Final

Report on the

Medical Loss Ratio Examination

of

PacificSource Health Plans
(Springfield, Oregon)

for the

2017 MLR Reporting Year

DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
Center for Consumer Information & Insurance Oversight
200 Independence Avenue SW
Washington, D.C. 20201

OVERSIGHT GROUP

March 29, 2021

In accordance with Title 45 of the Code of Federal Regulations (CFR), section 158.402, the Center for Consumer Information & Insurance Oversight (CCIIO) completed an examination of the Medical Loss Ratio (MLR) Annual Reporting Form submitted by PacificSource Health Plans (the Company) for the 2017 reporting year, including 2017, 2016, and 2015 data reported on that form. Following an exit conference with the Company, the Company responded to each Finding and Corrective Action. This final report, which will be made publicly available, incorporates the Company's response and CCIIO's evaluation of the response.

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I. Executive Summary

The Center for Consumer Information & Insurance Oversight (CCIIO) has performed an examination of the 2017 Medical Loss Ratio (MLR) Annual Reporting Form for PacificSource Health Plans (the Company) to assess the Company's compliance with the requirements of 45 CFR Part 158. We determined that the Company's 2017 MLR Annual Reporting Form contains some elements that are not compliant with the requirements of 45 CFR Part 158, and that impact consumer rebates.

We direct the Company to implement the necessary corrective actions to address the findings detailed in this report, including obtaining adequate information to accurately determine group size and market classification of policies; properly and accurately reporting incurred claims, risk adjustment transfer amounts, and earned premium; accurately restating prior year incurred claims; ensuring that activities and expenses reported as quality improvement activity (QIA) meet the regulatory definition of QIA and that the amounts reported do not exceed the actual expense; and properly reporting and accurately calculating taxes and regulatory fees.

To the extent that the findings could be quantified, the recalculation of the Company's 2017 MLRs resulted in changes to its reported MLRs in all states and markets in which the Company had health insurance coverage subject to 45 CFR Part 158 in effect. In the student market, the lower recalculated MLR fell below the applicable MLR standard, resulting in an estimated rebate liability of $372,548 for 2017. In all other markets in all states in which the Company had health insurance coverage subject to 45 CFR 158 in effect, the recalculated MLRs continued to exceed the applicable MLR standards and thus did not result in rebates being owed. However, due to the lack of adequate documentation supporting group size and market classification determinations, we cannot, at this time, conclusively assess the full impact of the examination findings on the Company's MLRs or rebate liability in any of the markets in the three states in which it operates.

II. Scope of Examination

CCIIO examined the Company's 2017 MLR Annual Reporting Form to determine compliance with 45 CFR Part 158. Title 45 CFR Part 158 implements section 2718 of the Public Health Service Act (PHS Act). Section 2718 of the PHS Act, as added by the Patient Protection and Affordable Care Act (PPACA), generally requires health insurance issuers to submit to the Secretary of the U.S. Department of Health & Human Services (HHS) an annual report concerning premium revenue and expenses related to group and individual health insurance coverage issued. The federal MLR is the proportion of earned premium, less certain taxes and regulatory fees, expended by an issuer on clinical services and activities that improve health care quality in a given state and market, after adjustments for the credibility of the experience or other factors, where applicable, and calculated using the average of three consecutive years of data. Section 2718 also requires an issuer to provide rebates to consumers if it does not meet the applicable MLR standard (generally, 80% in the individual and small group markets and 85% in the large group market).

This is the first examination of the Company's MLR Annual Reporting Form performed by CCIIO. The examination covered the reporting period of January 1, 2015 through December 31, 2017, including 2015, 2016, and 2017 experience and claims run-out through March 31, 2018. We conducted the examination in accordance with the CCIIO Medical Loss Ratio Examination Handbook (the Handbook). The Handbook sets forth the guidelines and procedures for planning and performing an examination to evaluate the validity and accuracy of the data elements and calculated amounts reported on the MLR Annual Reporting Form, and the accuracy and timeliness of any rebate payments. The examination included assessing the principles used and significant estimates made by the Company, evaluating the reasonableness of expense allocations, and determining compliance with relevant statutory accounting standards, MLR regulations and guidance, and the MLR Annual Reporting Form Filing Instructions.

The Company's response to each finding appears after the finding in the Conclusion, Corrective Actions, Company Responses, and CCIIO Replies section of this Report. The Company's implementation of the corrective actions was not reviewed for proof of implementation or subjected to the procedures applied during the examination. CCIIO's replies are based solely on a review of the Company's responses. CCIIO reserves the right to review the actual implementation of the Company's corrective action and proposed action plan for each finding in future MLR Annual Reporting Forms, examinations, or as otherwise may be appropriate.

