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Captive Newsletter

A Newsletter from the Captive Practice Group *July 2017*

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A NEW HOME FOR OUR BURLINGTON OFFICE

We are pleased to announce that we have moved our Burlington, Vermont office just around the corner to 30 Main Street. Our new space is beautiful, with great views of Burlington, Lake Champlain and the Adirondacks beyond. An adjacent parking garage provides convenient parking.

Please join us for an open house reception in our new Burlington office on Wednesday, September 27, 5:30-7:30 pm. Our new address is below on the left.

CAPTIVES AND HIPAA

Captives routinely receive medical information from a variety of sources. In many circumstances, disclosure of this information is prohibited under federal and state law — most especially the federal Health Insurance Portability and Accountability Act of 1996 ("HIPAA Rule") and related enactments. Enforcement of the HIPAA Rule by the US Department of Health and Human Services Office of Civil Rights ("OCR") has become much more aggressive in recent periods, resulting in fines ranging from tens of thousands to millions of dollars for breaches by both health care providers which were the source of shared information and organizations providing services to them, including insurers. Unfortunately, there remains a great deal of confusion about what is required by the HIPAA Rule and what steps captives should take to avoid problems. Captives and their service providers need to have a good understanding of what applies to their individual operations in order to avoid potential exposure to significant penalties.

A brief primer on the fundamentals of the HIPAA Rule may be helpful, starting with some key terms to understand:

1. *Protected Health Information or PHI*: Identifiable information created, received or maintained by a health care provider about an individual's health or health care, including demographic information.

2. *Health Care Operations*: Generally refers to the business operations of a health care provider or health plan and includes quality assessment, professional and legal services, and business administration, including obtaining medical liability coverage and claims management services.

3. <u>*Minimum Necessary*</u>: Health care providers and health plans must make reasonable efforts to limit the use or disclosure of *PHI* to the minimum necessary amount to accomplish the intended purpose unless it is for treatment related purposes.

4. <u>*Business Associate or BA*</u>: An organization or person providing *health care operations* related functions for, or services to, a health care provider or health plan which include the use or disclosure of *PHI*.

5. <u>*Business Associate Agreement or BAA*</u>: An agreement with provisions required by the HIPAA Rule in order for a health care provider to share *PHI* with a *Business Associate*, including acceptance of related obligations to protect PHI. Some terms may also be negotiated by the parties.

The HIPAA Rule allows a health care provider to disclose *PHI* related to liability insurance, quality review services, Patient Safety Organization reporting and other purposes within the definition of providing *health care operations* services. *PHI* shared with other insurers — including captives — such as workers' compensation carriers and auto liability insurers may be exempt from HIPAA. A captive is most likely serving as a *Business Associate* when it receives *PHI* from hospitals or other health care providers where it insures those providers. It needs to enter into a *Business Associate Agreement* in order to comply with the HIPAA Rule. In turn, the captive must also execute a subcontractor *Business Associate Agreement* with <u>other</u> organizations who may be assisting it in its services involving *PHI*, including many adjusters, managers, actuaries and other service providers.

Critically, as *Business Associates*, a captive and its service providers need to have policies and procedures in place to make sure handling of *PHI* complies with the HIPAA Rule, including the *minimum necessary* requirements. Essentially, the policies should determine (where possible) the parameters of how much *PHI* needs to be used and disclosed, and to whom, for the *health care operations* services to be provided for the health care provider or the next *Business Associate* in the chain or communication. Further, captives and other *Business Associates* need to: (1) provide training to employees and others who may view *PHI*, (2) conduct security risk analyses related to physical and electronic *PHI* storage and transmittal, and (3) implement procedures for promptly identifying and reporting any security incident or use or disclosure which could be considered a breach of the HIPAA Rule to the health care provider who disclosed the *PHI*. In turn, the health care provider may need to notify individual patients of the breach of *PHI* and report it to the OCR. Some *Business Associate Agreements* also seek to impose onerous indemnification provisions beyond the scope of the *minimum necessary* requirements.

The OCR, responding to pressure from the US Congress, has stepped up audits and investigations not only of health care providers and health plans, but also of *Business Associates*. We encourage captives receiving and handling *PHI* to review their operations and consider if sufficient policies and procedures are in place for compliance with the HIPAA Rule to protect the confidentiality and security of the *PHI* they receive. If you are not sure whether you are a *Business Associate*, if you have been asked to sign a *Business Associate Agreement* you would like reviewed, or if you are not sure you comply as a *Business Associate*, contact us. Beyond our experience with captives addressing these concerns, we have colleague health care practitioners completely familiar with this area of the law.

CONTINUED RRG EXEMPTION FROM NAIC TERRORISM DATA CALL

The Vermont Department of Financial Regulation ("DFR") recently announced that Vermont-domiciled risk retention groups remain exempt from the National Association of Insurance Commissioners ("NAIC") terrorism data call. DFR based its determination on a number of factors, including the limited number of RRGs that offer terrorism coverage; that any coverage offered would be restricted to their member/owners; and to prevent any conflict with the Liability Risk Retention Act ("LRRA"). DFR will provide the NAIC with a list of Vermont companies and their NAIC numbers. RRGs that choose to voluntarily provide data may do so. The NAIC website includes instructions at www.naic.org/industry_terrorism_risk_data_call.htm, with data submissions directed to the New York Department of Financial Services portal, https://myportal.dfs.ny.gov.

