Healthcare Services Group, Inc. (HCSG)

EXPRO Submission No. E-00758

Notice to Interested Persons – Reinsurance Arrangement

Purpose of this Document

You are hereby notified that HCSG and HCSG Insurance Corp. ("the Captive Insurer"), a wholly-owned subsidiary of HCSG, have applied to the U.S. Department of Labor ("DOL") for authorization under Prohibited Transaction Exemption 96-62 (PTE 96-62), 61 FR 39988, July 31, 1996, as amended at 67 FR 44622, July 3, 2002, to allow the Captive Insurer to enter into a reinsurance arrangement with Companion Life Insurance Company ("Companion Life") for certain benefits under the Healthcare Services Group Voluntary Limited Medical Benefits Health Plan (the "Plan") that covers eligible employees of HCSG and its subsidiaries and affiliates. Specifically, the proposed transactions would permit the reinsurance of risks and the receipt of premiums therefrom by the Captive Insurer, in connection with voluntary limited medical, group voluntary life insurance, and group voluntary short-term disability insurance sold by Companion Life, or any successor insurance company which is unrelated to HCSG (the Fronting Insurer), to the Plan.

It is represented that the submission has met the requirements for tentative authorization under PTE 96-62.

The purpose of the authorization is to exempt the proposed transactions from sections 406(a)(1)(D) and 406(b) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The authorization is necessary because the Captive Insurer is an affiliate of HCSG. Reinsurance of the Plan or any portion of the Plan by the Captive Insurer and the Captive Insurer's receipt of premiums therefrom constitute prohibited transactions under ERISA.

This notice (1) informs you of the application to the DOL and certain changes to the life, limited medical and short-term disability benefits to you, and (2) describes your right to comment to the DOL about the proposed transactions.

Overview

The Plan provides group voluntary limited medical and (upon DOL approval) will provide group voluntary life insurance and group voluntary short-term disability benefits to eligible employees at discounted group rates. Companion Life will reinsure the risks of these insurance benefits with the Captive Insurer. The reinsurance transactions represent an internal arrangement between Companion Life and the Captive Insurer, whereby Companion Life will reinsure 100% of the risks of the Captive Insurer. As the Fronting Insurer, Companion Life will continue to insure the benefits provided to you under the Plan.

The Plan administrator has determined that the reinsurance transactions are in the best interests of the Plan and the Plan participants and beneficiaries because of the benefit enhancements or improvements that will be provided to participants and beneficiaries in the event that the transactions are authorized by the DOL. Such authorization will be subject to the conditions described below.

Parties to the Proposed Reinsurance Transactions

HCSG provides management, administrative and operating expertise and services to the housekeeping, laundry, linen, facility maintenance and dietary service departments of the health care industry, including nursing homes, retirement complexes, rehabilitation centers and hospitals located throughout the United States. As of December 31, 2013, HCSG provided services to approximately 4,000 facilities in 48 states. Headquartered in Bensalem, PA, HCSG has over 4,700 salaried and 40,000 hourly employees throughout the United States. HCSG is a publicly-traded company with over $1.14 billion in revenue in 2013.

The Captive Insurer is an insurance company domiciled in New Jersey. The Captive Insurer was incorporated in New Jersey on January 17, 2014 and is a wholly-owned subsidiary of HCSG. The Captive Insurer has a Certificate of Authority from the State of New Jersey dated January 15, 2014, and a Certificate of Good Standing from the State of New Jersey dated April 24, 2014. The Captive Insurer's financial statements have been audited by Withum, Smith & Brown, P.C., an independent auditing firm.

Companion has specialized in employee benefits for more than 40 years. Companion Life has been rated "A+" by A.M. Best Company ("A.M. Best") for ten consecutive years. It is anticipated that Companion Life will enter into a reinsurance agreement with the Captive Insurer as soon as possible following final authorization of the subject transactions.

The Plan

The Plan is an employee welfare benefit plan, as described under section 3(1) of ERISA. HCSG sponsors the Plan for the benefit of active employees of HCSG and its subsidiaries and affiliates. All benefits under the Plan are offered on a fully-insured basis. The Plan's identifying number for DOL reporting purposes is 512. To reflect the broader nature of the benefits under the Plan, it is anticipated that the Plan name will be changed upon the DOL authorization of the subject transactions.

