureds. As a general rule, a novation is effected, and the insured no longer has a contractual relationship with the company which originated the coverage. As of the date of the assumption, the ceding company transfers and assigns all the contractual obligations under the insurance contracts to the assuming company. The insureds are notified of this event when they receive an assumption certificate (endorsement to the insurance contract) from the assuming company.

1. Transfer of Insurance Contracts
2. Cash and Other Assets

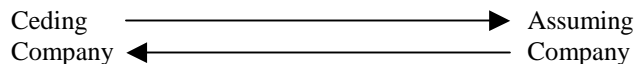


Assumption of Contractual Obligations

## *Portfolio Transfer/Rollover*

This approach involves a combination of indemnity reinsurance with the sale of the rights to the renewals and expirations associated with the book of business. A portfolio transfer agreement provides indemnity reinsurance whereby the ceding company usually transfers 100% of the future losses payable for the book of business without, however, affecting the underlying insurance contracts. In other words, the reinsurer agrees to indemnify the ceding company for 100% of the losses sustained under the insurance contracts but does not take over the direct contractual obligations under the contracts, as in the case of assumption reinsurance. The ceding company simultaneously takes steps to withdraw from the territory or line(s) of business by ceasing to write new business and nonrenewing existing business. The assuming company is then able to solicit the ceding company=s insureds and offer new coverage to begin at the time the old, nonrenewed coverage expires. The book of business is thus said to be Arolled over@ into the new company=s products.

Transfer of Assets and Reserves



Provides Indemnity Reinsurance

The requirements of HIPAA apply equally to HMOs and health insurers (both of which are referred to herein as Acarriers@). One of the most significant requirements of HIPAA is guaranteed renewability: the carrier may not nonrenew or cancel an insured=s coverage unless the insured does certain things, e.g., fails to pay the premium or

commits fraud. Exceptions to this general rule exist when the carrier desires to discontinue a type of coverage or withdraw from the market entirely. A carrier wishing to discontinue or nonrenew either a particular type of coverage or all coverage it offers in the small and/or large employer markets must comply with the requirements of Tex. Ins. Code art. 26.24 (for small employer business) and Tex. Ins. Code art. 26.87 (for large employer business).

Pursuant to Tex. Ins. Code art. 26.24(d), 26.25, 26.87(d), and 26.88, a carrier that makes certain specified notifications may elect to discontinue a particular type of small or large employer coverage, other than the small employer prototype plans mandated under Texas law. To discontinue a particular type of coverage, the carrier must offer each employer group the option of purchasing other comparable coverage that the carrier currently issues. In other words, it must offer replacement coverage. Discontinuation of coverage may take effect with respect to all affected groups 90 days from the date of the notice; it is not tied to each employer's renewal date. However, the Texas Department of Insurance (the ADepartment@) has required that the 90-day notice be timed with the group's premium due date, whether monthly or otherwise.

Pursuant to Tex. Ins. Code art. 26.24(a-c) and 26.87(a-c), a carrier may elect to nonrenew all small employer or large employer plans issued in the State of Texas or in an approved geographic service area upon compliance with certain specified notification requirements. To nonrenew all small and/or large groups, the carrier must withdraw from business and give the Department and each group 180 days notice prior to the group's next renewal date. A small or large employer carrier that has elected to nonrenew all small and/or large employer contracts in Texas or in an approved geographic service area may not write new coverage in Texas or in the geographic service area, as applicable, before the fifth anniversary of the date of notice to the Insurance Commissioner.<sup>1</sup>

Rules similar to those described above for small and large group business have been adopted by the Department for dealing with the discontinuation or nonrenewal of nongroup (individual) coverage.<sup>2</sup>

***Upon Acquisition of the Business by Assumption Reinsurance, What Limitations or Restrictions Does the Assuming Company Have with Respect To:***

- 1. Moving the Book of Business into its Own Products and Product Forms?***
- 2. Re-rating the Book of Business, i.e., Increasing the Rates for the Insureds?***

Assumption reinsurance is a transaction whereby the assuming insurer (reinsurer) assumes in writing the direct policy obligations of the ceding insurer in substitution for the obligations of the ceding insurer. Thus, because the assumption reinsurer becomes a substitute for the ceding insurer in performing its obligations, the assuming company becomes responsible for each of the obligations of the ceding company, including rating and renewal requirements.

Insurance carriers and HMOs that have assumed a book of business through an assumption reinsurance transaction are subject to the renewal and cancellation provisions of Chapter 26 of the Texas Insurance Code. Small and large group contracts are guaranteed renewable and may be canceled only for reasons authorized by the Texas Insurance Code and regulations. An assuming company wishing to discontinue the use of the products and product forms of the ceding company to move the book of business into its own products and forms would be required to comply with the 90-day notice requirements discussed above.

