



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 FirstCare Health Plans – West Texas**

**Report No. 1C-CK-00-13-064**

**Date: June 24, 2014**

**-- CAUTION --**

This audit report has been distributed to Federal officials who are responsible for the administration of the audited program. This audit report may contain proprietary data which is protected by Federal law (18 U.S.C. 1905). Therefore, while this audit report is available under the Freedom of Information Act and made available to the public on the OIG webpage, caution needs to be exercised before releasing the report to the general public as it may contain proprietary information that was redacted from the publicly distributed copy.

## AUDIT REPORT

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
FirstCare Health Plans – West Texas  
Contract Number CS 2321 - Plan Code CK  
Austin, Texas**

Report No. 1C-CK-00-13-064

Date: June 24, 2014



---

**Michael R. Esser  
Assistant Inspector General  
for Audits**

-- CAUTION --

This audit report has been distributed to Federal officials who are responsible for the administration of the audited program. This audit report may contain proprietary data which is protected by Federal law (18 U.S.C. 1905). Therefore, while this audit report is available under the Freedom of Information Act and made available to the public on the OIG webpage, caution needs to be exercised before releasing the report to the general public as it may contain proprietary information that was redacted from the publicly distributed copy.

---

## EXECUTIVE SUMMARY

---

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
FirstCare Health Plans – West Texas  
Contract Number CS 2321 - Plan Code CK  
Austin, Texas**

**Report No. 1C-CK-00-13-064**

**Date:** June 24, 2014

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at FirstCare Health Plans – West Texas (Plan). The audit covered contract years 2010 through 2013, and was conducted at the Plan’s office in Austin, Texas.

This report questions \$366,402 for inappropriate health benefit charges to the FEHBP in contract year 2011, including \$19,362 for lost investment income through May 31, 2014. 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 2010, 2012, and 2013.

For contract year 2011, we determined that the FEHBP rates were overstated by \$347,040 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 \$19,362 for lost investment income, calculated through May 31, 2014, on the defective pricing finding. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning June 1, 2014, until all defective pricing amounts have been returned to the FEHBP.

# CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY .....	i
I. INTRODUCTION AND BACKGROUND .....	1
II. OBJECTIVES, SCOPE, AND METHODOLOGY .....	3
III. AUDIT FINDINGS AND RECOMMENDATIONS .....	5
Premium Rate Review .....	5
1. Defective Pricing.....	5
2. Lost Investment Income.....	7
IV. MAJOR CONTRIBUTORS TO THIS REPORT.....	9
Exhibit A (Summary of Questioned Costs)	
Exhibit B (Defective Pricing Questioned Costs)	
Exhibit C (Lost Investment Income)	
Appendix (First Care Health Plan’s April 11, 2014, response to the draft report)	

# I. INTRODUCTION AND BACKGROUND

## Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at FirstCare Health Plans – West Texas (Plan). The audit covered contract years 2010 through 2013 and was conducted at the Plan’s office in Austin, Texas. For contract year 2013, the Plan is subject to the Medical Loss Ratio (MLR) rules and regulations. The audit was conducted pursuant to the provisions of Contract CS 2321; 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.

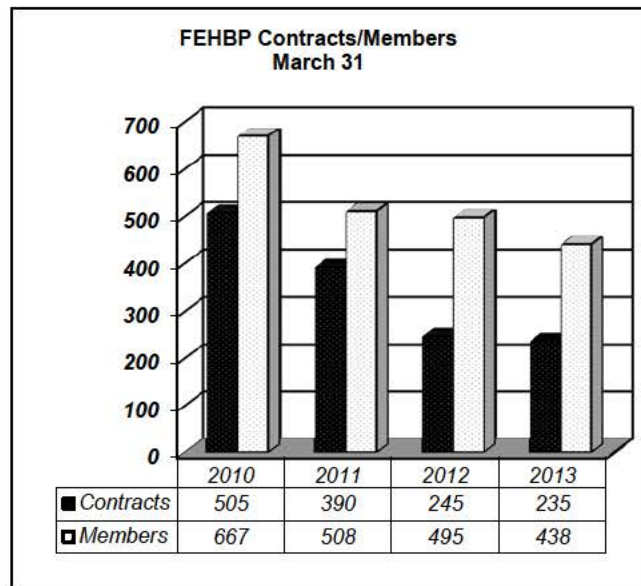
## Background

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 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.