Insurance Benefits Offered Under the Plan

The Plan currently offers the following insurance benefits to HCSG employees:

- **Limited Medical Insurance:** Under the limited medical component of the Plan, three coverage options (Economy, Standard and Premium) are available to Covered Employees. These options differ from each other only in the level of premium cost and the corresponding dollar amount of benefits provided for each covered service. In addition to the medical benefits, the Limited Medical Plan provides death benefits to surviving beneficiaries in the form of lump sum payments of varying amounts, as part of the benefit included in the premium cost. Additional details of the benefits are provided below. As of January 1, 2014, 1,800 Covered Employees of HCSG were enrolled in the Limited Medical Plan.

- **Life Insurance:** Currently, HCSG employees have the ability to purchase, on a voluntary basis, individual policies of life insurance benefits. Under the proposed transactions, voluntary life insurance benefits would be offered on a group basis. Under this group term life insurance component of the Plan, Covered Employees of HCSG will be given the opportunity to purchase coverage at discounted group rates from the individual policy rates currently offered. Additional details of the benefits are provided below. As of January 1, 2014, 2,500 HCSG employees purchased individual policies of life insurance benefits.

- **Short-Term Disability Insurance:** Currently, HCSG employees have the ability to purchase, on a voluntary basis, individual policies of short-term disability insurance benefits. Under the proposed transactions, voluntary short-term disability benefits would be offered on a group basis. Under this group short-term disability component of the Plan, Covered Employees of HCSG will be given the opportunity to purchase coverage at discounted group rates from the individual policy rates currently offered. As of January 1, 2014, 8,400 HCSG employees purchased individual short-term disability policies.

Changes to the Plan – Benefit Enhancements

The following benefit enhancements will be made available to all Plan participants affected by the proposed transactions, effective upon approval of this authorization by the DOL:

- **Accidental Death & Dismemberment Insurance:** All enrolled Plan participants will be provided with Accidental Death & Dismemberment insurance coverage with a benefit amount of $2,500 at no cost to the enrolled Plan participant or his or her beneficiaries or dependents. 100% of participants enrolled in any of the benefits under the Plan will be able to take advantage of this enhancement.

- **Group Voluntary Limited Medical Insurance:** Four enhancements will be made available with respect to voluntary limited medical insurance coverage. *First*, eligible employees will be able to purchase such coverage at group rates that will be reduced by 2.5% from current rates. 100% of participants enrolled in this benefit will be able to take advantage of this enhancement. *Second*, eligible employees will be able to purchase such coverage on a pre-tax basis through a "cafeteria plan" arrangement intended to comply with Section 125 of the Internal Revenue Code of 1986, as amended. 100% of participants enrolled in the limited medical insurance program will be able to take advantage of this enhancement. *Third*, the following additional term life insurance death benefits will be provided for each eligible employee with such coverage: $1,000 increase in life and AD&D insurance coverage for the employee, $500 increase in life insurance coverage for the spouse or a child between the ages of six months and 25 years, and $250 increase in life insurance coverage for a child between the ages of 15 days and six months. 100% of participants enrolled in this benefit will be able to take advantage of this enhancement. *Fourth*, participants enrolled in the Limited Medical Plan will be provided with access to Health Advocate, Inc., at no cost to those participants or their beneficiaries or dependents. Health Advocate, Inc. is a service that allows participants to navigate health care issues with the guidance of a trained professional, typically a registered nurse (a "Personal Health Advocate"), supported by medical directors and benefits and claims specialists. The Personal Health Advocate can be accessed 24 hours a day, seven days a week, and will assist with clinical issues, claims, benefits, grievances, paperwork, coordination of care between physicians and medical institutions, and other important needs. Health Advocate, Inc. estimates that between 3% - 5% of eligible employees utilize this benefit on average.

- **Group Term Life Insurance:** Eligible employees will be able to purchase group term life insurance at group rates that will be reduced by approximately 2.5% from current rates. 100% of participants enrolled in this benefit will be able to take advantage of this enhancement. In addition, the life insurance coverage is currently available on a guaranteed issue basis regardless of health (so that employees are eligible to purchase coverage without a physical examination) in amounts up to $25,000 for the employee and $10,000 for the spouse. Under the proposed transactions, the amount of guaranteed issue coverage available for purchase will be increased to a maximum of $30,000 for the employee and $15,000 for the spouse.

