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Section II Production

Appendix 14.1 **Professional Liability Insurance**

Residential care facilities face an increased liability risk because they provide day-to-day resident care. In 2004, HUD adopted professional liability insurance (PLI) standards for healthcare facilities insured under Section 232 in Housing Notices H04-01 and H04-15. This Appendix supersedes all previous guidance on PLI.

I. SECTION 232 PROGRAMS THAT REQUIRE PROFESSIONAL LIABILITY INSURANCE

PLI requirements apply to the following:

- A. New applications on behalf of residential care facilities seeking mortgage insurance under:
 - 1. Section 232 for new construction, substantial rehabilitation or blended rate of a residential care facility,
 - 2. Section 223(f) for the purchase or refinance of an existing facility.
- B. All residential care facilities currently insured under Section 232 and seeking approval:
 - 1. to refinance the facility using the Section 223(a) (7) program,
 - 2. to refinance the facility using the Section 223(f) program,
 - 3. finance a supplemental loan under Section 241(a),
 - 4. of a transfer of physical assets (TPA) involving Section 232 residential care facilities.

The PLI requirements of this Appendix may be reduced or modified for existing FHA-insured facilities. See Section V for details.

II. WHO REQUIRES PLI

The legal entity that holds the license from the state permitting it to operate the residential care facility and/or the entity responsible for the day-to-day operation of the facility and hands-on resident care (Operator). The Operator must have PLI coverage in compliance with the guidance in this chapter.

- 41
42 A. An entity is considered to be the Operator if any of the following apply:
43
44 1. The entity’s name appears on the state issued facility operating license,
45
46 2. The entity holds the provider agreements with third party payors (Medicare,
47 Medicaid or private pay),
48
49 3. The entity contracts to provide patient services (admissions agreement),
50
51 4. The entity holds the state-issued Certificate of Need,
52
53 5. A Management Agent that functions as the Operator, as defined above, will be
54 considered an Operator and subject to PLI requirements.
55
56 B. If a Management Agent is the entity that functions as the Operator, as defined above,
57 then it will be considered an Operator. However, if the Management Agent is the
58 entity that only provides administrative oversight and performs accounting, financial
59 management, purchasing and other corporate services, and it has no property interest
60 in the license, the license was issued and will be renewed without regard to the
61 Management Agent’s participation and another entity is fully responsible for all
62 licensed activity at the facility, then PLI is not required of this entity.
63
64 C. If the Operator is a subsidiary or an affiliate of another entity or in a corporate
65 structure where more than one residential care facility is owned and/or operated, then
66 the term Operator shall refer to the parent or controlling entity. The parent or
67 controlling entity must have PLI in compliance with the guidance in this chapter on
68 all entities that it controls, operates or manages even if some of those facilities do not
69 have FHA mortgage insurance.
70
71 The term “parent or controlling” entity refers only to business concerns such as
72 corporate or partnership entities. It does not refer to natural persons operating in their
73 individual capacities unless the owning entity is a sole proprietorship.
74

75 **III. TYPES OF ACCEPTABLE INSURERS**

76
77 The PLI insurance must be provided through an insurance carrier that has a Financial
78 Strength Rating of “A-“ or higher from A.M. Best or Financial Stability Rating of “A” or
79 higher from Demotech.

80 Acceptable forms of insurance include:

81
82 A. Commercial Insurance Policy

83
84 The PLI may be provided under a commercial insurance policy. The insurance
85 carrier or provider must have a Financial Strength Rating of “A-” or higher from

86 A.M. Best Company or a Financial Stability Rating of “A” or higher from Demotech
87 (the Financial Rating). The insurance company issuing the PLI policy must be
88 domiciled or licensed in the United States and must be authorized to provide PLI
89 insurance in the state where the policy is issued as an admitted and/or surplus lines
90 carrier.

91 92 B. Self-Insurance

93
94 Self-insurance is permissible subject to the guidance provided in Section IV.B. below.
95 For self-insurance, an insurance carrier or provider (also referred to as the “fronting
96 entity”) will be required to issue an insurance policy backed by liquid financial assets.
97 The carrier or fronting entity must be domiciled and authorized to provide insurance
98 in the United States. The insurance fronting entity must have an acceptable rating
99 from A.M. Best or Demotech.