For contract year 2010 through 2012, 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. For contract year 2013, the premium rates charged to the FEHBP under the MLR methodology are to be developed in accordance with the Plan’s state-filed standard rating methodology (or if the rating method does not require state filing, the Plan’s documented and established



rating method.) All FEHBP pricing data are to be sufficiently supported by accurate, complete, and current documentation. 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 Plan has participated in the FEHBP since 1988 and provides health benefits to FEHBP members in the West Texas - Amarillo area. The last audit of the Plan conducted by our office was a rate reconciliation audit that covered contract year 2009. There were no findings related to 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 included, as appropriate, in the Appendix.

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

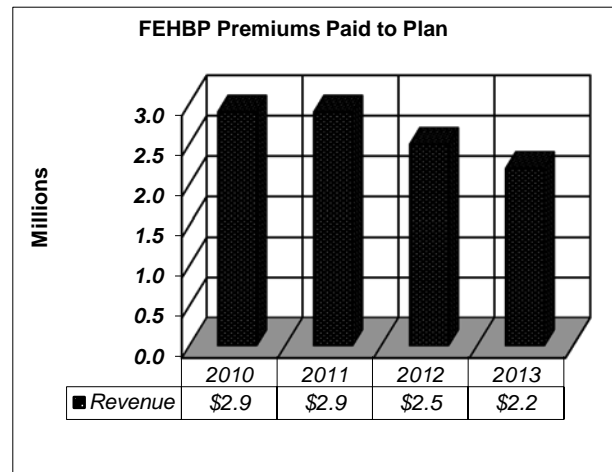
### **Objectives**

The primary objective of this performance audit was to determine whether the Plan was in compliance with the provisions of its contract and the laws and regulations governing the FEHBP. For contract years 2010 through 2012, the primary objective was to determine if the Plan offered the FEHBP market price rates based on the rates given to the similarly sized subscriber groups (SSSGs). For contract year 2013, the primary objective was to determine if the plan offered the FEHBP fair premium rates, based on its underwriting guidelines and OPM rules and regulations. We also verified 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 2013. The audit did not include tests of the Plan's 2013 MLR calculation which will remain subject to future audit. For these contract years, the FEHBP paid approximately \$10.5 million in premiums to the Plan, as 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 SSSGs were selected;

- the rates charged to the FEHBP in 2010 through 2012 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.

For contract year 2013, our review of internal controls was limited to the procedures the Plan has in place to ensure that the rates charged the FEHBP are developed in accordance with the Plan's standard rating methodology and the claims, factors, trends, and other related adjustments are sufficiently supported by source documentation.

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 August 2013 at the Plan's office located in Austin, Texas. Additional audit work was completed at our offices located in Washington, D.C. and Cranberry Township, Pennsylvania.

### **Methodology**

For contract years 2010 through 2012, 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. For contract year 2013, we examined the Plan's standard rating methodology as a basis for validating its federal rate submission and related documents. In addition, we verified that the factors, trends, and other related adjustments used to determine the FEHBP premium rates were supported by accurate, complete, and current source data.

We also examined claim payments to verify that the pricing data used to develop the FEHBP rates was accurate, complete, and valid. 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 reasonability 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**

**\$347,040**

The Certificate of Accurate Pricing the Plan signed for contract year 2011 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 entitled to a premium adjustment totaling \$347,040 (see Exhibit A). We found that the FEHBP rates were developed in accordance with OPM's rules and regulations in 2010, 2012, and 2013.

For contract year 2011, 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.

#### **2011**

The Plan selected [REDACTED] as SSSGs in contract year 2011. We agree with the Plan's selection of [REDACTED]. However, we disagree with the Plan's selection of [REDACTED] because another employer group, [REDACTED] was closer in subscriber size to the FEHBP. The Plan excluded [REDACTED] as an SSSG, citing separate line of business rules in the rate instructions. However, we determined that the group does not meet the separate line of business criteria necessary to be excluded as an SSSG.

Our analysis of the rates charged to the SSSGs showed that [REDACTED] received a [REDACTED] percent discount and [REDACTED] did not receive a discount. We recalculated the FEHBP rates by applying the above SSSG discount and determined that the FEHBP was overcharged \$347,040 in contract year 2011 (see Exhibit B).

