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

Final Audit Report

Subject:

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

Report No. 1C-Q1-00-10-026

Date: September 27, 2010

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

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-Q1-00-10-026 **Date:** 9/27/10

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Assistant Inspector General
for Audits

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

EXECUTIVE SUMMARY

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-Q1-00-10-026 **Date: 9/27/10**

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 2007 through 2009 and was conducted at the Plan's office in Albuquerque, New Mexico.

This report questions $3,225,779 for defective pricing in contract years 2008 and 2009. The questioned amount includes $2,975,728 for inappropriate health benefit charges and $250,051 due the FEHBP for lost investment income, calculated through August 31, 2010. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in 2007.

For contract years 2008 and 2009, we determined that the FEHBP's rates were overstated by $2,134,080 in 2008 and $841,648 in 2009 due to defective pricing. More specifically, the Plan did not select the correct similarly sized subscriber group (SSSG) for comparison to the FEHBP and did not apply that SSSG discount appropriately at line 5 of the FEHBP's rates in 2008. Additionally, the Plan did not apply the correct step-up factor to calculate the FEHBP line one rates for 2009.

Consistent with the FEHBP regulations and the contract, the FEHBP is due $250,051 for lost investment income, calculated through August 31, 2010, on the defective pricing finding. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning September 1, 2010, 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) in Albuquerque, New Mexico. The audit covered contract years 2007 through 2009. 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.

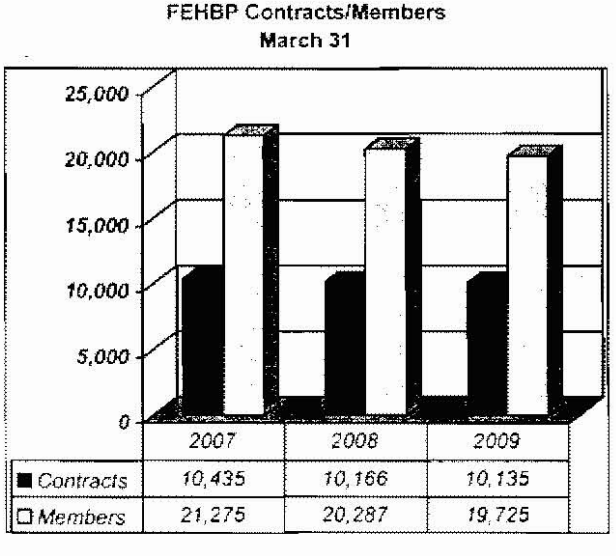
Background

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 Retirement and Benefits 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 throughout New Mexico. The last audit conducted by our office was a full scope audit and covered contract years 2003, 2005, and 2006. All matters related to 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 the preparation of this report and are included, as appropriate, as the Appendix.

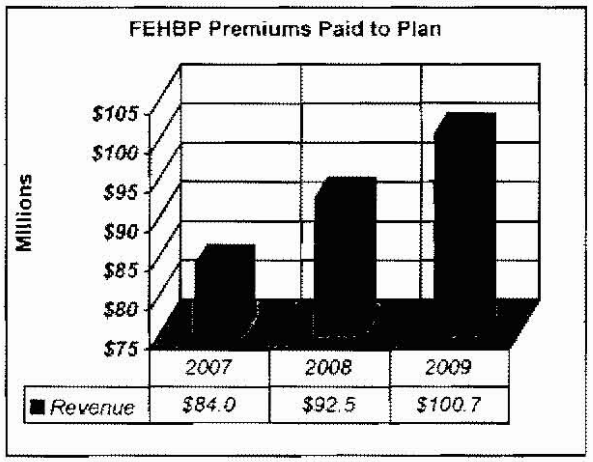
II. OBJECTIVES, SCOPE, AND METHODOLOGY

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 2007 through 2009. For these contract years, the FEHBP paid approximately $277.2 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 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 performed at the Plan's office in Albuquerque, New Mexico, during February 2010. Additional audit work was completed at our field offices in Jacksonville, Florida, and Cranberry Township, Pennsylvania.

