



**U.S. OFFICE OF PERSONNEL
MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS**

Final Audit Report

**AUDIT OF THE FEDERAL EMPLOYEES HEALTH
BENEFITS PROGRAM OPERATIONS AT
INDEPENDENT HEALTH**

Report Number 1C-QA-00-14-045
August 12, 2015

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EXECUTIVE SUMMARY

Audit of the Federal Employees Health Benefits Program Operations at Independent Health

Report No. 1C-QA-00-14-045

August 12, 2015

Why Did We Conduct the Audit?

The objectives of our audit were to determine if Independent Health (Plan) offered the Federal Employees Health Benefits Program (FEHBP) premium rates that were based on complete, accurate and current pricing data, and that the rates were equivalent to the Plan's Similarly Sized Subscriber Groups (SSSG), as provided in Federal Employees Health Benefits Acquisition Regulation 1652.215-70(a). Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and regulations governing the FEHBP.

What Did We Audit?

Under contract 1933, the Office of the Inspector General completed a performance audit of the FEHBP's rates offered for contract year 2012. Our audit fieldwork was conducted from September 15, 2014 through September 26, 2014 at the Plan's office in Buffalo, New York.



Michael R. Esser
*Assistant Inspector General
for Audits*

What Did We Find?

This report questions \$9,496,680 for inappropriate health benefit charges to the FEHBP in contract year 2012. The questioned amount includes \$8,969,710 for defective pricing and \$526,970 due the FEHBP for lost investment income, calculated through July 31, 2015.

For contract year 2012, the Plan did not apply the correct SSSG discount to the FEHBP rates. In addition, the Plan did not fully credit the FEHBP rates for a state assessment that was included in its community rates.

Additionally, we found that the Plan did not maintain original source documentation to support its rate development of the SSSGs as required by Section 3.4 of its FEHBP contract.

ABBREVIATIONS

FEHBAR	Federal Employees Health Benefits Acquisition Regulations
FEHBP	Federal Employees Health Benefits Program
IBNR	incurred but not reported
IHA	Independent Health Association
IHBC	Independent Health Benefits Corporation
[REDACTED]	[REDACTED]
OIG	Office of the Inspector General
OPM	U.S. Office of Personnel Management
Plan	Independent Health
PPO/POS	Preferred Provider Organization/Point of Service
[REDACTED]	[REDACTED]
SSSG	Similarly Sized Subscriber Group

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I. BACKGROUND

This final report details the findings, conclusions, and recommendations resulting from our audit of the Federal Employees Health Benefits Program (FEHBP) operations at Independent Health (Plan).

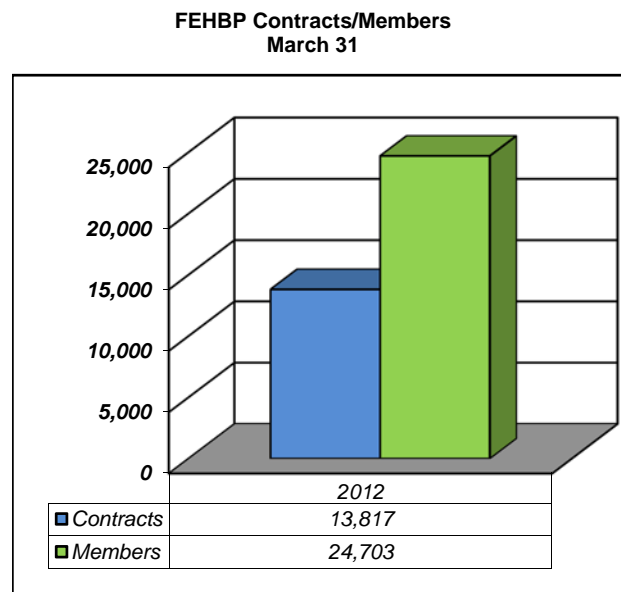
The audit covered contract year 2012 and was conducted at the Plan's office in Buffalo, New York. The audit was conducted pursuant to FEHBP contract CS 1933; 5 United States Code Chapter 89; and 5 Code of Federal Regulations Chapter 1, Part 890. The audit was performed by the U.S. Office of Personnel Management's (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

The FEHBP was established by the Federal Employees Health Benefits Act (Public Law 86-382), enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for Federal employees, annuitants, and dependents, and is administered by OPM's Healthcare and Insurance Office. Health insurance coverage is provided through contracts with health insurance carriers that provide service benefits, indemnity benefits, or comprehensive medical services.

Community-rated carriers participating in the FEHBP are subject to various Federal, state and local laws, regulations, and ordinances. While most carriers are subject to state jurisdiction, many are further subject to the Health Maintenance Organization Act of 1973 (Public Law 93-222), as amended (i.e., many community-rated carriers are federally qualified). In addition, participation in the FEHBP subjects the carriers to the Federal Employees Health Benefits Act and implementing regulations promulgated by OPM.

The FEHBP should pay a premium rate that is equivalent to the best rate given to either of the two groups closest in size to the FEHBP. In contracting with community-rated carriers, OPM relies on carrier compliance with appropriate laws and regulations and, consequently, does not negotiate base rates. OPM negotiations relate primarily to the level of coverage and other unique features of the FEHBP.

The chart to the right shows the number of FEHBP contracts and members reported by the Plan as of March 31, 2012.



The Plan has participated in the FEHBP since 1983 and provides health benefits to FEHBP members in Western New York. The last audit conducted by our office was a rate reconciliation audit and covered contract year 2013. There were no issues identified during that audit.