- **Short-Term Disability (STD):** HCSG employees currently do not participate in a group STD program (exception - employees located in New York, Rhode Island, New Jersey, California and Puerto Rico are covered under mandatory state STD programs). Under the proposed transactions, eligible HCSG employees will be able to purchase voluntary STD coverage at group rates that will be approximately 2.5% less than the rates available through other comparable group STD plans on the marketplace. 100% of participants enrolled in this benefit will be able to take advantage of this enhancement. In addition, the STD benefits will be offered to eligible employees without requiring evidence of insurability, provided that the eligible employee is an employee of HCSG on the effective date and enrolls when the STD benefits are first offered to that eligible employee, or within a limited time period when the employee is first employed by HCSG. 100% of employees who enroll in the STD benefit when it is first offered, along with 100% of employees who are hired after the effective date and who enroll in the STD program within 30 days of employment will be able to take advantage of this evidence of insurability enhancement.

Reasons for Entering Into the Proposed Transactions

The proposed transactions have a number of advantages for the Plan and the Plan participants and beneficiaries. In this regard, HCSG will substantially improve benefits for Covered Employees by providing the benefit enhancements described above. These benefit enhancements and improvements are not required of HCSG as part of a legal proceeding, court order, judgment, or Federal or State law. The enhancements will not cause any corresponding increase in the premium amount paid by Plan participants. HCSG will incur a total cost for the enhancements, including the subsidization of a portion of the premium to employees, of approximately $243,700 in the first year of the reinsurance arrangement and $236,200 annually thereafter.

In addition, the benefit enhancements were chosen with an understanding that they would be beneficial to the types of workers employed at HCSG. The overall reduction in premium for the benefits proposed to be offered through the HCSG group plans, along with the pre-tax savings provided through the proposed "cafeteria plan" structure for the medical benefit premiums, will provide a meaningful savings opportunity for these participating employees. In addition, Covered Employees may be working in jobs that involve physical duties or manual labor. The loss or incapacitation of these wage-earners can be devastating to the families. As a result, the proposed Accidental Death and Dismemberment coverage that will be added for all Plan participants can be a significant protection for these types of employees. According to a recent Employee Benefits Research Institute survey ("2013 Welfare Benefits Survey"), 70% of employees who are offered Accidental Death and Dismemberment Insurance through their employers take advantage of that benefit, demonstrating its value to the majority of employees.

Similarly, the death benefit that is associated with the Limited Medical Plan can provide an important cushion of solvency or funeral expenses for beneficiaries of Covered Employees who have limited resources or are lower-income families. In addition, the opportunity to purchase additional life insurance coverage on a guaranteed issue basis without being required to undergo a physical examination (which a number of these employees may not pass, or which could discourage many of these employees from purchasing this protection) provides additional protection for these participating employees and their beneficiaries.

Further, navigating through the healthcare and insurance system can be nearly impossible for these individuals. The addition of Health Advocate, Inc. will be a benefit that can provide these employees with a team that can help with claims processing, coordination of medical care, explanation of benefits, etc. and help them make more informed health care decisions. According to recent survey results from the Society of Human Resources Management ("2014 Employee Benefits – An Overview of Employee Benefit Offerings in the U.S."), many employers are offering and increasing employee benefits in this area. 51% of employers surveyed offer a benefit similar to Health Advocate, and an additional 1% of employers plan to offer this type of benefit in the next 12 months.

With respect to the benefit enhancement - waiver of evidence of insurability for current employees for the short-term disability insurance benefit, this waiver provides significant protection for the current employee population of HCSG. The waiver ensures that all employees who wish to purchase short-term disability coverage are able to do so, regardless of health status, provided they sign up within the first 30 days the benefit is offered (any longer period would result in a significant liability for the plan due to adverse selection). Again, the workforce of HCSG may perform a number of functions involving physical effort or manual labor, and short-term disability is a very important benefit for this population to ensure financial stability for employees and their families during recuperation from injury or illness. Disability insurance is considered an "extremely" or "very important" benefit by 48% of all employees surveyed in a recent Employee Benefits Research Institute Survey ("2013 Welfare Benefits Survey"). Moreover, the waiver of evidence of insurability for newly-hired employees also allows employees who wish to invest in this coverage to do so regardless of health status at the time of employment.