III. Summary of Findings

Page	Key Findings
8	**Failure to employ standards consistent with the definitions in §158.103 to correctly determine the size of group policyholders –** The Company did not correctly obtain the average number of employees from each group policyholder at the time of initial application or policy renewal and therefore may not have correctly determined each group's size and market classification.
8	**Failure to maintain adequate documentation as required by §158.502 –** The Company did not maintain the documents and other records necessary to enable CCIIO to verify the Company's determinations of size and market classification of group policyholders.
9	**Failure to accurately report incurred claims, as required by §158.140 –** The Company incorrectly reported various components of incurred claims due to calculation and reporting errors. As a result, the Company overstated its three-year aggregate incurred claims by a net total of $11,027,743 in the individual market, $2,128,474 in the small group market, $5,581,657 in the large group market, and $299,925 in the student market on its 2017 MLR Annual Reporting Form. In addition, the Company failed to deduct prescription drug rebates it received from incurred claims. As a result of this error, the three-year aggregate incurred claims were overstated by a total of $5,009,248 in the individual market, $5,817,505 in the small group market, $13,430,454 in the

Page	Key Findings
	large group market, and $738,051 in the student market on its 2017 MLR Annual Reporting Form.
9, 12	**Failure to submit an MLR Annual Reporting Form in the manner prescribed by the Secretary, as required by §158.110 –** The Company incorrectly restated its 2015 and 2016 incurred claims on Part 3, Line 1.2 in the prior year (PY2 and PY1) columns on the 2017 MLR Annual Reporting Form. As a result, the Company overstated its three-year aggregate incurred claims by a net total of $385,951 in the individual market and understated its three-year aggregate incurred claims by a net total of $1,294,511 in the small group market, $507,462 in the large group market, and $997,216 in the student market on its 2017 MLR Annual Reporting Form. In addition, the Company improperly included expected risk corridors payment amounts in experience rating refunds in the individual market. As a result, the Company understated its three-year aggregate incurred claims by $2,179,881 in the individual market on its 2017 MLR Annual Reporting Form. Further, the Company incorrectly reported its 2017 risk adjustment transfer amount in the Montana small group market. As a result, the Company overstated its net risk adjustment payments in the Montana small group market for the 2017 benefit year by $10,045,226 on its 2017 MLR Annual Reporting Form.
10	**Reporting of expenses as QIA that did not meet the definition of a QIA expense set forth in §158.150 –** The Company improperly included in its QIA expenses the expenses of programs that were not directed at the Company's enrollees, as well as amounts that exceeded the actual expense. As a result, the Company overstated its three-year aggregate QIA expenses by a total of $400,694 in the individual market, $605,136 in the small group market, $1,212,990 in the large group market, and $134,069 in the student market on its 2017 MLR Annual Reporting Form.
11	**Failure to properly report earned premium, as required by §158.130 –** The Company included various inappropriate adjustments to earned premium. As a result, the Company's three-year aggregate earned premium was overstated by a net total of $4,111,748 in the individual market and $36,955 in the student market, and understated by a net total of $2,797,987 in the small group market and $2,621,128 in the large group market on its 2017 MLR Annual Reporting Form.
11	**Failure to properly report taxes and regulatory fees, as required by §158.161 and §158.162 –** The Company reported various taxes and licensing or regulatory fees inaccurately due to various reporting and calculation errors. As a result, the Company understated its three-year aggregate taxes and licensing or regulatory fees by a net total of $5,573,334 in the individual market and overstated them by a net total of $12,794,997 in

Page	Key Findings
	the small group market, $21,981,632 in the large group market, and $1,527,512 in the student market on its 2017 MLR Annual Reporting Form. In addition, the Company improperly included federal and state employment taxes in taxes deductible from premium. As a result, the Company overstated its three-year aggregate taxes and licensing or regulatory fees by $969,168 in the individual market, $1,200,093 in the small group market, $3,148,303 in the large group market, and $217,737 in the student market on its 2017 MLR Annual Reporting Form. Further, the Company inaccurately reported the Patient Centered Outcomes Research Institute (PCORI) fees. As a result of this error, the Company overstated its three-year aggregate PCORI fees by a net total of $30,861 in the individual market, $89,859 in the small group market, and $31,437 in the student market, and understated its three-year aggregate PCORI fees by a net total of $188,484 in the large group market on its 2017 MLR Annual Reporting Form. The Company also incorrectly reported portions of its state premium taxes on the lines reserved for the state income taxes and the regulatory fees instead of the line reserved for state premium taxes, as required by the MLR Annual Reporting Form Filing Instructions. This error did not impact the MLR calculation.

Based on the adjustments that could be quantified, the examination findings resulted in changes to the Company's reported MLRs in all states and markets in which the Company had health insurance coverage subject to 45 CFR Part 158 in effect. In the nationwide student market, the lower recalculated MLR fell below the applicable MLR standard, resulting in a rebate liability of $372,548 for 2017. In all other markets in all states in which the Company had health insurance coverage subject to 45 CFR 158 in effect, the recalculated MLRs continued to exceed the applicable MLR standards and thus did not result in rebates being owed. Due to the lack of adequate documentation supporting group size and market classification, we cannot, at this time, conclusively assess whether there were additional errors that would impact the Company's MLRs or rebate liability.