The preliminary results of this audit were discussed with Plan officials at an exit conference and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan's comments were considered in preparation of this report and are included, as appropriate, as the Appendix to the report.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The primary objectives of the audit were to determine if the FEHBP premium rates were developed using complete, accurate and current data, and were equivalent to the Plan's Similarly Sized Subscriber Groups (SSSG), as provided in Federal Employees Health Benefits Acquisition Regulation (FEHBAR) 1652.215-70(a). Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and regulations governing the FEHBP.

Scope

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This performance audit covered contract year 2012. For this year, the FEHBP paid approximately \$115 million in premiums to the Plan.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM Rate Instructions to Community-Rated Carriers (rate instructions). These audits are also designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts.

We obtained an understanding of the Plan's internal control structure, but we did not use this information to determine the nature, timing, and extent of our audit procedures. However, the audit included such tests of the Plan's rating system and such other auditing procedures considered necessary under the circumstances. Our review of internal controls was limited to the procedures the Plan has in place to ensure that:

- The appropriate SSSGs were selected;
- the rates charged to the FEHBP were developed using complete, accurate and current data, and were equivalent to the best rate given to the SSSGs; and
- the loadings to the FEHBP rates were reasonable and equitable.

In conducting the audit, we relied to varying degrees on computer-generated billing, enrollment, and claims data provided by the Plan. We did not verify the reliability of the data generated by

the various information systems involved. However, nothing came to our attention during our audit testing utilizing the computer-generated data to cause us to doubt its reliability. We believe that the available data was sufficient to achieve our audit objectives. Except as noted above, the audit was conducted in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States.

The audit fieldwork was performed at the Plan's office in Buffalo, New York in September 2014. Additional audit work was completed at our office in Jacksonville, Florida.

Methodology

We examined the Plan's Federal rate submission and related documents as a basis for validating its Certificate of Accurate Pricing. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the FEHBP rates were reasonable and equitable. Finally, we used the contract, the FEHBAR, and the rate instructions to determine the propriety of the FEHBP premiums and the reasonableness and acceptability of the Plan's rating system.

To gain an understanding of the internal controls in the Plan's rating system, we reviewed the Plan's rating system policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rate Review

1. Defective Pricing

\$8,969,710

The Certificate of Accurate Pricing Independent Health (Plan) signed for contract year 2012 was defective. In accordance with Federal regulations, the FEHBP is therefore due a rate reduction for this year. Application of the defective pricing remedy shows that the FEHBP is due a premium adjustment of \$8,969,710 (see Exhibit A).

FEHBAR 1652.215-70 provides that carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates are complete, accurate, and current.

Furthermore, FEHBAR 1652.216-70 states that the subscription rates agreed to in the contract shall be equivalent to the subscription rates given to the community-rated carrier's SSSGs as defined in FEHBAR 1602.170-13. SSSGs are the Plan's two employer groups closest in subscriber size to the FEHBP. If it is found that

The FEHBP is due a rate reduction of \$8,969,710 for defective pricing in contract year 2012.

the FEHBP rates were increased because of defective pricing or defective cost or pricing data, then the rates shall be reduced in the amount by which the price was increased because of the defective data or information.

2012

The Plan selected [REDACTED] and [REDACTED] ([REDACTED]) as SSSGs for contract year 2012. We disagree with the Plan's selection of [REDACTED] as an SSSG. We selected [REDACTED] ([REDACTED]) because it was closest in subscriber size to the FEHBP. Our analysis shows that neither [REDACTED] nor the FEHBP received a discount, but [REDACTED] received a [REDACTED] percent discount. Since the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG, we applied [REDACTED]'s [REDACTED] percent discount to the FEHBP's rates.

[REDACTED]'s [REDACTED] percent discount is due to the following:

- Contrary to its filed Article 43 Large Group Rate Manual (rating methodology), the Plan used 16 months of claims experience to develop [REDACTED]'s rates. The Plan's filed rating methodology calls for the use of one or two years of claims experience in rating large groups, as determined by the number of enrolled subscribers. Thus, 16 months of claims experience is inconsistent with the Plan's rating methodology.

- The Plan used a step up factor of [REDACTED] in [REDACTED]'s rate development. However, based on enrollment data provided by the Plan, [REDACTED]'s step up factor should have been [REDACTED].
- The Plan did not use the correct retention or pooling factors as prescribed in its rating methodology. The retention factor should have been [REDACTED] percent, instead of [REDACTED] percent. The pooling factor should have been [REDACTED] percent, instead of [REDACTED] percent.
- The Plan did not provide sufficient documentation to support [REDACTED]'s benefit adjustment differences for the Encompass, preferred provider organization and preferred provider select benefit plans. As a result, all factors less than 1.00 were moved to 1.00 in our audited rate development.
- The Plan reduced [REDACTED]'s rates by applying an arbitrary underwriting adjustment of [REDACTED] percent.

In reviewing the FEHBP's reconciled rates, we also found that the Plan did not appropriately credit the FEHBP rates for a state assessment that was included in its community rates.

We calculated our audited FEHBP rates by applying [REDACTED]'s [REDACTED] percent discount and correcting the state assessment credit calculation. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$8,969,710 (see Exhibit B).

