FirstCarolinaCare Insurance Company

Pinehurst, NC

Report on Medical Loss Ratio Examination

As of December 31, 2011

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Honorable Wayne Goodwin
Commissioner of Insurance
State of North Carolina
Raleigh, North Carolina

Sir:

Pursuant to your instructions the North Carolina Department of Insurance ("Department") conducted a medical loss ratio ("MLR") examination of FirstCarolinaCare Insurance Company ("Company") as of December 31, 2011, including the period through March 31, 2012, for runoff activity. This is the Department's first MLR examination of the Company.

This examination was performed in accordance with examination standards established by the Department. The purpose of this examination was to examine the components of the MLR Annual Report Form as completed by the Company and submitted to the U.S Department of Health and Human Services ("HHS") for the 2011 MLR reporting year. The Department examined the components of the MLR Annual Report Form by utilizing the MLR Examination Procedures Spreadsheet developed by HHS in consultation with the National Association of Insurance Commissioners ("NAIC"). The findings and recommendations of our examination are based solely on the work performed and are provided in the Summary of Objectives, Findings and Recommendations beginning on page six (6).

Respectfully submitted,

Hasije P. Harris, CPA

Hasije P. Harris, CPA, CGMA
MLR Section Manager
Examiner-In-Charge
North Carolina Department of Insurance

December 5, 2014

STATE OF NORTH CAROLINA
COUNTY OF WAKE

Hasije Harris, MLR Section Manager, North Carolina Department of Insurance, being first duly sworn, deposes and says that this report on examination, subscribed by her, is true and correct to the best of her knowledge and belief.

Signature: Hasije P. Harris CPA Date: 12-5-2014
Hasije Harris

Sworn and subscribed before me this 5 day of December, 2014.

Notary Public Signature: Djidade B. Muhavi Notary Public Seal

Djidade B. Muhovi NOTARY My Comm. Exp. 9/5/2017 PUBLIC WAKE COUNTY, N.C.

1. Company Background

FirstCarolinaCare, Inc. commenced operations on October 1, 1999, as a taxable for-profit health maintenance organization ("HMO") organized as a stock corporation under the laws of the State of North Carolina and operating as a foreign HMO in the State of South Carolina. Effective April 30, 2007, FirstCarolinaCare, Inc. merged with the newly formed FirstCarolinaCare Insurance Company, Inc. ("Company"). On March 5, 2009, the Company converted to a non-profit taxable corporation under the laws of the State of North Carolina and changed its legal name to FirstCarolinaCare Insurance Company.

First Health of the Carolinas, Inc. ("First Health") is the sole member of the Company. The Company is licensed in North Carolina and South Carolina but operates exclusively as a single state insurer in the State of North Carolina. It is authorized to write life and health insurance with an HMO line of business. The Company offers one year health insurance contracts to small and large employer groups. Direct premiums earned in 2011 totaled $42,906,038 of which over 98% are in accident & health policies with the remainder consisting of "Mini-Med" business as defined for 2011 MLR reporting.

2. Scope of the Examination

The Department performed a limited scope examination on the components of the MLR Annual Report Form as completed by the Company and submitted to HHS for the 2011 MLR reporting year. The Department reviewed and tested, as deemed appropriate, the following items in accordance with 45 CFR Part 158: validity of the data regarding premiums, claims and expenses that the Company reported to HHS, including the propriety of the allocations of expenses used in such reporting, whether the activities associated with the Company's reported expenditures for quality improving activities meet the definition of such activities, the accuracy of rebate calculations, and the timeliness and accuracy of rebate payments as applicable.

3. Summary of Examination Objectives, Findings and Recommendations

MLR Components	Individual	Small Group	Large Group
Adjusted Incurred Claims	-	18,138,149	16,543,973
Plus: Quality Improvement Expenses	-	295,583	236,465
MLR Numerator	-	18,433,732	16,780,438
Premium Earned	-	22,717,171	19,304,249
Less: Federal & State Taxes and Licensing or Regulatory Fees	-	(535,854)	(455,350)
MLR Denominator	-	22,181,317	18,848,899
Preliminary MLR Before Credibility Adjustment	-	83.1%	89.0%
Credibility Adjustment	-	3.6%	4.1%
Credibility Adjusted MLR	-	86.7%	93.1%
2011 Standard/Waived MLR	75.0%	80.0%	85.0%
Rebate Amount	-	-	-

a. Reporting

Examination Objective:

Test the accuracy of MLR annual reporting and reconcile with the Supplemental Health Care Exhibit.

Findings:

The Company filed an MLR Annual Reporting Form by June 1, 2012 for the 2011 reporting year and is in compliance with Title 45 CFR §158.110(b). The Uninsured Plans data is either omitted or incomplete for the 2011-2013 reporting years.

Recommendations:

We recommend that the Company consider contacting HHS to determine if refiling of the 2011-2013 reports is required due to the inaccuracy of Uninsured Plans data for each year. Please note that the Uninsured Plans data has no impact on the calculation of the MLR for Individual, Small Group or Large Group plans. It is strictly a data reporting issue. We also recommend that the Director of Finance carefully review the instructions provided for the 2014 MLR Annual Reporting Form preparation so that 2014 Uninsured Plans data is accurately filed in 2015. It should be noted that due to the size of the Company, the Director of Finance prepares the entire MLR Annual Reporting Form and is also responsible for its review. The Company should train a First Health associate to review the MLR Annual Reporting Form in order to minimize the possibility of data reporting deficiencies in future years.

b) **Validation of the Consistency of Included/Excluded Data**

Test the accuracy of state and market classifications, the accuracy of reporting under the dual contracts option, and the reasonableness and accuracy of expense allocations.

