Private Exchanges and Fiduciary Obligations

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Introduction

The public exchanges (also known as “Marketplaces”) established by the Patient Protection and Affordable Care Act (“PPACA”) became operational in the fall of 2013. However, well before the Marketplaces opened, private exchanges had been in existence and were meeting the insurance needs of both employers and individuals. While the Marketplaces have garnered the majority of media attention as the nation has been busy implementing healthcare reform, many employers have been exploring the potential benefits of private exchanges because they are still very much interested in offering health benefits to their employees as part of a total rewards package.

While private exchanges offer numerous benefits, one of the primary benefits for employers is the potential to shift certain administrative responsibilities. However, while this is an attractive feature given the onerous burdens imposed upon employers as a result of the sheer volume of regulatory requirements, employers should be careful to note that the use of a private exchange does not relieve the employer of all of its fiduciary obligations.

In an effort to assist employers that are considering a private exchange, this article will highlight the key responsibilities that will remain with an employer continuing to act as the plan fiduciary. Moreover, while the focus of this article is on group health plan coverage, it is important to remember that other benefit plans subject to ERISA and offered by employers through a private exchange are similarly affected.

Coverage through a Private Exchange is Employer-Sponsored Coverage

The Employer Shared Responsibility mandate requires applicable large employers to offer “minimum essential coverage” to their full-time employees that is both affordable and provides minimum value, or face a penalty. Some confusion has arisen over whether health plan coverage offered through a private exchange is employer-sponsored coverage or individual coverage. Minimum essential coverage includes employer-sponsored group health plan coverage offered through a private exchange, whether insured or self-insured. Under PPACA, the essential element for purposes of determining whether the coverage made available by the employer is employer-sponsored coverage is whether the plan is maintained or established by the employer. While this is not a high threshold, the federal regulators have not issued specific guidelines or regulations to help employers determine when a plan is “maintained or established” by an employer — it is widely accepted that one key determinant is whether the plan is intended to be part of the employment relationship. A second key determinant is the level of the employer’s participation in establishing or maintaining the plan. As such, purchasing insurance in the employer’s name, funding at least a portion of the cost of coverage, or maintaining a self-insured health plan are all examples of employer actions indicating that the employer “maintains or establishes” a plan. Therefore, it is evident that employers can satisfy the requirements of the employer mandate by offering coverage through a private exchange.
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In light of the fact that employer-sponsored coverage provided through a private exchange is “employer-sponsored coverage” for purposes of PPACA, it is important to consider whether coverage is also “employer-sponsored coverage” for purposes of ERISA and thus giving rise to fiduciary obligations.

For purposes of ERISA, an employer-sponsored plan has four essential elements:

1. A plan, fund or program;
2. Established or maintained by the employer;
3. For the purpose of providing benefits specifically enumerated under ERISA; and
4. For participants and their beneficiaries.

Because of this broad coverage rule, basically all plans offering the types of benefits specified under ERISA and maintained by a private-sector employer are subject to ERISA. While governmental, non-electing church plans, and plans sponsored by Indian tribal governments are not subject to ERISA, governmental and non-electing church plans may be subject to state law requirements imposing fiduciary obligations similar to those imposed by ERISA. Thus, employer-sponsored coverage, regardless of the type of employer, may be subject to certain fiduciary obligations.

An employer with an ERISA plan may act as both the plan sponsor and the plan administrator. As the plan sponsor, the employer is responsible for: (1) creating the basic terms and conditions of the plan; (2) executing a written instrument containing those terms and conditions; and (3) establishing the procedure for making amendments. As the plan administrator, the employer is responsible for: (1) managing the plan; (2) adhering to the terms of the plans; and (3) providing participants with summary documents that describe the plan (and modifications) in a readily understandable form. Moreover, employers who choose to administer the plan will be subject to certain fiduciary responsibilities, although, some of these fiduciary responsibilities may be delegated to a third party.

