

Government of the District of Columbia
Department of Insurance, Securities and Banking



William P. White
Acting Commissioner

BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA

Re: Report on Limited Scope Financial Examination of
DC Chartered Health Plan Inc. – NAIC #95748

ORDER

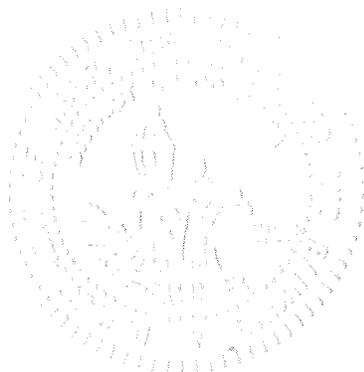
A Limited Scope Financial Examination of the above referenced company (“the Company”) has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“Department”).

It is hereby ordered on this 27th of November 2012, that the attached limited scope financial examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the Company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.




William P. White
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON LIMITED SCOPE EXAMINATION

OF

DC CHARTERED HEALTH PLAN, INC.

NAIC #95748

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SALUTATION

Washington, D.C.
November 8, 2012

Honorable William P. White
Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street, NE, Suite 701
Washington, D.C. 20002

Dear Commissioner White:

In accordance with the provisions of the District of Columbia Official Code Title 31, Chapter 14 (Law on Examinations), we have conducted a limited scope examination of certain activities of

DC CHARTERED HEALTH PLAN, INC. – NAIC #95748

hereinafter referred to as the “Company”, or “DC Chartered”, and the following Report on Examination is submitted. The Company is a licensed District of Columbia Medicaid Managed Care Organization (“MCO”) that operates exclusively in the District of Columbia. The Company was organized and commenced business in 1986.

BACKGROUND

On February 25, 2008, DC Chartered entered into Contract DCHC-2008-D-5052 (the “Contract”) with the District of Columbia Office of Contracting and Procurement (“DCOCP”) to provide healthcare services to the Medicaid eligible population enrolled in the District of Columbia Healthy Families Program (“DCHFP”) and to the Alliance eligible population enrolled in the DC Health Care Alliance Program (“Alliance Program”). The Contract is administered by the District of Columbia Department of Healthcare Finance (“DHCF”) (formerly known as the Medical Assistance Administration).

In July 2010, the DHCF required the transfer of a population of former members of the Alliance Program to the DCHFP. That population, referred to as the “774 population”, consisted of childless adults who had incomes at or below 133% of the federal poverty level.

In December 2010, the DHCF required the transfer of an additional population of former members of the Alliance Program to the DCHFP. That population, referred to as the “775 population”, consisted of childless adults who had incomes at or below 200% of the federal poverty level.

The effect of the transfers was to provide increased benefit coverage, particularly pharmacy benefit coverage, to the 774/775 populations than was made available under the Alliance Program.

Pursuant to the Contract, the DHCF conducts an annual actuarial review of the Contract’s capitation rates and establishes capitation rates for the 12-month period commencing each August 1. After the July and December, 2010 transfers of the 774 and 775 populations from the Alliance Program to the DCHFP, the DHCF conducted its actuarial review and established capitation rates for the August 1, 2011 – July 31, 2012 time period.

On November 30, 2011, the Company filed a claim with the Contracting Officer of the DCOCP for payment of \$25,771,117. The Company contended that rate adjustments made by the DHCF after the 774/775 populations were added to the DCHFP were not actuarially sound, as required by the Contract, and resulted in losses to the Company.¹ The Contracting Officer failed to issue a decision within 120 days of receipt of the claim; thus, the claim was deemed denied as of March 29, 2012.

On April 9, 2012, the Company filed an appeal of the Contracting Officer’s denial of its November 30, 2011 claim with the District of Columbia Contract Appeals Board (“Appeals Board”). Under the appeal, the Company is seeking:

- (1) a review of the capitation rate decision and the applicable assumptions as the rate chosen by the District is not actuarially sound or equitable, (2) a review of the annual

¹ The claim consisted of payments of approximately \$13,665,419 for losses experienced by DC Chartered from August 1, 2010 to October 31, 2011 and \$12,105,699 for the losses DC Chartered projected it would experience for the period between November 1, 2011 and April 30, 2012.

adjustment to the rates and the applicable assumptions as the adjustment is not actuarially sound or equitable, (3) an adjustment to the capitated rate to make such rates actuarially sound; and in the alternative, (4) an equitable adjustment to the capitated rate due to significant increases in actual pharmacy benefit costs.²

In the specific counts of the appeal, the Company alleges breach of contract and an equitable adjustment due to the DHCF's failure to compensate the Company for its increased cost of performance due to changed circumstances. The Company seeks, among other things, payment of \$25,771,117, plus accrued interest and reasonable attorneys' fees and costs. It is our understanding that a date has not been set for a ruling by the Appeals Board.