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

The Plan states that groups contracting with Southwest Health and Life are exempt from the SSSG elimination process due to the following reasons:

- (a) [REDACTED] cannot be an SSSG because it is not a customer group of SHA, dba FirstCare, but are customers of Southwest Health and Life.
- (b) Only groups that contract with SHA, dba FirstCare, "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 SHA, dba FirstCare, and Southwest Health and Life are two distinct and separately licensed corporations.

**OIG’s Response to the Plan’s Comments:**

Groups contracting with Southwest Health and Life are not exempt from SSSG consideration due to the following reasons:

(a) Southwest Health and Life 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 2011 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.

Southwest Health and Life does not meet the third criteria above; therefore, Southwest Health and Life cannot be considered a separate line of business for SSSG purposes.

(b) Any group that contracts with SHA, dba FirstCare, and its subsidiaries (excluding separate lines of business as established in the 2011 rate instructions above) can be selected as an SSSG.

According to the 2011 rate instructions, any group with which an FEHBP 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. To be a separate line of business, Southwest Health and Life 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.” Southwest Health and Life clearly does not have a separate workforce or management, since SHA, dba FirstCare, completes all administrative work for the Preferred Provider Organization product offered by Southwest Health and Life.

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, Southwest Health and Life does not meet the qualifications to be considered a separate line of business. Therefore, all Southwest Health and Life groups that meet 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. By using this as a reason to eliminate any potential SSSG, the Plan could essentially create a separate entity where the FEHBP is the only group meeting the criteria for inclusion, thus rendering the SSSG process irrelevant.

(d) Although both SHA, dba FirstCare, and Southwest Health and Life are shown as licensed corporations, Southwest Health and Life is a wholly-owned subsidiary of SHA, dba FirstCare. 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, Southwest Health and Life does not meet the qualifications to be considered a separate line of business. Therefore, all Southwest Health and Life groups, if meeting the SSSG criteria, can be selected as SSSGs.

### **Recommendation 1**

We recommend that the contracting officer require the Plan to return \$347,040 to the FEHBP for defective pricing in contract year 2011.

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

**\$19,362**

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 year 2011. We determined that the FEHBP is due \$19,362 for lost investment income, calculated through May 31, 2014 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning June 1, 2014, 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 \$19,362 to the FEHBP for lost investment income for the period January 1, 2011 through May 31, 2014. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning June 1, 2014, 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

---

██████████., Chief

██████████, Senior Team Leader

**EXHIBIT A**

**Firstcare Health Plans - Amarillo Area  
Summary of Questioned Costs**

Defective Pricing Questioned Costs

Contract Year 2011	<u>\$347,040</u>	
Total Defective Pricing Questioned Costs		\$347,040
Lost Investment Income		<u>\$19,362</u>
Total Questioned Costs		<u><b>\$366,402</b></u>

**EXHIBIT B**

**Firstcare Health Plans - Amarillo Area  
Defective Pricing Questioned Costs**

**Contract Year 2011**

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	■	■	
FEHBP Line 5 - Audited Rate	■	■	
Bi-weekly Overcharge	■	■	
To Annualize Overcharge:			
March 31, 2011 enrollment	■	■	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	■	■	
Total 2011 Defective Pricing Questioned Costs			<b><u>\$347,040</u></b>

**EXHIBIT C**

**Firstcare Health Plans - Amarillo Area  
Lost Investment Income**

<b>Year</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>Through May 31, 2014</b>	<b>Total</b>
<b>Audit Findings:</b>					
1. Defective Pricing	\$347,040	\$0	\$0	\$0	\$347,040
<hr/>					
Totals (per year):	\$347,040	\$0	\$0	\$0	\$0
Cumulative Totals:	\$347,040	\$347,040	\$347,040	\$347,040	\$347,040
Avg. Interest Rate (per year):	2.563%	1.875%	1.538%	0.885%	
Interest on Prior Years Findings:	\$0	\$6,507	\$5,336	\$3,073	\$14,916
Current Years Interest:	\$4,446	\$0	\$0	\$0	\$4,446
<hr/>					
Total Cumulative Interest Calculated Through May 31, 2014:	\$4,446	\$6,507	\$5,336	\$3,073	<b>\$19,362</b>