**Identification of a Plan Fiduciary**

ERISA specifically requires each plan to have a “named fiduciary.” This can be the plan sponsor (usually the employer) or, the plan sponsor may designate an individual (by title and function) or a benefits committee, as the plan’s named fiduciary. Moreover, anyone who exercises (or is responsible for exercising) any discretionary authority, or control, over the management or administration of the plan is a plan fiduciary—even if not formally designated as a fiduciary. In other words, anyone who is responsible for any activity that falls within the definition of fiduciary duties is considered a fiduciary of the plan under ERISA.

The named fiduciary is usually an individual who has general authority to control and manage the operation and administration of the plan. As noted above, the named fiduciary may be the plan sponsor, i.e., the employer.
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However, it is often best for the named fiduciary to be an individual or organization other than the plan sponsor. In other words, if “ABC Organization” is the named fiduciary, then ABC Organization’s board of directors has total responsibility (and liability) for the plan. Because the board has many other organizational responsibilities, it is probably not in the best position to manage the many day-to-day aspects of the plan’s administration. Therefore, it may be more appropriate to specify an officer of the employer (e.g., vice president of human resources) or a committee (e.g., an employee benefit plan administration committee formed specifically for this purpose or possibly even the compensation committee of the board) as the named fiduciary of the plan.

It should be noted that whoever is the named fiduciary must proceed with caution because the fiduciary may be held personally liable for any breach of fiduciary duty, and monetary damages may be imposed against the fiduciary. It is therefore critical for employers/plan administrators to know what activities rise to the level of a fiduciary duty, the specific fiduciary responsibilities, and the entities performing the function.

Tasks of a Plan Fiduciary

Plan fiduciaries have numerous responsibilities, including selecting and monitoring third-party service providers, negotiating the compensation of third-party providers, interpreting plan provisions, exercising discretion in approving or denying plan benefits, and pursuing claims as an assignee of the plan. Some of these duties may be delegated, such as approving or denying plan benefits, but others may not be delegated.

When fiduciary duties are delegated, federal and state law requires the named fiduciary to review and evaluate the performance of the party performing the delegated duties at reasonable intervals. The review must include steps to ensure that the plan’s performance is in accordance with plan documents and all applicable law. So, even if an employer acting as a plan fiduciary delegates certain fiduciary responsibilities to a private exchange provider, a process must remain in place to assess the private exchange provider’s actions to ensure that any delegated duties are properly performed.

Activities in an Exchange Giving Rise to Fiduciary Obligations

Plan administrators have broad fiduciary responsibilities when administering employer-sponsored plans subject to ERISA. In the context of an employer-sponsored health plan, a fiduciary has:

1. A duty of undivided loyalty;
2. A duty to use plan assets solely for the benefit of plan participants and beneficiaries;
3. A duty to act with procedural prudence; and
4. A duty to act in accordance with the documents governing the plan.
The fact that an employer provides employer-sponsored coverage through a private exchange does not exempt that employer from the aforementioned fiduciary responsibilities; rather, it results in a small twist on how those obligations are ultimately fulfilled.

Given the various obligations imposed upon employers who sponsor health care coverage, employers who are evaluating the use of a private exchange must take into account the fact that different private exchange platforms provide different levels of service. Some private exchange platforms merely act as an electronic marketplace for the sale of insurance. Other private exchange platforms provide enhanced services such as employee communication support, ancillary benefits, and consulting services. Thus, when considering the fiduciary responsibilities that will be delegated to a third party, such as a private exchange, and those that will remain with the plan administrator, employers should pay special attention to the level of integration available between the private exchange operator’s software system and the employer’s software systems. Moreover, irrespective of which duties are delegated to a third party, the plan administrator is ultimately responsible to ensure that designated third parties are capable of fulfilling the delegated activities, as well as monitoring the actual performance of those third parties to ensure compliance. In all cases, the specific duties delegated to third parties, as well as those retained by the employer, should be enumerated in a written agreement between the parties. These issues, and more, will vary from private exchange service provider to service provider and should be analyzed in the context of not only an employer’s business operations, but also with an eye toward fulfilling the employer’s fiduciary responsibility.