The three-year adjusted, aggregated numerator and denominator, along with the resulting credibility-adjusted MLRs and rebates for 2017, for the states and markets in which the MLRs changed as a result of the examination are shown in the following tables. The differences between the amounts in the "As Filed" and "As Recalculated" rows reflect the net result of the adjustments made to properly restate incurred claims; subtract prescription drug rebates from incurred claims; remove employment taxes and disallowed QIA expenses; and correct various errors in incurred claims, risk adjustment transfer amounts, earned premium, and federal and state taxes and regulatory fees. The amounts in the "As Recalculated" rows additionally include the Company's revisions related to the recovered risk corridors payment amounts, as described in Subsequent Events section of this report.

Recalculated MLRs[1] and Rebates for the Individual, Small Group, and Large Group Markets for the 2017 Reporting Year

Idaho

	Individual Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$17,666,393	$21,864,181	84.0%	$0
As Recalculated	$14,702,604	$18,788,885	81.5%	$0
Difference	($2,963,789)	($3,075,296)	(2.5%)	$0

	Small Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$16,399,069	$18,631,988	91.6%	$0
As Recalculated	$15,823,446	$20,597,511	80.4%	$0
Difference	($575,623)	$1,965,523	(11.2%)	$0

	Large Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$87,646,086	$87,886,365	101.6%	$0
As Recalculated	$85,268,484	$87,506,337	99.3%	$0
Difference	($2,377,602)	($380,028)	(2.3%)	$0

Montana

	Individual Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$168,155,303	$138,146,434	123.2%	$0
As Recalculated	$136,386,483	$143,927,303	96.3%	$0
Difference	($31,768,820)	$5,780,869	(26.9%)	$0

	Small Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$110,585,950	$134,318,636	83.8%	$0
As Recalculated	$115,062,316	$135,556,485	86.4%	$0
Difference	$4,476,366	$1,237,849	2.6%	$0

	Large Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$78,626,004	$89,780,961	89.6%	$0
As Recalculated	$76,724,165	$89,584,120	87.7%	$0
Difference	($1,901,839)	($196,841)	(1.9%)	$0

[1] The MLRs shown may not equal the quotient of the numerator divided by the denominator due to the inclusion of a credibility adjustment, in accordance with §158.230.

Oregon

	Individual Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$110,637,104	$120,718,661	93.4%	$0
As Recalculated	$88,663,747	$109,328,035	82.9%	$0
Difference	($21,973,357)	($11,390,626)	(10.5%)	$0

	Small Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$232,901,917	$252,499,241	93.1%	$0
As Recalculated	$225,318,485	$266,178,805	85.5%	$0
Difference	($7,583,432)	$13,679,564	(7.6%)	$0

	Large Group Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$680,992,546	$747,957,528	91.0%	$0
As Recalculated	$665,554,348	$776,096,976	85.8%	$0
Difference	($15,438,198)	$28,139,448	(5.2%)	$0

Student Health Plans

	Individual Market			
	Numerator	Denominator	MLR	Rebate
As Filed	$40,269,589	$50,521,113	81.4%	$0
As Recalculated	$40,094,760	$52,260,845	78.4%	$372,548
Difference	($174,829)	$1,739,732	(3.0%)	$372,548

IV. Company Overview

A. Description, Territory, and Plan of Operation

The Company is a not-for-profit health insurer domiciled in the state of Oregon and sells individual, group, and student health insurance policies in Idaho, Montana, and Oregon.

During the 2015, 2016, and 2017 MLR reporting years, the Company operated in the individual, small group, large group, and student markets that were subject to the MLR reporting requirements of 45 CFR Part 158. As of December 31, 2017, the Company reported a total of 137,862 covered lives and $675,527,373 in direct earned premium for policies subject to the MLR reporting and rebate requirements under 45 CFR Part 158, and a total of 209,695 covered lives and $703,951,277 in direct earned premium from all health lines of business. The Company's only line of business not subject to the MLR regulations at 45 CFR Part 158 is stand-alone dental insurance.

B. Management

The corporate officers and board of directors of the Company as of December 31, 2017 were:

Officers

Name	Title
Kenneth P. Provencher	President/Chief Executive Officer
Kristin E. Kernutt	Secretary
Peter F. Davidson	Chief Financial Officer
Erick Doolen	Chief Operating Officer
Dan Roth	Chief Medical Officer
Dan Stevens	Executive Vice President
Sharon Thomson	Executive Vice President

Directors

Name	
Jeffrey Barber	Divya Sharma
Robert Bentley	Claire Spain-Remy
George Brown	David Vinson
Edwin Dahlberg	Mark Werner
Ron King	Charles Wilhoite
Roger Saydack	John Winter Jr.
Patricia Schmitt	Richard Wright Jr.

