Bloomberg BNA

Health Insurance Report™

VOL. 0, NO. 0 DECEMBER 12, 2012

New Competitors in Health Insurance Marketplace: The Consumer Controlled, Operated and Oriented Plan Federal Loan Program




BY LYNN SHAPIRO SNYDER, DALY D. E. TEMCHINE, LESLEY YEUNG, AND SELENA BRADY

Shapiro Snyder is a senior member at Epstein Becker & Green PC, where she practices in the Health Care and Life Sciences and Litigation Practices in the Washington office. She may be contacted at Lsnyder@ebglaw.com. Temchine is a senior member at EBG, where he practices in the Health Care and Life Sciences and Litigation Practices in the Washington office. He may be contacted at Dtemchine@ebglaw.com. Yeung is an attorney at EBG, where she practices in the Health Care and Life Sciences and Litigation Practices in the Washington office. She may be contacted at Lyeung@ebglaw.com. Selena Brady is an attorney at EBG, where she practices in the Health Care and Life Sciences Practice in the Washington office. She may be contacted at Sbrady@ebglaw.com.

I. New Competitors in the Health Insurance Marketplace

There will be new competitors in the health insurance marketplace, especially in the individual and small group health insurance marketplace on or after Jan. 1, 2014, when the health reform provisions of the Patient Protection and Affordable Care Act (''ACA'') become operational through state and federal health insurance exchanges. Several of these new competitors will be new to a particular market because of certain provisions in the ACA.

One new health insurance competitor in a state may be health plans offered through the Multi-State Plan Program (''MSPP''). MSPP is being implemented by the U.S. Office of Personnel Management (''OPM'') under the ACA. Through contracts with OPM, certain health insurance issuers will offer at least two multi-state plans (''MSPs'') on each of the individual and small group market exchanges authorized under the ACA. OPM published proposed regulations on the program in the Dec. 5 *Federal Register* (75 Fed. Reg. 72,582).

 ISSN 2154-8986

The other new health insurance competitor in a state may be the Consumer Operated and Oriented Plan (''CO-OP'') that has been the recipient of significant federal funding. The total in CO-OP loans already awarded by the Centers for Medicare & Medicaid Services (''CMS'') is over $1.8 billion. The largest single award was in New York (over $174 million) and most recently in October CMS awarded the second highest amount to an entity in Ohio (over $129 million). As of the end of October 2012, 23 states had a CO-OP in operation.[1] The goal is to have one CO-OP in each of the 50 states. The next application deadline is Dec. 31, 2012. All awards are expected to be made by July 1, 2013. The purpose of this article is to describe in more detail this new potential competitor and the unique federal ACA regulatory requirements applicable to CO-OPs.

II. Description of the Program and Current Funding Status

With the passage of the ACA in 2010, Congress established goals to expand health insurance coverage and to provide new avenues for uninsured Americans to purchase health insurance. The ACA created the Consumer Operated and Oriented Plan Program (''the Program'') to promote the creation of consumer controlled, nonprofit health insurance organizations that would provide affordable health plan alternatives in state and regional markets.[2] The Program's stated purpose is to provide better and more cost effective health plans for individuals and small group markets. As stated in the preamble to the final regulation on this topic, ''by adding competition to State markets, CO-OPs have the potential to promote efficiency, reduce premiums and/or premium growth, and improve service and benefits to enrollees. . .resulting attempts to maintain or regain market share by traditional insurance issuers competing with CO-OPs could lead to system-wide savings across millions of enrollees.''[3]

To achieve the Program's goals, beginning January 1, 2014, CO-OPs can offer health plans through the States'[4] Affordable Insurance Exchanges (''Exchanges'').[5]

CMS's CO-OP Program has $3.4 billion in funding of which $1.8 billion is committed.[6] These funds are to be used to provide loans to fund eligible CO-OP applicants to achieve the goal of having a CO-OP in each state to participate in the Exchanges.[7]

There are two types of loans that are available, and they address two distinct concerns under the Program.

First, Congress believed that initial capitalization poses significant difficulties for CO-OPs. As a consequence, the CO-OP Program utilizes a competitive application process to award start-up loans to qualifying CO-OPs.

