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ACO Repayment Mechanisms – Surety Bonds

Mar 23, 2018

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Medicare Shared Savings Program ("MSSP") Track 1+, Track 2 and Track 3 ACOs, and NextGen ACOs, have two-sided risk. CMS requires these ACOs to provide a repayment mechanism to assure that shared losses can be repaid.

Depending on its track, an ACO's repayment mechanism equals 1% or 2% of the ACO's total per capita Medicare Parts A and B fee-for-service expenditures for its assigned beneficiaries, as determined based on expenditures used to establish the ACO's benchmark.

CMS accepts letters of credit (LOC), cash held in escrow, and/or surety bonds for this purpose. While LOCs are an acceptable form of collateral, LOCs are costly and inflexible, and ACOs often struggle to find the capital to place into escrow funds. The better, more cost-effective option for ACOs is using a surety bond.

Reasons to consider a surety bond as an alternative to an LOC:

1. **Credit capacity**: An LOC ties up the company's credit capacity, thus reducing financial flexibility. Surety bonds are not credited against a company's bank line.
2. **Covenants:** Banks may place restrictive covenants on the client in return for extending a bank line of credit, or they may require extensive financial reporting. Surety companies typically offer more flexibility.
3. **Security:** Banks may choose to take a security interest in the client's assets. This security is required to be perfected through the filing of public documents (UCC filings) that publicize their secured lender status. A surety is generally an unsecured creditor and a UCC filing is rarely made.
4. **Default defenses**: A bank LOC is a demand instrument; a surety bond typically is not. An LOC may be drawn down at any time, without any reason; the company has no defenses. With a surety bond, the surety requests proof of a company's default from the obligee and works with the principal to identify defenses. This protects the principal from the obligee taking possession of the bond proceeds without merit.
5. **Claim handling:** the surety typically has a professional, dedicated claims staff available to handle disputes and to assist in the claim resolution process. Banks do not have a claims staff, which requires a client to resolve disputes on its own.
6. **Rates:** LOC rates can be volatile: the LOC rate may include a commitment fee or utilization fee, as well as issuance fees, in addition to a stated rate. Surety rates tend to be stable and are directly tied to the credit quality of the principal and to the types of obligations bonded.

Why a Surety Bond? Surety Bonds:

- Keep your capital intact
- Are unsecured and don’t require UCC filings
- Have stable rates
- Don’t have restrictive covenants

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