BERN
STEIN
SHUR

Bernstein, Shur,
Sawyer & Nelson, P.A.
100 Middle Street
PO Box 9729
Portland, ME 04104-5029

T (207) 774-1200
F (207) 774-1127

Steven Gerlach
(207) 228-7128 direct
sgerlach@bernsteinshur.com

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Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, D.C. 20210

Attention: Definition of Employer—Small Business Health Plans, RIN 1210-AB85

Re: Association Health Plans—comments on proposed regulations

To whom it may concern:

My firm represents the Foundation for Government Accountability, a conservative advocacy group based in Naples, Florida, focused on developing principled strategies to replace failed health and welfare programs nationwide ("FGA"), and the Allumbaugh Agency, a forward-thinking employee benefits broker and administrator based in Augusta, Maine ("TAA"). On behalf of FGA and TAA, this letter responds to the request for comments issued by the Department of Labor Employee Benefits Security Administration (the "Department") in connection with proposed regulations under 29 CFR Part 2510 regarding the definition of "Employer" under section 3(5) of the Employee Retirement Income Security Act of 1974 ("ERISA"). We are generally very pleased with the priority the Department has placed on Association Health Plans ("AHPs") in its regulatory guidance and believe that AHPs stand to make a significant difference to small employers across the country. Our comments fall under five headings: interstate regulation, VEBA concerns, ESOP-owned companies, working owners and nondiscrimination.

Interstate Regulation. Regarding interstate regulation, the proposed regulations appear to leave open the question of which states' MEWA rules apply to any given arrangement. Specifically, for groups in which the commonality-in-interest requirement is satisfied by employers in the same trade, industry, line of business or profession, or by employers doing business in the same metropolitan area, an AHP that crosses state lines is made possible and even likely. In its Federalism Statement, the Department notes that this issue is especially significant for self-insured MEWA plans that are subject to "any State insurance law that regulates insurance ... to the extent that such State law is not inconsistent with ERISA." The Department further notes that "State rules vary widely in practice, and many States regulate AHPs less stringently than individual or small group insurance."

This wide variance raises concerns regarding regulatory arbitrage (a.k.a. "race to the bottom") in which self-insured AHPs are formed in jurisdictions with little-to-no regulation and then exported to AHP members in other states whose laws the AHP would otherwise violate. Of the many potential resolutions to this issue, we would favor the Department issuing a class exemption under ERISA Section 514(b)(6) that is based on either an existing state MEWA statute or a model MEWA statute developed by the Department. At the foundation of this class exemption would be minimum requirements AHPs would be required to meet to qualify for the exemption. This would provide for a baseline of uniformity in regulation for AHPs crossing state lines and help prevent the arbitrage mentioned above.

The above-referenced variance also raises opposite concerns where a self-insured AHP may be overly burdened by the requirement to comply with the inconsistent MEWA statutes of every state in which it operates. The obligation to deal with different loss reserve, reinsurance, trust and administrative requirements for every state, could render a multi-state AHP impracticable. We believe that the class exemption described above would help remedy this issue. In addition, however, we would favor permitting states to enter into interstate compacts that would level the playing field regarding AHP compliance and enforcement, at least as between those states entering the compact. We expect such a compact would leave to an AHP's home state certain basic requirements of AHP design and financial standards, but would permit other participating states to regulate the behavior of AHP members, service providers and purveyors within their boundaries.

On a related concern, we would recommend treating fully funded self-insured plans (i.e., plans that are funded up to the maximum liability before stop-loss coverage kicks in) as fully insured for AHP purposes. Such treatment (and all of our suggestions thus far) would, in keeping with President Trump's executive order of October 12, 2017, encourage competition and ensure choice in the health coverage marketplace by keeping a path open to self-insurance.

VEBA Concerns. One of the key advantages of self-insured plans is the ability to smooth out claim and cost volatility over time by accumulating reserves in years for which claims experience is low. The tax treatment of reserves is crucial to many employers, however, and turns on, among other things, whether the plan is funded by a VEBA trust. That is, unless held in a VEBA trust, AHP reserves could be subject to taxation, notwithstanding the nonprofit status of the association sponsoring the plan. The tax regulations regarding who may be a member of a VEBA, however, are unclear as to whether all AHPs contemplated under the proposed regulations would be eligible to hold plan assets in a VEBA.

On the one hand, Treasury Regulations section 1.501(c)(9)-2(a)(1) provides that VEBA eligibility is defined by an "employment-related common bond." This language is broad enough that it could include members of an AHP that is defined by geographic region or line of business alone because, under the proposed regulations, those members would have a common "employer" for plan purposes—the association sponsoring the plan. On the other hand, that regulation goes on to give examples of groups that meet the VEBA eligibility standard, including "employers engaged in the same line of business in the same geographic locale." This example implies that an AHP whose participating employers' relationship is based on either a line of business <u>or</u> a geographic locale may not satisfy the employment-related common bond requirement to participate in a VEBA.[1]

Importantly, this is not just a tax technicality; the taxability of the surplus would likely be a deal-breaker for most associations looking to self-insure. As mentioned above, taking self-insurance off the table is anathema to the President's executive order to encourage competition and ensure choice in the health coverage marketplace. Fortunately, we believe there are both precedent and a simple fix. Regarding precedent, labor unions, under the same treasury regulation, are permitted to sponsor VEBAs covering employees in multiple lines of business and multiple geographic locations because the union itself is their employment-related common bond. As a simple fix, a similar approach could be taken with AHPs. That is, we would recommend that the Department work with the IRS to issue guidance under section 501(c)(9) and its regulations. That guidance would expressly permit AHPs to fund their plans using VEBAs because the AHP itself is the employment-related common bond for the purposes of section 1.501(c)(9)-2(a)(1), necessarily provided that the AHP meets at least one of the commonality-in-interest requirements of the proposed regulations.

