

## 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. Professional Liability Insurance (PLI) is common in the healthcare industry and provides important mitigation to this liability risk.

#### 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 or substantial rehabilitation 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. to finance a supplemental loan under Section 241(a),
  4. of a transferChange of physical assets (TPAOwnership (CHOW) and/or a Change of Operator (CHOP) 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.

A. An entity is considered to be the Operator if any of the following apply:

1. The entity's name appears on the state-issued facility operating license,
2. The entity holds the provider agreements with third party payors (Medicare, Medicaid or private pay),
3. The entity contracts to provide patient services (admissions agreement),
4. The entity holds the state-issued Certificate of Need,
5. A Management Agent that functions as the Operator, as defined above, will be considered an Operator and subject to PLI requirements.

B. If a Management Agent is the entity that functions as the Operator, as defined above, then it will be considered an Operator. However, if the Management Agent is the entity that only provides administrative oversight and performs accounting, financial management, purchasing and other corporate services, and it has no property interest in the license, the license was issued and will be renewed without regard to the Management Agent's participation and another entity is fully responsible for all licensed activity at the facility, then PLI is not required of this entity.

C. If the Operator is a subsidiary or an affiliate of another entity or in a corporate structure where more than one residential care facility is owned and/or operated, then the term Operator shall refer to the parent or controlling entity. The parent or controlling entity must have PLI in compliance with the guidance in this chapter on all entities that it controls, operates or manages even if some of those facilities do not have FHA mortgage insurance.

The term "parent or controlling" entity refers only to business concerns such as corporate or partnership entities. It does not refer to natural persons operating in their individual capacities unless the owning entity is a sole proprietorship.

### **III. TYPES OF ACCEPTABLE INSURERS**

The PLI insurance must be provided through an insurance carrier that has a Financial Strength Rating of "A-" or higher from A.M. Best or Financial Stability Rating of "A" or higher from Demotech.

Acceptable forms of insurance include:

A. Commercial Insurance Policy

The PLI may be provided under a commercial insurance policy. The insurance carrier or provider must have a Financial Strength Rating of “A-” or higher from A.M. Best Company or a Financial Stability Rating of “A” or higher from Demotech (the Financial Rating). The insurance company issuing the PLI policy must be domiciled or licensed in the United States and must be authorized to provide PLI insurance in the state where the policy is issued as an admitted and/or surplus lines carrier.

## B. Self-Insurance

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

## C. State Insurance Providers

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

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

## 2. Patient Compensation Funds

A Patient Compensation Fund (PCF) is a fund enacted through legislation by some states that provides coverage for judgments or settlements in a medical liability cause of action above a defined amount. States that have these funds have different criteria defining which settlements and judgments are eligible. In

131 assessing the ability of an applicant to meet its PLI requirement, ORCF may  
132 accept insurance provided by a PCF as long as the Operator is a participant.  
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136 **IV. REQUIRED MINIMUM COVERAGE LIMITS, SELF-INSURANCE, AND**  
137 **MISCELLANEOUS PROVISIONS**

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139 A. Minimum Coverage Requirements

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

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

- 154  
155 1. The minimum required coverage for all residential care facilities is:
- 156 a. \$1,000,000 per occurrence and,
  - 157 b. An overall aggregate amount that is adequate to fund outstanding claims with  
158 a minimum of \$3,000,000 and,
  - 159 c. -The per-occurrence deductible or self-insured retention shall not exceed  
160 \$25100,000.
- 161  
162 2. Waiver. If the proposed financing is infeasible due to the cost or availability of  
163 PLI, applicants may petition ORCF to amend the minimum coverage requirement.  
164 The Operator's lender's request must include a clear explanation of the specific  
165 provision they are requesting to waive, a clear summary of the proposed PLI  
166 policy, and the lender's analysis and justification of the policy. Justification  
167 should include the claims history combined with of the projects on the policy,  
168 evidence that the cost of a compliant policy would create a financial burden to the  
169 project, and the operator's financial capacity to provide mitigation of claims in  
170 excess of the limits allowed. Waiver requests should be submitted in the firm  
171 application.
- 172  
173 3. Per Occurrence or Per Event vs. Claims Made. The PLI policy may be either:
- 174 a. An "occurrence" or "per event" policy, which provides coverage regardless  
175 of when the claim is reported, as long as the occurrence giving rise to the  
176 claim occurred during the original policy period; or
  - 177  
178 b. A "claims-made" policy, which provides coverage for claims that are brought  
179 to the insurer during the policy period or during a designated, extended  
180 reporting period beyond the policy expiration date. Since the term of the

181 policy is normally one year, the Operator must also provide extended  
182 reporting period insurance coverage (“tail coverage”) if the policy renewal  
183 does not cover claims from prior years or, in lieu of the tail coverage, the  
184 Operator can provide a dedicated cash equivalent escrow fund for the full  
185 amount of the expected claims. The tail insurance provides coverage for an  
186 extended period that shall be based on the maximum statute of limitations for  
187 filing claims of negligence, injuries, wrongful death, and/or improper care for  
188 the various States where the facilities are located. If the coverage provided is  
189 underwritten on a claims-made basis, the policy must contain a retroactive  
190 date of coverage consistent with the earliest retroactive date in place for any  
191 prior claims-made policy in force or may be 'retro date inception' if the policy  
192 immediately preceding was underwritten on an occurrence basis.

