



Special Attention of:

Regional Office
Directors, Multifamily
Hub Directors,
Multifamily Program
Center Directors,
Operations Officers,
Project Management
Directors, Construction
Analysts, Valuation
Processors, Multifamily
Housing Project Managers,
and Multifamily
Mortgagees

Notice H 04-01

Issued: January 6, 2004

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Cross References:

Multifamily Accelerated Processing
(MAP) Guide
HUD Handbook 4600.1 REV 01
HUD Handbook 4350.1 REV-1
Notice H01-03

Subject: Professional Liability Insurance for Section 232
Programs.

I. BACKGROUND.

On April 10, 2001, HUD issued Notice H01-03, titled "Review of Health Care Facility Portfolios and Changes to the Section 232 Programs." The expiration date of that Notice has been extended by Notice H03-21 to October 31, 2004. Section X of Notice H01-03 established the requirement that HUD insured healthcare facilities maintain professional liability insurance. Further the Notice directed Field Office staff in the mortgage underwriting process to require adequate insurance coverage.

Since the Notice was published a number of carriers of liability insurance products have decided to stop underwriting policies in several States. Furthermore, liability insurance premiums continue to increase at an alarming rate in some States in the country.

II. PURPOSE.

This Notice supercedes Section X of Notice H 01-03. It is being issued to provide guidance concerning

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professional liability insurance in mortgage underwriting and in asset management.

III. PROFESSIONAL LIABILITY INSURANCE.

A. HUD requires health care facilities to maintain professional liability insurance. This insurance shall be obtained from an insurance company with an "A" rating or better from A.M. Best Company. Through this Notice, HUD is also establishing the following requirements for professional liability insurance for healthcare facilities.

B. Housing's Requirements

1. Housing's professional liability insurance requirements apply to the following:
 - a. All healthcare facilities seeking mortgage insurance under Section 232 for new construction or substantial rehabilitation of a facility.
 - b. All healthcare facilities seeking mortgage insurance under Section 232 pursuant to Section 223(f) for the purchase or refinance of an existing facility.
 - c. All healthcare facilities seeking an operating loss loan under Section 223(d) of the National Housing Act.
 - d. All healthcare facilities seeking mortgage insurance under Section 241 supplemental loan program.
 - e. All healthcare facilities currently insured under Section 232 and seeking to refinance the facility using the Section 223(a)(7) program.
 - f. All owners and/or lessees proposing to replace the operator/manager of a Section 232 healthcare facility.
 - g. All transfers of physical assets ("TPA") involving Section 232 healthcare facilities.

2. As part of the mortgagee's application for firm commitment all healthcare facilities will be required to submit the following documentation from operators/managers.
 - a. Current list of healthcare facilities where the entity is the operator or manager.
 - b. Three years of audited financial statements from the operator/manager. In addition, the operator/manager must submit an updated interim unaudited financial statement including the supporting documentation if more than 3 months have expired since the closing date of the latest audited statement.
 - c. A six-year loss history of claims filed against the operator/manager for all facilities of the operator/manager. It should include all claims where the operator/manager was found liable. All claims should include either the actual award amount or the potential award amounts based on compensatory damages, medical expenses, and punitive damages. The claims history shall also address the various State statutes of limitations—for filing claims of negligence, injuries, wrongful death, and/or improper care based on where the various healthcare facilities are located.
 - d. Current inventory of all inquiries made or threatened claims based on occurrences of negligence, injuries, wrongful death, and/or improper care where a claim has not been filed but could still be filed based on statute of limitations for the State where the occurrence occurred. The inventory should also include an estimate of the potential award amounts based on compensatory damages, medical expenses, and punitive damages. The operator/manager must certify to the accuracy of this inventory. The certification must be signed, and dated

by the operator/manager and include the following statement:

"HUD will prosecute false claims and statements. Convictions may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)"

- e. The most recent actuarial study of inquires and claims of negligence, injuries, wrongful death, and or improper care made against the operator/manager.