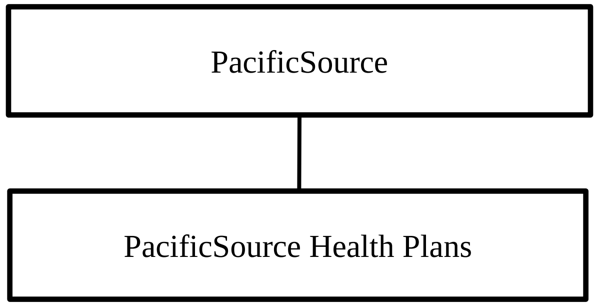
Company management and corporate-level personnel responsible for the preparation, submission, and attestation of the 2017 MLR Annual Reporting Form were:

Name	Title
Kenneth P. Provencher	CEO Attester
Peter F. Davidson	CFO Attester

C. Ownership

The Company is a member of an insurance holding group system.

PacificSource Health Plans
Organizational Chart[2] as of December 31, 2017



D. Agreements

As of December 31, 2017, the Company had entered into the following intercompany agreements that are pertinent to a review of its MLR Annual Reporting Form:

1. An Administrative Services Agreement with PacificSource, the Company's direct parent company.
2. A Tax Allocation Agreement with PacificSource and various other affiliates.

E. Reinsurance

During 2015, 2016, and 2017, the Company did not have any reinsurance agreements in effect that impacted the MLR reporting of its health insurance policies subject to the regulations at 45 CFR Part 158.

V. Accounts and Records

The Company's main administrative and financial reporting office is located at 110 International Way, Springfield, OR 97477. The Company provided adequate access to its accounts and records, including computer and other electronic systems, as required by §158.501.

As noted herein, the Company was not in compliance with §158.502 with regard to maintaining adequate documentation and other evidence necessary to enable CCIIO to verify that the MLRs and rebates owed were calculated in accordance with 45 CFR Part 158. Specifically, the Company did not obtain accurate information or maintain documentation regarding the employee count of group policyholders, which is necessary to determine group size and market classification.

VI. Examination Results

[2] This is an excerpt from the organization chart provided by the Company and includes only those entities whose relationship to the Company impacted the MLR examination.

The Company's 2015, 2016, and 2017 MLR Annual Reporting Forms were filed by the due date, but were not filed in the manner prescribed by the Secretary, as further described below.

During 2015, 2016, and 2017, the Company reported that it met or exceeded the applicable MLR standards in all states and markets in which it had business subject to the reporting and rebate requirements of 45 CFR Part 158 and thus was not required to pay rebates to its enrollees.

Based on the errors found during the examination that could be quantified, MLRs for the 2017 reporting year were recalculated and resulted in an estimated rebate liability of $372,548 in the nationwide student market. However, due to the Company's lack of adequate documentation to support its group size and market classification determinations, we cannot conclusively assess whether there were additional errors that could impact the Company's MLRs or rebate liability.

A. MLR Data

Market Classification

Incorrect Procedures for Determining Group Size

The Company adopted policies and procedures for determining group size and market classification that are inconsistent with the definitions in §158.103 applicable to the 2015-2017 reporting years. Section 158.103 employs the applicable definitions of Large Employer, Large Group Market, Small Employer, and Small Group Market in section 2791(e) of the PHS Act. Section 2791(e) of the PHS Act requires that small and large group market classifications be based on the *average number of employees on the business days of the calendar year preceding the coverage effective date*. The Company did not obtain the necessary information from group policyholders to determine employer size in accordance with these definitions, and therefore may have incorrectly determined the market classification for group policies in the period covered by this examination.

The documentation available to the examiners consisted of copies of recent billing invoices, copies of checks, the master policy, and the application or group renewal confirmation form, none of which contained the average number of employees on the business days of the calendar year preceding the coverage effective date. The Company inappropriately utilized the number of eligible employees at the time each policy was written or renewed to determine group size and market classification. Therefore, based on the available documentation, the examiners could not confirm whether the Company correctly determined group size, and consequently the market classification, of the group policies included in the sample tested. However, and despite the fact that the Company employed standards that were inconsistent with the definitions in §158.103, the policies tested during the examination were assigned to the correct market classification based on the (possibly incorrect) information the Company obtained from the group policyholders.

The precise impact of the failure to accurately determine group size and market classification cannot be conclusively determined due to the Company's lack of adequate documentation necessary to support its determinations.

Aggregation

Based upon the procedures performed, other than the possibly incorrect group size and market classification determinations noted above, nothing additional came to our attention that would indicate that the samples of policies, claims, and other items tested during the examination were not correctly assigned to the appropriate states, markets, and lines of business in accordance with §158.120.

