



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

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# Final Audit Report

**Subject:**

## **Audit of the Federal Employees Health Benefits Program Operations at Lovelace Health Plan**

**Report No. 1C-Q1-00-13-011**

**Date: October 10, 2013**

**-- CAUTION --**

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## AUDIT REPORT

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Lovelace Health Plan  
Contract Number CS 1911 - Plan Code Q1  
Albuquerque, New Mexico**

Report No. 1C-Q1-00-13-011

Date: 10/10/13



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## EXECUTIVE SUMMARY

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**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Lovelace Health Plan  
Contract Number CS 1911 - Plan Code Q1  
Albuquerque, New Mexico**

**Report No. 1C-Q1-00-13-011**

**Date: 10/10/13**

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Lovelace Health Plan (Plan). The audit covered contract years 2010 through 2012, and was conducted at the Plan's office in Albuquerque, New Mexico.

This report questions \$5,056,088 for inappropriate health benefit charges to the FEHBP in contract years 2010 and 2012, including \$111,985 for lost investment income through September 30, 2013. We found the FEHBP rates were developed in accordance with applicable laws, regulations, and the Office of Personnel Management's Rate Instructions to Community-Rated Carriers for 2011.

For contract year 2010, we determined that the FEHBP rates were overstated by \$560,536 due to defective pricing. More specifically, the Plan did not apply the correct step-up factor to calculate the FEHBP rates.

For contract year 2012, we determined that the FEHBP rates were overstated by \$4,383,567 due to defective pricing. More specifically, the Plan did not apply the correct SSSG discount to the FEHBP rates.

Consistent with the FEHBP regulations and contract, the FEHBP is due \$111,985 for lost investment income, calculated through September 30, 2013, on the defective pricing finding. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning October 1, 2013, until all defective pricing amounts have been returned to the FEHBP.

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# I. INTRODUCTION AND BACKGROUND

## Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Lovelace Health Plan (Plan). The audit covered contract years 2010 through 2012. The audit was conducted pursuant to the provisions of Contract CS 1911; 5 U.S.C. Chapter 89; and 5 Code of Federal Regulations (CFR) Chapter 1, Part 890. The audit was performed by the Office of Personnel Management's (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

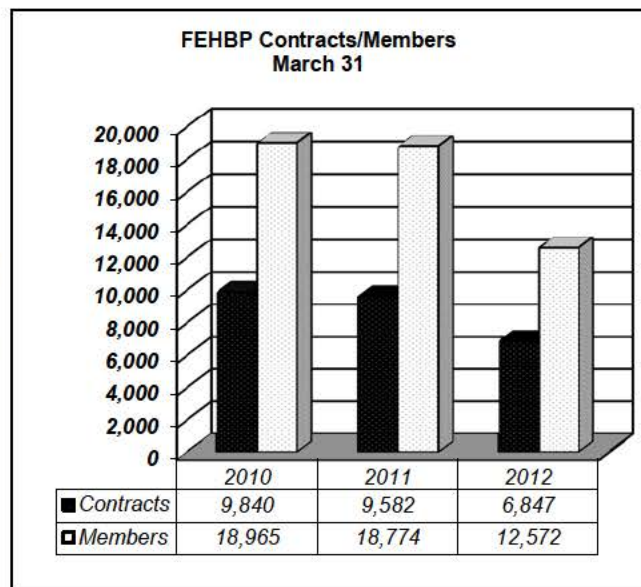
## Background

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. The FEHBP is administered by OPM's Healthcare and Insurance Office. The provisions of the Federal Employees Health Benefits Act are implemented by OPM through regulations codified in Chapter 1, Part 890 of Title 5, CFR. Health insurance coverage is provided through contracts with health insurance carriers who 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 market price rate, which is defined as the best rate offered 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 for each contract year audited.



The Plan has participated in the FEHBP since 1981 and provides health benefits to FEHBP members in the state of New Mexico. The last audit of the Plan conducted by our office was in 2010, and covered contract years 2007 through 2009. All findings from that audit have been resolved.

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 included, as appropriate, in the Appendix.