The assuming company also steps into the shoes of the ceding company with respect to rate adjustments for the book of business. Before making any adjustments to the rates charged under the assumed policies and HMO contracts, the assuming company must comply with the notice and filing requirements described below.

As a general matter, both health insurers and HMOs may increase the premium rates charged under a particular policy or HMO contract upon written notice to the policy or contract holder at least 30 days prior to the effective date of the rate increase. The notice must specify the amount of the rate increase and the date on which the increase will take effect.<sup>3</sup> These provisions do not appear to impose a requirement that rates may be adjusted only at renewal. The Department's Life/Health Group has stated, however, that, while the rules do not state that rates may be increased only at renewal, the Department might view a rate increase during a contract term as inappropriate.

The percentage increase in the premium rates charged to a small employer for a new rating period is restricted by the

provisions of Tex. Ins. Code art. 26.33. The premium increases for small employers generally may not exceed the sum of (1) the percentage change in the new business premium rate from the first day of the previous rating period to the first day of the new rating period; (2) a maximum 15 percent adjustment for claims experience, health status, or duration of coverage; and (3) adjustments for changes in case characteristics (age, gender, etc.) of the group. These restrictions do not apply to policies or HMO contracts issued to large employers or to small employer HMO contracts other than the state-promulgated prototype forms, however. No state statutory or regulatory provisions impose restrictions on rate adjustments for large employer groups, other than the general requirement under 28 Tex. Admin. Code '11.706 (for HMO rates) that all rates be reasonable and adequate. For federally qualified HMOs, federal regulations impose some restrictions on the rates applied to groups of fewer than 100 persons when an Aadjusted community rating@ methodology is used.

***What Is Required in Texas to Effect a Novation of the Insurance Contract and Eliminate the Ceding Company=s Liabilities When the Book of Business Is Transferred by Assumption Reinsurance?***

In general, a novation is the creation of a new obligation in the place of an old one, either by the substitution of a new agreement between the same parties, or by the substitution of a new debtor or a new creditor, accompanied by mutual consent and agreement of the parties with intent to extinguish, and resulting in the extinguishment of, the old obligation.<sup>4</sup>

The basic elements of a novation are (1) a previous valid obligation; (2) an agreement of the parties to a new contract; (3) the extinguishment of the old contract; and (4) the validity of the new contract.<sup>5</sup> In general, while the creation of a new contract does not automatically effect a novation, the insured=s consent to extinguishment of the old contract may be implied.<sup>6</sup> Where an endorsement specifies that the assuming insurer is taking over all obligations of the ceding insurer, this language should be effective to create a novation of the original contract because the insured will likely be deemed to have accepted the endorsement by paying premiums under the contract to the assuming insurer.

The ability to effect a novation of an insurance contract through assumption reinsurance may be affected by the language of the contract itself. For example, some group insurance/HMO contracts have anti-assignment clauses, which prohibit the assignment of the contract by either party. The parties to the transaction should pay particular attention to the group contracts to determine whether there are any such provisions that may prevent transfer of the insurance or HMO contracts by assumption.

***Under an Assumption Reinsurance Transaction, Is the Assuming Company Required to Have the Product Forms of the Ceding Company Approved as its Own Product?***

The assuming company is required to obtain approval of the ceding company=s product forms in its own name if it plans to issue new business using those forms or if it intends to renew existing contracts using the ceding company=s forms and would deliver new or updated copies of any of the forms at renewal (i.e., rather than discontinuing the use of the ceding company=s forms and providing coverage under its own approved forms at renewal). If the assuming company will issue new business on the forms being assumed, the ceding company must submit to the Department a letter authorizing the withdrawal of those forms previously approved under its name.

***If the Assuming Company Decides That the Book of Business Cannot Be Made Profitable, What Are its Limitations on Non-renewing or Canceling the Business?***

In this situation, the assuming company would be subject to the same limitations with respect to the discontinuation or nonrenewal of contracts as set forth above. A small or large employer contract may be canceled only in cases involving the contract holder=s failure to pay premium, fraud or intentional misrepresentation of a material fact, noncompliance with contract terms, absence of any enrollee who lives or works in the service area in which the assuming company is authorized to do business, or termination of the employer=s membership in the association being covered.<sup>7</sup> Thus, the assuming company must either go through the discontinuation process or withdraw from the market.