In the Company's Annual Statement as of December 31, 2011 (due March 1, 2012), the Company did not record a receivable for the \$25,771,117 claim. However, in the Company's Quarterly Statement as of June 30, 2012 (due August 15, 2012), the Company established an accrued retrospective premium receivable ("premium receivable") of \$24,060,016.³

In meetings and communications with the District of Columbia Department of Insurance, Securities and Banking ("DISB"), the Company and its consultants have contended that the Contract is a retrospectively rated contract, as defined in Statement of Statutory Accounting Principles No. 66 – Retrospectively Rated Contracts ("SSAP 66") of the NAIC *Accounting Practices and Procedures Manual*. As a result, the Company believes the amount it claims is due under the Contract represents an admitted asset under statutory accounting principles.

SCOPE OF EXAMINATION

Pursuant to the Memorandum of Understanding between Rector & Associates, Inc. and the DISB with respect to this limited scope examination, the scope of the examination is to review the information surrounding the inclusion of amounts in the financial statement related to DC Chartered's interpretation of the Medicaid contract as a retrospectively rated contract and the establishment of an asset in the financial statement as a result of the currently pending action with the Appeals Board. Should the conclusion be that the establishment of an asset is appropriate, the DISB does not need a determination as to whether the amount established by DC Chartered is appropriate given the circumstances.

The following materials were reviewed in the performance of the limited scope examination:

- Contract No. DCHC-2008-D-5052 (Medicaid Services contract between DCOCP and DC Chartered), and related attachments
- April 9, 2012 DC Chartered Appeal to the Appeals Board

² Based on the remedies sought by DC Chartered in the appeal, it is not clear whether the Appeals Board might award DC Chartered only a portion of its \$25,771,117 claim if the Appeals Board finds in favor of DC Chartered on only certain of its requested remedies.

³ Please note that we have been unable to determine why the Company recorded a receivable of \$24,060,016, vs. the \$25,771,117 claim that it filed with the Contracting Officer of the DCOCP and that it is claiming on appeal.

- Annual Statement as of December 31, 2011 and Quarterly Statement as of June 30, 2012 for DC Chartered
- District of Columbia Statutes and Regulations
- NAIC *Accounting Practices and Procedures Manual* (as of March 2012)
- Position papers titled “Accounting and Reporting for Pharmacy Retrospective Equitable Capitation Rate Adjustment (Retrospective Equitable Adjustment) for Costs Incurred” prepared on behalf of the Company by Millennium Consulting Services, LLC dated June 2012 (“June Position Paper”) and July 2012 (“July Position Paper”)
- Various electronic communications between the DISB and the Company related to discussion of the statutory accounting treatment of the premium receivable

In addition to the listed documents, several telephone conferences were held with members of the DISB to discuss matters relevant to the assessment of the Company’s statutory accounting treatment of the receivable.

SUMMARY FINDINGS

Based on our analysis, we believe that the determination of whether the Contract is a retrospectively rated contract in accordance with statutory accounting principles is a very close question. The relevant statutory accounting principles, as described herein, do not specifically address the relevant facts and the Contract language, which is unclear with respect to the manner in which rate adjustments are made. Despite the lack of clarity in the relevant Contract language, we believe the relevant language supports DC Chartered’s position that the Contract is a retrospectively rated contract and that DC Chartered’s claim for additional premium payments is an asset in accordance with SSAP No. 66. In other words, we believe that it is reasonable to interpret the Contract to expect that DC Chartered could receive premium adjustments based on DC Chartered’s loss experience relating to the Contract, including loss experience resulting from changes to the terms of the Contract.