Second, Congress believed that state law licensure requirements regarding reserve levels applicable to insurers could present an obstacle to the creation of CO-OPs. Consequently, solvency loans provide funds that qualify as reserves under state law and are available to qualifying CO-OPs.[8] The start-up loans provide funding for the costs associated with forming and developing the CO-OP. The loans can be provided jointly or separately.[9]

The loans have different repayment terms. The start-up loans have a repayment term of 5 years beginning on the date of each draw-down on the loan by a CO-OP. Each draw-down has its own 5 year repayment period. Solvency loans operate in the same manner, but have a repayment term of 15 years.[10]

III. Eligibility Criteria for Federal CO-OP Loans

To be eligible for the loans provided under the CO-OP Program, a prospective organization must be a nonprofit member organization and intend to become a CO-OP.[11] A prospective organization is ineligible where the organization is, ever was, or has a predecessor that was, a state licensed insurance issuer on or before July 16, 2009 (a ''pre-existing issuer''), or is related to such an issuer.[12] Also, an organization is not eligible where pre-existing issuers or related entities provide 25 percent or more of the organization's funding.[13] Finally, an organization that is sponsored by a state or local government and receives 40 percent of its funding from the government also is ineligible.[14] Note, however, that a CO-OP can enter into arm's length business relation-

---

[1] *See* Appendix A for a complete list of states, CO-OPs and sponsors.

[2] *See* ACA § 1322(a) (2010); Establishment of Consumer Operated and Oriented Plan (CO-OP Program), 76 Fed. Reg. 77,392, 77,392 (Dec. 13, 2011) (to be codified at 45 C.F.R. § 156). The Department of Health and Human Services published a Final Rule setting forth the CO-OP Program's eligibility, standards, and loan terms on December 13, 2011. The regulations became effective February 13, 2012. *See* generally http://cciio.cms.gov/programs/coop/index.html.

[3] 76 Fed. Reg. at 77,410.

[4] If a State fails to establish an Exchange, the federal government can step in and create an exchange. *See* ACA § 1321(c)(1)(B) (2010).

[5] *See* ACA § 1322(a)(2) (2010); 76 Fed. Reg. at 77,392.

[6] 76 Fed. Reg. at 77,392. The Department of Defense and Full-Year Continuing Appropriations Act, Pub. L. No. 112-10 § 1857 (2011) permanently reduced the initial $6 billion that had been appropriated for the CO-OP Program. A report by the Congressional Budget Office projected that there would be little interest in CO-OPs and estimated that no more than $3 billion would be necessary to fund the Program in the most optimistic circumstances.

[7] *Id.* at 77,392. The ACA permits the Program to fund multiple CO-OPs in each state as long as there is sufficient funding to ensure that a CO-OP exists in every state. CMS has already taken advantage of this provision by awarding funding to two CO-OPs in Oregon.

[8] *See* ACA § 1322(b)(1) (2010); 45 C.F.R. § 156.520(a)(2) (2012).

[9] *See* ACA § 1322(b)(1) (2010); 45 C.F.R. § 156.520(a) (2012).

[10] *See* 45 C.F.R. §§ 156.520(b)(1)–(2) (2012).

[11] *See* ACA § 1322(c)(1) (2010); 45 C.F.R. § 156.510(a) (2012).

[12] *See* ACA § 1322(c)(2)(A) (2010); 45 C.F.R. § 156.510(b)(1) (2012). The regulation further specifies that where an organization or its sponsor is a foundation established by preexisting issuers, a holding company controlled by pre-existing issuers, a trade association comprised of pre-existing issuers, or a foundation established by pre-existing issuers, the organization is not eligible for the CO-OP Program.

[13] *See* 45 C.F.R. § 156.510(b)(1)(ii) (2012).

[14] *See* ACA § 1322(c)(2)(B) (2010); 45 C.F.R. § 156.510(b)(iii) (2012).

