

DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
7500 Security Boulevard
Baltimore, Maryland 21244-1850



MEDICARE DRUG BENEFIT AND C & D DATA GROUP

CORRECTIVE ACTION PLAN REQUEST

December 18, 2012

Contract ID: S5904

Brendan Hodges
Medicare Compliance Officer
Blue Cross and Blue Shield of Florida, Inc.
4800 Deerwood Campus Parkway
DCC Building 100, 7th Floor
Jacksonville, FL 32246

Delivered via email to Brendan Hodges at Brendan.Hodges@bcbsfl.com

RE: Actuarial Compliance Issues

Dear Mr. Hodges,

The Centers for Medicare & Medicaid Services (CMS) is issuing a request for a Corrective Action Plan (CAP) to BLUE CROSS AND BLUE SHIELD OF FLORIDA, INC. (hereinafter "BCBSFL"), regarding its performance under Medicare Prescription Drug Plan (PDP) Sponsor contract S5904, because it failed to meet one or more actuarial standards in submitting its 2012 and 2013 Part D bids. The actuarial standards were clearly set forth in the Contract Year (CY) 2012 and CY 2013 versions of the Instructions for Completing the Prescription Drug Plan Bid Pricing Tool (BPT), issued by CMS on April 8, 2011, and April 6, 2012, respectively, through the Health Plan Management System (HPMS).

Pursuant to 42 CFR §423.265(c), each potential Part D sponsor must submit annually a bid and supplemental information in a format to be specified by CMS for each Part D plan it offers. Specifically, the regulation states that the bid must be prepared in accordance with CMS actuarial guidelines based on generally accepted actuarial principles. A qualified actuary must certify the plan's actuarial valuation (which may be prepared by others under his or her direction or review), and must be a member of the American Academy of Actuaries to be deemed qualified. Applicants may use qualified actuaries from outside their organization to prepare their bids.

As stated in CMS' bid instructions, Part D bids are comprised of two basic components, the plan benefit package (or, PBP - a set of benefits for a defined Medicare Advantage or PDP service area) and BPT (a financial proposal for the prescription drug plan that a sponsor intends to offer Medicare beneficiaries in a format required by CMS). The CMS Office of the Actuary (OACT) reviews the BPT to make sure that it conforms to actuarial standards. Among the elements OACT reviews are non-benefit expenses (NBE) (i.e., all of the administrative costs incurred in the operation of the Medicare Prescription Drug Plan) and the method sponsors use in making an "allocation" of expenses (i.e., accurately attributing costs where they actually occurred among the sponsor's operations). CMS expects that these expenses can be "supported," meaning that the assumptions behind the numbers that comprise the bid should be reasonably and readily understandable by an actuary.

During a bid audit conducted by CMS contractors following the 2012 Prescription Drug Plan bid submission for BCBSFL starting on September 15, 2011, CMS discovered that BCBSFL had reduced its CY2012 Part D projected non-benefit expenses (NBE) by more than half when compared to the base period (i.e., the previous credible bid-specific experience the sponsor used in the development of projected allowed costs for its current bid proposal). This dramatic decrease in its CY2012 projected NBE was accomplished primarily through the reduction and exclusion of indirect expenses. The audit also revealed a number of other issues related to the development of the projected NBE. The audit report stated that BCBSFL was unable to support the development of its projected NBE in its CY2012 bids as required by Appendix B of the Instructions for Completing the Prescription Drug Plan Bid Pricing Tool For Contract Year 2012, which requires plan sponsors to support NBE assumptions in Worksheet 2 with the following: "A reconciliation of the base period NBE reported in Worksheet 1 of the BPT to audited material such as corporate financial statements and plan-level operational data, a description of the administrative costs included in each NBE category in the BPT, and detailed support for the development of projected NBE."

According to the bid audit, BCBSFL was not compliant with the BPT instructions based upon the following:

1. BCBSFL failed to provide quantitative support during the audit process for the calculations needed to arrive at the 2011 reallocated expenses.
2. The total projected NBE amount for the Part D product could not be adequately traced from the base period expenses (net experience for the year being used for the basis of the projection), which reconcile to the financial statements, to the projection period.
3. BCBSFL did not provide adequate support for the allocation method going forward or the level of the projected NBE.
4. BCBSFL failed to provide quantitative support for the significant reduction in the indirect projected NBE category.
5. BCBSFL excluded numerous indirect expenses and failed to provide support to adequately demonstrate that many of those indirect expenses were properly allocated to other lines of business.
6. Adjustments were made to direct and sales/marketing expenses to account for the new allocation. For example, the argument was made to include actuarial services as direct

expenses in the base period since certain actuaries work strictly on Part D. However, in the projection period, actuarial NBE had been removed entirely.