It is important to point out that when DC Chartered takes the position that the Contract is a retrospectively rated contract, it should take into account its *entire* loss experience to determine its final policy premium, not just the loss experience resulting from the transfer of the 774 and 775 populations from the Alliance Program to the DCHFP. SSAP No. 66 makes clear that a retrospectively rated contract’s final policy premium is calculated based on the loss experience of the insured during the term of the policy, not just the loss experience resulting from a contract change or a particular set of benefits.

Finally, as previously indicated, we were not asked as part of this limited scope examination to determine whether the amount of the premium receivable established by DC Chartered in its Quarterly Statement as of June 30, 2012 is appropriate. However, it is important to note that even if a reporting entity correctly admits an asset for statutory accounting purposes, the entity still must determine whether the asset is “impaired.” Pursuant to statutory accounting principles, if it is probable that an impairment has occurred and the impairment can be measured, the asset must be reduced to its impaired value.

ANALYSIS

Relevant Statements of Statutory Accounting Principles

SSAP No. 66 defines a retrospectively-rated contract as follows:

A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy or a formula required by law.

In addition, SSAP No. 66 provides that:

Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* (SSAP No. 5R), respectively.

DC Chartered's Position on Premium Receivable

DC Chartered's analysis of the methodology behind its establishment of the premium receivable is described in the Position Papers and claim. DC Chartered's argument is two-fold:

- *Capitation Rate Retrospective Adjustment Due To Contract Change* -- First, DC Chartered appears to assert that when the DHCF transferred the 774 and 775 populations from the Alliance Program to the DCHFP in July 2010 and December 2010, respectively, the DHCF changed the services to be covered under the Contract. According to DC Chartered, this change should have triggered a retrospective upward adjustment to the Contract's capitation rate for the time period commencing on the dates of the transfers of the 774 and 775 populations.
- *Annual Capitation Rate Adjustment* -- Second, DC Chartered asserts that when the DHCF conducted its actuarial review and established capitation rates for the August 1, 2011 – July 31, 2012 time period, the DHCF should have taken into account the July 2010 and December 2010 transfers of the 774 and 775 populations from the Alliance Program to the DCHFP. Accordingly, DC Chartered believes that the capitation rates commencing on August 1, 2011 should have been adjusted upward to take into account the transfers of the 774 and 775 populations.

Capitation Rate Retrospective Adjustment Due To Contract Change

Contract Provisions. Section B.3.1 of the Contract states, in part:

In the event that the District, pursuant to the Changes Clause of the Standard Contract Provisions, adds, deletes, or changes any services to be covered by the Contractor under

DCHF or the Alliance Program the District will review the effect of the change and equitably adjust the capitation rate (either upward or downwards) if appropriate....

The “Changes Clause” referenced in Section B.3.1 of the Contract states, in part:

The Contracting Officer may, at any time, by written order, and without notice to the surety, if any, make changes in the contract within the general scope hereof. If such change causes an increase or decrease in the cost of performance of this contract, or in the time required for performance, an equitable adjustment shall be made....

When read in conjunction with each other, these two sections of the Contract seem to require that if the Contract is changed to add, delete or change services covered by DC Chartered, the DHCF must review the effect of the change and equitably adjust the capitation rate.

As previously indicated, the Contract requires DC Chartered to provide healthcare services to the Medicaid eligible population enrolled in DCHF and to Alliance Program members. In July 2010 and December 2010, the DHCF required the transfer of the 774 population and 775 population, respectively, of Alliance Program members to the DCHF. It is our understanding that DC Chartered’s position is that pursuant to Section B.3.1, these transfers resulted in a change to the Contract because the transfers added or changed the services to be covered by the Contract.

It could be argued that the DHCF *did not* add or change services to be covered by the Contract. Instead, the DHCF only transferred individuals who were already covered under the Contract from one category (Alliance Program members) to another category (DCHF enrollees). Transferring individuals between categories of covered enrollees may not add or change services that were covered by the Contract since the same individuals were covered by the Contract both before and after the transfer.

However, DC Chartered claims in its appeal that the 774 and 775 populations previously were not eligible for pharmacy benefits that DCHF enrollees are eligible to receive through the Medicaid managed care program. As a result, these populations received pharmacy benefits through the Alliance Program which were significantly more restrictive than the benefits DC Chartered was required to provide these populations after they were transferred to the DCHF.