#### 193 194 B. Self-Insurance

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

- 202 1. The escrow must be pledged exclusively for the PLI policy, but the self-insurance  
203 policy may also have additional pledges of liquid assets for workers  
204 compensation, property, auto and general liability insurance.
- 206 2. The escrow must be placed directly under the control of the fronting entity. A  
207 letter-of-credit may be substituted for liquid assets; however, the letter of credit  
208 must be assigned directly to the fronting entity and must be issued by an  
209 acceptable financial institution.
- 210 3. An acceptable financial institution is one that has assets of not less than  
211 \$125,000,000 and/or 50 times the amount of the letter of credit (whichever is  
212 higher), is organized under the laws of the United States or a State thereof and is  
213 regulated and examined (for banking institutions) by the Comptroller of the  
214 Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve  
215 System and has a long-term bank deposit rating of “A-1” or better by Moody’s  
216 Investor Services, “A+” by Standard and Poor’s or “A+” by Fitch Ratings. If the  
217 letter of credit provider is an affiliated non-insurance entity of an insurance  
218 company, ORCF may also accept a Long Term Issuer Credit Rating from A.M.  
219 Best of “A+” or higher assigned to such entity. (A Long Term Issuer Credit  
220 Rating assigned to a non-insurance entity by A.M. Best should not be confused  
221 with a Financial Strength Rating issued by A.M. Best, which refers to the  
222 capability of an insurance company to meet its financial obligations to  
223 policyholders.)  
224  
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- 226 4. ORCF will accept a maximum per-occurrence self-insured retention (SIR) of  
227 \$100,000. ORCF may require a lower SIR, to an amount not less than \$25,000, if  
228 it determines that this is necessary after completing its review of the PLI Package  
229 (Section VII, below).  
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231 C. Lower Minimum Required Coverage in Certain States.  
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233 Some states have enacted legislation ~~which~~that limits the amount that can be  
234 recovered as the result of a professional liability claim. ORCF may allow reduced  
235 PLI coverage for facilities in those states after review on a case-by-case basis, and a  
236 waiver will be required.  
237



238 D. Additional Requirements for Certain Operators and Facilities.

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240 If an applicant utilizes self-insurance, or a JUA, and/or ~~is if~~ the ~~Operator of~~PLI policy  
241 has 50 or more residential care facilities, ~~ORCF will the lender must~~ conduct a  
242 comprehensive PLI review. Section VII below lists the materials to be reviewed and  
243 submitted ~~for as part of~~ this review. ORCF will review the lender's review to  
244 determine whether this policy is an acceptable risk.

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246 V. **EXISTING FHA INSURED FACILITIES**

247  
248 A. ORCF will review all applications under Section 232 that seek:

- 249  
250 1. To refinance an existing FHA insured residential care facility pursuant to  
251 Section 223(a)-(7) or Section 223(f),  
252  
253 2. To finance a supplemental loan under section 241(a),  
254  
255 3. Approval of ~~TPA~~Change of Ownership (CHOW) and/or a Change in  
256 Operator (CHOP) involving Section 232 residential care facilities.

257  
258 B. If the current PLI does not meet the requirements in this chapter, ORCF will  
259 determine if it is adequate to cover anticipated liabilities and claims. If satisfactory,  
260 ORCF will accept the existing PLI. However, if the PLI review provides evidence  
261 that the current PLI is not adequate to meet anticipated claims, the PLI insurance  
262 requirements of this Appendix will apply.

263  
264 C. Applicants may petition ORCF to reduce the minimum coverage requirement, if the  
265 residential care facility is already FHA-insured and is seeking to lower the level of  
266 PLI coverage. The FHA lender should submit a request to ORCF, and include the  
267 information with the Firm Application. The Operator's claims history must provide  
268 justification for the request to lower the minimum coverage amount and the additional  
269 cost of the insurance for the project must reflect a financial burden to the project. A  
270 review of the operator's financial position must be supplied to provide support for  
271 mitigation of claims in excess of the limits allowed.

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273 VI. **NEW CONSTRUCTION / SUBSTANTIAL REHABILITATION**

274  
275 A. If the residential care facility is being financed as a new construction or a substantial  
276 rehabilitation, evidence of insurability for professional liability (preferably an  
277 insurance quote) should be presented to ORCF prior to initial closing. For Operators  
278 of multiple residential care facilities, a PLI policy covering those facilities must be  
279 provided to ORCF. A PLI policy acceptable to ORCF must be in place for the  
280 Operator prior to the issuance of a certificate of occupancy and commencement of  
281 operations of the new or substantially renovated facility.