100 101 C. State Insurance Providers

102
103 1. Joint Underwriting Associations (JUA) are insurance providers that are authorized
104 by state legislatures, regulated and financially controlled by state governmental
105 entities. JUA’s or state insurance providers must meet the following criteria to be
106 eligible providers of PLI for the purposes of this Appendix:

- 107
108 a. The JUA and/or the state insurance provider must have been authorized by an
109 act of the state legislature and must be regulated by the state government in
110 the state where the PLI policy is issued.
111 b. The insurance provider must have been in continuous operation for four years
112 or longer,
113 c. The JUA and/or the state insurance provider must provide audited or state
114 approved financial statements for the past three years.
115 d. The JUA and/or the state insurance provider must have capital or surplus that
116 is at least 2.5 times the amount of annual claims, and
117 e. ORCF may consider other factors at its sole discretion in order to make a
118 reasonable determination regarding the acceptability of a JUA or a state
119 insurance provider, and may accept ratings by A.M. Best or Demotech as
120 specified in this chapter in lieu of these requirements.

121 122 2. Patient Compensation Funds

123
124 A Patient Compensation Fund (PCF) is a fund enacted through legislation by
125 some states that provides coverage for judgments or settlements in a medical
126 liability cause of action above a defined amount. States that have these funds have
127 different criteria defining which settlements and judgments are eligible. In
128 assessing the ability of an applicant to meet its PLI requirement, ORCF may
129 accept insurance provided by a PCF as long as the Operator is a participant.
130

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132 IV. **REQUIRED MINIMUM COVERAGE LIMITS, SELF-INSURANCE, AND**
133 **MISCELLANEOUS PROVISIONS**

134
135 A. Minimum Coverage Requirements

136
137 ORCF requires a level of PLI that is sufficient to meet professional liability claims
138 and obligations. ORCF has established minimum acceptable levels for the
139 deductible, the coverage amount per occurrence, and an aggregate cap for the term
140 of the policy. The per occurrence and aggregate levels shall reflect historical claims
141 amounts and trends.

142
143 ORCF may determine that higher per occurrence or aggregate amounts of PLI
144 coverage are necessary based on its review of the claims history and/or pending
145 claims. More stringent coverage may be required if the Operator’s claim history is
146 trending negative, or if the proposed insurance does not appear to be adequate to
147 meet anticipated annual or long term claims payment obligations. Other
148 circumstances that might lead to more stringent PLI requirements include the
149 financial condition of the Operator or the results of an actuarial study.

- 150
151 1. The minimum required coverage for all residential care facilities is:
152 a. \$1,000,000 per occurrence and,
153 b. An overall aggregate amount that is adequate to fund outstanding claims with
154 a minimum of \$3,000,000 and,
155 c. The per-occurrence deductible shall not exceed \$25,000.
156
157 2. Waiver. If the proposed financing is infeasible due to the cost or availability of
158 PLI, applicants may petition ORCF to amend the minimum coverage requirement.
159 The Operator’s claims history combined with evidence that the cost of a
160 compliant policy would create a financial burden to the project.
161
162 3. Per Occurrence vs. Claims Made. The PLI policy may be either:
163 a. An “occurrence” policy, which provides coverage regardless of when the
164 claim is reported, as long as the occurrence giving rise to the claim occurred
165 during the original policy period; or
166
167 b. A “claims-made” policy, which provides coverage for claims that are brought
168 to the insurer during the policy period or during a designated, extended
169 reporting period beyond the policy expiration date. Since the term of the
170 policy is normally one year, the Operator must also provide extended
171 reporting period insurance coverage (“tail coverage”) if the policy renewal
172 does not cover claims from prior years or, in lieu of the tail coverage, the
173 Operator can provide a dedicated cash equivalent escrow fund for the full
174 amount of the expected claims. The tail insurance provides coverage for an
175 extended period that shall be based on the maximum statute of limitations for
176 filing claims of negligence, injuries, wrongful death, and/or improper care for

177 the various States where the facilities are located.

178 B. Self-Insurance

179

180 The fronting insurance provider shall obtain an escrow of liquid assets from the
181 Operator (i.e. cash, cash equivalents, readily marketable securities or a letter-of-
182 credit) that is sufficient to finance current and anticipated claims expenses under the
183 self-insurance policy. The amount of the escrow will be determined from an actuarial
184 study obtained by the Operator.

185

186 1. The escrow must be pledged exclusively for the PLI policy, but the self-insurance
187 policy may also have additional pledges of liquid assets for workers
188 compensation, property, auto and general liability insurance.

189

190 2. The escrow must be placed directly under the control of the fronting entity. A
191 letter-of-credit may be substituted for liquid assets; however, the letter of credit
192 must be assigned directly to the fronting entity and must be issued by an
193 acceptable financial institution.