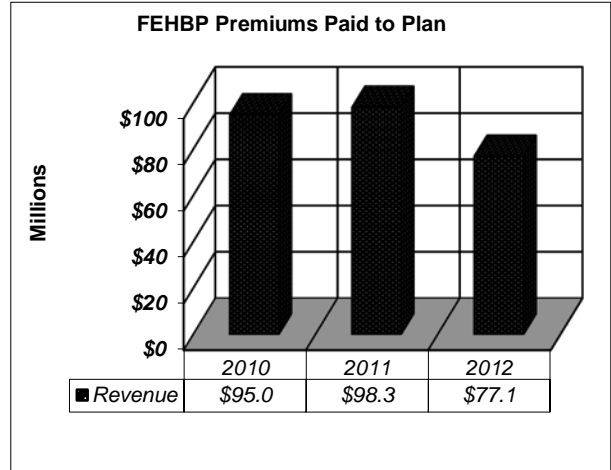
## **II. OBJECTIVES, SCOPE, AND METHODOLOGY**

### **Objectives**

The primary objectives of the audit were to verify that the Plan offered market price rates to the FEHBP and to verify that the loadings to the FEHBP rates were reasonable and equitable. 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 years 2010 through 2012. For these contract years, the FEHBP paid approximately \$270.4 million in premiums to the Plan. The premiums paid for each contract year audited are shown on the chart above.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM's 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 similarly sized subscriber groups (SSSG) were selected;
- the rates charged to the FEHBP were the market price rates (i.e., equivalent to the best rate offered 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 conducted during December 2012 in Albuquerque, New Mexico. Additional audit work was completed at our offices located in Washington, D.C. and Jacksonville, Florida.

### **Methodology**

We examined the Plan's Federal rate submissions and related documents as a basis for validating the market price rates. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the market price was actually charged to the FEHBP. Finally, we used the contract, the Federal Employees Health Benefits Acquisition Regulations, 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**

**\$4,944,103**

The Certificates of Accurate Pricing Lovelace Health Plan (Plan) signed for contract years 2010 and 2012 were defective. In accordance with federal regulations, the FEHBP is therefore due a rate reduction for these years. Application of the defective pricing remedy shows that the FEHBP is entitled to a premium adjustment totaling \$4,944,103 (see Exhibit A).

Carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an SSSG. SSSGs are the Plan's two employer groups closest in subscriber size to the FEHBP. If it is found that the FEHBP was charged higher than the market price rate (i.e., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price rate.

#### **2010**

In 2010, the Plan did not apply the correct step-up factor to the FEHBP rates. The Plan could not support the membership used in its original FEHBP step-up factor calculation. Therefore, we recalculated the step-up factor based on the membership provided by the Plan. As a result, we applied a [REDACTED] step-up factor in the FEHBP audited rate development instead of the [REDACTED] step-up factor that the Plan used. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$560,536 (see Exhibit B).

#### **Plan's Comments (see Appendix):**

The Plan argues they applied the correct step-up factor to the FEHBP rates. The Plan used a snap-shot of aggregate census data from March 31, 2009. Due to retro-activity the detailed census information can no longer be pulled from their data warehouse. They believe the step-up factor should be viewed as correct even though some of the data cannot be reproduced.

#### **OIG's Response to Plan's Comments:**

Per the rate instructions, plans must maintain all supporting documents related to the rate developments for the FEHBP and SSSGs. The Plan could not provide original support for the membership used in the FEHBP rate development, however, a membership report from April 30, 2009 was provided to the auditors. Since the Plan could not support the original membership used in the rate development, the auditors used the membership from the support provided by the Plan.

The Plan argues that the membership report provided as support includes retro-activity. However, the report clearly states that the tiered membership is a snap shot as of April 30, 2009, and that retro-activity is not included. The Plan said the membership they used was from March 31, 2009, which is in accordance with the rate instructions. However, the variance between the unsupported membership used by the Plan and the April 30, 2009 membership report is larger than our acceptable threshold. Using the membership from the April 30, 2009 census report results in a step-up factor of [REDACTED] compared to the Plan's step-up factor of [REDACTED]

## 2012

The Plan selected [REDACTED] and [REDACTED] as SSSGs for contract year 2012. We do not agree with these selections. We selected [REDACTED] and [REDACTED] because they were closer in size to the FEHBP.

Our analysis of the rates charged to the SSSGs shows that [REDACTED] received an [REDACTED] percent discount and [REDACTED] received a [REDACTED] percent discount. The discounts given to [REDACTED] are due to the Plan not consistently applying the correct medical and pharmacy trends, pooling charges, and credibility percentages for the FEHBP and the SSSGs' rates. Our audited rates were developed by using the most recent rate filing for all groups.