Methodology

We examined the Plan's federal rate submissions and related documents as a basis for validating the market price rates. Further, we examined claim payments to verify that the cost data used to develop the FEHBP rates was accurate, complete, and valid. 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 (FEHBAR), and OPM's Rate Instructions to Community-Rated Carriers 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's policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rates

1. Defective Pricing — $2,975,728

The Certificates of Accurate Pricing the Plan signed for contract years 2008 and 2009 were defective. In accordance with federal regulations, the FEHBP is therefore due a price adjustment for these years. Application of the defective pricing remedies shows that the FEHBP is entitled to premium adjustments totaling $2,975,728 (see Exhibit A). We found that the FEHBP rates were developed in accordance with OPM's rules and regulations for contract year 2007.

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, 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. If it is found that the FEHBP was charged higher than a market price (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.

2008

The Plan selected [redacted] as the SSSGs in 2008. We agree with the selection of [redacted]; however, we disagree with the selection of [redacted]. We selected the [redacted] since it was closer in size to the FEHBP and it did not meet any of the SSSG exclusion requirements.

Our review of the rates charged to the SSSGs shows that [redacted] received a [redacted] percent discount that was not applied to the FEHBP. This discount was due to [redacted] did not receive a discount. As a result, we applied the [redacted] percent discount in the development of our FEHBP audited rates. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged $2,134,080 (see Exhibit B).

Plan's Comments (See Appendix):

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

(a) [redacted] cannot be an SSSG because [redacted] is not a customer group of Lovelace Health Solutions (LHS) d.b.a. Lovelace Health Plan but is a customer of LIC.

(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 LIC and LHS are two distinct and licensed corporations.

OIG's Response to the Plan's Comments:

Groups contracting with LIC are not exempt from the SSSG elimination process due to the following reasons:

(a) LIC does not meet the criteria to be a separate line of business. According to the 2008 rate instructions, "Groups covered under a separate line of business of a carrier 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;
- 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."

LIC does not meet the third criteria above; therefore, LIC 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 2008 Rate Reconciliation Instructions above) can be selected as an SSSG.

According to the 2008 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, and groups having point of service products)."

(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, LIC 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." LIC clearly does not have a separate workforce or management,

since LHS completes all administrative work for LIC and LIC'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 qualification. As discussed above, LIC does not meet the qualifications to be considered a separate line of business. Therefore, [redacted] and all other LIC 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 LIC are shown as licensed corporations, LIC 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, LIC does not meet the qualifications to be considered a separate line of business. Therefore, [redacted] and all other LIC groups, if meeting the SSSG criteria, can be selected as SSSGs.

2009

In 2009, the Plan did not apply the correct step-up factor to the FEHBP rates. The Plan erroneously applied the prior year step-up factor of [redacted] instead of the current year factor of [redacted] As a result, we applied the current year step-up factor of [redacted] in the development of our FEHBP audited rates. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged $841,648 (see Exhibit B).

Plan's Comments (See Appendix):

The Plan agrees that an incorrect step-up factor was used to develop the FEHBP 2009 contract year rates and does not dispute the finding. The Plan acknowledges that $841,648 should be returned to the FEHBP for the 2009 contact year.

Recommendation 1

We recommend that the contracting officer require the Plan to return $2,975,728 to the FEHBP for defective pricing in contract years 2008 and 2009.

2. Lost Investment Income **$250,051**

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 findings in

contract years 2008 and 2009. We determined that the FEHBP is due $250,051 for lost investment income, calculated through August 31, 2010 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning September 1, 2010, until all defective pricing amounts have been returned to the FEHBP.

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 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 issue.

Recommendation 2

We recommend that the contracting officer require the Plan to return $250,051 to the FEHBP for lost investment income for the period January 1, 2007 through August 31, 2010. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning September 1, 2010, until all defective pricing amounts have been returned to the FEHBP.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

[redacted] Auditor-in-Charge

[redacted] Staff Auditor

[redacted] Staff Auditor

[redacted] Chief

[redacted] Senior Team Leader

Exhibit A

Lovelace Health Plan
Summary of Questioned Costs

Defective Pricing Questioned Costs:	
Contract Year 2008	$2,134,080
Contract Year 2009	$841,648
Total Defective Pricing Questioned Costs	**$2,975,728**
Lost Investment Income	**$250,051**
Total Questioned Costs	**$3,225,779**

Exhibit B

Lovelace Health Plan
Defective Pricing Questioned Costs

2008 Contract Year

	Single	Family	
Plan's Reconciled Rates	[redacted]		
Audited Rates			
Biweekly Overcharge			
To Annualize:			
x March 31, 2008 Headcount	[redacted]		
x Pay Periods	26	26	
Subtotal	[redacted]		
Total 2008 Defective Pricing Questioned Costs			**$2,134,080**