Finally, the proposed transactions will pose little, if any, risk of abuse or loss to the Plan's participants because of the protection provided by Companion Life, which has an "A" rating from A.M. Best or the equivalent from another rating agency. In this regard, should the Captive Insurer fail or refuse to perform its obligations under the reinsurance arrangement, Companion Life, as the Fronting Insurer, will not be relieved of its liability to the Plan.

<u>The Independent Fiduciary</u>

In connection with the submission to the DOL, HCSG has retained, at its expense, Milliman (the "Independent Fiduciary" or "Milliman"), an international firm of consultants and actuaries with expertise in employee benefits and insurance, to serve as an independent fiduciary for this transaction. The Independent Fiduciary has been engaged to act as the Independent Fiduciary on behalf of the Plan for the purpose of evaluating, and if appropriate, approving the transaction. Specifically, William J. Thompson, FSA, MAAA, Principal and Consulting Actuary with Milliman has been appointed to undertake the duties of the Independent Fiduciary. In this regard, Milliman is responsible for conducting a due diligence review and analysis of the proposed transaction and for providing a written opinion as to whether the arrangement complies with the DOL's requirements for an administrative exemption. Milliman certifies that it is qualified to serve as the Independent Fiduciary and the personnel who comprise Milliman are experienced in prohibited transaction exemptions issued by the DOL. Milliman represents that it is independent in that it does not have, and has not previously had, any relationship with any party in interest (including any affiliates thereof) engaging in the proposed transactions. Further, Milliman represents that the gross income it received from HCSG for fiscal year 2014 (January 1 – December 31, 2014) does not exceed two percent of its gross annual income from all sources for that fiscal year.

In connection with the proposed transactions, Milliman, among other things: (a) reviewed a draft of HCSG's request for an administrative exemption from the DOL; (b) conferred with HCSG's representative to discuss the transaction and the Plan; and (c) conducted such other due diligence reviews as were deemed necessary. Milliman also considered the premiums to be paid by the Plan for the proposed coverages, and determined that the premiums were lower than the premiums that had been charged for comparable benefits before the benefit enhancements were added.

Milliman confirmed that the Captive Insurer is (a) licensed to do business in the State of New Jersey; and (b) obtained a Certificate of Authority from the State of New Jersey dated January 15, 2014 and a Certificate of Good Standing from the State of New Jersey dated April 24, 2014; and that the Captive Insurer's financial statements have been audited by an independent auditing firm. Milliman has reviewed a copy of the audit report, and is satisfied that there are no issues outstanding. Milliman has determined that the Captive Insurer is licensed by a State whose law requires that an actuarial review of reserves be conducted annually by an independent firm of actuaries, and reported to the appropriate regulatory authority. Milliman has represented that the Plan will pay no more than adequate consideration for the benefits, and will pay no commissions with respect to the purchase of the benefits.

Milliman has also determined that the reinsurance arrangement will result in an immediate and objectively determined benefit in the form of the benefit enhancements described above under "Changes to Plan – Benefit Enhancements." Milliman states that the benefit enhancements provide a means of reducing personal financial risks that may be unavailable to many of the Plan participants as individuals, which provides a value to these persons even if they never file a claim. In addition, Milliman will represent the interests of the Plan as independent fiduciary at all times with respect to the transactions. As the Independent Fiduciary, Milliman will monitor compliance by the parties with the term and conditions of the proposed transactions, and will take whatever action is necessary and appropriate to safeguard the interests of the Plan and its participants and beneficiaries with respect thereto, and ensure that the proposed transactions remain in the interest of the Plan and its participants and beneficiaries.

If it becomes necessary in the future to appoint a successor Independent Fiduciary to replace Milliman, the applicants will notify the DOL sixty days in advance of the appointment of such successor. Any successor Independent Fiduciary will have the same, or substantially similar, responsibilities, experience and independence as Milliman, and there shall be no lapse in time between the resignation or termination of the former Independent Fiduciary and the appointment of the successor Independent Fiduciary. In the event a successor Independent Fiduciary is appointed to represent the interests of the Plan with respect to the subject transactions, there may be no lapse in time between the resignation or termination of the former Independent Fiduciary and the appointment of the successor Fiduciary.