The Plan also applied a medical risk adjustment factor to the manual portions of the SSSG rates. The Plan did not supply documentation for this adjustment. Therefore, the medical risk adjustment factor was changed to 1.00 in our audited rates.

The Plan had originally applied a [REDACTED] percent self [REDACTED] percent family "other" discount to the FEHBP in the reconciliation. However, the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG. We recalculated the FEHBP rates using the [REDACTED] percent discount given to [REDACTED] and removed the [REDACTED] percent self and [REDACTED] percent family "other" discount. A comparison of our audited rates to the Plan's reconciled rates shows that the FEHBP was overcharged \$4,383,567 in contract year 2012 (see Exhibit B).

### Plan's Comments (see Appendix):

The Plan states that groups contracting with Lovelace Insurance Company (LINC) are exempt from the SSSG elimination process due to the following reasons:

- (a) [REDACTED] cannot be SSSGs because they are not customer groups of Lovelace Health Systems (LHS), d.b.a. Lovelace Health Plan, but are customers of LINC.
- (b) Only groups that contract with LHS, "the Carrier" are eligible for SSSG consideration.

(c) The Plan asserts that the definition of “Carrier” is the entity contracting with the FEHBP and does not include the subsidiaries and affiliates of the entity.

(d) Both LINC and LHS are two distinct and separately licensed corporations.

### **OIG’s Response to Plan’s Comments**

Groups contracting with LINC are not exempt from SSSG consideration due to the following reasons:

(a) LINC does not meet the OPM criteria to be a separate line of business. According to OPM’s definition of separate lines of business in the 2012 rate instructions, groups that are covered under a separate line of business which meet all of the following criteria should be excluded from SSSG consideration:

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

LINC does not meet the third criteria above; therefore, LINC cannot be considered a separate line of business.

(b) Any group that contracts with LHS and its subsidiaries (excluding separate lines of business as established in the 2012 rate instructions above) can be selected as an SSSG.

According to the 2012 rate instructions, any group with which an FEHB carrier enters into an agreement to provide health care services may be an SSSG (including government entities, groups that have multi-year contracts, groups having point of service products, and purchasing alliances).

(c) The interpretation that the term “Carrier”, as established in Carrier Letter 2005-11, excludes subsidiaries and affiliates is inaccurate. The rewording of “parent company” to “carrier” and the addition of “subsidiary” to the first disqualifying point does not negate the second and third disqualifying points. To be a separate line of business, LINC must be a “separate business division”, must have separate financial accounting with “books and records that provide separate revenue and expense information,” and must have a “separate work force and separate management involved in the design and rating of the healthcare product.” LINC clearly does not have a separate workforce or management, since LHS completes all administrative work for LINC and LINC’s management consists of LHS members only.

OPM clearly establishes that all three disqualifying points must be met to exclude an entity (including separate and distinct legal entities) and their contracted groups from

SSSG eligibility. As discussed above, LINC does not meet the qualifications to be considered a separate line of business. Therefore, all LINC groups, if meeting the SSSG criteria, can be selected as SSSGs.

The assumption that OPM allows the elimination of all entities simply by the use of incorporation as a reason is incorrect. Using this reasoning of SSSG elimination, the Plan could create a company where the FEHBP is the only group meeting the criteria for inclusion, thus rendering the SSSG process irrelevant.

(d) Although both LHS and LINC are shown as licensed corporations, LINC is a wholly-owned subsidiary of LHS. As stated above, OPM requires that all three disqualifying points must be met to exclude an entity (including separate workforce and management involved in the design and rating of the healthcare product) and their contracted groups from SSSG qualification. As discussed above, LINC does not meet the qualifications to be considered a separate line of business. Therefore, all LINC groups, if meeting the SSSG criteria, can be selected as SSSGs.

### **Recommendation 1**

We recommend that the contracting officer require the Plan to return \$4,944,103 to the FEHBP for defective pricing in contract years 2010 and 2012.

### **2. Lost Investment Income**

**\$111,985**

In accordance with the FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing findings in contract years 2010 and 2012. We determined that the FEHBP is due \$111,985 for lost investment income, calculated through September 30, 2013 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning October 1, 2013, until all defective pricing finding amounts have been returned to the FEHBP.

Federal Employees Health Benefits Acquisition Regulation 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 were 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 did not address this finding.