  HIR ISSN 2154-8986

ships with issuers for various administrative services so long as the issuer has no authority to control the affairs of the CO-OP.[15]

As the goals of the CO-OP Program are to provide better health care and to focus on CO-OP members' needs, CO-OPs must meet certain standards prescribed in the law. A CO-OP must operate under strict ethics, conflict of interest, and disclosure standards.[16] It is necessary that a CO-OP have a strong consumer emphasis. This begins with the requirement that a majority of a CO-OP board must consist of members. The Program mandates that each CO-OP maintain certain standards of governance that relate to control by its members. A CO-OP's Board of Directors must be elected by a majority vote of a quorum of members 18 years of age or older.[17] All CO-OP members must be eligible to vote for each Director and have one vote.[18] The Program criteria limit each Director to a single vote. Although Board positions may be designated for specialized experts, these positions cannot constitute a majority of the Board.[19] No government representative or pre-existing issuer may hold a Board membership.[20] Also, the Program mandates standards for CO-OP Boards of Directors that require them to emphasize timeliness of services, and responsiveness and accountability to members.[21]

The Program dictates how CO-OPs must utilize profits or surplus revenue to lower premiums and improve benefits or quality of care for their members.[22]

With respect to the application of surplus, loan eligible CO-OPs can be sponsored by such groups as employers, employer associations, accountable care organizations (''ACOs''), provider groups and, potentially, other private entities who are not issuers. Nothing in the final regulations precludes the possibility that a premium refund could be shared between employers and their employees. Nor is there anything in the final regulations that prohibits surplus revenues from being allocated to an ACO, for example, perhaps based on its meeting certain targets. Indeed, nothing in either the ACA or the final regulations prohibits bonus arrangements between CO-OPs and vendors that have been negotiated at arms' length.

To be eligible for loans, the health plan offerings that CO-OPs issue must meet specific standards. CO-OPs must issue two thirds of their coverage contracts in the individual or small group markets.[23] They also are required to provide at least one qualified health plan in their state's Exchange in both the silver and gold benefit levels within 36 months of the time they receive a start-up loan, and within one year of the receipt of a solvency loan.[24] If a CO-OP offers small group coverage, it is required to provide at least one qualified health plan at each of the silver and gold benefit levels in a Small Business Health Options Program Exchange.[25]

The CMS requirement that a CO-OP must issue two thirds of its coverage contracts in the individual or small group market is a significant operational requirement. While it means that a CO-OP's plan offerings do not need to be limited to offerings in the Exchanges,[26] it does mean that the CO-OP will need to monitor its sales activities to be sure that it satisfies this requirement, especially if the CO-OP decides to offer coverage contracts to large groups as well. The CMS requirement is that each insurance policy or contract that an issuer sells constitutes a single activity regardless of the size of the group.

A restriction on a CO-OP's ability to start marketing imposed by the Program limits the CO-OP's ability to offer health plans in a state until the state implements the market reforms required by part A of Title XXVII of the Public Health Service Act.[27] CO-OPs must obtain the same state licensing as other health plans in the state in which the CO-OP is offering a qualified health plan. As a consequence, CO-OPs must satisfy the same requirements and are subject to the same state regulatory supervision as commercial and other non-profit issuers. Also, to participate in the state Exchanges, CO-OPs have to meet the requirements imposed by the Exchanges, and states in which they offer products, as well federal requirements, which are in addition to the federal loan requirements.[28]

In sum, CO-OPs are subject to the same economic burdens imposed by state and federal regulatory requirements on their commercial insurer competitors. It also seems likely that, unless they are uniquely successful in containing health care costs, their actuarial risk of loss may be about the same as their competitors' risk of loss. It is possible that the only advantage CO-OPs have under the Program when compared to their competitors is that they have a source of federal financing for start-up and reserve purposes.

The value of this advantage might well be outweighed by the regulatory requirements that are imposed by the Program. For example, all issuers are subject to the Minimum Loss Ratio (''MLR'') requirement of the ACA.[29] As a theoretical matter, the MLR does not preclude a highly efficient commercial issuer from realizing a profit, or a non-profit issuer from realizing a surplus within applicable federal and state regulations. It is not clear, however, whether a CO-OP's obligation under the Program to apply any surplus to premium refunds or to increasing or improving member care, precludes CO-OPs from applying a surplus to any other seemingly legitimate CO-OP business purpose – e.g. bonuses, wage increases.

---

[15] Consumer Operated and Oriented Plan (CO-OP) Program – Frequently Asked Questions (updated March 8, 2012), CMS: The Center for Consumer Information & Insurance Oversight, http://cciio.cms.gov/resources/fundingopportunities/coop_foa_faq.html.

