NELSON HARDIMAN
HEALTHCARE LAWYERS

Client Alert: New DMHC Regulation Expands Knox-Keen Licensure Requirements

A new regulation is about to disrupt California healthcare risk-sharing relationships by expanding significantly the types of enti licensed by the California Department of Managed Health Care ("DMHC"). **Effective July 1, 2019**, the new DMHC licensing regulation establishes a new scope of entities and individuals who, for the first time, will require a Knox-Keene health plan lice Healthcare organizations operating in California and bearing financial risk need to prioritize understanding the implications of new licensing regulation and developing a strategy for compliance.

History of Health Care Service Plans and Current Practi

In order to understand the new regulation, it is useful to begin with a brief history of how the current California capitated risk environment emerged. Enacted in 1975, the Knox–Keene Act regulated Health Maintenance Organizations (HMOs) in Califor health plans that undertook to provide for the health of subscribers in return for periodic subscription payments. The underlyin was the disastrous prospect of a health plan collecting funds and bearing risk based on a promise to cover the future cost of healthcare services and then being insolvent and unable to deliver, leaving people without coverage and access to care.

The California Health and Safety Code currently defines "health care services plan" as "any person who undertakes to arrang the provision of health care services to subscribers or enrollees, or to pay for or to reimburse any part of the cost for those se in return for a prepaid or periodic charge paid by or on behalf of the subscribers or enrollees" (Cal. Health & Safety Code §1345(f)(1)). Under the current Knox-Keene regulations overseen by the DMHC, entities defined as "health care service plans required to apply for and operate under one of two license types:

- *Full-Service Knox-Keene Licenses.* Full-Service Knox-Keene licenses are issued to entities providing at least six basic c services; for instance primary care, hospital inpatient care, and home health services.
- *Specialized Knox- Keene License* Specialized Knox-Keene licenses are issued to entities providing only a single health service, such as dental or mental health.

In addition, both of the license categories above can fall under the "restricted" subcategory, although this is not explicitly state the Knox-Keene Act or in any DMHC regulations. Restricted or Limited Knox-Keene licensees do not create their own insuran products, and instead, merely bear risk by contracting and paying claims with and for providers. Limited Knox-Keene licensee not contract directly with employer groups or individuals, and instead, enter into delegated risk relationships under which they risk through contracts with Knox-Keene licensees offering global risk products to the market (*i.e.* employers and individuals).

Despite their existence, restricted or limited licenses were not previously regarded as a requirement. Some hospitals and independent physician associations (IPAs) participated, without any Knox-Keene license, in global capitation arrangements, w the financial risk of agreeing to provide all of a subscriber's health care for a monthly fixed payment was passed down from a regulated insurance plan to the providers participating in a global capitation arrangement. The regulated insurance plan would up contracts to pay hospitals, medical groups, or both, a fixed monthly fee, and then assign a group of patients to such entitie complete patient care. This gave the providers a chance for great profits if the group of patients assigned were kept healthy a not seek or receive medical services in a given month. It also exposed providers to great losses if the group of patients requir massive amounts of medical service in any given month.

Problems arose from this model because providers lacked the skills required to effectively assess and project the health care services costs for the patients assigned to them. Many hospitals and IPAs ran into significant financial distress and some faile altogether as a result.

To remedy this issue, in 2005, DMHC implemented rules requiring "Risk Bearing Organizations" ("RBOs") that contracted with insurers to bear professional risk in global capitation arrangements to report financial metrics to the DHMC so that DMHC cou monitor their solvency and financial health. Although RBOs were required to report financial metrics, this reporting and the corrective plan function was still largely left to the regulation of the licensed insurers, as the Knox-Keene Act did not expand t DMHC's reach to directly regulate activities of RBOs through licensing. Despite the monitoring, RBOs continued to regularly fa

Expanded Regulation of RBOs Now Requires Licensing

In 2018, the Legislature again acted and passed the expanded licensing requirements that take effect on July 1, 2019. The new regulation adds that any person who assumes “global risk” will have to obtain a license to operate at least a Restricted Knox Keene license. The new regulation defines the term “prepaid or periodic charge” as: “(a)ny amount of compensation either at the start or end of a predetermined period, for assuming the risk, or arranging for others to assume the risk, of delivering or arranging for the delivery of the contracted-for health care services for subscribers or enrollees that may be fixed either in amount or percentage of savings or losses in which the entity shares” (28 C.C.R. 1300.49 (a)(4)).

The expansive definition of “global risk” and “prepaid or periodic charge” means any entity or person assuming costs for the provision of hospital inpatient, hospital outpatient, or hospital ancillary services (institutional risk) and any entity or person assuming costs for the provision of physician, ancillary, or pharmacy services (professional risk), whether for a fixed amount or for a percentage, will likely be required to obtain a Knox-Keene health plan license. The intent of the law is to capture the RBOs which were previously unlicensed and only indirectly regulated, and to subject them to full Knox-Keene regulation. The purpose of requiring licensure is to require that certain financial metrics, such as working capital and tangible net equity, be actually met, and not just reported, as was the case under the 2005 RBO regulations. The intent of licensing is also to ensure that RBOs have sufficient infrastructure to manage, project, and pay claims of downstream contracted providers, and that they have sufficient clinical care coordination and case management infrastructure to ensure efficient and appropriate care. Accordingly, RBOs will need to start getting applications on file in advance of the new regulation’s implementation.

The new regulation does provide for certain exemptions that may be granted by the DMHC primarily when it would be in the public interest to provide an exemption and such exemption would not be detrimental to the protection of subscribers, enrollees or persons regulated under the Knox-Keene Act. This broad language was intended to exempt (i) public institutions participating in such plans that are already heavily regulated through Medi-Cal waiver and other programs, and (ii) ACOs that are federally chartered and report to the CMS periodically under specific terms of the ACA.

Notably, an exemption must be applied for, and the application process for an exemption is basically the same as the application process for the Knox-Keene license.

Moving Forward

The new regulation will apply only to contracts issued, amended, or renewed on or after July 1, 2019. Healthcare organizations engaged in risk-bearing and risk-sharing relationships, even for limited scopes of outpatient service, must evaluate whether they need to apply for licenses or can address the new compliance requirements in the near-term through alternative contractual arrangements.

Nelson Hardiman advises healthcare organizations on compliance with Department of Managed Health Care regulations, and offers resources for organizations affected by the forthcoming Knox-Keene regulatory developments. For more information on obtaining licenses or applying for exemptions under the new regulation, contact Rob Fuller or Jessica Weizenbluth at (310) 203-2800.