Incurred Claims

Incorrect Reporting of Incurred Claims

The Company incorrectly reported incurred claims on its 2015, 2016, and 2017 MLR Annual Reporting Forms[3] due to numerous reporting and calculation errors. For example, the Company improperly included adjustments representing incurred but not reported (IBNR) claims in its claims paid on Part 2, Line 2.1b, when these amounts were already included in its direct claims liability on Part 2, Line 2.2b of the 2016 MLR Annual Reporting Form, resulting in a double-counting of outstanding 2016 claims. In addition, the Company incorrectly included a portion of certain claims adjudicated but withheld from payments to providers and never ultimately paid in its incurred claims reported on Part 3, Line 1.2 of the 2015, 2016, and 2017 MLR Annual Reporting Forms. As a result of the net effect of these errors, the Company overstated its three-year aggregate incurred claims by a net total of $11,027,743 in the individual market, $2,128,474 in the small group market, $5,581,657 in the large group market, and $299,925 in the student market on its 2017 MLR Annual Reporting Form.

Failure to Deduct Prescription Drug Rebates from Incurred Claims

The Company did not deduct the prescription drug rebates it received in 2015, 2016, and 2017 from incurred claims, as required by §158.140(b)(1)(i). As a result, the Company overstated its three-year aggregate incurred claims by a total of $5,009,248 in the individual market, $5,817,505 in the small group market, $13,430,454 in the large group market, and $738,051 in the student market on its 2017 MLR Annual Reporting Form.

Incorrect Reporting of Prior Year Incurred Claims

The Company incorrectly restated its 2015 and 2016 incurred claims on Part 3, Line 1.2 in the PY2 and PY1 columns of the 2017 MLR Annual Reporting Form in the individual, small group, large group, and student markets. The Company also failed to adjust for the development of 2015 and 2016 incurred claims that occurred during 2016 and 2017. According to the 2017 MLR Annual Reporting Form Filing Instructions, the amount reported on Part 3, Line 1.2 in the PY2 and PY1 columns must include incurred claims restated as of 3/31 of the year following the MLR reporting year. As a result, the Company overstated its three-year aggregate incurred claims reported on its 2017 MLR Annual Reporting Form by a net total of $385,951 in the individual market and understated its three-year aggregate incurred claims by $1,294,511 in the small group market, $507,462 in the large group market, and $997,216 in the student market.

Incorrect Reporting of Experience Rating Refunds

The Company incorrectly reported as experience rating refunds on Part 2, Lines 2.8b and 2.9b of the 2017 MLR Annual Reporting Form amounts representing net payments expected from HHS

[3] Although the Examination was of the Company's 2017 MLR Annual Reporting Form, due to the errors identified during the examination in the 2015 and 2016 data included on the 2017 MLR Form, the Company's 2016 and 2015 MLR Forms were also reviewed with regard to the errors identified as part of this examination.

under the federal risk corridor program for the 2014, 2015, and 2016 benefit years. According to the 2017 MLR Annual Reporting Form Filing Instructions, Part 2, Lines 2.8b and 2.9b should exclude risk corridor payments or charges and reserves or accruals. As a result, the Company understated its three-year aggregate incurred claims by a total of $2,179,881 in the individual market on its 2017 MLR Annual Reporting Form.

Based upon the procedures performed, including the validation of a sample of incurred claims (as defined by §158.140) reported by the Company, other than the reporting and calculation errors noted above, nothing additional came to our attention that would indicate that incurred claims were not accurately reported.

Claims Recovered Through Fraud Reduction Efforts

Based upon the procedures performed, no errors were noted in how the Company reported recoveries of paid fraudulent claims, which §158.140(b)(2)(iv) allows as an adjustment to incurred claims up to the amount of fraud reduction expenses.

Quality Improvement Activities (QIA)

Improper Inclusion of Expenses for Activities That Do Not Qualify as QIA

The Company improperly included expenses for certain activities that did not meet the definition of QIA at §158.150 on its 2015, 2016, and 2017 MLR Annual Reporting Forms. The largest portion of amounts improperly included in QIA were for contributions to various community-based health programs and initiatives that were not directly associated with or for the benefit of the Company's enrollees. According to §158.150(b)(1)(iii), QIA expenses must be directed toward individual enrollees or incurred for the benefit of specified segments of enrollees. In addition, the Company incorrectly reported several qualifying QIA expenses that exceeded the total amount of the actual expenses. As a result, the Company overstated its three-year aggregate QIA expenses by a total of $400,694 in the individual market, $605,136 in the small group market, $1,212,990 in the large group market, and $134,069 in the student market on its 2017 MLR Annual Reporting Form.

Based upon the procedures performed, other than the improper inclusion of expenses that did not meet the definition of QIA and the improper reporting of amounts that exceeded the actual expense noted above, nothing additional came to our attention that would indicate that other QIA expenses were not accurately reported and reasonably allocated among the Company's states and markets, as required by §158.170.