194

195 3. An acceptable financial institution is one that has assets of not less than
196 \$125,000,000 and/or 50 times the amount of the letter of credit (whichever is
197 higher), is organized under the laws of the United States or a State thereof and is
198 regulated and examined (for banking institutions) by the Comptroller of the
199 Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve
200 System and has a long-term bank deposit rating of "A-1" or better by Moody's
201 Investor Services, "A+" by Standard and Poor's or "A+" by Fitch Ratings. If the
202 letter of credit provider is an affiliated non-insurance entity of an insurance
203 company, ORCF may also accept a Long Term Issuer Credit Rating from A.M.
204 Best of "A+" or higher assigned to such entity. (A Long Term Issuer Credit
205 Rating assigned to a non-insurance entity by A.M. Best should not be confused
206 with a Financial Strength Rating issued by A.M. Best, which refers to the
207 capability of an insurance company to meet its financial obligations to
208 policyholders.)

209

210 4. ORCF will accept a maximum per-occurrence self-insured retention (SIR) of
211 \$100,000. ORCF may require a lower SIR, to an amount not less than \$25,000, if
212 it determines that this is necessary after completing its review of the PLI Package
213 (Section VII, below).

214

215 C. Lower Minimum Required Coverage in Certain States.

216

217 Some states have enacted legislation which limits the amount that can be recovered as
218 the result of a professional liability claim. ORCF may allow reduced PLI coverage
219 for facilities in those states after review on a case-by-case basis, and a waiver will be
220 required.

221

222 D. Additional Requirements for Certain Operators and Facilities.

223
224 If an applicant utilizes self-insurance, a JUA, and/or is the Operator of 50 or more
225 residential care facilities, ORCF will conduct a comprehensive PLI review. Section
226 VII below lists the materials to be submitted for this review.

227
228 V. **EXISTING FHA INSURED FACILITIES**

229
230 A. ORCF will review all applications under Section 232 that seek:

- 231
232 1. To refinance an existing FHA insured residential care facility pursuant to
233 Section 223(a) (7) or Section 223(f),
234
235 2. To finance a supplemental loan under section 241(a),
236
237 3. Approval of TPA involving Section 232 residential care facilities.

238
239 B. If the current PLI does not meet the requirements in this chapter, ORCF will
240 determine if it is adequate to cover anticipated liabilities and claims. If satisfactory,
241 ORCF will accept the existing PLI. However, if the PLI review provides evidence
242 that the current PLI is not adequate to meet anticipated claims, the PLI insurance
243 requirements of this Appendix will apply.

244
245 C. Applicants may petition ORCF to reduce the minimum coverage requirement, if the
246 residential care facility is already FHA-insured and is seeking to lower the level of
247 PLI coverage. The FHA lender should submit a request to ORCF, and include the
248 information with the Firm Application. The Operator's claims history must provide
249 justification for the request to lower the minimum coverage amount and the additional
250 cost of the insurance for the project must reflect a financial burden to the project.

251
252 VI. **NEW CONSTRUCTION / SUBSTANTIAL REHABILITATION**

253
254 A. If the residential care facility is being financed as a new construction or a substantial
255 rehabilitation, evidence of insurability for professional liability (preferably an
256 insurance quote) should be presented to ORCF prior to initial closing. For Operators
257 of multiple residential care facilities, a PLI policy covering those facilities must be
258 provided to ORCF. A PLI policy acceptable to ORCF must be in place for the
259 Operator prior to the issuance of a certificate of occupancy and commencement of
260 operations of the new or substantially renovated facility.

261
262 B. If the Operator or parent does not currently operate a residential care facility, it must
263 present evidence of insurability for professional liability. The evidence must consist
264 of written documentation from an insurance company or an insurance broker
265 specializing in residential care facilities. The documentation must indicate that the
266 Operator is eligible to be insured under a policy that meets ORCF's minimum

267 coverage requirements. It must also include a current estimate of the cost of the PLI
268 policy. The insurance policy must be in place prior to the issuance of a certificate of
269 occupancy and the commencement of operations of the new or substantially
270 renovated residential care facility, if the facility is not operational at the time of the
271 firm commitment.

272
273 C. In the case of new construction or substantial rehabilitation, the estimated cost must
274 be adjusted to reflect the anticipated cost at the estimated date that the coverage will
275 be bound.

276
277 **VII. MATERIALS REQUIRED TO BE SUBMITTED TO ORCF (the PLI PACKAGE)**

278
279 The following will be submitted for the PLI review:

280
281 A. Information about the PLI insurance coverage:

- 282
283 1. Copy of the insurance ACORD – showing the limits of coverage (both facility
284 and aggregate limits if there is more than one facility) and deductible/SIR and
285 facilities with bed counts included under this coverage;
286 2. Evidence of insurance company(‘s) rating. (Printout of Financial Rating.)