APPENDIX

Tel 512.320.7200  
Fax 512.320.7210

April 11, 2014

**Via Email: [REDACTED]  
and Overnight Delivery**

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

**Re: SHA, L.L.C. d/b/a FirstCare Health Plans  
Draft Audit Report No. 1C-CK-00-13-064**

Dear [REDACTED]:

This law firm represents SHA, L.L.C. (dba FirstCare Health Plans) (“FirstCare”), a community rated “carrier” under the Federal Employees Health Benefits Program (“FEHBP”). This letter and accompanying exhibits constitute the response of FirstCare to the above-referenced draft audit report (the “Draft Report”) on the FEHBP operations of FirstCare for contract years 2010 through 2013.

The Draft Report contains preliminary findings of alleged defective pricing in contract year 2011. Specifically, for 2011, the Draft Report claims that FirstCare did not apply a discount to the FEHBP that FirstCare allegedly gave a similarly sized subscriber group (“SSSG”). The Draft Report recommends that FirstCare return \$363,329 to the FEHBP, representing \$347,040 in alleged defective pricing and \$16,289 in alleged lost investment income.

FirstCare disputes the Draft Report’s findings and recommendations with respect to contract year 2011. FirstCare does not dispute the Draft Report’s finding and recommendation regarding the other years covered by the audit. Per your request, we are providing this response on a compact disk in Microsoft Word format and also via hard copy.

For contract year 2011, FirstCare identified [REDACTED] and [REDACTED] as its SSSGs. The Draft Report agrees with FirstCare’s selection of [REDACTED] but disagrees with the selection of [REDACTED]. According to the Draft Report, the auditors selected the [REDACTED] [REDACTED] it was closer in size to the FEHBP and did not meet any SSSG

exclusion requirements. However, ██████████ cannot be an SSSG under FirstCare's contract with the Office of Personnel Management ("OPM") because ██████████ was not a customer of FirstCare.

To be ineligible for SSSG status, ██████████ need not fit within one of the exceptions from SSSG eligibility applicable to particular types of carrier customers, because it was not a customer of FirstCare in the first place. FirstCare correctly excluded ██████████ as ██████████ was a PPO subscriber group of Southwest Life & Health Insurance Company ("Southwest") and was covered by a separate line of business. Under Texas law, FirstCare is **prohibited** from offering a PPO line of business; it may only offer HMO products. The PPO product issued to ██████████ is a line of business that, under Texas law, could only be offered by Southwest.

██████████ does not qualify for SSSG status because ██████████ was not a customer group of FirstCare (and by law could not be a PPO customer group of FirstCare). ██████████ was a customer of Southwest, an insurance company subsidiary of FirstCare that is a separate corporate legal entity from FirstCare. *See* Organizational Chart attached hereto as Exhibit A. *See also* Group Contract between Southwest and ██████████ attached hereto as Exhibit B and the applicable enrollee evidence of coverage (excerpts) issued by Southwest for ██████████ plan participants attached as Exhibit C. Since ██████████ was not a customer group of the FEHBP carrier – FirstCare – and was covered under a separate line of business offered by Southwest, ██████████ cannot be an SSSG under FirstCare's contract with OPM.

### **Only Customers of FirstCare May 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 offering separate lines of business.

OPM's rating instructions regarding SSSGs are consistent with the definitions discussed above. Specifically, in connection with guidance excluding customers of a separate line of business of a carrier from SSSG eligibility, OPM defines a separate line of business as follows:

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.
- 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).

As evidenced by the foregoing, OPM recognizes that group customers under a separate line of business are not eligible for SSSG consideration. [REDACTED] therefore, cannot be an SSSG because it did not contract with FirstCare for health benefits coverage in 2011, and FirstCare could not have legally offered [REDACTED] the PPO line of business.

### **FirstCare and Southwest Are Separate and Distinct Legal Entities.**

FirstCare and Southwest are separate and distinct legal entities. FirstCare is incorporated as a Texas limited liability company and does business using the name FirstCare Health Plans. *See* FirstCare Articles of Organization attached as Exhibit D. FirstCare is licensed by the Texas Department of Insurance as a health maintenance organization. *See* FirstCare Certificate of Authority attached hereto as Exhibit E. FirstCare has contracted with OPM as an FEHBP contractor since 1988.