## **Recommendation 2**

We recommend that the contracting officer require the Plan to return \$111,985 to the FEHBP for lost investment income for the period January 1, 2010, through September 30, 2013. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning October 1, 2013, until all defective pricing amounts have been returned to the FEHBP.

## **IV. MAJOR CONTRIBUTORS TO THIS REPORT**

### **Community-Rated Audits Group**

██████████, Auditor-in-Charge

██████████, Auditor

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██████████., Chief

██████████, Senior Team Leader

**Lovelace Health Plan  
Summary of Questioned Costs**

Defective Pricing Questioned Costs

Contract Year 2010	\$560,536	
Contract Year 2012	<u>\$4,383,567</u>	
Total Defective Pricing Questioned Costs		<b>\$4,944,103</b>
Lost Investment Income:		<b><u>\$111,985</u></b>
Total Questioned Costs		<b><u>\$5,056,088</u></b>



**Lovelace Health Plan  
Defective Pricing Questioned Costs**

**2010**

	<u>Self</u>	<u>Family</u>
FEHBP Line 5 - Reconciled Rate	[REDACTED]	[REDACTED]
FEHBP Line 5 - Audited Rate	[REDACTED]	[REDACTED]
Biweekly Overcharge	[REDACTED]	[REDACTED]
To Annualize Overcharge:		
March 31, 2010 Enrollment	[REDACTED]	[REDACTED]
Pay Periods	<u>26</u>	<u>26</u>
Subtotal	[REDACTED]	[REDACTED]

**Total 2010 Questioned Costs**

**\$560,536**

**2012**

	<u>Self</u>	<u>Family</u>
FEHBP Line 5 - Reconciled Rate	[REDACTED]	[REDACTED]
FEHBP Line 5 - Audited Rate	[REDACTED]	[REDACTED]
Biweekly Overcharge	[REDACTED]	[REDACTED]
To Annualize Overcharge:		
March 31, 2012 Enrollment	[REDACTED]	[REDACTED]
Pay Periods	<u>26</u>	<u>26</u>
Subtotal	[REDACTED]	[REDACTED]

**Total 2012 Questioned Costs**

**\$4,383,567**

**Total Defective Pricing Questioned Costs:**

**\$4,944,103**

**Lovelace Health Plan  
Lost Investment Income**

<b>Year</b>	2010	2011	2012	30-Sep-2013	Total
<b>Audit Findings:</b>					
1. Defective Pricing	\$560,536	\$0	\$4,383,567	\$0	\$4,944,103
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Totals (per year):	\$560,536	\$0	\$4,383,567	\$0	\$4,944,103
Cumulative Totals:	\$560,536	\$560,536	\$4,944,103	\$4,944,103	\$4,944,103
Weighted Avg. Interest Rate (per year):	3.188%	2.563%	1.875%	1.500%	
Interest on Prior Years Findings:	\$0	\$14,364	\$10,510	\$37,081	\$61,955
Current Years Interest:	\$8,934	\$0	\$41,096	\$0	\$50,030
<hr/>					
Total Cumulative Interest Calculated Through September 30, 2013:	\$8,934	\$14,364	\$51,606	\$37,081	<b>\$111,985</b>

APPENDIX

**Lovelace**  
Health Plan

May 21, 2013

[REDACTED]

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: Lovelace Health System, Inc. d/b/a Lovelace Health Plan  
Draft Audit Report No. IC-Q1-00-13-011**

Dear [REDACTED]

This letter is the response of Lovelace Health System, Inc. d/b/a Lovelace Health Plan (“LHS”) to the above-referenced draft audit report (the “Draft Report”) on the Federal Employees Health Benefits Program (“FEHBP”) operations of LHS for contract years 2010 through 2012.

The Draft Report contains preliminary findings of defective pricing in contract years 2010, 2011, and 2012. Specifically, for 2010, the Draft Report claims that LHS did not apply the correct step-up factor to calculate the FEHBP rates. For 2011, the Draft Report claims that LHS did not apply the correct medical and pharmacy trend factors to calculate the FEHBP rates. Finally, for 2012, the Draft Report claims that LHS did not apply the correct discount to the FEHBP that LHS allegedly gave a similarly sized subscriber group (“SSSG”).

As discussed below, LHS disputes the Draft Report’s findings and recommendations with respect to contract years 2010, 2011, and 2012.

**I. Contract Year 2010**

The Draft Report alleges that LHS did not apply the correct step-up factor to the FEHBP rates. The support for this conclusion is the fact that LHS was not able to replicate the data used in the step-up calculation. Therefore, the auditors recalculated the step-up factor using different membership.