Earned Premium

Incorrect Reporting of Earned Premium

The Company included various inappropriate adjustments to its direct written premium reported on Part 2, Line 1.1 on its 2017 MLR Annual Reporting Form. Errors included adjustments for year-end estimates of federal risk adjustment and risk corridor program payments and/or charges. According to the 2017 MLR Annual Reporting Form Filing Instructions, risk adjustment amounts must not be reflected in written premium reported on Part 2, Line 1.1 in the 3/31 columns that are used in MLR calculations. Errors also included other miscellaneous finance adjustments that did not meet the definition of earned premium under §158.130. As a result of the net effect of these errors, the Company's three-year aggregate earned premium was overstated by a net total of $4,111,748 in the individual market and $36,955 in the student market, and understated by a total of $2,797,987 in the small group market and $2,621,128 in the large group market on its 2017 MLR Annual Reporting Form.

Based upon the procedures performed, other than the reporting errors noted above, nothing additional came to our attention that would indicate that earned premium was not properly reported on a direct basis or that the data elements underlying the 2015, 2016, and 2017 premium as reported on the Company's 2017 MLR Annual Reporting Form were not compliant with §158.130.

Taxes

Inaccurate Reporting of Taxes and Fees

The Company incorrectly reported federal and state income taxes and regulatory authority licenses and fees on numerous lines in Part 1 on its 2015 and 2017 MLR Annual Reporting Forms due to various reporting and calculation errors. For example, the federal and state income taxes reported on Part 1, Lines 3.1a and 3.2a on the 2015 MLR Annual Reporting Form were inaccurately recorded due to a calculation error. In addition, the Company improperly included adjustments representing prior year true-ups and accruals of regulatory fees on Part 1, Line 3.3b of the 2017 MLR Annual Reporting Form. As a result of the net effect of these errors, the Company's three-year aggregate federal and state taxes and licensing or regulatory fees deductible from premium were understated by $5,573,334 in the individual market and overstated by $12,794,997 in the small group, $21,981,632 in the large group market, and $1,527,512 in the student market on its 2017 MLR Annual Reporting Form.

Incorrect Reporting of Employment Taxes

In addition to the errors noted above, the Company improperly reported various federal and state employment taxes (e.g. FICA, FUTA, and SUTA taxes) on Part 1, Lines 3.1d and 3.2a on its 2016 and 2017 MLR Annual Reporting Forms. According to §158.162(a)(2) and §158.162(b)(2)(iv), federal and state employment taxes must not be excluded from premium as part of the MLR calculation. According to the 2017 MLR Annual Reporting Form Filing Instructions, federal and state employment taxes and state unemployment taxes should be reported on Part 1, Line 5.5c, which is reserved for federal and state employment taxes and assessments, and is not deducted from premium in the MLR calculation. As a result, the Company overstated its three-year aggregate federal and state taxes and licensing or regulatory fees deductible from premium by a total of $969,168 in the individual market, $1,200,093 in the small group market, $3,148,303 in the large group market, and $217,737 in the student market.

Incorrect Reporting of Patient Centered Outcomes Research Institute (PCORI) Fees

The Company also incorrectly reported the PCORI fees on its 2015, 2016, and 2017 MLR Annual Reporting Forms. According to the 2017 MLR Annual Reporting Form Filing Instructions, Part 1, Line 3.1b should include the PCORI fees attributed to applicable policies in effect during the MLR reporting year. The Company instead reported the PCORI fees paid during the MLR reporting year that were attributed to the policies in effect during the preceding MLR reporting year. As a result, the Company's three-year aggregate PCORI fees were overstated by $30,861 in the individual market, $89,859 in the small group market, and $31,437 in the student market, and understated by $188,484 in the large group market.

Incorrect Reporting of State Premium Taxes
The Company further incorrectly reported its state premium taxes on Part 1, Lines 3.2a and 3.3b on its 2015, 2016, and 2017 MLR Annual Reporting Forms, which are reserved for state income taxes and regulatory fees, respectively. According to the 2017 MLR Annual Reporting Form Filing Instructions, state premium taxes should be reported on Part 1, Line 3.2b. This error did not have any impact on the MLR calculation.

Based upon the procedures performed, other than the reporting errors noted above, nothing additional came to our attention that would indicate that the taxes and regulatory fees excluded from 2015, 2016, and 2017 earned premium on the Company's 2017 MLR Annual Reporting Form did not comply with §158.161 and §158.162, and were not accurately reported and reasonably allocated among the Company's states and markets, as required by §158.170 and in accordance with its federal tax allocation agreement. On its 2017 MLR Annual Reporting Form, the Company reported that it allocated its federal income taxes to each state and market based on the underwriting gain/(loss), which the examination confirmed.