Plan's Comments (see Appendix):

The Plan disagrees with the selection of [REDACTED] as an SSSG for 2012 and contends that:

- Federal regulations apply by carrier. The Plan asserts that [REDACTED] is covered under a separate carrier than that of the FEHBP. [REDACTED] is covered under Independent Health Benefits Corporation (IHBC) while the FEHBP is covered by Independent Health Association (IHA). The Plan argues that Federal regulations do not permit OPM to use an SSSG of a different carrier as a basis for imposing a rate reduction.
- OPM's proposed 2015 legislation would change the definition of SSSGs, but the regulation has not yet been adopted and it may not be imposed retroactively. The Plan asserts that OPM currently does not have existing authority to require a carrier to include subscriber groups of a subsidiary carrier in determining SSSGs.
- [REDACTED] is new business subject to the new business exclusion. While [REDACTED] employees were enrolled with IHBC as of January 1, 2010, [REDACTED] joined with two other entities to secure group coverage effective January 1, 2012. The rating for the larger group was developed based on an aggregation of the number of eligible employees for the three groups.
- New York's regulatory requirements restrict the application of a subscriber group covered by a non-health maintenance organization (HMO) as an SSSG for community rated

FEHBP coverage issued by an HMO. Even if affiliated, HMO and non-HMO carriers in New York are required to calculate rates based upon distinct rating pools, which are subject to distinct regulations that have a significant impact on premium rates and risk selection. The Plan also argues that it may not legally apply discounts to its community rated products.

- 48 CFR 1602.170-13 (d) states that “OPM shall determine the FEHBP rate by selecting the lower of the two rates derived by using rating methods consistent with those used to derive the SSSG rates.” The Plan believes this regulation does not permit the FEHBP community rates to benefit from an experience rated SSSG discount. OPM would be required to recalculate the FEHBP rates according to the experience rating methodology used for [REDACTED]
- The auditors did not use the correct retention and pooling factors. Per [REDACTED]’s request for proposal, there were more than 3,000 eligible employees potentially enrolling with the Plan. The Plan believes this is the appropriate enrollment figure to use when determining the retention and pooling costs and factors.
- The auditors should not have changed the benefit factors under 1.00 to a factor of 1.00. The Plan feels that this is inappropriate and provided additional documentation to support its benefit adjustment calculation.
- An underwriting adjustment is not akin to a discount and its rate manual permits underwriting adjustments. Underwriting adjustments allow a carrier to determine a proper rate for each experience rated account based on the specific attributes of that group. The application of an underwriting adjustment to a community rated product is prohibited by New York State law.
- It has fully credited the FEHBP for state assessments including the New York Graduate Medical Education Assessment and Bad Debt and Charity Care surcharges and assessments.

The Plan acknowledges that:

- 16 months of claims data was used in its rating of [REDACTED] and the audited calculation used 12 months.
- The auditor calculated the conversion factor correctly.

OIG’s Response to the Plan’s Comments:

OIG’s selection of [REDACTED] as an SSSG

- The Plan did not provide sufficient documentation to support its position that the FEHBP and the SSSGs are covered by two separate carriers. IHA is the parent company which contracts with OPM and is licensed for HMO products. IHBC is a wholly-owned

subsidiary of the Plan and is used to sell its Article 43 business or Preferred Provider Organization/Point of Service (PPO/POS) products. The OIG agrees that the state of New York has legislation and licensing requirements governing HMOs and PPO/POS products. Hence the reason the Plan formed IHBC to sell insurance products. However, in order for IHBC employer groups to be excluded for SSSG purposes, IHBC would need to meet the separate lines of business definition and all of the following criteria would need to be met:

- a. It must be a separate organizational unit, such as a division;
- b. It must have a separate financial accounting with “books and records that provide separate revenue and expense information; and
- c. It must have a separate work force and separate management involved in the design and rating of the healthcare product.

The Plan did not provide evidence that these three requirements were all met.

- OPM is not retroactively imposing a 2015 regulation. The OIG’s criteria for selecting ██████ as an SSSG are the 2012 rate instructions. It provides that all groups meeting specific criteria can be an SSSG with certain exceptions. The 2012 rate instructions do not specifically exclude subscriber groups covered by a separate carrier that is an affiliate or subsidiary of the carrier issuing the FEHBP plan. Therefore, ██████ is an acceptable SSSG.
- ██████ is not a new group for contract year 2012. The 2012 rate instructions exclude a new group (starting its first contract year between July 2, 2011 and July 1, 2012) and a second year group (a group starting its second contract year between July 2, 2011, and July 1, 2012) that normally would be rated by adjusted community rating. ██████’s first contract with the Plan began January 1, 2010. The addition of new enrollees does not meet the criteria for a new group.
- Also, the plan did not provide sufficient documentation supporting the 2012 policy for ██████ and the new enrollees. Each new entity associated with ██████ was rated separately. The enrollment used in the Plan’s ██████ rate development did not reflect the statements in the request for proposal.
- OPM expects a carrier to use the same rating method for the FEHBP as it uses for SSSGs. However, different rating methods are acceptable if the carrier rates an SSSG using a method consistent with the carrier established policies. The Plan has distinct and well-documented rating methodologies for HMO and non-HMO employer groups, as regulated by the state of New York. These different rating methodologies are valid and accepted by OPM. The Plan rated ██████ and the FEHBP appropriately and in accordance with its internal rating policies.
- The Plan did not provide sufficient evidence to support its statement that it may not legally apply discounts to its community-rated products.