Milliman's views of the benefit enhancements are as follows:

The enhancements are useful to the Plan participants in several ways:

- The 2.5% premium reduction for several plans will lower the cost of the benefits for those employees that purchase the coverage.

- The introduction of a cafeteria plan to allow pre-tax premium payments will further reduce the after-tax cost of the benefits for participating employees.

- The amount of benefits has been improved.

- The Health Advocate benefit can help participants make more appropriate and cost-effective choices of health care services they need.

- Term life benefits have been increased at no cost to participants in the Limited Medical Plan.

- Participants in any of the voluntary plans are covered by an employer-paid AD&D Plan.

Milliman also assessed participant utilization of the proposed benefit enhancements. Milliman estimated that 1,600 of 1,800 eligible participants (88.9%) would take advantage of the Limited Medical benefit enhancements, 870 of 2,500 eligible participants (35%) would take advantage of the Life Insurance benefit enhancements, and 1,075 of 8,400 eligible participants (13%) would take advantage of the Short-Term Disability benefit enhancements.

Milliman estimates that the annual premium savings to employees in connection with the reinsurance arrangement will be $139,500. Additionally, Milliman estimates that if employees utilize the new cafeteria program to pay their premiums on a pre-tax basis, employees could save up to an additional $261,000.

According to Milliman, the combination of these improvements may make the voluntary benefits attractive to more employees, allowing broader coverage in these programs by HCSG's workforce, resulting in improved financial security for those employees. In addition, Milliman states that these enhancements are protective of the Plan because they encourage broader employee participation in the programs, the result of which would be a broader spread of insurance risk as well as increased volume of benefits and predictability of the expected costs of the Plan. Over time, Milliman asserts, this expansion may result in lower premium rates, a benefit that will accrue to the participating HCSG employees. Additionally, according to Milliman, these enhanced benefits will make HCSG a more attractive employer, which could be beneficial for attracting and retaining employees.

Customariness of Proposed Transactions and Similarity to Other Previous Exemptions

The DOL has granted several individual exemptions for substantially similar transactions within the last ten years. The requested auhorization is substantially similar to the individual exemptions involving captive reinsurance that were granted by the DOL to:

- **PTE 2013-06**, issued to The Coca-Cola Company ("TCCC"), located in Charleston, South Carolina, 78 FR 19323 (March 29, 2013).

- **PTE 2014-03**, issued to The Intel Corporation, located in Santa Clara, California), 79 FR 19927 (April 10, 2014).

Satisfaction of ERISA Section 408(a) Statutory Criteria

It is represented that the proposed transactions are administratively feasible because, among other things, the reinsurance of the Plan's risks will be subject to annual review by an Independent Fiduciary, which can be audited. Furthermore, HCSG will bear the cost of the exemption application and of notifying the interested persons. Finally, the proposed transactions will not require continued monitoring or other involvement by the DOL.

In addition, it is represented that the proposed transactions are in the interests of the Plan's participants and beneficiaries because they will include enhancements to and an increase in Plan benefits provided to the participants and beneficiaries, as described above.

Finally, the proposed transactions are protective of the rights of the Plan's participants and beneficiaries because the transactions require the review and approval by an Independent Fiduciary, at HCSG's expense, of the reinsurance transactions and the benefit enhancements offered under the Plan. Specifically, HCSG has retained Milliman to analyze the transactions and render an opinion that the requirements of the authorization have been met.

Conditions of the Authorization

(a) If approved by the DOL, the authorization will be subject to the following conditions: The Captive Insurer:

(1) Is a party in interest with respect to the Plan solely by reason of a stock or partnership affiliation with HCSG that is described in Section 3(14)(E) or 3(14)(G) of ERISA;

(2) Is licensed to sell insurance or conduct reinsurance operations in at least one U.S. state, the State of New Jersey;

(3) Has obtained a certificate of authority from the commissioner of its domiciliary state, the State of New Jersey, which has not been revoked or suspended;

(4)(A) Has undergone examination by a certified CPA for its last completed taxable year immediately prior to the taxable year of the reinsurance transaction covered by this exemption; or

(B) has undergone a financial examination by the New Jersey Department of Insurance within five (5) years prior to the end of the year preceding the year in which such reinsurance transaction has occurred; and

(5) Is licensed to conduct reinsurance transactions by New Jersey, a state whose law requires that an actuarial review of reserves be conducted annually by an independent firm of actuaries and reported to the appropriate regulatory authority.