To calculate the step-up factor, LHS used a snap-shot of aggregate census data based on the date of March 31, 2009. The original number of contracts and members provided for this calculation was correct. The formula that was used was also applied correctly. However, due to retro-activity the detailed census information can no longer be pulled from the LHS data warehouse. We believe the step-up factor should be viewed as correct even though some of the data cannot be reproduced.

**Deleted by OIG – Not Relevant to the Final Report**

### III. Contract Year 2012

For contract year 2012, LHS identified [REDACTED] as its SSSGs. The Draft Report did not agree with LHS' selections. According to the Draft Report, the auditors selected [REDACTED] because they were closer in size to the FEHBP. However, neither [REDACTED] can be an SSSG under LHS' contract with the Office of Personnel Management ("OPM") since neither [REDACTED] was a customer of LHS.

As we explain in more detail below, [REDACTED] do not qualify for SSSG status because [REDACTED] were not customer groups of LHS. Both [REDACTED] were customers of Lovelace Insurance Company ("LINC"), an insurance company subsidiary of LHS that is a separate corporate legal entity from LHS. Since neither [REDACTED] were customer groups of the FEHBP carrier – LHS, neither [REDACTED] can be a SSSG under LHS' contract with OPM.

#### **A Only Customers of the FEHBP Contracting Carrier Can Be SSSGs; Customers of a Corporate Subsidiary of the Carrier Cannot Be SSSGs.**

OPM's rating requirements for the FEHBP, including instructions for identifying the SSSGs, are governed by the FEHB Act, the FEHB Acquisition Regulation ("FEHBAR"), OPM's Standard Contract for Community-Rated Health Maintenance Organization Carriers (the "Standard Contract") and OPM's annual rate instructions.

The FEHBAR defines the SSSGs as follows:

(a) Similarly sized subscriber groups (SSSGs) are a comprehensive medical plan carrier's two employer groups that: (1) As of the date specified by OPM in the rate instructions, have a subscriber enrollment closest to the FEHBP subscriber enrollment; and, (2) Use any rating method other than retrospective experience rating; and, (3) Meet the criteria specified in the rate instructions issued by OPM.

(b) Any group with which an FEHBP 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 products).

48 C.F.R. § 1602.170-13 (emphasis added).

Thus, under OPM's regulations for the FEHBP, the SSSGs must be groups of "the carrier."

The term "carrier" is defined in the FEHB Act as follows:

"[C]arrier" means a voluntary association, corporation, partnership, or other nongovernmental organization which is lawfully engaged in providing, paying for, or reimbursing the cost of, health services under group insurance policies or contracts, medical or hospital service agreements, membership or subscription contracts, or similar group arrangements, in consideration of premiums or other periodic charges payable to the carrier, including a health benefits plan duly sponsored or underwritten by an employee organization and an association of organizations or other entities described in this paragraph sponsoring a health benefits plan[.]

5 U.S.C. § 8901(7) (emphasis added). See also 48 C.F.R. § 1602.170-1.

The definition of carrier in the Standard Contract incorporates the statutory definition and further provides that the term "may be used interchangeably with the term Contractor." See Standard Contract at § 1.1.

Based on the foregoing definitions, the term "carrier" as used in the definition of SSSGs refers to the legal entity that contracts with OPM to offer a health benefits plan under the FEHBP. The definition of carrier does not include separately incorporated subsidiaries of the carrier that are distinct legal entities.

OPM's rating instructions regarding SSSGs are consistent with the definitions discussed above. In this regard, it is critical to distinguish between lines of business or divisions within a single company, on the one hand, and companies that are separate and distinct legal entities on the other. OPM itself acknowledged this distinction when it issued guidance on circumstances when a customer served by a separate line of business of a carrier could be excluded from SSSG consideration. After initially proposing guidance that could have resulted in confusion as to whether customers of a separate legal entity could be treated as customers of the "carrier" and therefore be eligible to be SSSGs, OPM acknowledged concerns about its initially proposed guidance, and modified it to remove any potential ambiguity.