Federal Risk Adjustment Program
The Company incorrectly reported the risk adjustment transfer amounts for the 2017 benefit year on Part 3, Line 1.6 on the 2017 MLR Annual Reporting Form. The Company incorrectly reported $5,022,613 as an expected payment, when it should have recorded the amount as an expected charge. As a result, the Company overstated its net risk adjustment payments in the Montana small group market for the 2017 benefit year by $10,045,226.

Based upon the procedures performed, other than the error noted above, nothing additional came to our attention that would indicate that the Company did not properly report the expected charges and payments under the federal risk adjustment program for the 2017 benefit year, in compliance with §158.140(b)(4)(ii).

B. Credibility-Adjusted MLR and Rebate Amount Calculation

Based upon the procedures performed, the Company correctly applied the credibility adjustment when the Company calculated and reported its MLRs, in accordance with §§158.230-158.232. The Company's credibility-adjusted MLRs were calculated using the correct formula in accordance with 45 CFR Part 158 and the applicable MLR Annual Reporting Form Filing Instructions.

Based on the Company's reported final MLRs, which exceeded the applicable standards in all states and markets for 2015, 2016, and 2017, the Company used the correct procedures to determine that no rebates were due for those years in those states and markets.

C. Rebate Disbursement and Notice

According to its 2015, 2016, and 2017 MLR Annual Reporting Forms, the Company did not owe rebates in any state or market for 2015, 2016, and 2017, and therefore was not required to and did not issue any Notices of rebates for those years, in accordance with §158.250.

D. Compliance with Previous Recommendations

The Company indicated that neither CCIIO nor any state regulatory entity had previously performed an examination of the Company's MLR processes and reporting. The State of Oregon Department of Consumer & Business Services Insurance Division performed a financial examination of the Company in 2013, covering the period January 1, 2011 through December 31, 2013. The financial examination did not result in any findings that impacted the Company's federal MLR calculation or reporting.

VII. Subsequent Events

The Company is required to inform CCIIO of any subsequent events that may affect the currently attested 2017 MLR Annual Reporting Form.

On April 27, 2020, the Supreme Court ruled that section 1342 of the PPACA created an enforceable government obligation to pay issuers the amounts previously unpaid for the 2014-2016 benefit years under the federal risk corridors program.[4] The Company recently obtained recovered risk corridors payment amounts for 2014, 2015, and 2016 and these amounts were not previously included in full on the Company's 2015-2018 MLR Annual Reporting Forms.[5] On December 30, 2020, CMS issued final guidance clarifying how issuers should revise their 2015-2018 MLR Annual Reporting Forms to reflect risk corridors payment amounts recovered as a result of the litigation, and pay any additional rebates to enrollees, if required.[6] The risk corridors payment amounts recovered by the Company for the 2015 and 2016 benefit years impact its 2017 MLR Annual Reporting Form because the 2015 and 2016 data are included on that form. The amounts described in this examination report incorporate the Company's revisions related to the recovered risk corridors payment amounts.

VIII. Conclusion, Corrective Actions, Company Responses, and CCIIO Replies

CCIIO examined PacificSource Health Plan's 2017 MLR Annual Reporting Form to assess the Company's compliance with the requirements of 45 CFR Part 158. The examination involved determining the validity and accuracy of the data elements and calculated amounts reported on the 2017 MLR Annual Reporting Form, and the accuracy and timeliness of any rebate payments. As detailed above, the Company's 2017 MLR Annual Reporting Form contained some elements that were not compliant with the requirements of 45 CFR Part 158. Based on the cumulative effect of the examination findings that could be quantified, it is estimated that the Company owes rebates of $372,548 in the student market and does not owe rebates in any other states or markets in which the Company had health insurance coverage subject to 45 CFR 158 in effect. However,

[4] *Maine Community Health Options v. United States*, 140 S. Ct. 1308), 590 U.S. __ (2020).

[5] https://www.regtap.info/uploads/library/RC_CSRandMLR_091516_v1_5CR_091516.pdf. See also, MLR Annual Reporting Form Instructions for 2015 through 2018, available at https://www.cms.gov/cciio/Resources/Forms-Reports-and-Other-Resources/index#Medical_Loss_Ratio.

[6] https://www.cms.gov/files/document/mlr-guidance-rc-recoveries-and-mlr-final.pdf.

due to the lack of adequate documentation to support its group size and market classification determinations, we cannot at this time conclusively assess whether there were additional errors that could impact the Company's MLRs or rebates.

As a result of this examination, CCIIO directs the Company to implement the following corrective actions:

Corrective Action #1

The Company must adopt and implement procedures to ensure that it obtains and maintains accurate information from its employer groups at the time of policy application and at renewal in order to determine the correct group size and market classification of its group policies, consistent with the definitions in section 2791(e) of the PHS Act and the applicable requirements of 45 CFR Part 158 and related technical guidance. This should include, but not be limited to, obtaining and maintaining accurate documentation related to the average number of employees for the calendar year preceding the coverage effective (or renewal) date. Alternatively, for the 2017 and later reporting years, the Company may elect to use the applicable state employee counting method, unless the state method does not take into account non-full-time employees, in which case the full-time equivalent method described in section 4980H(c)(2) of the Internal Revenue Code should be used. The Company must adopt and implement procedures to ensure that it obtains and maintains accurate information from its employer groups in order to determine the correct group size and market classification of its group policies under the applicable employee counting method.