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[1] Although not on point here, this is consistent with IRS interpretation. *See* the 7th Circuit's decision in *Water Quality Ass'n Employees' Benefit Corp. v. United States,* 795 F.2d 1303, 7 EBC 1737 (7th Cir. 1986), and the IRS's response in GCM 39817.

ESOP-Owned Companies. According to the National Center for Employee Ownership ("NCEO"), as of 2014 (the last year for which data is available), there were 6,717 ESOP-owned companies in the U.S. (3,709 were considered "small" businesses) covering about 14 million participating employees. ESOP-owned companies have at least two well-established national associations: NCEO and the ESOP Association. We believe that either or both of these associations would be prime candidates to establish and operate an AHP. Their members often have as much in common if not more than companies working in the same industry or geographic area due to the unique culture of employee-ownership and the unique regulatory scheme in which ESOP companies operate. Moreover, permitting such companies to work together through their associations to establish market power and economies of scale is consistent with the Department's stated goals in issuing the proposed regulations. As of the current draft, however, the regulations would not permit ESOP-owned companies to establish an AHP because they do not meet the stated commonality-in-interest requirements. We believe this is an easy fix, however. If the Department agrees with our assessment, we recommend that it revise the proposed regulations to establish a third category of employers that meet the commonality-in-interest standards—ESOP-owned companies.

Working Owners. We agree with the extension of AHP coverage to working owners. We believe, however, that the limitations placed on their eligibility by the proposed regulations unnecessarily complicate plan administration and require a higher standard for working owners than for other employees. Specifically, it seems unnecessary that working owners should have an hours-worked requirement that is different from the hours-worked requirement as stated in the AHP's plan documents. For example, if the employers (or an employer) participating in the AHP determine that employees working 20 hours per week qualify for coverage under the AHP, then we see no reason that working owners should be required to work more than 20 hours per week to get coverage. Moreover, this requirement creates a documentation issue (the written representations) for the AHP over-and-above that required for other eligible employees.

Further, making the requirements of Code section 162(l) expressly required for AHP participation does not seem connected to the proposed regulations' goal of expanding AHP access to working owners. Put differently, we ask whether these requirements would stand alone as AHP rules if section 162(l) were amended or repealed. It is worth noting that tax deductibility may not be the only consideration for the working owner. A given working owner may be willing to forego the tax deduction if the cost economies and cultural advantages of participating in an AHP outweigh the value of that deduction. Consider, for example, the flow-through tax regime passed under the recent tax reform legislation, which in many cases will lower the effective tax rates to working owners. Such lower tax rates may make a tax deduction for his or her own health coverage less compelling to a working owner. By including the requirements of section 162(l) here, however, the proposed regulations foreclose a business decision by the working owner based on such considerations. In addition, similar to the work requirement discussed above, incorporating these tax requirements places an administrative burden on the AHP by requiring the written representations from the working owner to be obtained and kept on file. Moreover, the requirement that the working owner have no other group coverage available unfairly limits his or her choices in the marketplace. Put differently, non-owner employees will be able to choose between their spouse's employer's plan and the AHP. There seems to us to be no clear rational to prohibiting that same choice to working-owners.

In sum, we believe that the proposed regulations should be revised to permit working owners to participate in an AHP on the same terms as other employees, subject only to the requirements of the governing plan documents. The limitations placed on their eligibility by the proposed regulations are unnecessary given the goals of the Department and existing tax requirements, and place an additional documentation burden on the AHP and the working owners.

Nondiscrimination. The proposed regulations would prohibit treating "different employer members of the group or association as distinct groups of similarly situated individuals," for the purposes of its nondiscrimination, rules. That is, the proposed regulations would prevent an AHP from denying membership or charging different rates to an employer member based on that member's claims experience. Although we generally agree with this approach, we believe that an exception is necessary to encourage the growth of small AHPs.

Specifically, consider the circumstance where an AHP is established and maintained by a group of small employers, but then a large employer—an employer that is experience rated—joins the AHP. Assume that the large employer has several years of high claims experience and enough employees so that it would substantially increase the cost to the entire group (except the large employer, which would enjoy lower costs if it joined the AHP). Under these circumstances, the AHP is in a no-win situation. If it permits the large employer to join the AHP without separately rating it, then the costs for the other members go up, which may lead to the other members leaving the AHP. Moreover, once the claims experience for the entire group goes up, the AHP will have a competitive disadvantage in attracting large groups that have good claims experience—such employers will either join another AHP or remain on the large group market on their own. On the other hand, if the AHP denies membership to the large employer, or insists that the large employer take a larger share of the costs of the plan, the AHP is in violation of the proposed regulations' nondiscrimination rules.

In our view, the above scenario is not only possible, but likely in the first few years of an AHP's lifespan. Moreover, we believe that the dilemma described could put many small AHPs out of business before they have had a chance to get off the ground. Put differently, any time the insurance markets lack parity there is substantial risk of adverse selection. In the above example, the AHP market is more favorable than the large group market, thereby attracting large groups with poor claims experience. To remedy this issue, we recommend drafting an exception to the nondiscrimination rules that would permit AHPs to continue group rating for large groups, as is the current practice with MEWAs today. We recognize that once an AHP reaches a critical mass of employee members, the addition of a large group is less likely to have a significant effect on overall costs. We believe this argues for a limit on group rating based on actuarially determined membership numbers, but it does not undo the potentially disastrous effects that "taking all comers" would have on young AHPs with fewer members.

Respectfully submitted,

Steven R. Gerlach, Esq., LL.M
Bernstein, Shur, Sawyer & Nelson, P.A.

SRG/smp

cc: Joel Allumbaugh
Tarren Bragdon