One possible alternative exists which is not very feasible. Texas law allows an accident and health insurance carrier or HMO, with the agreement of each covered employer, to renegotiate the health insurance or HMO contract that has been issued.<sup>8</sup> The renegotiated contract may include any amended or renegotiated durational limits, dollar limits, deductibles, or coinsurance amounts applicable to services or benefits covered under the contract. Any changes in the renegotiated

contract may not, however, operate solely to terminate eligibility of any member of the group (with coverage under the contract before the renegotiation) for a sickness or injury for which services were being provided or benefits were paid before the renegotiation.

***In a Rollover Transaction, What Is Required for the Ceding Company to Nonrenew or Cancel the Insureds' Contracts for the Book of Business?***

A ceding company wishing to nonrenew its contracts must comply with the requirements of Tex. Ins. Code art. 26.24 and 26.87, as described above. Thus, the ceding company must give each group 180 days prior written notice of nonrenewal. In addition, a ceding carrier initiating a total or substantial withdrawal from a line of insurance must file a withdrawal plan as required under Tex. Ins. Code art. 21.49-2C.

Tex. Ins. Code art. 3.51-6A addresses the replacement of group accident and health insurance coverage, including the determination of the carrier responsible for liability in cases where one carrier's plan of benefits replaces a plan of similar benefits issued by another carrier. The statute provides that the prior carrier is liable only to the extent of its accrued liabilities and extension of benefits, regardless of the replacement coverage obtained by its insureds. In applying any waiting periods in its plan, the succeeding carrier must give credit for the satisfaction or partial satisfaction of the same or similar provision under the prior plan and must allow all eligible insureds who were covered under the prior plan on the date of its discontinuance to enroll under the new plan.

The ceding company should also ensure compliance with requirements related to the issuance of certificates of creditable coverage to all insureds covered under the contracts it nonrenews or cancels.<sup>9</sup>

***In a Rollover Transaction, Are There Any Limitations on What Products and Rates May Be Offered to the Insureds?***

In contrast to assumption reinsurance, where the reinsurer assumes the direct policy obligations of the ceding insurer in substitution for the obligations of the ceding insurer, in a rollover transaction, the indemnity reinsurer does not assume the ceding insurer's contractual obligations. Generally, the insured does not have any rights against the indemnity reinsurer that are not specifically set forth in the reinsurance agreement or in a specific agreement between the reinsurer and the insured.<sup>10</sup> Therefore, where there is no endorsement to the insurance contract, as is the case in a rollover transaction, the reinsurer has no direct obligation to the insured. When the original insurance contract expires, the indemnity reinsurer may offer the insured the same products and rates as it may offer to any other insured with which it has no existing or previous relationship. The reinsurer may offer the ceding company's insureds any products and rates it is currently marketing in small or large employer markets, as long as all appropriate filings have been submitted for informational or approval purposes to the Department.

***In a Rollover Transaction, May the Notice of Nonrenewal by the Run-off Company Be Combined with a Simultaneous Offering of Coverage by the New Company?***

The new company's offering of coverage may only be made by the new company itself or by its appropriately licensed and appointed agents. The ceding company would not be authorized under Texas agents licensing laws to engage in any form of solicitation on behalf of the assuming company. It is possible that the two notices could be combined in one mailing to all insureds, assuming the notices made clear that each was prepared and issued by the respective company. The new company should ensure that the materials offering coverage do not imply joint marketing or any relationship between it, the ceding company, and the insured that does not exist.

***Endnotes***

1. Upon withdrawal from a particular market, the insurance company or HMO must also comply with the requirements of the Texas AWithdrawal Plan@ statute. See Tex. Ins. Code art. 21.49-2C.
2. See 28 Tex. Admin. Code ' 11.506(3)(D).

3. Tex. Ins. Code art. 3.51-10; 28 Tex. Admin. Code ' 11.506(16).
4. *DoAll Dallas Co. v. Trinity Nat=l Bank*, 498 S.W.2d 396 (Tex. Civ. App.--Texarkana 1973, writ ref=d n.r.e.).
5. *FDIC v. Waggoner*, 999 F.2d 826, 829 (5<sup>th</sup> Cir 1993).
6. *But see American Nat=l Ins. Co. v. Briggs*, 70 S.W.2d 491 (Tex. Civ. App.CBeaumont 1934, writ dism=d).
7. Tex. Ins. Code art. 26.23 and 26.86.
8. Tex. Ins. Code art. 3.51-6(C).
9. Tex. Ins. Code art. 3.51-6(C).
10. Tex. Ins. Code art. 3.10(h); 5.75-1(g).