Specifically, in 2005, in connection with guidance excluding customers of a separate line of business of a carrier from SSSG eligibility, OPM proposed to define a separate line of business as follows:

Groups covered under a separate line of business of a **parent company** that offers an FEHBP product are excluded from consideration as an SSSG. To be considered a separate line of business all of the following criteria must be satisfied:

- It must be a separate organizational unit, such as a division or **subsidiary**,
- It must have separate financial accountability with "books and records that provide separate revenue and expense information that is used for internal planning and control,
- It must have a separate work force and separate management involved in the design and rating of the healthcare product.

See OPM letter dated February 23, 2005. (emphasis added)

In response to comments that OPM's use of the terms "parent company" and "subsidiary" would cause confusion regarding whether groups that are not customers of the carrier, but are customers of a separate legal entity subsidiary or sister corporation of the carrier, could be considered SSSGs, OPM modified the language, changing "parent company" to "carrier" and deleted the word "subsidiary".<sup>1</sup> Specifically, OPM noted

Some of the carriers had problems with the term "parent company" since they thought this implied groups could be SSSGs even though

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<sup>1</sup> See e.g., Comment letter dated March 3, 2005.

a legal entity other than the FEHBP carrier provides the coverage. They said the use of the words “parent company” and “subsidiary” creates confusion about intent of the proposed policy.

One respondent said the word “subsidiary” presented a problem because it typically refers to a separate and distinct legal entity. They said the wording would create uncertainty about whether groups who are not customers of the carrier could in some instances be considered SSSGs. They propose amending the language by changing “parent company” to “carrier” and striking out the word “subsidiary.”

One carrier said that our description appears to encompass a carrier’s sister corporations which are separate legal entities and, potentially, not contracted with OPM as approved carriers. They do not believe it is the intent to cross into separate legal entities even between commonly owned corporations to select potential SSSGs.

We agree to change “Parent Company” to “Carrier” and strike out the word “subsidiary.”

See OPM Carrier Letter No. 2005-11. (emphasis added)

OPM’s revisions in response to comments demonstrate the agency’s clear intent, consistent with and as required by its regulations, to exclude from consideration as an SSSG those groups that are not customers of the Carrier that contracts with OPM. The clarified instructions remain to address situations where a group customer of a separate line of business, operated as a division within a single carrier, could be excluded from SSSG eligibility. They do not seek to expand the contractual and regulatory definition of SSSGs. The instructions make clear that a determination as to whether a program is a separate line of business is made as with respect to the operations “of a carrier.”

As evidenced by the foregoing, OPM recognizes that the carrier with which it contracts under the FEHBP and the carrier’s affiliate(s) are separate legal entities and only group customers of the FEHBP carrier are eligible for SSSG consideration. [REDACTED] therefore, cannot be SSSGs since they did not contract with LHS for health benefits coverage in 2012.

## **2. LHS and LINC Are Separate and Distinct Legal Entities.**

LHS and LINC are separate and distinct legal entities. LHS is incorporated as a New Mexico corporation and does business using the name Lovelace Health

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Plan. LHS is licensed by the New Mexico Public Regulation Commission, Insurance Division as a health maintenance organization.

LINC is a separately incorporated New Mexico corporation. LINC is licensed by the New Mexico Public Regulation Commission, Insurance Division as a life and health insurer. LINC is not an FEHBP contractor.

As separately licensed companies, LHS and LINC are each subject to separate chapters of the New Mexico Insurance Code. Each submits separate sets of audited and certified financial statements. Each company is also separately capitalized in accordance with New Mexico law.

As demonstrated by the foregoing, LHS and LINC are separately incorporated and licensed legal entities with their own respective business. Therefore, based on the FEHB Act, FEHBAR, OPM Standard Contract, and OPM rate instructions, groups that contract with LINC, such as ██████████, are not eligible to be an SSSG under LHS' contract with OPM. As a result, the Draft Report's finding and recommended adjustment based on ██████████ is erroneous. LHS correctly identified its 2012 SSSGs as ██████████ and the FEHBP is not due a rate adjustment for that year.

## II. Conclusion

As discussed above, LHS disputes the Draft Report's findings and recommendations with respect to contract years 2010, 2011, and 2012. LHS disputes that it engaged in defective pricing for any of those contract years and that any adjustments are due to the FEHBP for those years.



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If you have any questions regarding this correspondence, please contact me  
at [REDACTED].

Sincerely,

Ben R. Slocum  
Chief Executive Officer  
Lovelace Health Plan

cc: [REDACTED]  
Chief, Health Insurance Group III

[REDACTED]  
Actuaries Group, OPM

[REDACTED]  
Audit Resolution, OPM