- 283 B. If the Operator or parent does not currently operate a residential care facility, it must  
284 present evidence of insurability for professional liability. The evidence, which must  
285 be included in the Lender's application, must consist of written documentation from  
286 an insurance company or an insurance broker specializing in residential care facilities.  
287 The documentation must indicate that the Operator is eligible to be insured under a  
288 policy that meets ORCF's minimum coverage requirements. It must also include a  
289 current estimate of the cost of the PLI policy. The insurance policy must be in place  
290 prior to the issuance of a certificate of occupancy and the commencement of  
291 operations of the new or substantially renovated residential care facility, if the facility  
292 is not operational at the time of the firm commitment.  
293
- 294 C. In the case of new construction or substantial rehabilitation, the estimated cost must  
295 be adjusted to reflect the anticipated cost at the estimated date that the coverage will  
296 be bound.  
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298 **VII. MATERIALS REQUIRED TO BE SUBMITTED TO ORCF (the PLI PACKAGE)**

299  
300 The following will be submitted for the PLI review:

- 301 A. Information about the PLI insurance coverage:
- 302
- 303 1. Copy of the insurance ACORD – showing the limits of coverage (both facility  
304 and aggregate limits if there is more than one facility) and deductible/SIR and  
305 facilities with bed counts included under this coverage;  
306 2. Evidence of insurance company('s) rating. (Printout of Financial Rating.)  
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- 308
- 309 B. Current list of all ~~residential care facilities that the Operator operates and the~~  
310 ~~percentage ownership if that ownership exceeds 25%.~~ facilities on the PLI policy.  
311
- 312 C. Financial statements for the most recent three years for the Operator and  
313 consolidated financial statements for the parent of the Operator.  
314
- 315 D. A six-year loss history of professional liability claims filed or expected to be filed  
316 against it for all facilities ~~controlled by on the parent Operator~~ PLI policy. The six-  
317 year loss history should be provided in annual summary form (prepared by the  
318 insurance company or third-party administrator) and should:  
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- 320 1. Provide a current inventory of all paid or settled claims,  
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- 322 2. Break out the expected cost of claims in a year by year summary in separate  
323 line items the amount of the actual and/or anticipated awards including  
324 claims expenses, and any funds reserved for estimated claims,  
325

3. Show total actual or estimated claims costs for compensatory damages, medical expenses, punitive damages and legal expenses incurred processing the claim,
4. Total number of insured beds for each of the six years,
5. Identify all potential or expected professional liability claims in excess of \$~~1550~~,000 that have been or may be filed for all periods within the statute of limitations for the State where the claim occurred,
6. Include a brief discussion or chart that provides the timeframe for the statutes of limitations for filing claims of negligence, injuries, wrongful death, and/or improper care based-the law in the states where the parent Operator's facilities are located.

E. ~~State licensing surveys for~~ If any related facility (operator, parent of the operator, or facility on the PLI policy) has recent (within the last ~~three~~3 years for all individual facilities of the Operator if the Operator has less than five facilities. If the Operator has five or more facilities, provide copies of state licensing surveys where there has been a pattern of serious unresolved) "G" or higher citations, deficiencies (deficiencies where there is, or other instances of actual harm to residents commonly referred to as "G" or higher level deficiencies) that were not removed within a one month period. Please, please provide a narrative discussion regarding the topic, the risk, and how it will be mitigated.

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

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

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

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

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

### **III. MORTGAGEE QUALIFIED PLI REVIEW**

When a PLI policy is complex or when the lender does not have sufficient expertise to properly assess whether a PLI policy meets HUD's requirements, the lender should engage the services of a qualified PLI professional. HUD may require the lender to engage a qualified PLI professional in complex situations where HUD needs assurance that the policy is compliant or in situations where a waiver is requested.

### **IX. LENDER'S REVIEW OF PLI PACKAGE AND OPINION**

~~The mortgagee shall include as part of its underwriting analysis~~ The lender must review all of the PLI exhibits, clearly explain the operator's PLI policy and explain how it meets the handbook requirements. If a waiver is requested, the lender must identify which specific provision it is requesting to waive and provide a thorough and compelling justification. The lender should also include, as part of its underwriting analysis, a recommendation to ORCF concerning the acceptability of the sponsor's PLI and risk management programs. These should include at least the documents Section VII above, the firm application checklist.

### **X. ANNUAL REVIEW BY MORTGAGEE**

Annually, the mortgagee will review the current PLI status of the Operator, including:

- A. An update of the loss history; and
- B. A copy of insurance ACORD, PLI policy, certificate or memorandum of insurance or other evidence of the required insurance coverage.

The purpose of this annual review is to confirm that there have not been negative trends in the professional liability incidents, claims or changes in insurance coverage (without HUD's approval) since the time of underwriting. Please refer to Section III, Asset Management, Chapter 3.10.7 for specific details regarding the annual review.