Findings:

The Company complied with all state and market classification requirements for the 2011 reporting year and is in compliance with Title 45 CFR §158.110, §158.120 and §158.220. There are no dual option contracts written by the Company as defined under Title 45 CFR §158.120(c). No formal documentation or studies were available to support the cost allocation processes used by the Company. Title 45 CFR §158.170 uses language such as "Allocation to each category should be based on a generally accepted accounting method that is expected to yield the most accurate results" and "Any basis adopted to apportion expenses must be that which is expected to yield the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses." All categories of non-premium or claim expense are allocated by member-months except federal and state taxes which are allocated by premium revenue. Although these are reasonable methods of expense allocation, the standard specified in the language above requires more precise documentation (e.g. questionnaires) and analysis for these allocations.

Recommendations:

We recommend that the Company perform and document a formal study of the allocation process to report the most accurate allocation of expenses.

c) **Validation of Data Utilized in Calculating MLR**

Examination Objective:

Test the accuracy of reporting for new business, the accuracy of reporting of reinsurance and the accuracy of life-years.

Findings:

The Company accurately reported new business in 2011 in compliance with Title 45 CFR §158.121. The "block of business" test for reinsurance was not applicable for this Company in 2011. Life-Years were reported accurately as required in compliance with Title 45 CFR §158.230(b).

Recommendations:

None

d) **Calculation of the Medical Loss Ratio Numerator**

Examination Objective:

Test the accuracy of reporting of claims, the classification of activities that improve health care quality, and the aggregation of data in the MLR numerator.

Findings:

From the claims data requested, we were able to reconcile the totals reported by lines of business to the Company's claims system. We were able to verify the lines of business on a sample basis without exception. During our review of third-party vendor payments as specified in Title 45 CFR §158.160, Claims Processing Fees for one claims vendor were erroneously included in Direct Claims for the entire year (approx. $80K for 2011). The examiner subsequently reviewed all other fees paid to the other primary outside claims vendor and verified that no other non-claim payments were recorded in direct losses.

We also were required to test that health care quality improvement expenses reported on the MLR Form conform to the definition of health care quality improvement expenses in Title 45 CFR §158.150-151. In addition, health care quality improvement (QI) activities reported on the MLR Form must be consistent with the activities described in Part 4 of the MLR Annual Reporting Form. Our examination did not identify any specific exception to these tests, however, we did note that policies and procedures had not been developed to provide guidance, define ownership, or convey documentation requirements for QI activities and expenses. This would include providing certainty regarding roles and responsibilities for identifying eligible QI programs, the level of documentation required and the appropriate retention policy for MLR records. Effective formal policies and procedures are required to manage risk in an organization.

Aggregation of multi-year data is not applicable for the 2011 MLR reporting year.

Recommendations:

We recommend that the Director of Finance implement preventative internal controls so that current and future vendor administrative costs are recorded properly as general expenses and are excluded from reported losses in the Annual Statement, Supplemental Health Care Exhibit and the MLR Annual Reporting Form.

We also recommend that the necessary departments meet and create MLR policies and procedures related to QI expenses included in the MLR calculation.

e) **Calculation of the Medical Loss Ratio Denominator**

Examination Objective:

Test the accuracy of reporting of earned premiums, taxes and regulatory fees and the aggregation of data in the MLR denominator.

Findings:

According to Title 45 CFR §158.221(c), the denominator of MLR is comprised of premium revenue, as defined in Title 45 CFR §158.130, minus federal and state taxes, and licensing and regulatory fees as described in Title 45 CFR §158.161(a) and Title 45 CFR §158.162(a) (1) and (b) (1). From the premium data requested, we were able to verify the data used to calculate the premium revenue on a sample basis without exception. Based on our examination, the Company included appropriate premiums earned in the MLR denominator. We examined the reasonableness of the federal and state taxes, and the licensing and regulatory fees, including the propriety of allocations. The Company's allocation methodology, federal and state taxes, and licensing and regulatory fees reported in the MLR denominator are reasonable and conform to the regulations.

Recommendations:

None

f) **Validation of the MLR Calculation**

Examination Objective:

Test the accuracy of the MLR standard, the MLR calculation, the aggregation of member-months and life-years, the accuracy of base credibility factor, the accuracy of the deductible factor and the accuracy of the credibility adjustment.

Findings:

The Company used the appropriate 2011 MLR standards for Individual, Small and Large Group business as defined under Title 45 CFR §158.210 and Title 45 CFR §158.211. The base credibility factor is correct and the deductibility factor is acceptable as specified by Title 45 CFR §158.232(a) and (d). This resulted in an accurate base credibility factor calculation for each category of business.

Although the member-months differences identified for each selection were immaterial when comparing the summary and detail database reports, the Company is not able to produce a detail report from the database as of 12/31/2011 which would precisely match the member-month totals reported on the MLR filing. A system enhancement should be implemented to enable selection of database information at any valuation date to accurately support reported totals.

Recommendations:

We recommend that the Company either initiate an IT project with their external vendor to enable member-months report generation on a historical basis or print and retain the member-months reports on a quarterly basis, at a minimum, so that documentation is available to support historical reported management member-month data.

Appendix A – Report Distribution

Craig Humphrey, Interim President and COO
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Michael George, Director of Finance
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