Southwest is a separately incorporated Texas insurance company. *See* Southwest Articles of Incorporation attached as Exhibit F. Southwest is licensed by the Texas Department of Insurance as a life and health insurer. *See* Southwest Certificate of Authority attached hereto as Exhibit G. Southwest is not an FEHBP contractor.

As separately licensed companies, FirstCare and Southwest are each subject to separate chapters of the Texas Insurance Code. As a health maintenance organization, FirstCare is primarily governed by Chapter 843, Tex. Ins. Code. As a life and health insurer, Southwest is governed by separate licensure requirements under a range of provisions, including Chapter 841 Tex. Ins. Code. By law, FirstCare may only offer HMO products and not PPO products (such as the PPO product sold to [REDACTED])

We would also note that FirstCare and Southwest have separate tax ID numbers ██████████ and ██████████, respectively) and that, while FirstCare is taxed as a partnership entity, Southwest is taxed as a corporation (and the IRS recognizes them as separate entities).

### **FirstCare and Southwest Have Separate Financial Accountability.**

Each of FirstCare and Southwest submit separate sets of audited and certified financial statements. Copies of the 2011 reports are attached hereto as Exhibits H and I. Each company is also separately capitalized in accordance with Texas law. As can be seen from the audited reports, Southwest is not “rolled up” in FirstCare’s financials.

We would further point out that FirstCare and Southwest submit separate NAIC Quarterly and Annual Financial Statements to TDI and have different requirements with respect thereto in that FirstCare is an HMO and Southwest is an insurance company. In addition, FirstCare and Southwest are required to be audited as separate entities and have separate audit reports.

We further note that, under the federal Affordable Care Act (“ACA”), FirstCare and Southwest are recognized as separate underwriting entities with separate lines of business. With respect to the medical loss ratio “rebating” requirements under ACA for 2011, 2012, and 2013 (the years in question), ACA requires that the rebates be separately calculated for each company for each of such company’s lines of business.

### **FirstCare and Southwest Have Separate Work Force and Separate Management.**

FirstCare and Southwest each have separately elected Boards of Directors and separately appointed officers.

From a rating and underwriting perspective, we point out that each of FirstCare and Southwest have their own separate base rates and that, as a separate line of business, Southwest’s PPO groups have separate rating characteristics than the HMO groups of FirstCare. The rating rules in Texas are different for HMO and PPO products.

Furthermore, within FirstCare and Southwest, there is a further separation of underwriting duties between (i) standard accounts for groups subject to state taxation and (ii) jumbo accounts for non-taxable groups, such as FEHBP and certain state and university accounts. The standard accounts are tax-paying entities, and they all have a PPO product offering in the portfolio offered to them; whereas, the jumbo accounts **do not** receive a PPO offering and in addition they **do not** pay state taxes. FirstCare and Southwest took intentional and deliberate efforts to segregate the staff who had responsibility for the standard tax-paying accounts from the staff responsible for the jumbo non-taxable groups. This segregation of duties was done specifically for the purpose of separating the duties for underwriting and rating with respect to FEHBP from the duties relating to standard groups such as ██████████.

In the case of ██████████ only had a PPO offering. It did not have an HMO offering, thus there was no possibility of “cost-shifting” to shift risk and benefits between FirstCare and Southwest.

As demonstrated by the above discussion, FirstCare and Southwest are separately incorporated and licensed legal entities with their own respective lines of business. Therefore, based on the FEHB Act, FEHBAR, OPM Standard Contract, and OPM rate instructions, a group that contracts with Southwest, such as ██████████, is not eligible to be an SSSG under FirstCare’s contract with OPM. As a result, the Draft Report’s finding and recommended adjustment based on ██████████ are erroneous. FirstCare correctly identified its 2011 SSSGs as ██████████ and ██████████ ██████████, and the FEHBP is not due a rate adjustment for that year.

FirstCare disputes that it engaged in defective pricing in contract year 2011 and that any adjustment is due the FEHBP for that year and further disputes the related lost investment income.

On behalf of FirstCare, we are interested in learning more about specific instances in which OPM has recognized the “separate line of business” exception and to review the related documentation pertaining to such cases. We will submit an FOIA request to obtain such information.

If you have any questions regarding this correspondence, please contact me at ██████████ ██████████.

Sincerely,

██████████

Enclosures

cc: FirstCare Health Plans  
██