- 1) If available for any operator/manager with up to 50 healthcare facilities; and
- 2) Required of any operator/manager of more than 50 healthcare facilities.

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

- f. For a substantial rehabilitation or existing healthcare facility seeking FHA mortgage insurance, provide evidence that the facility had professional liability insurance coverage for a period of time equal to the State's statute of limitations for filing claims of negligence, injuries, wrongful death, and or improper care.

If during the statute of limitations period there was no insurance coverage or the coverage failed to provide for occurrences that could lead to claims filed in later years, the owner/operator/manager must provide an estimate of the extent of unfunded insurance liability by occurrence.

Note: This information is required regardless of who may have owned or operated the facility prior to seeking FHA mortgage insurance.

- g. Credit reports on the following:
- 1) The operator/manager;
 - 2) Operating officers of the operator/manager; and
 - 3) Any stockholder with a 10 percent or more interest in the operator/manager.

- h. The operator/manager's certification authorizing the release of banking and credit information similar to the following is required:

"To Whom It May Concern:

Please be advised that the undersigned, as operator or manager, hereby consents to the release of any banking and credit information in connection with the loan application of (project name) to the U. S. Department of Housing and Urban Development, any Delegated Processor or any Technical Discipline Contractor contracted by HUD to process this application.

By: _____ Date: _____"

- i. A statement whether an identity of interest, as defined by the HUD, exists or will exist between the mortgagor and the operator/manager.
- j. The operator/manager's current resume.
- k. Form HUD-2013 Supp, listing a sampling of bank and trade references, with disclosure of prior legal action, outstanding delinquent Federal debt and SSN or EIN for:
 - 1) The operator/manager; and
 - 2) Operating officers of the operator/manager.

1. If the sponsor, mortgagor, principal of the mortgagor, general contractor or operator/manager, has any delinquent Federal debt, the information outlined in III.B.2.k. above.

The Office of Management and Budget Circular A-129, "Managing Federal Credit Programs," prescribes policies and procedures for managing Federal credit programs and for collecting loans and other receivables and applies only to the applicant of a HUD-insured mortgage or a Section 202/811 capital advance. However, it has been administratively decided to apply the requirements of this Circular to the operator/manager of a health care facility seeking FHA mortgage insurance.

- m. State licensing surveys [inspection reports] for the last three years of all individual facilities of the operator/manager to determine the quality of care provided by the operator/manager.
 - n. For items III.B.2.b. and III.B.2.c. above, the Hub/Program Center Director or the Director of Multifamily Development, as appropriate, may modify either or both of these requirements only if the operator/manager has not been in business for a sufficient period of time to meet the requirement(s).
3. HUD will determine if the operator/manager *does or does not* represent an acceptable credit and financial risk to the Department based on an analysis of:
 - a. The credit investigation of the entity;
 - b. The financial capacity of the entity;
 - c. The entity's claims history; and
 - d. The entity's operating history.
 4. An operator/manager with up to 50 healthcare facilities including facilities which will be seeking HUD mortgage insurance over the next

18-months, shall provide professional liability insurance with a blanket policy that meets the following requirements:

- a. The Hub/Program Center will establish a level of professional liability insurance that is acceptable to the Department with a deductible, per occurrence coverage amount and an aggregate cap to be established by HUD. The insurance company that is providing the professional liability insurance shall administer any escrow if the insurance includes a component of self-insurance.
- b. The minimum required coverage is:
 - 1) \$1,000,000 per occurrence and
 - 2) \$3,000,000 aggregate
- c. The per occurrence deductible not to exceed \$25,000.
- d. The operator/manager may acquire the insurance on a "cash front basis" (sometimes known as "administered self-insurance"). The term "cash front basis" means the posting of insurance backed by liquid assets (i.e. cash, cash equivalents, or readily marketable securities) or by letter-of-credit.
 - 1) The escrow cannot be pledged for any other outside purpose. It must be specifically for the professional liability insurance.
 - 2) The liquid assets escrow must either be placed with, or the letter-of-credit issued by, an acceptable financial institution.
 - 3) An acceptable financial institution is one that:
 - a) Has assets of not less than \$100,000,000;
 - b) Is organized under the laws of the United States or a State

thereof and is regulated and examined by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve Board; and