Based on our understanding of the effect of the 774 and 775 population transfers on the benefits DC Chartered was required to provide, it appears that DC Chartered was required to provide additional services in the form of increased pharmacy benefits. DC Chartered then argues that this change should have triggered a retrospective upward adjustment to the Contract’s capitation rate for the time period commencing on the dates of the transfers of the 774 and 775 populations (July 1, 2010 and December 10, 2010, respectively).

Analysis of SSAP and Contract Provisions. As previously indicated, SSAP No. 66 defines a retrospectively-rated contract as a contract that has:

- A final policy premium calculated based on the loss experience of the insured during the term of the policy; and
- A stipulated formula set forth in the policy or a formula required by law.

First, the DHCF's review of the effect of the Contract changes can be viewed as determining the "final policy premium calculated based on the loss experience of the insured during the term of the policy." In addition, the DHCF's equitable adjustment of the capitation rate can be viewed as "the stipulated formula set forth in the policy".

We recognize that simply requiring the DHCF to equitably adjust the capitation rate, if appropriate, is not the type of "stipulated formula" that normally is found in a retrospectively rated contract. However, it seems appropriate that in this type of contract, the "stipulated formula" is limited to determining the appropriate equitable adjustment to the capitation rate, rather than including a specific formula for changes in the capitated rate.

In addition, DC Chartered's July Position Paper points out that:

The District's courts define an equitable adjustment as 'the difference between what it would have reasonably cost to perform the work as originally required and what it reasonably cost to perform the work as changed.' (Page 3, July Position Paper.)

Although rudimentary, the courts have essentially defined an equitable adjustment as the following "formula":

Equitable Adjustment = Cost to perform work as changed +/- Cost of work as originally required

The DHCF's decision to redefine the 774/775 populations by transferring them from the Alliance Program to the DCHFP arguably triggered the Changes Clause and, accordingly, required the DHCF to assess the impact of the change and equitably adjust DC Chartered's capitation rate. In effect, the change created a liability for DHCF and an asset (premium receivable) for DC Chartered.

Annual Capitation Rate Adjustment

Contract Provisions. Sections B.3.2 and B.3.3 of the Contract provide:

B.3.2 No later than twelve (12) months after the date of the Contract Award and annually thereafter, the District will conduct an actuarial review of the capitation rates in effect to determine the actuarial soundness of the rates paid to the Contractors. The actuarial review will be based upon the rates offered by Contractor and will take into account factors such as inflation, significant changes in the demographic characteristics of the member population, or the disproportionate enrollment selection of Contractor by members in certain rate cohorts.

B.3.3 This actuarial review of the capitation rates may result in an annual adjustment, either increase or decrease, to the capitation rates. The District and Contractor shall negotiate the actual amount of the adjustment; however, the negotiated adjustment shall be actuarially sound in accordance with 42 C.F.R. 438.6(c).

Pursuant to these sections, the DHCF is required to review DC Chartered's capitation rates on an annual basis to determine if the rates are actuarially sound by taking into account, among other things, DC Chartered's loss experience.

DC Chartered argues that when the DHCF conducted its actuarial review and established capitation rates for the August 1, 2011 – July 31, 2012 time period, the DHCF should have taken into account the July 2010 and December 2010 transfers of the 774 and 775 populations from the Alliance Program to the DCHFP. Accordingly, DC Chartered argues that the capitation rates commencing on August 1, 2011 should have been adjusted upward to take into account the transfers of the 774 and 775 populations.

Analysis of SSAP and Contract Provisions. As previously indicated, SSAP No. 66 defines a retrospectively-rated contract as a contract that has:

- A final policy premium calculated based on the loss experience of the insured during the term of the policy; and
- A stipulated formula set forth in the policy or a formula required by law.

First, the DHCF's review of DC Chartered's capitation rates can be viewed as determining the "final policy premium calculated based on the loss experience of the insured during the term of the policy."

In addition, Sections B.3.2 and B.3.3 require that any changes to the capitation rate be actuarially sound, which is defined to be actuarial soundness in accordance with 42 C.F.R. 438.6(c). 42 C.F.R. 438.6(c) defines actuarially sound capitation rates to be rates that are:

- Developed in accordance with generally accepted actuarial principles and practices;
- Appropriate for the populations to be covered and the services to be furnished; and
- Certified by an actuary who meets the standards of the American Academy of Actuaries and uses practice standards established by the Actuarial Standards Board.