██████'s discount calculation

- The Request for the Proposal the Plan referenced states that ██████ had 3,500 to 3,600 employees. Of the estimated 3,500 employees, ██████ covered 2,328 employees at the time the group was rated. This figure was used in the auditor's rate calculation for ██████. We found no support in any other rating documents provided during our site visit to show that total group membership was greater than 3,000.
- After reviewing the documentation submitted by the Plan, the auditors concluded that the Plan did not provide sufficient documentation to support its experience period and renewal period benefit adjustment factors. As a result, all factors less than 1.00 were moved to 1.00 in our audited rate development.
- OPM requires the Federal group net-to-carrier rates to be at least equivalent to the rates for the SSSGs. Therefore, we expect the Federal group to receive at least the largest rate discount and any other advantage given to either SSSG. The underwriting adjustments stated in the Plan's underwriting manual are subjective. The Plan did not provide any verifiable basis for acceptance. Therefore, the underwriting adjustments are considered to be discretionary discounts to be applied to the FEHBP's rates.
- The Plan did not appropriately credit the FEHBP for the New York state assessment. The Plan used 2012 FEHBP enrollment and premium data and the 2013 tax assessment to develop the FEHBP's tax credit. These time periods of enrollment, premium and tax assessment data do not reflect the same time period used to develop the community rates. The audited FEHBP tax credit was recalculated using data which reflects the same time period as the community rates.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$8,969,710 to the FEHBP for defective pricing in contract year 2012.

2. Lost Investment Income

\$526,970

In accordance with FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing finding in contract year 2012. We determined the FEHBP is due \$526,970 for lost investment income, calculated through July 31, 2015 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning August 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

The FEHBP is due lost investment income on the defective pricing finding in the amount of \$526,970

FEHBAR 1652.215-70 provides that, if any rate established in connection with the FEHBP contract was increased because the carrier furnished cost or pricing data that was not complete, accurate, or current as certified in its Certificate of

Accurate Pricing, the rate shall be reduced by the amount of the overcharge caused by the defective data. In addition, when the rates are reduced due to defective pricing, the regulation states that the government is entitled to a refund and simple interest on the amount of the overcharge from the date the overcharge was paid to the carrier until the overcharge is liquidated.

Our calculation of lost investment income is based on the United States Department of the Treasury's semiannual cost of capital rates.

Plan's Comments (see Appendix):

The Plan disagrees with the defective pricing finding and therefore believes that the FEHBP did not experience a loss of investment income.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$526,970 to the FEHBP for lost investment income, calculated through July 31, 2015. We also recommend that the contracting officer recover lost investment income on amounts due for the period beginning August 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

3. Records Retention

The Plan did not comply with the records retention clause of its FEHBP contract. After several requests, the Plan failed to provide sufficient and appropriate documentation to support ██████'s 2012 rate development. Specifically, incurred but not reported (IBNR) factors to support the IBNR total added to paid claims and benefit adjustment factors were not supported. Although we ultimately developed audited rates using alternative methods, the FEHBP contract requires the Plan to retain and make available all records supporting its rate submissions for a period of six years after the end of the contract term to which records relate.

Plan's Comments (see Appendix):

The Plan contends the draft report did not include enough information to provide an appropriate response.

Recommendation 3

We recommend that the contracting officer assess the maximum penalty allowed in the contract between OPM and the Plan for the Plan's non-compliance of the records retention clause.

In addition, we recommend that the contracting officer inform the Plan that:

- OPM expects it to fully comply with the records retention provision of the contract and all applicable regulations;

- it should maintain copies of all pertinent rating documents that show the factors and calculations the Plan uses in developing the actual rates for the FEHBP and the groups closest in size to the FEHBP for each unaudited year; and
- the applicable community-rated performance factors described in FEHBAR 1609.7101-2 will be enforced if information requested during an audit is not provided.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

COMMUNITY-RATED AUDITS GROUP

██████████, Auditor-in-Charge

██████████, Senior Team Leader

██████████, Chief

EXHIBIT A

Independent Health Summary of Questioned Costs

Defective Pricing Questioned
Costs

Contract Year 2012 \$8,969,710

Total Defective Pricing Questioned Costs \$8,969,710

Lost Investment Income \$526,970

Total Questioned Costs **\$9,496,680**

EXHIBIT B

Independent Health Defective Pricing Questioned Costs

Contract Year 2012

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	\$ [REDACTED]	\$ [REDACTED]	
FEHBP Line 5 - Audited Rate	1\$ [REDACTED]	1\$ [REDACTED]	
Bi-weekly Overcharge	\$ [REDACTED]	\$ [REDACTED]	
To Annualize Overcharge:			
March 31, 2012 enrollment	[REDACTED]	[REDACTED]	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	\$2,742,789	\$6,226,921	\$8,969,710
Total Defective Pricing Questioned Costs			<u>\$8,969,710</u>

EXHIBIT C

Independent Health Lost Investment Income

Year	2012	2013	2014	2015	
Audit Findings:					Total
1. Defective Pricing	\$8,969,710	\$0	\$0	\$0	\$8,969,710
Totals (per year):	\$8,969,710	\$0	\$0	\$0	\$8,969,710
Cumulative Totals:	\$8,969,710	\$8,969,710	\$8,969,710	\$8,969,710	\$8,969,710
Avg. Interest Rate (per year):	1.875%	1.563%	2.063%	2.250%	
Interest on Prior Years Findings:	\$0	\$140,152	\$185,000	\$117,727	\$442,879
Current Years Interest:	\$84,091	\$0	\$0	\$0	\$84,091
Total Cumulative Interest Calculated Through July 31, 2015:	\$84,091	140,152	\$185,000	\$117,727	526,970

APPENDIX

March 9, 2015

██████████
Chief, Community-Rated
Audits Group
U.S. Office of Personnel Management
Office of the Inspector General
800 Cranberry Woods Drive
Suite 270
Cranberry Township, Pennsylvania 16066

Re: Draft Audit of Independent Health Association Report No. IC-QA-000140045

Dear ██████████,

I am writing in response to the draft audit report issued to Independent Health Association (“IHA”) dated January 28, 2015. The draft report questions IHA’s health benefit charges to the Federal Employee Health Benefit Program (“FEHBP”) for calendar year 2012. IHA believes that its FEHBP premium rates for 2012 were appropriately calculated. The audit findings are inconsistent with federal law and the calculations include errors.