2009 Contract Year

	Single	Family	
Plan's Reconciled Rates	[redacted]		
Audited Rates			
Biweekly Overcharge			
To Annualize:			
x March 31, 2009 Headcount			
x Pay Periods	26	26	
Subtotal	[redacted]		
Total 2009 Defective Pricing Questioned Costs			**$841,648**

Total Defective Pricing Questioned Costs **$2,975,728**

Exhibit C

Lovelace Health Plan
Lost Investment Income

Year Audit Findings:	2008	2009	2010	Total
Defective Pricing	**$2,134,080**	**$841,648**	**$0**	**$2,975,728**
Totals (per year):	$2,134,080	$841,648	$0	$2,975,728
Cumulative Totals:	$2,134,080	$2,975,728	$2,975,728	$2,975,728
Average Annual Interest Rate:	4.9375%	5.2500%	3.1875%	
Interest on Prior Years Findings:	$0	$112,039	$63,234	$175,273
Current Years Interest:	$52,685	$22,093	$0	$74,778
Total Cumulative Interest Through August 31, 2010	$52,685	$134,132	$63,234	**$250,051**

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Appendix

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August 18, 2010

Melissa D. Brown
Chief, Community-Rated Audits Group
U. S. Office of Personnel Management
Office of the Inspector General
1900 E Street, NW
Room 6400
Washington, DC 20415-1100

Re: Lovelace Health System, Inc. d/b/a Lovelace Health Plan
Draft Audit Report No. IC-Q1-00-10-026

Dear Melissa:

This firm is legal counsel to Lovelace Health System, Inc. (dba Lovelace Health Plan) ("LHS"), a community rated Carrier under the Federal Employees Health Benefits Program ("FEHBP"). This letter and accompanying exhibits constitute the response of 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 2007 through 2009.

The Draft Report contains preliminary findings of defective pricing in contract years 2008 and 2009. Specifically, for 2008, the Draft Report claims that LHS did not apply a discount to the FEHBP that LHS alleged gave a similarly sized subscriber group ("SSSG") and recommends that LHS return $2,134,080 to the FEHBP. For 2009, the Draft Report claims that LHS did not apply the correct step-up factor to the FEHBP's rates and, as a result, overcharged the FEHBP by $841,648.

As discussed below, LHS disputes the Draft Report's findings and recommendations with respect to contract year 2008. LHS does not dispute the Draft Report's finding and recommendation regarding 2009. Per your request, we are providing this response on a compact disk in Word format and also via hard copy.

I. Contract Year 2008

For contract year 2008, LHS identified Western Teamsters and Comcast as its SSSGs. The Draft Report agrees with LHS' selection of Western Teamsters but disagrees with the selection of Comcast and the other SSSG. According to the Draft Report, the auditors selected the University of New Mexico ("UNM") "since it was closer in size to the FEHBP and it did not meet any SSSG exclusion requirements." (emphasis added) However, UNM simply cannot be an SSSG under LHS' contract with the Office of Personnel Management ("OPM") since UNM was not a customer of LHS. To be ineligible for SSSG status UNM need not fit within one of the exceptions from SSSG eligibility applicable to particular types of Carrier customers, since it was not a customer of LHS in the first place. OPM has explicitly recognized this, and did so specifically in connection with the exception from SSSG status instructions. As a result, it is irrelevant whether UNM met an "SSSG exclusion requirement".

As we explain in more detail below, UNM does not qualify for SSSG status because UNM was not a customer group of LHS. UNM was a customer of Lovelace Insurance Company ("LIC"), an insurance company subsidiary of LHS that is a separate corporate legal entity from LHS. See Organizational Chart attached hereto as Exhibit A. See also Group Contracts between LIC and UNM attached hereto as Exhibit B and the applicable enrollee Evidence of Coverage issued by LIC for UNM plan participants attached as Exhibit C. Since UNM was not a customer group of the FEHBP carrier – LHS, UNM cannot be an 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).
>
> (c) Exceptions to the general rule stated in paragraph (b) of this section are (and the following groups must be excluded from SSSG consideration): (1) Groups the carrier rates by the method of retrospective experience rating; (2) Groups consisting of the carrier's own employees; (3) Medicaid groups, Medicare groups, and groups that have only a stand alone benefit (such as dental only); and (4) A purchasing alliance whose rate-setting is mandated by the State or local government.
>
> (d) 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.