We recognize that simply requiring the DHCF to take into account actuarial soundness in determining capitation rates is not the type of "stipulated formula" that normally is found in a retrospectively rated contract. However, it is generally understood that actuarial principles and practices include the use of formulas to determine appropriate capitation rates.

Based on this analysis, we believe it is appropriate to consider the Contract to be a retrospectively rated contract due to the DHCF's required annual review of capitation rates in accordance with Sections B.3.2 and B.3.3. We note that if the DHCF failed to perform the required annual review or, alternatively, performed the review and failed to establish actuarially

sound rates, the amount of the deficiency in the capitated rates would be a liability for the DHCF and an asset (premium receivable) for DC Chartered.

Determination of Retrospective Rate for Entire Contract

As previously indicated, the scope of our examination was limited to reviewing DC Chartered's interpretation of the Medicaid contract as a retrospectively rated contract and determining whether it was appropriate for DC Chartered to establish the premium receivable as an asset in its financial statements. Based on our analysis, we have found that relevant Contract language supports DC Chartered's position that the Contract is a retrospectively rated contract and that the premium receivable can be considered an asset in accordance with SSAP No. 66.

At the same time, it is important to point out that when DC Chartered takes the position that the Contract is a retrospectively rated contract, it should take into account its *entire* loss experience to determine its final policy premium, not just the loss experience resulting from the transfer of the 774 and 775 populations from the Alliance Program to the DCHFP. SSAP No. 66 makes clear that a retrospectively rated contract's final policy premium is calculated based on the loss experience of the insured during the term of the policy, not just the loss experience resulting from a contract change or a particular set of benefits.

In addition, we noted that the Contract states that the retrospective capitation rate adjustment could result in a downward adjustment, as described in Section B.3.1, and that the annual rate review could result in a decrease in the capitation rate, as described in Section B.3.3. In other words, the Contract language envisions that it might be necessary for DC Chartered to record a liability due to, as an example, a required premium refund to the DHCF.

Additional Considerations

We were not asked as part of this limited scope examination to determine whether the amount established by DC Chartered in its Quarterly Statement as of June 30, 2012 is appropriate. However, we believe the DISB should be aware of other statutory accounting guidance that might impact the amount of the accrued retrospective premium that could be considered to be impaired.

SSAP No. 5R requires reporting entities to perform an on-going assessment as to the possible impairment to assets. In other words, even if a reporting entity correctly admits an asset for statutory accounting purposes, the entity still must determine whether the asset is "impaired."

SSAP No. 5R defines an impairment of an asset as an existing condition, situation, or set of circumstances involving uncertainty as to a possible loss that ultimately will be resolved when one or more future events occur or fail to occur. In addition, three definitions are used to assess whether an asset is impaired:

- a. Probable – The future event or events are likely to occur;

- b. Reasonably Possible – The chance of the future event or events occurring is more than remote but less than probable;
- c. Remote – The chance of the future event or events occurring is slight.

If it is probable that an impairment has occurred and the impairment can be measured, the asset must be reduced to its impaired value.

RECOMMENDATION

As previously noted in this Report, the Contract language does not set out a stipulated formula that is to be used to determine retrospective and annual premium adjustments or directly define what types of changes to DCHFP or the Alliance Program result in the addition, deletion or change in services to be covered by a contractor such as DC Chartered.

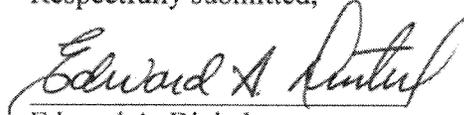
Accordingly, we recommend that to the extent possible, DC Chartered with the DCOCP and the DHCF develop language in their contracts to define and clarify a formula for calculating premium and capitation rate adjustments and the circumstances under which services are added, deleted, or changed. Clarifying the contract language will provide accurate calculation of any receivable/payable incurred under the contracts due to retrospective and annual premium adjustments.

SIGNATURES

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Sarah W. Schroeder
Neil K. Rector

Respectfully submitted,



Edward A. Dinkel
Rector & Associates, Inc.

Under the Supervision of,



Nathaniel Kevin Brown, CFE, CPA
Chief Financial Examiner
District of Columbia Department of Insurance,
Securities and Banking