A. Federal Law requires OPM to Use an SSSG Covered by the Same Carrier

The 2012 FEHBP policy was issued by IHA. The draft audit report suggests that IHA should have considered ██████████ (“██████████”) to be a similarly sized subscriber group (“SSSG”) and further suggests that FEHBP was entitled to a price reduction as a result of a perceived discount in the ██████████ pricing. ██████████ is a group covered by a separate and distinct carrier, Independent Health Benefits Corporation (“IHBC”). Federal law does not permit OPM to use an SSSG of a different carrier as a basis for imposing a rate reduction. This issue was raised in a letter from Mark Johnson to ██████████ dated October 1, 2014, copy attached, but subsequent regulatory developments make this even more clear. *See Exhibit A.*

1. The SSSG must be Covered by the Same Carrier and IHA and IHBC are Separate Carriers

FEHBP premium rates must include any discounts that a carrier has applied to its SSSGs as defined in FEHBAR 1602.170-13. *See* 48 CFR 1652.216-70(b)(2)(ii). SSSGs are a carrier’s two employer groups that have subscriber enrollment closest to the FEHBP enrollment. *See* 48 CFR 1602.170-13(a). “Any group with which an FEHB carrier enters into an agreement to provide health care services is a potential SSSG (including separate lines of business, government entities, groups that have multi-year contracts, and groups having point-of-service contracts).” *See* 48 CFR 1602.170-13(b).

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The draft audit asserted that IHA should have selected an SSSG from IHBC's book of business and that premium refunds are due to OPM as a result. However, federal regulations require SSSGs to be selected from groups which obtain coverage through the same carrier. *See* 48 CFR 1602.170-13. For purposes of the FEHBP, "carrier" is defined in 48 CFR 1602.170-1 as follows:

"Carrier means a voluntary association, corporation, partnership, or other nongovernmental organization which is lawfully engaged in providing, delivering, paying for, or reimbursing the cost of health care services under group insurance policies or contracts, medical or hospital service agreements, membership or subscription contracts, including a health maintenance organization, a nonprofit hospital and health service corporation, or any other entity providing a plan of health insurance, health benefits or health services, in consideration of premiums or other periodic charges payable to the carrier."

IHA and IHBC are separate carriers which are licensed by separate New York State regulatory agencies and subject to distinct regulatory requirements. IHA is a separate corporate entity from IHBC. IHA is a health maintenance organization. IHBC is a nonprofit hospital and health service corporation. IHA operates pursuant to a certificate of authority issued by the New York State Department of Health pursuant to Article 44 of the New York Public Health Law. In contrast, IHBC operates pursuant to a license issued by the New York State Department of Financial Services pursuant to Article 43 of the New York Insurance Law. Importantly, IHA, as an HMO, and IHBC, as a nonprofit hospital and health services corporation, are subject to distinct regulatory requirements that have a significant impact on premium rates and risk selection.

Federal regulations clearly apply SSSG by carrier, although SSSGs may be selected from a separate line of business. Federal regulations do not require carriers to consider the rates of a group policy issued by a separate carrier even if they are in an apparent affiliate relationship. Because IHA and IHBC are separate carriers, [REDACTED] may not be used as a basis for determining if IHA issued a defective rate for 2012.

2. OPM has proposed a regulation which would change the definition of SSSGs, but the regulation has not yet been adopted and it may not be imposed retroactively

On January 7, 2015, OPM issued a notice of proposed rulemaking which proposes to change the definition of SSSGs to include subscriber groups covered by a separate carrier that is an affiliated subsidiary of the carrier issuing the FEHBP plan, subject to certain limitations. We have attached a copy of the full current definition of SSSG and a copy of the proposed revised definition. See Exhibit B. Comments on the proposed regulation are due back to OPM by March 9, 2015.

As discussed above, OPM does not have existing authority to require a carrier to include the subscriber groups of a subsidiary carrier in determining SSSGs. OPM's proposed regulation is further proof that a regulatory change is needed to require a carrier to consider subscriber

groups of a separate carrier which is a subsidiary in selecting a SSSG. The regulation has not yet been adopted, and the proposed approach certainly may not be applied retroactively to an audit of rates established for 2012.

Notably, the proposed regulation would not allow [REDACTED] to be considered a SSSG. This is true because the proposed regulation includes other changes to the definition of SSSG which, in conjunction with certain ACA requirements effective as of 2014, would make it more appropriate to consider the subscriber groups of an affiliated carrier in determining SSSGs. For example, the proposed regulation includes a requirement that any SSSG must be rated based on traditional community rating (“TCR”) “in order to maintain alignment between the TCR-rated FEHB group and the subscriber group used for comparison.” *See* “Provisions of This Proposed Regulation,” 80 FR 926-01. This provision is designed to avoid a comparison of apples and oranges, such as the comparison of the TCR-rated FEHBP group to the prospectively experience-rated [REDACTED] group made in the draft audit report. Additionally, the proposed regulation requires plans to select the single subscriber group which is closest in size to the FEHBP plan, which would have been the [REDACTED] group that IHA submitted as the SSSG for 2012. Thus, OIG’s attempt to retroactively apply only a portion of this proposed regulation prior to its effective date is arbitrary and capricious.