- c) Has a long-term bank deposit rating of "A-1" or better by Moody's Investor Services or "A+" by Standard and Poor's.
 - e. Higher amounts of coverage may be required based on the review performed in III.B.3. above of the operator/manager's claim history and/or current inventory of all inquiries made and occurrences, along with loss history of claims filed against the operator/manager, and an actuarial study.
- 5. An operator/manager of more than 50 healthcare facilities including facilities which will be seeking HUD mortgage insurance over the next 18-months, shall be sent to Headquarters for prior review and approval before the Hub/Program Center can issue a firm commitment, authorize a change in operator or manager, or approve a TPA. Following the guidance of Section IV of this Notice, the staff within the Office of Multifamily Development in Headquarters will analyze the information and recommend to a committee of senior Housing Officials, the following:
 - a. Establish a level of professional liability insurance for a blanket policy that is acceptable to the Department with a deductible of \$250,000 up to \$1,000,000 per occurrence with an aggregate cap to be established by HUD. The insurance company that is providing the professional liability insurance shall administer any escrow.
 - c. The operator/manager may acquire the insurance on a "cash front basis." See III.B.4.d. above.

- d. The insurance company must be licensed by the Insurance Commissioner in the State(s) where the healthcare Facilities are located.
- 6. For those States listed in Appendix 1 the Hub/Program Center Director can refer an operator/manager listed in III.B.4. above to the Office of Multifamily Development in Headquarters for an evaluation of the professional liability insurance risk and recommendation to a committee of senior Housing Officials as discussed in Section IV. of this Notice.
 - a. The referral can occur where the per bed insurance premium for professional liability insurance required in III.B.4.b. above makes the proposal infeasible based on the following:
 - 1) A new construction or substantial rehabilitation healthcare facility is considered infeasible if the maximum insurable mortgage is less than 80 percent of value.
 - 2) An existing healthcare facility is considered infeasible if the maximum insurable mortgage is less than 75 percent of value.
 - b. Headquarters may establish alternative deductible, coverage amounts, and other conditions of insurance listed in this document, for cases coming from those designated States listed in Appendix 1. A minimum level of coverage will be required in these cases.
 - c. The operator/manager may acquire the insurance on a "cash front basis." (See III.B.4.d. above.)
 - d. Appendix 1 will be updated every six months by notice published in the Federal Register.
- 7. Some operators/managers with healthcare facilities in both designated and non-designated States may meet the professional

liability insurance requirements by providing two separate insurance policies (i.e. one policy for the designated States and one for the non-designated States).

8. HUD requires the professional liability insurance policy to be either:
 - a. An occurrence policy which provides coverage regardless of when the claim is reported, as long as the occurrence giving rise to the claim occurred during the original policy period; or
 - b. A claims-made policy which provides coverage for claims that are brought to the insurer during the policy period or during a designated extended reporting period beyond the policy expiration. Since the term of the policy is normally one year the operator/manager must also purchase an "extended reporting tail." The tail provides coverage for an extended period that shall be based on the maximum statute of limitations for filing claims of negligence, injuries, wrongful death, and/or improper care for the various States where the facilities are located.
9. If the healthcare facility is already insured and is seeking to change the level of coverage, the staff of the Office of Multifamily Housing Programs will analyze the information and make recommendations to the committee.
10. The insurance company issuing the professional liability insurance must be licensed by the Insurance Commissioner in the State(s) where the healthcare facilities are located.