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.

Finally, the term "health benefits plan," which is used in the definition of carrier, is defined as follows:

> Health benefits plan means a group insurance policy, contract, medical or hospital service agreement, membership or subscription contract, or similar group arrangements provided by a carrier for the purpose of providing, arranging for, delivering, paying for, or reimbursing any of the costs of health care services.

48 C.F.R. § 1602.170-9 (emphasis added).

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 attached hereto as Exhibit D. (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".[1] 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 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."

[1] See e.g., Comment letter dated March 3, 2005 attached hereto as Exhibit E.

See OPM Carrier Letter No. 2005-11 attached hereto as Exhibit F. (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."

Therefore, the "separate line of business" instruction – which inquires into whether separate staffs are used for certain activities within the supposedly separate line of business -- cannot be applied to a subsidiary of the carrier that contracts with OPM. The fact that the carrier that contracts with OPM also performs administrative services for the subsidiary, or vice versa, does not create a different result. The provision of administrative services by a corporate parent to an affiliate is very common in the health plan and other industries. Such arrangements do not affect the legal separateness of the related parties. That the same staff may perform certain functions for both LIC and LHS is irrelevant to whether UNM can be an SSSG of LHS. Thus, UNM's ineligibility to be an SSSG does not depend on satisfaction of the criteria OPM has established for determining if a program within a single company can be deemed a "separate line of business." A different conclusion would not only violate the FEHBP regulations and the Standard Contract, but would radically alter the premises of health plans' participation in the FEHBP. This is true, not only for regional plans like LHS, but also for major national insurance companies that have many different subsidiaries that are licensed as insurers and as health maintenance organizations, often operating within the same states.

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. UNM, therefore, cannot be an SSSG since it did not contract with LHS for health benefits coverage in 2008.

2. LHS and LIC Are Separate and Distinct Legal Entities.

LHS and LIC are separate and distinct legal entities. LHS is incorporated as a New Mexico corporation and does business using the name Lovelace Health Plan. See LHS Articles of Incorporation attached as Exhibit G. LHS is licensed by the

New Mexico Public Regulation Commission, Insurance Division as a health maintenance organization. See LHS Certificate of Authority attached hereto as Exhibit H. LHS has contracted with OPM as an FEHBP contractor since 1981. A copy of pertinent pages of LHS' community rated contract with OPM contract are attached as Exhibit I. A copy of pertinent pages from the 2008 LHS FEHBP brochure is attached as Exhibit J.

LIC is a separately incorporated New Mexico corporation. See LIC Articles of Incorporation attached as Exhibit K. LIC is licensed by the New Mexico Public Regulation Commission, Insurance Division as a life and health insurer. See LIC Certificate of Authority attached hereto as Exhibit L. LIC is not an FEHBP contractor.

As separately licensed companies, LHS and LIC are each subject to separate chapters of the New Mexico Insurance Code. As a health maintenance organization, LHS is primarily governed by N.M. Stat. Ann. § 59A-46-1 et. seq. As a life and health insurer, LIC is governed by separate licensure requirements under a range of provisions, including N.M. Stat. Ann. § 59A-20-1 (regulating life insurance contracts) and N.M. Stat. Ann. § 59A-22-1 et seq. (regulating health insurance contracts). Each submits separate sets of audited and certified financial statements, attached hereto as Exhibits M (LHS) and N (LIC). Each company is also appropriately capitalized in accordance with New Mexico law.

As demonstrated by the foregoing, LHS and LIC 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, a group that contracts with LIC, such as UNM, is not eligible to be an SSSG under LHS' contract with OPM. As a result, the Draft Report's finding and recommended adjustment for based on UNM are erroneous. LHS correctly identified its 2008 SSSGs as Western Teamsters and Comcast, and the FEHBP is not due a rate adjustment for that year.

II. Conclusion

LHS acknowledges that $841,648 should be returned to the FEHBP for contract year 2009. LHS disputes that it engaged in defective pricing in contract year 2008 and that any adjustment is due the FEHBP for that year.

If you have any questions regarding this correspondence, please contact me at 202 624-2820.

Sincerely,

Arthur N. Lerner

enclosures

cc: Angela Martinez
Christine Rinn