3. [REDACTED] was a New Business, Subject to the New Business Exclusion

Our determination that [REDACTED] does not meet the definition of an SSSG is further supported by the 2012 community rating guidelines for FEHBP plans. The guidelines exclude new groups (starting the first contract year between July 2, 2011 and July 1, 2012) and second year groups (starting the second contract year or first between July 2, 2011 and July 1, 2012) from consideration as SSSGs. *See* Exhibit C. While some [REDACTED] employees were enrolled with IHBC as of January 1, 2010, [REDACTED] joined with other [REDACTED] entities to secure group coverage effective January 1, 2012. The policy and the rates at issue were developed in response to an RFP for coverage of eligible enrollees from [REDACTED], [REDACTED] and [REDACTED]. As discussed below, rating for this larger group was developed based on an aggregation of the number of eligible employees in all three [REDACTED] entities. *See* Exhibit D. Therefore, [REDACTED] should be excluded from SSSG consideration pursuant to 2012 rating guidelines as a new group starting their first contract year between July 2, 2011 and July 1, 2012.

4. New York’s regulatory requirements make inappropriate to use a subscriber group covered by a non-HMO as an SSSG for community rated FEHBP coverage issued by an HMO

There are strong policy reasons why [REDACTED], as a non-HMO group, should not be used as an SSSG for the purpose of FEHBP rates. Even if affiliated, HMO and non-HMO carriers in New York are required by law to calculate rates based upon distinct rating pools which are subject to distinct regulations which have a significant impact on premium rates and risk selection. For example, in 2012, New York HMOs were required by law to issue large group coverage on a guaranteed issue basis, while non-HMOs were not. HMOs were required to write only highly comprehensive benefit plans with minimal cost sharing, while non-HMOs had

the flexibility to issue a range of coverage options subject to range of cost sharing options. Additionally, HMOs were required to issue large group coverage on a community rated basis, while non-HMOs were permitted to extend experience rated pricing. These distinct rating requirements shape the rating pools that serve as the foundation for pricing. For this reason, FEHBP rates for a product issued by IHA as an HMO may not be fairly compared with the rates of a similarly sized non-FEHBP group that purchased a non-HMO experience rated product through IHBC. While a comparison of HMO and non-HMO rates may be reasonable in states with that apply consistent rating methodology, in New York, such a comparison is a comparison of apples and oranges.

5. New York law does not permit pricing consistent with the draft audit results

Pricing consistent with the draft audit results could not be legally achieved in New York. The draft audit results attempt to apply perceived discounts applicable to an experience rated product to the FEHBP community rate by selecting an SSSG of a non-HMO. This approach essentially seeks to blend the benefits of community rating with some, but not all, of the features of experience rating. As an HMO, IHA may not legally apply discounts to its community rated products. To access such discounts, OPM would need to purchase an experience rated product through IHBC. However, full application of the experience rating methodology would apply to rating of such a product, so the FEHBP program would lose the benefit of community rating. The FEHBP rates for 2012 would have been higher if FEHBP purchased an experience rated plan and audit report's hybrid rating methodology is inconsistent with State law.

6. Federal regulations require FEHBP pricing to be determined based on methods which are consistent with the rating method applied to the SSSG

As discussed above, the audit finding applies perceived discounts applied to [REDACTED] rates to the community rated FEHBP rates without applying the experience rating methodology used for [REDACTED]. This hybrid rating methodology is inconsistent with federal regulations and guidance. The federal regulation which defines SSSGs states: "OPM shall determine the FEHBP rate based upon the lower of the two rates derived *based upon rating methods consistent with those used to derive the SSSG rates* [emphasis added.]" (See 48 CFR 1602.170-13(d)). This language requires that the FEHBP rates be determined by using rating methods consistent with those used to derive the SSSG rates. The language does not provide OPM with the flexibility to use only components of the rating method used to derive the SSSG rate. If [REDACTED] was an appropriately selected SSSG, OPM would be required to recalculate the FEHBP rate according to the full experience rating methodology used for [REDACTED]. Federal regulations do not permit the FEHBP rates to benefit from community rating while securing the perceived discounts applied to an experience rated SSSG.

The 2012 Community Rating Guidelines expressly address the circumstance where a different rate method is used for the FEHBP product and the SSSG. Specifically, the guidelines state:

"the carrier is expected to use the same rating method for the Federal group as it uses for the SSSG though different rating methods are acceptable in some

situations. If, however, the carrier rates an SSSG using a method inconsistent with the carrier-established policies, the Federal group is entitled to a discount *based on the SSSG rating method applied to the federal group* [emphasis added].” See Exhibit C, page 11.

Although IHA disagrees, the draft audit results indicate that the auditors disagree with IHA’s choice of [REDACTED] and [REDACTED] as the SSSGs. The auditors selected [REDACTED] as the SSSG. Further, citing 48 CFR 1652.70, the report then determines that a discount was applied to [REDACTED] because [REDACTED] “received a rate lower than that determined according to the carrier’s established policy.” See 48 CFR 1652-70(b)(ii). The audit then concludes that a rebate is due based on a perceived inconsistency between IHBC’s rating of the [REDACTED] policy and IHBC’s established rating practices. Although the audit findings conclude that IHBC rated [REDACTED] in a manner that was inconsistent with its policy, the audit findings do not recalculate the federal rate “based on the SSSG rating method applied to the federal group.” This attempt to apply discounts without applying the full experience rating method applied to [REDACTED] is inconsistent with the 2012 Community Rating Guidelines. When this issue was raised with auditors on August 28, 2014, IHA received a written e-mail response that the discount needed to be applied to FEHBP rates, but the FEHBP rate did not need to be recalculated according to the SSSG rating method because IHA and IHBC applied an acceptable rating method to the HMO and non-HMO products. We see no basis in guidance or regulations for a conclusion that a discount is due based on an inconsistency with a IHA’s established policy without also triggering an obligation to apply the SSSG rating method.