IV. THE PROFESSIONAL LIABILITY INSURANCE COMMITTEE.

- A. Composition of the Professional Liability Insurance Committee ("Committee")
 1. The Committee shall consist of five members.
 2. Committee members:

- a. The Deputy Assistant Secretary ("DAS") for Multifamily Housing shall act as Chairman of the Committee.
- b. HUD Multifamily Housing Officials shall be designated by the DAS for Multifamily Housing. Three Officials will be chosen from among the Multifamily Housing Office Directors and the DAS's senior staff. A fourth Official will be a senior member of the field staff.
- c. The Housing Officials may serve on a continuing basis or may be chosen for a particular review, as the DAS for Multifamily Housing determines.
- d. The following individual cannot serve on the Committee:

The Director of the Office making the recommendation.

3. Non-voting Advisors to the Committee shall include a designee of the Office of General Counsel

B. Functions, Duties and Powers of the Committee.

1. The Committee shall set an appropriate level of professional liability coverage after:
 - a. An impartial review of all information submitted to the Committee; and
 - b. After making a factual determination that the Department's financial interests are protected.

C. Support staff for the Committee.

1. The Office of Multifamily Development will supply the support staff for the Committee. Support duties include:
 - a. Coordinate Committee activities with other HUD offices and government agencies.

- b. Develop the agenda and policy issues for Committee meetings.
 - c. Keeps the official minutes of the Board and the case files on all Committee actions.
 - f. Draft all notices, orders, letters and directives on behalf of the Committee.
 - g. Perform other duties assigned by the Chairman or directed by the Committee.
- 2. The Director of the Office of Multifamily Development or the Office of Asset Management, as appropriate, will present the findings and recommendations to the Committee for its approval. In this capacity, the Director shall:
 - a. Collect, analyze, prepare and submit to the Committee the recommendation concerning the professional liability insurance.
 - b. Refer cases for Committee consideration.
- D. Office of General Counsel
 - 1. Advises the Committee as to the legal sufficiency of actions it proposes to take.
 - 2. Assists the Committee in reviewing the Committee's drafts of decisions and orders.
 - 3. Provides other legal advice as requested by the Committee.

V. **PROFESSIONAL LIABILITY INSURANCE IN UNDERWRITING THE HEALTHCARE FACILITY.**

- A. Reference is made to Form HUD-92264-HCF, Health Care Facility Summary Appraisal Report.

Line 3, Insurance and Liability, of Section F, Estimated Annual Operating Expense, of Form HUD-92264-HCF, includes general liability insurance, Directors and Officers insurance and operator/manager's professional liability insurance. Compute the estimated annual cost of

the professional liability insurance policy as follows:

1. If the operator/manager has a blanket policy covering more than one healthcare facility:
 - a. Divide the current cost of the insurance policy by the number of beds in the various facilities covered. Multiply this per bed cost by the number of beds in the subject facility.
 - b. Compute the cost of a facility-specific professional liability insurance policy using the current prevailing premium rates in the subject State for the required coverage in Section III.B.4. or determined by Headquarters on Section III.B.5.
 - c. Use the greater of a. or b. above in computing Line 3 of the form.
2. If the operator/manager is using or intends to use a facility-specific professional liability insurance policy:
 - a. Compute the cost of a facility-specific professional liability insurance policy using the current prevailing premium rates in the subject State for the required coverage in Section III.B.4. or determined by Headquarters on Section III.B.5.
 - b. Obtain from the operator/manager a letter of intent to provide required level of professional liability insurance coverage, and a price quote for the insurance coverage from a properly licensed insurer.
 - c. Use the greater of a. or b. above in computing Line 3 of the form.
3. In the case of new construction or substantial rehabilitation, the estimated cost must be adjusted to reflect the cost at the estimated date that the coverage will be bound.

B. Reference is made to Form HUD 92264-A, Supplement to Project Analysis.

1. On Line 2c, Other Escrows of Section II, of Form HUD-92264-A, Mortgage Credit will determine the amount of unfunded professional liability insurance for the subject facility, if any, for substantial rehabilitation and refinance transactions.

a. The unfunded liability occurs when the healthcare facility either had no professional liability insurance or had a claims-made policy with no extended reporting tail with a term equal to or greater than the State's statute of limitations for filing claims of negligence, injuries, wrongful death, and or improper care.

b. Compute the extent of the unfunded financial liability that may be incurred based on actual occurrences during each year of the State's statute of limitation.

c. Require that a dedicated cash escrow be established for each year of the statute of limitations period.

d. The mortgagee may only release funds from a specific year's escrow to pay claims for occurrences relating to that year, or when the statute of limitations has passed for that specific year.