[16] *See* ACA § 1322(c)(3) (2010); 45 C.F.R. §§ 156.515 (b)(2) – (3) (2012).

[17] *See* 45 C.F.R. § 156.515(b)(1) (2012).

[18] 45 C.F.R. §§ 156.515(b)(1)(ii)–(iii) (2012). The regulation further specifies the timeframe for establishing the operational board and the number of people running for board election. *See id.* at §§ 156.515(b)(1)(iv)–(v) (2012).

[19] *See* 45 C.F.R. §§ 156.515(b)(2)(ii)–(iv) (2012).

[20] *See id.* at § 156.515(b)(2)(v) (2012).

[21] *See* ACA § 1322(c)(3) (2010); 45 C.F.R. § 156.515(b)(4) (2012).

[22] *See* ACA § 1322(c)(4) (2010).

[23] *See* 45 C.F.R. § 156.515 (c)(1) (2012). The CO-OP is permitted to offer plans to large group markets so long as the proper ratio is maintained.

[24] *See id.* at § 156.515 (c)(2) (2012).

[25] *See id.* at. § 156.515 (c)(3) (2012).

[26] 76 Fed. Reg. at 77,402.

[27] *See id.* at § 156.515(c)(4) (2012).

[28] *See* ACA § 1322(c)(5).

[29] *See* ACA § 1001, adding § 2718(b)(1) to the Public Health Service Act.

As previously noted, CMS is accepting applications until Dec. 31, 2012.[30] Of course, the availability of future awards assumes that the funds not yet awarded do not disappear in the course of the ''fiscal cliff'' and debt ceiling negotiations between the Congress and the Obama Administration. CMS, however, through an external, independent review panel, continues to evaluate applications for loans under the CO-OP Program and announces awards on a rolling basis.

IV. Legal and Regulatory Considerations for Loan Recipients

Loan recipients under the CO-OP Program should have a thorough understanding of the federal and state regulatory environment such as state insurance laws, state privacy laws, HIPAA, ERISA, HITECH, Stark and fraud and abuse laws. They also must ensure that they are in compliance with the enumerated requirements in their loan agreement with CMS and all other regulatory provisions of the Program.

For example, the loan funds cannot be used for marketing activities. Other prohibited uses of the loan funds include the following:

a). Activities to influence legislation at the federal, state or local level of government;

b). To cover or pay excessive executive compensation as determined by CMS in its sole but reasonable discretion; and

c). To fund staff retreats, promotional giveaways; construction of facilities, including clinical facilities.[31]

Consequently, CO-OPs will need access to funds other than the Federal loan funds if they are to succeed. CO-OPs also will need to establish effective compliance mechanisms to meet these and the other CMS loan agreement requirements.

Penalties for non-compliance are significant. The final regulations provide for a penalty payment of 110% of the loan amount if CMS terminates the loan for noncompliance.[32]

Interestingly, the loans are general obligations of the CO-OP. As the intent of the loans, especially the Solvency Loan, is to provide financing to the CO-OP that could satisfy the ''risk based capital'' needed to operate an issuer under state insurance laws, these loans ''will have a claim on cash flow and reserves of Borrower [CO-OP] that is subordinate to (a) claim payments, (b) basic operating expenses, and (c) maintenance of required reserve funds while Borrower is operating as a CO-OP under State Insurance Laws.''[33]

CMS has taken an important position with respect to the conversion or sale of CO-OPs at a later time. In its final regulations CMS ruled that ''CO-OPs are not permitted to convert to a for-profit or non-consumer operated entity at any time or to partake in any activities that have the effect of such a conversion (for example, selling a substantial portion of its enrollment to a for-profit entity), *even after they have fully repaid their Start-up Loans and Solvency Loans*. In the potential case of insurer financial distress, a CO-OP follows the same process as traditional insurers and must comply with all applicable State laws and regulations.''[34] (emphasis added) Consequently, if a CO-OP runs into financial difficulties, it may have to pursue state insolvency procedures, and jeopardize repayment of the federal loan, rather than pursue an exit strategy involving a sale to a competitor.