Company Response

"We are working with the Oregon DFR to ensure alignment between the state and federal counting methodologies, specifically regarding the treatment of non-full time employees to ensure appropriate group size classification. We will obtain and maintain accurate documentation related to the average number of employees for the calendar year preceding the coverage effective or renewal date."

CCIIO Reply

CCIIO accepts the Company's response and the corrective action plan.

Corrective Action #2

The Company must adopt and implement procedures to ensure it properly and accurately calculates and reports incurred claims on its MLR Annual Reporting Form in accordance with §158.140 and the MLR Annual Reporting Form Filing Instructions, including deducting prescription drug rebates from incurred claims and properly restating prior year incurred claims.

Company Response

"We have changed our data sources and methodology in order to ensure compliance with MLR regulations and instructions. In particular, prescription drug rebates are now being deducted from incurred claims and prior year incurred claims are being properly restated."

CCIIO Reply

CCIIO accepts the Company’s response and the corrective action plan.

Corrective Action #3

The Company must adopt and implement procedures to ensure that activities and expenses reported as QIA meet the requirements of §158.150 and that sufficient documentation exists to support such determination, and that the reported amounts are accurate. The Company must perform additional quantitative analysis to ensure that the appropriate percentage of each activity or transaction that qualifies as a QIA pursuant to §158.150 is reported on its MLR Annual Reporting Form.

Company Response

“We have a better understanding of which activities and expenses qualify as QIA as a result of the MLR examination. We have enhanced our internal processes in order to accurately capture QIA expenses and ensure that they are well-documented and allocated as QIA appropriately.”

CCIIO Reply

CCIIO accepts the Company’s response and the corrective action plan.

Corrective Action #4

The Company must adopt and implement procedures to ensure that it properly and accurately reports earned premium in accordance with §158.130 and the MLR Annual Reporting Form Filing Instructions, including ensuring that earned premium excludes accruals for risk adjustment payments and charges and adjustments that do not meet the definition of earned premium under §158.130 and the MLR Annual Reporting Form Filing Instructions.

Company Response

“We have changed our data sources and methodology in order to ensure compliance with MLR regulations and instructions. Specifically, risk adjustment transfers and other accounting adjustments are not included in premium amounts reported on the MLR Annual Reporting Form.”

CCIIO Reply

CCIIO accepts the Company’s response and the corrective action plan.

Corrective Action #5

The Company must adopt and implement procedures to ensure that amounts reported as federal and state taxes and regulatory fees are calculated accurately and meet the requirements of §158.161 and §158.162 and the MLR Annual Reporting Form Filing Instructions, ensuring that these amounts are reported on the correct lines, in the correct reporting year, and do not include employment taxes.

Company Response

"We have enhanced our review process to ensure compliance with MLR regulations and instructions. Specifically, employments taxes are no longer included and additional checks have been implemented to ensure that taxes are reported accurately and not duplicated."

CCIIO Reply
CCIIO accepts the Company's response and the corrective action plan.

Corrective Action #6
The Company must adopt and implement procedures to ensure it properly and accurately reports risk adjustment transfer amounts on its MLR Annual Reporting Form in accordance with §158.140 and the MLR Annual Reporting Form Filing Instructions.

Company Response
"We have enhanced our review process to ensure that this type of sign error does not occur in the future and that we are in full compliance with MLR regulations and instructions regarding the reporting of risk adjustment transfer amounts."

CCIIO Reply
CCIIO accepts the Company's response and the corrective action plan.

Corrective Action #7
The Company must re-file its 2017 MLR Annual Reporting Form to rectify the errors and findings stated herein, adjusting both the current year (CY) and prior year (PY) columns as applicable, including calculating any additional rebates due to its enrollees. Any underpaid rebates calculated by the Company as a result of the findings herein should be paid as soon as possible but in no event later than sixty (60) days from the date of the Company's receipt of the Final MLR Examination Report.

Company Response
"We will refile the 2017 MLR Annual Reporting Form with all of the audit findings rectified. In addition, we will pay any resulting rebates due to enrollees within sixty days of receipt of the Final MLR Examination Report."

CCIIO Reply
CCIIO accepts the Company's response and the corrective action plan.

The corrective actions provided in this report should be shared with and adopted by, as applicable, any affiliated entities of the Company, such as parent or subsidiaries, if any, that are similarly subject to the MLR reporting and rebate requirements of 45 CFR Part 158.

CCIIO thanks the Company and its staff for its cooperation with this examination.