C. Before sending a case to Counsel's Office prior to closing, the Hub or the Program Center Director shall assure the Counsel's Office in writing that the healthcare facility meets the required professional liability insurance requirements.

VI. ANNUAL REVIEW.

At the same time as the submission of the Financial Assessment Subsystem (FASS) compliant annual audited financial statements, the mortgagor must insure that the operator or manager of any healthcare facility subject to this Notice provides to the Office of Multifamily Housing Programs in Headquarters evidence

of compliance with the professional liability insurance requirements.

- A. The evidence shall include but is not limited to:
 - 1. The information required in III.B.2. above;
and
 - 2. A duplicate copy of professional liability insurance policy, certificate or memorandum of insurance or other evidence of the required insurance coverage.
- B. Based on a review of the above-listed evidence, the Department may require a higher level of coverage. Examples of what may trigger a higher level of coverage include but are not limited to:
 - 1. Increased claims;
 - 2. Operator/manager advances from controlling 50 or fewer facilities to more than 50 facilities; or
 - 3. Changes in States listed in Appendix 1, Geographic Areas Where Professional Liability Insurance Is Difficult To Obtain As Of The Date Hereof.
- C. If the Department determines a higher level of coverage is required they will notify the mortgagor and/or lessee, the operator, and the mortgagee of record by certified mail.
- D. The owner's Regulatory Agreement, either Form HUD-92466 or Form HUD-92466-E, and the operator's Regulatory Agreement, Form HUD-92466-NHL, will be amended to include the annual review requirements and the operator's maintenance of an acceptable level of professional liability insurance.
 - 1. In HUD-92466-NHL (1/92), add the following new provision as "(a)" after section "(5)":
 - (a) If applicable, shall maintain the requisite level of professional liability insurance as The Mortgagor and/or Lessee and/or Operator and/or Management Agent, as determined by the Commissioner, submit an annual certification of compliance to HUD.

2. In HUD-92466 (11/02), add the following new provision as "(4)" after section "9(h)":

(4) The Mortgagor and/or Lessee and/or Operator and/or Management Agent, as applicable, shall maintain the requisite level of professional liability insurance as determined by the Commissioner. Annually, the mortgagor shall ensure that the Lessee/Operator/Management Agency, as applicable, provides to HUD a certification of compliance with HUD's professional liability insurance requirements.

3. In HUD-92466-E (3/92), add the following new provision as "(k)" after section "(9)":

(k) The Mortgagor and/or Lessee and/or Operator and/or Management Agent, as applicable, shall maintain the requisite level of professional liability insurance as determined by the Commissioner. Annually, the mortgagor shall ensure that the Lessee/Operator/Management Agency, as applicable, provides to HUD a certification of compliance with HUD's professional liability insurance requirements.

VII. THE MORTGAGEE OF RECORD.

Nothing in this Notice can be construed as relieving the lender of its requirement to enforce all of HUD's insurance requirements.

VIII. FOR FURTHER INFORMATION.

If you have questions concerning this Notice feel free to contact the Office of Multifamily Development at (202) 708-1142.

IX. PAPERWORK REDUCTION ACT.

The information collection requirements contained in this Notice have been submitted to the Office of Management and Budget (OMB) for review and approval under the Paperwork Reduction Act of 1995 (44 U.S.C. 3520). Once an OMB approval number has been assigned, FHA will announce the approval number. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection

displays a currently valid OMB control number. HUD has submitted the information collection requirements contained in this document to OMB for review, but those requirements have not yet been approved by OMB.

Note: The Hub or Program Center Director may not waive the requirements outlined in this Notice.

John C. Weicher
Assistant Secretary for Housing -
Federal Housing Commissioner