7. The membership related to the NBE projection varies from the membership in the bids. Some of the expenses were developed on an aggregate basis and some were developed on a per member per month (PMPM) basis.

The above-mentioned bid audit findings were memorialized in a final bid audit report which was provided to BCBSFL on March 21, 2012, along with a letter addressed to the President and CEO of BCBSFL, Patrick Geraghty. The letter described the need for documented support of BCBSFL's future bid submissions and the potential for BCBSFL to be subject to a CMS compliance action should the support be not forthcoming.

Regarding BCBSFL's 2013 bid submission, BCBSFL disregarded CMS' previous audit findings and used the same allocation methodology that resulted in the CY2012 negative bid audit findings. The 2013 submission lacked the necessary explanation and support regarding the development of the projected NBE, and offered nothing beyond the same inadequate support and lack of explanatory information that accompanied BCBSFL's CY2012 bid submission. As representatives of OACT conveyed to BCBSFL following the CY2012 bid audit, correction of all bid audit findings from the prior year was a prerequisite to the successful completion of the OACT bid desk review, the process in which the bid is actuarially examined for completeness, accuracy, adequate support, and reasonability, for the sponsor's proposed CY2013 Part D plans.

CMS is also particularly concerned with BCBSFL's incomplete and misleading responses to direct questions from OACT staff regarding the specific methodology it used to calculate and support the development of its projected NBE as well as whether the allocation methodology was applied in a consistent manner across all products. In a communication with CMS on August 6, 2012, BCBSFL told CMS that its allocation process was consistent across all segments, allocating 100 percent of all costs. However, on August 20th and 21st, BCBSFL stated that they could not demonstrate that each allocation basis was consistently applied to all product lines. This failure is particularly disconcerting since BCBSFL's bid did not reflect the sponsor's actual expenses, as required by CMS guidance.

In addition to the above-described substantive issues with BCBSFL's bid, BCBSFL also prolonged the resolution of this matter. After these issues were identified in the CY2012 bid audit, CMS instructed BCBSFL to fully vet the findings and make necessary corrections to its bid development processes before the CY2013 bids were due. This did not occur. Questions that were originally raised in the CY2012 bid audit, which began in September 2011, were not fully answered until late August 2012 under the scrutiny of an extended CY2013 bid desk review.

CMS requests that your organization take corrective action to come into compliance. The first opportunity for BCBSFL to demonstrate that it has taken the necessary corrective action will be the 2014 bid cycle. Therefore, CMS requests that BCBSFL address these areas of noncompliance in the spring of 2013 leading up to the 2014 bid cycle. We request that you provide CMS by May 1, 2013, a copy of the corrective action plan you implemented to address the identified issues and to ensure they will not recur. This plan should include a full explanation and support for the proposed allocation methodology BCBSFL plans to use to develop

projected NBE for its CY2014 Part D Plan (PDP and MA-PD) bids. It should also address how each expense is allocated in the base period, how each will be allocated in the contract year (i.e. the allocation basis used to attribute the expenses to product lines), why the allocation basis used for each expense category is reasonable, and demonstrate that each allocation basis is consistently applied to all product lines, including MA, PDP, and other lines of business. CMS will rely on BCBSFL's 2014 bid submission to determine whether the corrective action plan has been successfully implemented. Please provide your CAP to Michael Neuman at Michael.Neuman@cms.hhs.gov. CMS will consider the CAP closed once your organization has provided the requested report, and OACT has determined that BCBSFL's 2014 bid submission demonstrates that it has effectively resolved the issues described above.

We appreciate your prompt attention to this matter. In the event your organization does not successfully complete its CAP, CMS will consider additional compliance and enforcement actions, including imposition of intermediate sanctions (*e.g.*, the suspension of marketing and enrollment activities).

If you have any questions, please contact Michael Neuman at (410) 786-7069 or email Michael.Neuman@cms.hhs.gov.

Sincerely,



Cynthia G. Tudor, Ph.D.
Director
Medicare Drug Benefit and C & D Data Group

CC via email:

Jennifer Shapiro, CMS
Scott Nelson, CMS
Michael Neuman, CMS
Pamela Miller, CMS