A Primer on ERISA Preemption

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Introduction

The increasing popularity of employer self-funding of healthcare benefits has expanded the scope of professionals involved in this specialized industry segment. Although this sector remains primarily in the domain of the accident & health and benefits world, extending the use of captives to include medical stop loss has stretched the relevancy to include property & casualty practitioners and risk managers. It's important for this expanded professional universe to understand the legislation that has powered the tremendous growth in self-funded health plans in a post Affordable Care Act (ACA) world.

Most insurance professionals routinely engaged in the self-funded healthcare arena are aware that properly structured self-insurance plans can preempt state-level insurance regulations and benefit mandates. This preemption capability is bestowed upon self-insured benefit plans by way of the U.S. Department of Labor (DOL) through the Employee Retirement Income Security Act of 1974 (ERISA). While most benefit professionals are aware of ERISA's preemption capabilities, not many are familiar with the actual mechanics that drive the preemption ability of self-funded benefit plan.

Understanding ERISA preemption is important to understanding self-insurance plan design and structures, including the use of captives for medical stop loss.

ERISA's Legislative Intent

ERISA regulates the voluntary delivery of employee benefits from an employer to its employees. Since its enactment, ERISA has become the preeminent legislation governing employee benefit plans. The prevailing thought among legislatures at the time of its ratification was that if employers considered benefit delivery to be too onerous or expensive, many employers might cut back or even discontinue their benefit offerings to employees. The twofold intent of this legislation was to provide definitive rights and (non-discriminatory) protections to benefit plan participants while simultaneously streamlining plan administration, compliance and delivery for employers. The latter point has been particularly significant for large multi-jurisdictional employers, as ERISA provides one uniform set of regulations prescribed at the federal level to mitigate an employer's burden of having to comply with differing insurance regulations and benefit mandates in every state of their operation.

Self-Insured versus Fully-Insured Regulation

It's important to distinguish the healthcare benefit plan (the Plan) from medical stop loss insurance. The U.S. DOL, by way of ERISA, has regulatory jurisdiction over the Plan, but does not regulate insurance. Within a self-insured structure, the employer (aka Plan Sponsor) assumes the financial liability for all the claim obligations of the Plan. The Plan is defined by a Plan Document which is a comprehensive written document, equivalent to a master insurance policy, that defines the benefits and levels of coverage that are provided to plan participants. Since the Plan is self-funded and "deemed" not to be insurance, and therefore not subject to state mandates, the employer is free to define benefits, provided within the Plan, at any depth or level desired. The DOL will primarily regulate the administration of the Plan to ensure that the benefits are provided in a non-discriminatory manner. It will also define prohibited transactions from any parties-in-interest that could compromise the stability or fiduciary objectiveness of the Plan. In short, the DOL only regulates a Plan Sponsor's responsibilities as they relate to overall Plan administration, and the non-discriminatory delivery of benefits to employees.

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Self-Insured versus Fully-Insured Regulation *continued*

Individual states regulate insurance, including medical stop loss purchased by a Plan Sponsor. While a state cannot regulate the benefits provided by a self-funded Plan, it can regulate minimum stop loss deductibles and aggregate attachments – but not to levels that would impede an employer's ability to self-fund a health plan. Medical stop loss insurance provided directly to an employer by its own single-parent captive (captive issued policy) is also not subject to all the same state regulations as a captive fronted by an insurance company, e.g. the captive issued policy would not be filed with the state as an insurance product to be sold or distributed to other (unrelated) entities. If the captive chooses to use a licensed issuing carrier (fronting carrier) to provide the stop loss – a typical requirement for most group captives – the stop loss policy issued to the employer by the carrier would need to be a filed policy and subject to state regulation.

How preemption works:

It should first be noted that the intent of ERISA was not to strip the states of their governing powers over insurance. Those powers, granted to states by the McCarran-Ferguson Act of 1945, are recognized and preserved by ERISA. The legislation does however, provide that an employee benefit plan itself is not deemed to be insurance and, as such, is not subject to state regulation.

ERISA's broad preemption ability is derived from three subsections of the Act:

1. The "Preemption Clause":

"Except as provided in subsection (b) of this section (The Saving Clause), the provisions of this chapter and subchapter III of this chapter shall supersede any and all state laws insofar as they may now or hereafter relate to any benefit plan." [ERISA §514(a)]

When determining what constitutes a properly qualified plan under ERISA insofar as preemption ability, the following two clauses come into play:

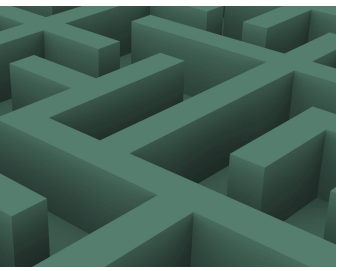
2. The "Savings Clause":

"Except as provided in subparagraph (B) (The Deemer Clause), nothing in this subchapter shall be construed to exempt or relieve any person from any state which regulates insurance, banking or securities." [ERISA §514(b)(2)(a)].

3. The "Deemer Clause":

"Neither an employee benefit plan, nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for the purpose of any law of any state purporting to regulate insurance companies, insurance contracts, banks, trust companies or investment companies." [ERISA §514(b)(2)(B)]

These three clauses work together as follows: The Preemption Clause generally preempts any state laws that relate to the benefit plan. The Saving Clause acknowledges that it is not the intent of the Preemption Clause to take away the state's right to generally regulate insurance. Lastly, the Deemer Clause forbids the states to "deem" an employee benefit plan (particularly a self-insured plan) to be engaged in the business of insurance.



How preemption works: *continued*

So, to recap (and hopefully clarify): The U.S. Department of Labor, via ERISA, governs the benefit plan itself, while the states govern the actual insurance (stop loss) associated with a benefit plan. With a fully-insured benefit plan, the states assume a de facto control of the Plan as all risk is transferred from the employer to an insurance contract which is regulated by the state, rather than the DOL, and subject to all benefit mandates. A self-insured plan in contrast, has the ability to supersede any benefit mandates promulgated by state insurance regulations that would be applicable to a fully-insured benefit plan. The ability to preempt state insurance and benefit mandates provides a self-insuring employer with an enormous amount of flexibility in tailoring a benefit plan to best fit the needs of its employee population, balanced by its own budgetary and funding parameters.

The basic preemption mechanics of properly constructed self-insured health plans are not complicated. The most important concept is distinguishing of the Plan itself from insurance. The bigger challenge – especially in this post ACA environment - is orientating risk managers and benefits managers to the intricacies of each other's business segment as self-funding and using captives for medical stop loss continues to expand.

About the Author

Phillip C. Giles, CEBS has more than 30 years of Accident and Health and Property and Casualty alternative risk experience and leads business development initiatives for MSL Captive Solutions.

In 2019, Phil was named Reinsurance Specialist of the Year by Cayman Captive Magazine. In 2017, Phil was presented with the Captive Professional of the Year recognition at the U.S. Captive Awards. He has been named to Captive Review's Power 50 listing of most influential individuals in the worldwide captive insurance industry and is a regular content contributor to several industry publications.

About MSL Captive Solutions, Inc.

MSL Captive Solutions is the industry's only platform devoted exclusively to the development of comprehensive (re)insurance solutions for group and single-parent medical stop loss captives.

MSL Captive Solutions provides consultative underwriting support to some of the industry's leading stop loss carriers and opperates independently to work with all qualified brokers, consultants and captive managers.

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