**Duty of Undivided Loyalty**

The duty of undivided loyalty requires a plan fiduciary to act solely in the best interests of plan participants and beneficiaries. Under this duty, a fiduciary is strictly prohibited from engaging in self-dealing transactions or transaction that otherwise create a conflict between the plan fiduciary’s duties and his or her personal interests. This means that not only must the plan fiduciary refrain from using plan assets for personal interest, but he or she must also avoid favoring the interests of a third-party (such as a service provider) over the interests of the plan. As such, individuals responsible for selecting and maintaining service providers to the plan should refrain from placing themselves in a position where their acts will prevent them from functioning with complete loyalty to participants. This may mean, for example, avoiding transactions with any exchange operator with whom the fiduciary may have a personal or financial interest.

In addition, the duty of loyalty requires a fiduciary to disclose material information that the fiduciary knows a participant, or a beneficiary, does not have and will need in order to make an informed decision. Thus, a fiduciary must disclose complete and accurate information material to the [participant’s or] beneficiary’s circumstances. This means that the plan fiduciary must accurately and timely communicate with respect to the
benefits available under the plan, as well as any and all design changes. This can be problematic because many employers hope to shift some of their administrative burden to exchange operators in an effort to ease their own administrative costs. For many employers, employee communications with respect to plan benefits is often seen as a primary target when they seek to shift their administrative burden. However, while employers/plan administrators may contractually agree to shift employee communications to a private exchange operator, any employer/plan administrator who does this, must be aware that it still retains a duty of undivided loyalty to communicate complete, accurate and timely information with respect to the plan’s benefits and design and cannot completely withdraw from the employee communications function.

Furthermore, when first joining a private exchange, participants and beneficiaries are likely to be somewhat confused by the new manner in which they will elect and purchase coverage. At this crucial time period, accurately and timely communication will be essential. As a threshold matter, employees may be confused as to whether the exchange is a private exchange or a public exchange, so employers should be prepared to address this issue. Employees will also need to know who to contact for information about a specific question or topic — the employer, the exchange operator, the insurance carrier or the third-party administrator. There may be a need to offer employees a hotline, a web address, and a physical address for any questions they may have or to obtain additional information. The obligation to maintain each of these resources must be clearly spelled out in the agreements between the parties. Lastly, employers will wish to ensure that a consistent message is provided from all relevant parties — the employer, the exchange operator, and each insurer or third-party administrator.

Finally, while an employer may contract with the private exchange operator to distribute plan materials, such as open enrollment materials, summaries of material modification, Summaries of Benefits and Coverage, COBRA notices, Medicare Part D notices, and other notices required by PPACA, the ultimate responsibility to make sure that information is accurately communicated remains with the plan fiduciary — which often is the employer acting as the plan administrator. Although employers may shift the technical responsibility for the distribution of plan communications to private exchange operators, the fiduciary responsibility to communicate complete and accurate information remains with the plan fiduciary. Therefore, while it is prudent for employers to clearly address communication responsibilities in service contracts with private exchange operators, they must retain control over communication content and be prepared to fulfill their duty of undivided loyalty by ensuring that all communication materials are accurate and timely.
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Duty of Exclusive Benefit

The duty to act for the exclusive benefit of the plan participants and beneficiaries requires the plan fiduciary to act for the exclusive purpose of providing benefits to plan participants and beneficiaries while defraying the reasonable expenses of the plan. Hiring an outside vendor — such as a private exchange operator — must be viewed in the context of whether hiring a particular private exchange operator is a reasonable expense of the plan or the plan sponsor. In addition, because a fiduciary can be held liable for the acts or omissions of any party to whom a fiduciary responsibility has been delegated, if the fiduciary has knowledge of a breach of fiduciary duty by any delegee, the fiduciary must be ready to step in and reassert a delegated function to safeguard the best interests of the plan, its participants and beneficiaries. For this reason, any contract with a private exchange operator should permit termination of certain delegated duties and potentially the entire relationship by the plan, without penalty on reasonably short notice, so that the plan is not locked into an arrangement that would prevent the plan from resuming previously delegated duties.

