HONIGMAN ALERT

Insurance and Health Care Departments

April 11, 2011

Centers for Medicare and Medicaid Services Eliminates Investment Restrictions on Offshore Captive Insurers

In a transmittal dated March 1, 2011, effective as of November 11, 2010, the Centers for Medicare and Medicaid Services (CMS) deleted in its entirety Provider Reimbursement Manual (PRM) § 2162.2.A.4, which imposed certain investment restrictions on offshore captive insurers related by common ownership or control to the provider(s) the captive covered. This change in long standing CMS policy potentially is beneficial to hospitals that continue to receive Medicare cost reimbursement, or that receive Medicaid payment in states where Medicaid payments are based on Medicare cost reimbursement principles for premiums paid to offshore captives.

The now deleted PRM § 2162.2.A.4 provided as follows:

> 4. In the case of offshore captives, investments by a related captive insurance company are limited to low risk investments in United States dollars such as bonds and notes issued by the United States Government; debt securities issued by United States corporations or governmental entities within the United States rated in the top two classifications by United States recognized securities rating organizations at the time of investment; debt securities of foreign subsidiaries of United States corporations rated in the top two classifications by United States recognized securities rating organizations at the time of investment where the parent United States corporations guaranteed (on the face of the securities) payment of the subsidiaries' securities; and deposits (including Certificates of Deposit) in United States banks or their foreign subsidiaries, and foreign banks rated in the top two short term classifications by United States recognized securities rating organizations. Low risk investments may also include investments of non-United States issuers including foreign governments and corporations and supranational agencies rated in the top two classifications by United States recognized securities rating organizations (effective with investments made on or after 10/11/91). Effective for investments made on or after 10/06/95, the limitation on related offshore captive insurance company investments is extended to include the above described low risk investments rated in the top three classifications by United States recognized securities rating organizations. Additionally, investments may include dividend paying equity securities listed on a United States stock exchange provided that the investment in equity securities does not exceed 10 percent of the company's admitted assets, with the investment in any specific equity issue further limited to 10 percent of the total equity security investment. (All such captives are required to annually submit to a designated intermediary a certified statement from an independent certified public accountant or actuary attesting to compliance or non-compliance with these requirements for the previous period.) These investments cannot be pledged or used as collateral for loans obtained by the captive or parties related to the captive either directly or indirectly, nor may investments be made in a related organization.

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> Recognizing that a captive's portfolio may presently contain other than low risk United States based investments and that possible losses in converting a captive's current portfolio to acceptable investments may result, the Medicare program allows any investments owned by the captive on July 31, 1978 to be considered acceptable investments under this section. As investments held by the captive on July 31, 1978 subsequently mature, are exchanged for other types of investments or sold, any proceeds that are reinvested must be invested in accordance with the provisions of this section.

Apparently CMS deleted PRM § 2162.2.A.4 in its entirety as a result of the August 13, 2010 decision of the United States Court of Appeals for the District of Columbia in *Catholic Health Initiatives v Sebelius* (Case No. 09-5377). In that case, the Court invalidated PRM § 2162.2.A.4 on procedural grounds, stating that CMS failed to promulgate the investment restrictions as a regulation in accordance with the Administrative Procedure Act. The PRM is not a regulation, and it is not published with notice and comment.

Implementation of the change in policy is subject to some ambiguity in light of the November 11, 2010 effective date. Implementation would be clearer if the effective date were October 1, 2010, which is the first day of the Federal Fiscal Year, or if it were stated as being applicable to provider cost reporting periods occurring on or after the November 11, 2010 effective date. It is clear, however, that effective as of November 11, 2010, offshore captive insurers related to providers are no longer subject to the investment restrictions of PRM § 2162.2.A.4. Moreover, providers eligible for cost reimbursement may claim Medicare payment for premiums paid to such offshore captives for the period on and after November 11, 2010. CMS has not issued guidance as to whether it is necessary for a provider to prorate the Medicare claim for a premium payment made to an offshore captive for a period that includes time prior and subsequent to November 11, 2010. It also is worth noting that while the investment restrictions were eliminated, the PRM contains other requirements that a provider must meet in order to claim premium payments made to both onshore and offshore captives.

As witnessed by the *Catholic Health Initiatives* case, some hospitals have filed appeals challenging the validity of PRM § 2162.2.A.4. In the event a hospital has a timely, jurisdictionally valid appeal pending that challenges PRM § 2162.2.A.4 for periods prior to November 11, 2010, there may be available the argument that, in light of the *Catholic Health Initiatives* case and the deletion of PRM § 2162.2.A.4., the case should be resolved in the hospital's favor. There is merit to this argument because at issue in the *Catholic Health Initiatives* case were the fiscal years 1997 through 2002, which clearly pre-dated November 11, 2010. It is not clear at present, however, whether CMS would agree that the deletion of PRM § 2162.2.A.4 has a retroactive effect for periods prior to November 11, 2010 other than for the hospitals that participated in the *Catholic Health Initiatives* case. Hospitals potentially benefiting from this change in law who have filed cost reports that have not yet been audited may wish to consider filing an amendment to their cost reports claiming the applicable premium cost. Although it is uncertain at present whether the cost will be allowed, filing the amendment to the cost report may establish the basis for an appeal.

If you have any questions regarding this development, please contact Kenneth R. Marcus or any of the other attorneys listed on this alert.