(b) The Plan will pay no more than adequate consideration for the insurance contracts.

(c) No commissions will be paid by the Plan with respect to the direct sale of such contracts or the reinsurance transactions.

(d) In the initial year of any reinsurance contract involving the Captive Insurer and Companion Life or any successor insurance company (the Fronting Insurer), there will be an immediate and objectively determined benefit to the Plan's participants and beneficiaries in the form of increased benefits approximating the increase in benefits described herein, and such benefits will continue in all subsequent years of each reinsurance contract with the Captive Insurer and in every renewal of such contract.

(e) In the initial year and subsequent years of coverage provided by the Fronting Insurer, the formula used to calculate premiums by the Fronting Insurer will be similar to formulae used by other insurers providing comparable coverage under similar programs, the premium charge calculated according to that formula will be reasonable, and the premium will be comparable to the premium charged by the Fronting Insurer and its competitors with the same or better rating providing similar coverage under comparable programs.

(f) The Plan will only contract with a Fronting Insurer with a financial strength rating of "A" or better from A. M. Best Company. The reinsurance arrangement between the Captive Insurer and the Fronting Insurer will be indemnity insurance only (i.e., the Fronting Insurer will not be relieved of liability to the Plan if the Captive Insurer is unable or unwilling to cover liability arising from the reinsurance arrangement).

(g) The Plan has retained an independent, qualified fiduciary (the "Independent Fiduciary") or successor to such fiduciary, as described in the section above entitled "Independent Fiduciary," to analyze the transaction and to render an opinion that the requirements of Sections (a) through (f) above and (h) below of this authorization have been satisfied.

(h) Participants and beneficiaries in the Plan will receive in subsequent years of every contract of reinsurance involving the Captive Insurer and the Fronting Insurer no less than the immediate and objectively determined increased benefits such participants and beneficiaries received in the initial year of each such contract involving HCSG and the Fronting Insurer.

(i) The Independent Fiduciary will: monitor the transactions described herein on behalf of the Plan on a continuing basis to ensure such transactions remain in the interest of the Plan; take all appropriate actions to safeguard the interests of the Plan; and enforce compliance with all conditions and obligations imposed on any party dealing with the Plan.

(j) In connection with the reinsurance arrangement, the Independent Fiduciary will review all contracts (and any renewal of such contracts) of the reinsurance of risks and the receipt of premiums therefrom by the Captive Insurer and will determine whether the requirements of this authorization, and the terms of the increased benefits continue to be satisfied.

The transactions meet the requirements for tentative authorization under PTE 96-62.

<u>Your Right to Comment on Tentative Authorization</u>

As an interested person, you have the right to submit comments to the DOL on the Notice to Interested Persons. If you decide to do so, you should submit your comments to the following address:

Employee Benefits Security Administration
Office of Exemption Determinations,
Division of Individual Exemptions
U.S. Department of Labor
200 Constitution Avenue, N.W.
Room N-5700
Washington, D.C. 20210
Attn: Joseph Brennan

Be sure to refer to the submission number, which is E-00758. Comments must be received by the DOL no later than March 14, 2015.

Comments may be faxed or e-mailed to Joseph Brennan at the DOL. The fax number is (202) 219-0294 and Mr. Brennan's e-mail address is Brennan.Joseph@dol.gov. If you have questions regarding the proposed reinsurance transactions or your right to comment on this tentative authorization, you may call Mr. Brennan at (202) 693-8819.

All comments will be made available to the public. **Warning**: Do not include any personally identifiable information (such as name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments may be posted on the Internet and can be retrieved by most Internet search engines.

HCSG expects to implement the reinsurance arrangement as soon as practicable following the date of final authorization, but no later than 90 days following final authorization.

If you have any questions about the benefits that are described in this Notice to Interested Persons, please contact Andy Kush, via e-mail at akush@hcsg.com.

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