Duty to Act with Prudence

Under the duty to act with prudence, a fiduciary must act with the care, skill, prudence and diligence that a prudent person in similar circumstances would use. This duty requires a fiduciary to adhere to a careful process when making decisions, a means to document those decisions and the basis upon which they were made.

Given the important role that a private exchange operator fills in the delivery of employees’ benefits, a plan fiduciary should consider the following actions when investigating and selecting a private exchange operator:

1. Compare private exchange operators using the same information (e.g., services offered, experience, costs, software compatibility, call center support, employee communications, legal and regulatory compliance responsibility, selection of carriers or third party administrators, variation of plan selection, etc.);

2. Obtain information about the private exchange operation (e.g., its financial condition and experience with group health plans of similar size and complexity);

3. Evaluate information about the quality of the exchange operator’s services; the identity, experience, and qualifications of professionals who will be handling the day-to-day and managerial responsibilities for operating the exchange; any recent litigation or enforcement action that has been taken against the private exchange operator; and the private exchange operator’s experience or performance record; and

4. Ensure that any required licenses, ratings or accreditations are current.

Plan fiduciaries should likewise consider fees when deciding upon a service provider such as a private exchange operator. If fees for services are paid...
out of plan assets (e.g., from employee contributions), fiduciaries should understand the fees and expenses charged and the services provided. While ERISA does not state a specific permissible level of fees, it does require that fees charged to a plan be “reasonable.” “Reasonable” fees includes the recognition that the lowest cost operator, even offering the same or similar services, is not necessarily the most prudent choice.

When initially selecting a service provider, plan fiduciaries should determine which services are covered by the estimated fees and which are not. Some service providers offer a number of services for one fee (i.e., a “bundled” services arrangement), and others charge separately for individual services.

Plan expenses may be paid by the employer, the plan, or both. In any case, the plan document should specify how fees are paid, and the fiduciary must ensure that those fees and expenses are reasonable, necessary for the operation of the plan, not excessive for the services provided and not expenses for which the plan sponsor is responsible.

An employer should document its selection and monitoring process and the results of its analyses, and, if using an internal administrative committee, should educate committee members on their roles and responsibilities in the selection process and ongoing monitoring. If the employer or committee lacks the expertise required to evaluate one or more of the services offered, the employer should obtain the necessary expertise from outside resources. All contracts should be reviewed by legal counsel and copies of all agreements should be retained according to an organization’s document retention policies.

**Duty to Act According to Plan Documents**

A plan must name a fiduciary, which as noted above may be a person or an organization. That named fiduciary must administer the plan according to the stated plan terms. This, as a threshold matter, means that a plan must have a written plan document and that even if an employer chooses to provide benefits through a private exchange, so long as the coverage is employer-sponsored coverage, the plan must have a plan document. As a second matter, the plan must be administered according to plan terms. This means that eligibility decisions, plan benefits and plan administration must follow the plan terms.

If the private exchange operator is responsible for on-line enrollment and administration of special enrollments and changes in status, the plan fiduciary must take steps to ensure that those functions are fulfilled in accordance with the plan documents. In addition, any other duties delegated to the private exchange operator must also be carried out in accordance with plan documents. The employer as plan administrator will thus remain responsible for maintaining a plan document and ensuring that the private exchange operator acts in accordance with plan terms when performing any delegated duties.

With proper planning and careful analysis, choosing to work with a private exchange operator can be a win for both employers and employees.
Conclusion

Employers wishing to engage private exchange operators to assist with the provision of benefits to their employees will find great potential value in doing so. However, employers must be aware that they cannot entirely divorce themselves from fiduciary responsibility by hiring a private exchange operator. In fact, selecting a private exchange operator is a fiduciary act. Employers should be careful to fully vet potential exchange operators and clearly define roles between the employer, the private exchange operator, and any insurance carrier or third party administrator involved. Clear communication explaining how an exchange works and who is responsible from an employee's perspective will be essential in the successful launch and continued application of an exchange. With proper planning and careful analysis, choosing to work with a private exchange operator can be a win for both employers and employees.
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