Lastly, the federal regulation addressing accounting and price adjustment states: “The subscription rates agreed to in this contract shall be equivalent to the subscription rates given to the carriers similarly sized subscriber groups as defined in FEHBAR 1602.170-13...*The subscription rates shall be determined according to the carrier’s established policy, which must be applied consistently to the FEHBP and the carrier’s SSSGs.* [emphasis added]. If an SSSG receives a rate lower than that determined according to the carrier’s established policy, it is considered a discount. The FEHBP must receive a discount equal to or greater than the carrier’s largest SSSG discount.” See 48 CFR 1652.216-70(b)(ii). This regulation provides that discounts should be applied if a carrier deviates from its established policy. However, the regulation also provides that the established policy “must be applied consistently to the FEHBP and the carrier’s SSSG.” The regulation does not permit application of the discount without use of the SSSG rating method.

As discussed above, IHA does not believe [REDACTED] meets the definition of an SSSG. Additionally, as discussed in section B of this letter, IHA does not believe IHBC applied discounts to the [REDACTED] product. However, even if such interpretations were enforceable, to determine if FEHBP rates were defective in comparison to [REDACTED], the 2012 FEHBP rates would need to be recalculated on an experience rated basis. As noted in item 5 above, FEHBP rates for 2012 benefitted from community rating. The rates would be higher if recalculated on an experience rated basis and no rebate would be due.

B. The Calculations are Not Correct

As discussed above, IHA does not believe that OPM may legally force premium adjustments for defective pricing based upon a determination that [REDACTED] should have been used as the SSSG because [REDACTED] does not meet the definition of an SSSG as a group covered by a separate and distinct carrier. However, we think it is important to convey that there are also inaccuracies in the calculations OPM has used to determine that approximately \$13.7M would be due to OPM for “defective pricing” even if such an interpretation was enforceable.

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2. Discounts Applied to [REDACTED] (\$10.6M)

There are also inaccuracies in the calculations used to determine that discounts were applied to [REDACTED] which should also be applied to the FEHBP rates. The federal regulation that is relevant to determining if a discount has been applied to an SSSG and if a discount should be applied to FEHBP rates as a result states:

“...The subscription rates shall be determined according to the carrier’s established policy, which must be applied consistently to the FEHBP and the carrier’s SSSGs. If an SSSG receives a rate lower than that determined according to the carrier’s established policy, it is considered a discount. The FEHBP must receive a discount equal to or greater than the carrier’s largest SSSG discount.” See 48 CFR 1652.216-70(b)(ii)

As required by New York law, IHBC established premium rates for the [REDACTED] group according to its established rating methodology set forth in its rate manual which was filed with the New York Department of Financial Services (“DFS”). [REDACTED] did not receive “a lower rate than that determined according to the carrier’s established policy” and could not be considered to have received a discount pursuant to 48 CFR 1652.216-70. Therefore, the 2012 FEHBP rates would not be entitled to a discount even if [REDACTED] met the definition of an SSSG.

Rating manuals necessarily include significant complexities to ensure accuracy in pricing and meet regulatory requirements. Therefore, this letter separately addresses each point raised in the draft audit report and provides supplemental Exhibits:

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(b) Benefit Adjustment Factor (\$1.8M)

A benefit adjustment was included in [REDACTED]’s rates as a standard step in the rating process which is supported by IHBC’s rate manual. Many large groups, like [REDACTED], offer employees a choice of benefit packages. For example, a large group may want to offer a highly comprehensive plan with low member cost sharing alongside of a high deductible health plan and a product with moderate levels of cost sharing. As a first step in rating such

groups, a single aggregate rate is developed. This aggregate rate represents an average premium that does not account for selection and variations in benefit design. Next, adjustments are applied to account for anticipated differences in utilization and experience associated with the benefit design of each product. These adjustments are applied based on pre-determined rating relativities which are set forth in IHBC's rate manual. For ██████████, when the rating relativities set forth in the rate manual were applied to the initial aggregate rate, the aggregate rate decreased for one benefit design and increased for two benefit designs.

While the draft audit report does not include much explanation, the report indicates that "the Plan did not include sufficient documentation to support ██████████'s benefit adjustment differences for the Encompass, PPO and PPS benefit plans. As a result, all factors less than 1.00 were moved to 1.00 in our audited rate development." We note that the auditors did accept the calculation and did not similarly move factors in excess of 1.00 to 1.00.

We have attached a copy of the benefit adjustment factor and its supporting documentation. See Exhibit G. Similar documentation was sent to the auditor in charge on September 25, 2014 and October 24, 2014. The auditors did not request any additional information. ██████████'s benefit adjustments were calculated consistent with the rating relativities set forth in the manual. As such, no discount was applied and no adjustment could be considered due pursuant to 48 CFR 1652.216-70(b)(ii) if ██████████ was an appropriately selected SSSG.

While IHA does not believe ██████████ is an appropriately selected SSSG, even if ██████████'s selection was consistent with federal law, changing the benefit adjustment factor on the Passport Select Plan from ██████████ to 1.0 is not appropriate. This represents a \$1.8M reduction in the audit findings.