287
288 B. Current list of all residential care facilities that the Operator operates and the
289 percentage ownership if that ownership exceeds 25%.

290
291 C. Financial statements for the most recent three years for the Operator and
292 consolidated financial statements for the parent of the Operator.

293
294 D. A six-year loss history of professional liability claims filed or expected to be filed
295 against it for all facilities controlled by the parent Operator. The six-year loss
296 history should be provided in annual summary form (prepared by the insurance
297 company or third-party administrator) and should:

- 298
299 1. Provide a current inventory of all paid or settled claims,
300
301 2. Break out the expected cost of claims in a year by year summary in separate
302 line items the amount of the actual and/or anticipated awards including
303 claims expenses, and any funds reserved for estimated claims,
304
305 3. Show total actual or estimated claims costs for compensatory damages,
306 medical expenses, punitive damages and legal expenses incurred processing
307 the claim,
308
309 4. Total number of insured beds for each of the six years,

310

- 311 5. Identify all potential or expected professional liability claims in excess of
312 \$15,000 that have been or may be filed for all periods within the statute of
313 limitations for the State where the claim occurred,
314 6. Include a brief discussion or chart that provides the timeframe for the statutes
315 of limitations for filing claims of negligence, injuries, wrongful death, and/or
316 improper care based-the law in the states where the parent Operator’s
317 facilities are located.
318

319 E. State licensing surveys for the last three years for all individual facilities of the
320 Operator if the Operator has less than five facilities. If the Operator has five or more
321 facilities, provide copies of state licensing surveys where there has been a pattern of
322 serious unresolved deficiencies (deficiencies where there is actual harm to residents
323 commonly referred to as “G” or higher level deficiencies) that were not removed
324 within a one month period. Please provide a narrative discussion regarding the topic,
325 the risk and how it will be mitigated.
326

327 F. A recent actuarial study for the parent Operator if available, or if the parent Operator
328 utilizes self-insurance-, and include audited (if available) financial statements for any
329 captive insurance company.
330

331 *Note: This information is considered proprietary and is exempt from Freedom of*
332 *Information Act requests.*
333

334 G. For a substantial rehabilitation of an existing residential care facility, the mortgagee shall
335 provide evidence that the facility had PLI coverage for a period equal to the State’s
336 statute of limitations for filing claims. If during the statute of limitations period there
337 was no insurance coverage or the coverage failed to provide for events that could lead to
338 claims filed in later years, the Operator must provide an estimate of the extent of
339 unfunded insurance liability by occurrence.
340

341 H. If the residential care facility has been purchased by a new owner and the new owner
342 and/or Operator has any direct or indirect liability for operations of the residential care
343 facility prior to the date of sale transaction, the Operator must provide an estimate of the
344 extent of unfunded insurance liability by occurrence, if any. If the new owner or
345 Operator has no obligations to pay claims incurred prior to the to the purchase date, the
346 lender should state this in the Lender Narrative.
347

348 *Note: Prior claims information should be provided regardless of who may have owned*
349 *or operated the facility prior to seeking FHA mortgage insurance. This information is*
350 *important because it provides historical information about the previous Operator. It*
351 *can indicate the quality of care and management capability that has been present in the*
352 *facility and identify important Operator issues that need to be reviewed during the*
353 *ORCF underwriting process.*
354

355 VIII. **MORTGAGEE REVIEW OF PLI PACKAGE AND OPINION**

356
357 The mortgagee shall include as part of its underwriting analysis a recommendation to ORCF
358 concerning the acceptability of the sponsor's PLI and risk management programs. These
359 should include at least the documents Section VII above, the firm application checklist.
360

361 **IX. ANNUAL REVIEW BY MORTGAGEE**

362
363 ~~Concurrent with the submission of the Financial Assessment Subsystem (FASS),~~ Annually,
364 the mortgagee will review the current PLI status of the Operator, including:

- 365
366 A. An update of the loss history ~~consistent with the requirements of VII, DE.~~ above;
367 and
368
369 B. A copy of insurance ACORD, PLI policy, certificate or memorandum of insurance
370 or other evidence of the required insurance coverage.

371
372 The purpose of this annual review is to confirm that there have not been ~~no material~~
373 changes ~~negative trends~~ in the professional liability incidents, claims or insurance coverage
374 (without HUD's approval) since the time of underwriting. Please refer to Section III, Asset
375 Management, Chapter 3.10.7 for specific details regarding the annual review.

376