FATCA WITHHOLDING, DOCUMENTATION AND REGISTRATION REQUIREMENTS MAY APPLY TO CAPTIVE TRUSTS

The Foreign Account Tax Compliance Act ("FATCA") imposes certain withholding and documentation requirements on "withholding agents," which can include any banks, entities, and individuals making payments to a "foreign financial institution."

FATCA originally became effective on July 1, 2014, but withholding and reporting became effective as of January 6, 2017.

FATCA combats tax evasion by U.S. taxpayers with overseas financial accounts. It requires non-U.S. entities to identify U.S. taxpayers who hold directly or indirectly certain foreign financial accounts and to report related information to the IRS. Parties that do not comply are subject to 30% withholding on certain payments of U.S. source income.

Certain trusts formed by offshore captives and reinsurers to secure obligations under reinsurance agreements, such as Regulation 114 Trusts, may be included in FATCA requirements. The requirements of the law are highly fact-specific but could mean that dividend or other payments on trust assets are subject to 30% withholding and reporting to the IRS. The IRS may also require trusts to register with them in some instances.

In the past few months, we have seen auditors paying new attention to this issue and have had several offshore clients moving to address the requirements. Given the complexity of FATCA's regulations, offshore captives and other insurers using onshore trusts should take steps to determine whether they will need to make changes to address FATCA in their operations. Talk to us or a U.S. tax advisor for more information.

NEWS FROM THE VERMONT STATE HOUSE

CAPTIVE LEGISLATION PASSED

The Vermont General Assembly adjourned on May 18, two weeks after a target date and without the usual fanfare, as legislators knew a rare veto session was likely. That occurred when Gov. Phil Scott (R) vetoed the FY18 budget bill and an education property tax bill related to teacher healthcare. Lawmakers reassembled June 21 to address those two vetoes and reached compromise with the Governor. The governor also vetoed a bill to legalize marijuana which was not part of the compromise and will be addressed next session.

The drama of adjournment and the veto session livened an overall session otherwise largely mundane. New leadership in the House and Senate, changes in committee make-up and a new administration slowed the start. There will be no such excuses next year, nor will they likely be necessary.

Despite the initial pace and concluding controversy, the Legislature and Governor again demonstrated support for Vermont's leadership in the captive industry. Act 12 (introduced as H.85) became effective on May 1 with the Governor's signature in a public, ceremonial event at the State House. As is typical of Vermont captive legislation, the bill contains a series of technical amendments to add clarity or efficiency or reflect practice, as well as a series of ideas aimed at enhancing Vermont's position among domiciles.

The biggest change permits Vermont to license agency captive insurance companies, albeit with a few requirements addressing potential abuses. While other captive domiciles have authorized such formations, Vermont regulators were historically cool to the idea for a number of reasons. Those were partially satisfied by requirements aimed at transparency and disclosure to insureds of the relationship between the captive and its controlling agency. Specifically, the requirements are:

- An insurance agency or brokerage that owns or controls the agency captive must remain in regulatory good standing in all states in which it is licensed;

- The agency captive may insure only risks of commercial policies placed by or through an insurance agency or brokerage that owns or controls the agency captive insurance company and, if required, provides the Commissioner the form of such commercial policies;

- The agency captive must disclose to the original policyholder, in a form or manner approved by the Commissioner, any limitations, rights, and obligations held by the agency captive as a result of its affiliation with an insurance agency or brokerage;

- If required, and like other captives, the business written by an agency captive must be:

    - Fronted by an insurance company licensed under the laws of any state.
    - Reinsured by a reinsurer authorized or approved by Vermont.
    - Secured by a trust fund in the United States for the benefit of policyholders and claimants or funded by an irrevocable letter of credit or other arrangement that is acceptable to the Commissioner.

- The captive must maintain minimum capital of $500,000.00;

- The captive must be owned or directly or indirectly controlled by one or more insurance agencies or brokerages licensed under the laws of any state and only insure risks of policies placed by or through such agency; and

- The captive must comply with investment requirements for traditional insurers.

An agency captive can be incorporated as a stock insurer, as a nonprofit corporation, or as a manager-managed limited liability company.

Beyond agency captives, eligibility for a so-called "shelf license" was expanded to allow any captive insurance company to apply for dormant status. The amendments added clarity that a captive may use statutory accounting principles or international financial reporting standards in its annual report without obtaining a permitted practice from the Commissioner. Protected cells that choose to incorporate are now only required to have "protected cell" or "IC" in their names but not also the traditional corporate monikers such as "Inc." or "Ltd." The Governance Standards for risk retention groups also have been further tweaked to provide relief from required auditor partner rotation in limited circumstances.

And finally, an amendment passed in another bill expands Vermont's premium tax credit for new captives. The amendment increases the existing $7,500 first year tax credit to $10,000 over the first two years. The State hopes increasing and spanning the tax credit over two years will be attractive to programs facing start-up costs. The revised credit took effect July 1 and applies to new formations on or after January 1, 2017.

If you have questions about this year's captive "housekeeping" bill or suggestions for next year's consideration, please contact us.

E-MAIL OPTION AND ARCHIVE

To receive Primmer's *Captive Newsletter* via e-mail, please contact Kurt Lutes at **klutes@primmer.com** or at 802-223-2102.

This edition of the *Captive Newsletter* is also available on our website at **www.primmer.com/publications-and-presentations**.

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