(c) Retention and Pooling Factor (\$2.8M)

The draft audit findings indicate that IHBC did not use the correct retention and pooling factors in establishing rates for ██████████. However, the retention and pooling factors applied by IHBC were consistent with IHBC's rating manual.

As per the attached ██████████'s Request for Proposal, there were more than ██████████ eligible employees potentially enrolling with IHBC. See Exhibit D, pages 2-3. IHBC rated this group based on the number of eligible employees described in the RFP. A copy of the RFP was provided to the auditor in charge on October 2, 2014. No additional information was requested.

The retention factor for groups entering an Encompass Plus or Passport plan without insured pharmacy coverage with ██████████ + eligible enrollees is ██████████%. The retention factor for groups entering a Passport Plan Select without insured pharmacy coverage with ██████████ + eligible enrollees is ██████████%. We have attached a copy of "The Variable Retention Rating Structure" from IHBC's 2012 Large Group Rating Manual. See Exhibit H. You will see that the retention factor used depends on the size of the group and type of product to be rated.

Similarly, given [REDACTED] was a new group, IHBC rated the group with the expectation that more than 3,000 subscribers would enroll. As a result, the group qualified for a pooling level of \$ [REDACTED]. As per the attached "Pooling Charges Worksheet" from the IHBC 2012 Rating Manual, the charge for a \$ [REDACTED] pooling level is [REDACTED]%. See Exhibit I. Accordingly, the pooling credits were also calculated using the \$ [REDACTED] level.

The retention and pooling factors used for [REDACTED] were correct and consistent with IHBC's rate manual. Therefore, no discount was applied and a rebate would not be due even if [REDACTED] was an appropriately selected SSSG. This further reduces the audit findings by \$ 2.8M.

(d) Underwriting Adjustment (\$3.8M)

IHBC applied an underwriting adjustment of [REDACTED]% to [REDACTED]'s rates consistent with IHBC's rate manual. An underwriting adjustment is not akin to a discount. Rather, underwriting adjustments are an integral component of the experience rated formula approved by the New York DFS. Underwriting adjustments allow carriers to determine a proper rate for each experience rated account based on the specific attributes of that group.

As discussed above, application of an underwriting adjustment to community rated products is prohibited by New York State law. During the audit period in question, FEHBP subscribed to a community rated product. Therefore, it would not have been legal for IHA to apply such an adjustment to the FEHBP rates.

Attached is a copy of IHBC's 2012 rate manual where underwriting adjustments are addressed. The rate manual permits underwriting adjustments of plus or minus [REDACTED]% for new business and plus or minus [REDACTED]% for existing business. See Exhibit J. IHBC applied a [REDACTED]% underwriting adjustment to [REDACTED] consistent with IHBC's rating policy which permits adjustments of up to [REDACTED]% for new business. Given the adjustment was consistent with IHBC's rating policy, the adjustment does not equate to a discount.

Given that the [REDACTED]% underwriting adjustment falls within the bounds allowed for underwriting adjustments in IHBC's rate manual, no rebate would be due to FEHBP for application of discount if [REDACTED] was an appropriately chosen SSSG. Therefore, the audit findings should be reduced by \$3.8M.

(f) Step-Up Factor

We agree with the conversion factor calculated by the auditor. IHBC should have used [REDACTED] rather than [REDACTED]. However, this adjustment was included in the calculation of a XX underwriting adjustment noted in (d) above. This adjustment did not cause the underwriting adjustment to exceed the limits allowed in the rate manual. Therefore, no discount was applied and no rebate would be due on this basis if [REDACTED] was an appropriately selected SSSG.

(g) Number of Months Used in Claims Experience

We acknowledge the use of 16 months of claims data instead of the 12 months cited in the audit report. However, this adjustment was included in the calculation of a XX underwriting adjustment noted in (d) above. This adjustment did not cause the underwriting adjustment to exceed the limits allowed in the rate manual. Therefore, no discount was applied and no rebate would be due on this basis if [REDACTED] was an appropriately selected SSSG.

C. Records Retention and Lost Investment Income (\$0.6M)

The draft audit report does not include enough information for us to determine the basis for the record’s retention finding or provide an appropriate response.

With respect to loss of investment income, IHA does not agree that premium rebates are due to the FEHBP. Since the underlying rebates are not due, the FEHBP program did not experience lost investment income. Therefore, the finding that IHA owes \$0.6M to FEHBP for lost income is inaccurate.

Conclusion

In summary, we strongly believe that [REDACTED] is not an SSSG under federal law. Therefore, IHA should not owe rebates to OPM based on perceived discounts applied to [REDACTED] rates. Secondly, even arguing in the alternative, no rebates are due to FEHBP for 2012 because [REDACTED]’s premium rates did not include discounts. [REDACTED]’s rates were calculated in full compliance with IHBC’s rating manual consistent with federal requirements. Therefore, the following adjustments would need to be made to the audit findings even if [REDACTED] was determined to be an SSSG:

	Audit	Actual
1. GME and BDDC	\$3.1M	\$0
2. Discounts Applied		\$0
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b. Benefit Adjustment	\$1.8M	\$0
c. Retention and Pooling	\$2.8M	\$0
d. Underwriting	\$3.8M	\$0
Total	\$13.7M	\$0

We think it is important to resolve these issues as quickly as possible. We request a meeting including OPM attorneys to address the legal issues, particularly in view of OPM’s recently proposed regulation which creates a very clear legal impediment to using the subscriber groups of separate subsidiary carriers as SSSG prior to its adoption.

Very truly yours,

██████████, VP, Actuarial

Underwriting and Informatics

cc:

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