V. Legal and Regulatory Considerations for Potential Vendors

The availability of federal funding through the Program creates business opportunities for entities that are capable of quickly providing an insurance operations infrastructure that a CO-OP will need to succeed. CO-OPS cannot have been in existence since before July 16, 2009 or be related to a ''pre-existing issuer.'' CO-OPs are likely to engage such entities to provide insurance operations support, such as administrative and transaction processing services, benefit management, reinsurance, information technology, membership administration, and board election administration. These services may be provided by traditional health plan and business vendors, third-party administrators, systems and application vendors, and established health plans with excess administrative capacity.

While some of these potential vendors are likely to have experience in the traditional insurance regulatory environment, it is important for them to understand this unique regulatory scheme that is in place for the CO-OPs operating under the Program.

[30] *See* U.S. Department of Health and Human Services Consumer Operated and Oriented Plan Program Funding Opportunity Announcement, http://www.grants.gov/search/search.do?mode=VIEW&oppId=109093.

[31] *See* CMS Proposed Loan Agreement for start-up and solvency loans, Section 3.6, p. 14-5.

[32] *See* 45 C.F.R. § 156.520(c)(3).

[33] *See* CMS Proposed Loan Agreement for start-up and solvency loans, Section 3.4, p. 13.

[34] 76 Fed. Reg. at 77,407; *See also* 45 C.F.R. § 156.520(f).

APPENDIX A*

STATE	CO-OP	SPONSOR
Arizona	Compass Cooperative Health Network	Local experts in insurance, chronic disease coordination, use of health information technology to better coordinate care and business startup
Colorado	Colorado Health Insurance Cooperative, Inc.	Rocky Mountain Farmers Union Educational and Charitable Foundation, Inc.
Connecticut	HealthyCT	Connecticut State Medical Society and the CSMS-IPA (a statewide Independent Practice Association)

  HIR ISSN 2154-8986

APPENDIX A*		
STATE	**CO-OP**	**SPONSOR**
Iowa	CoOpportunity Health	Iowa Institute
Kentucky	Kentucky Health Care Cooperative	Coalition of business leaders, providers and community organizations
Louisiana	Louisiana Health Care Cooperative, Inc.	Coalition of providers and business leaders, including Ochsner Health System
Maine	Maine Community Health Options	Maine Primary Care Association
Maryland	Evergreen Health Cooperative, Inc.	
Massachusetts	Minutemen Health, Inc.	Tufts Medical Center and Vanguard Health Systems
Michigan	Michigan's Consumer Healthcare CO-OP	Coalition of 15 county health plans
Montana	Montana Health Cooperative	Coalition of small businesses and community leaders
Nebraska	CoOpportunity Health	Iowa Institute
Nevada	Hospitality Health CO-OP	Culinary Health Fund, Unite HERE Health, and the Health Services Coalition
New Jersey	Freelancers CO-OP of New Jersey	Freelancers Union
New Mexico	New Mexico Health Connections	Coalition of community groups, business leaders and providers
New York	Freelancers Health Service Corp.	Freelancers Union
Ohio	Coordinated Health Plans of Ohio, Inc.	Community Health Solutions of America, LLC
Oregon	Freelancers CO-OP of Oregon	Freelancers Union

APPENDIX A		
STATE	**CO-OP**	**SPONSOR**
Oregon	Oregon's Health CO-OP (Incorporated as Community Care of Oregon)	CareOregon
South Carolina	Consumer's Choice Health Insurance Company	Volunteers from not-for profit organizations, member driven employer groups, and business advocates
Tennessee	Community Health Alliance Mutual Insurance Company	Healthcare 21 Business Coalition and LBMC Employment Partners
Utah	Aarches Community Health Care	Association of Utah Community Health, the Salt Lake City Chamber, and the Utah Health Policy Project
Vermont	The Vermont Health CO-OP (Incorporated as the Consumer Health Coalition of Vermont)	
Wisconsin	Common Ground Healthcare Cooperative	Common Ground

* This information is provided based on the latest update of awards for CO-OPs, dated October 12, 2012 from Healthcare.gov's website. The announcement of the awards is available at http://www.healthcare.gov/news/factsheets/2012/02/coops02212012a.html.