STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

AHCCCS' Healthcare Group Program (HCG)

REPORT HIGHLIGHTS
PERFORMANCE AUDIT

Subject

HCG provides health insurance primarily to Arizona's small businesses and their employees. It provides a variety of health plans through health maintenance organizations (HMO) and preferred provider organizations (PPO). HCG covers the costs of providing these plans with premiums paid by employers.

Our Conclusion

HCG's administrative costs are about 8.5 percent of the program's total costs. While no universal standard exists for the amount of reserves that insurance companies should have, HCG's efforts to ensure financial stability appear to be in-line with insurance industry practices. HCG is enforcing the requirement that employers be without group healthcare coverage for 180 days.

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HCG Provides Health Insurance to Small Businesses

Healthcare Group of Arizona

One estimate is that only about a third of Arizona's small businesses offer health insurance to employees, mainly because few private insurers serve small businesses or the cost is too expensive. Healthcare Group (HCG), a program within the Arizona Health Care Cost Containment System (AHCCCS), provides health insurance to Arizona's small businesses and political subdivisions.

HCG: Key Facts

- Businesses participating—5,877
- Average business size—1.7 employees
- Average members per business—3
- Political subdivisions participating—10
- Total members (with dependents)—17,850

Eligibility requirements—Small businesses qualify for HCG coverage if:

- They have been in business for at least 60 days.
- They employ between 1 and 50 people.
- 80 to 100 percent of employees are enrolled.
- They have not had group health insurance in the last 6 months.

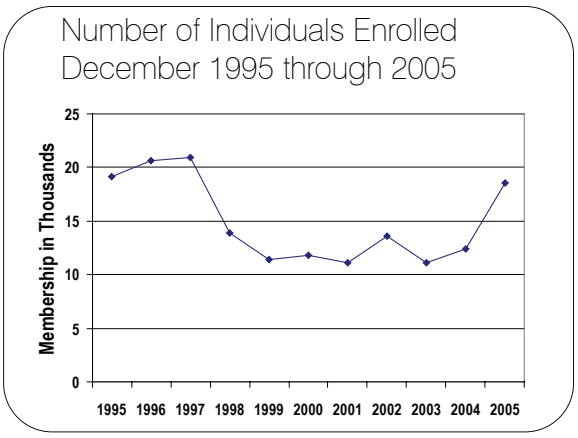
Types of coverage—HCG offers both HMO and PPO plans. HCG offers three levels of HMO coverage. The most comprehensive plan, the Classic, is designed for those seeking a wide range of benefits or with ongoing-care needs because of chronic conditions. The Secure plan is for those with limited needs beyond routine medical care and preventive services. Finally, the Active plan is for those in good health who require only preventive and routine healthcare.

HCG contracts with three HMO contractors who provide the coverage on a capitated basis. Capitation means that the HMO receives a set fee for each participant, whether the participant uses any or a multitude of services.

HCG contracts with a PPO that is paid by HCG on a fee-for-service basis and operates state-wide. There are two PPO products available—one providing comprehensive coverage and one providing lower levels of coverage.

HCG began offering dental and vision coverage state-wide in 2005.

Enrollment trends—In the late 1990s, HCG's number of members declined sharply, and those who remained were generally in poorer health than previous members. As a result, between fiscal years 1999 and 2005, the Legislature subsidized HCG with a $3 million to $8 million appropriation each year.



In fiscal year 2004, HCG redeveloped its business model and health plans, and the number of members has increased. HCG's goal is to increase its enrollment to 50,000 members by July 2007.

HCG Pays Various Administrative Costs

HCG is funded by employer-paid premiums. The employers can either deduct these premiums from their employees' paychecks or pay the employees' premiums as a fringe benefit. Statutes allow HCG to use a portion of this premium revenue along with other revenues to pay its administrative costs. The law requiring this audit directed us to examine HCG's administrative costs.

Administrative costs are 8.5 percent—While statutes do not define administrative costs, AHCCCS has defined administrative costs for its other programs. This definition includes all costs associated with overall program management and operation, including data processing, marketing, administrative staff, and other operating costs.

Using this definition, from July 1, 2003 to September 30, 2005, HCG's administrative costs were 8.5 percent of the program's total costs.

AHCCCS allocates costs to HCG—AHCCCS has made an effort to ensure that it does not subsidize HCG's administrative costs. Specifically, AHCCCS has made an effort to capture and allocate HCG's administrative costs, including its building lease, telecommunications, printing, advertising, equipment, supplies, repair and maintenance, and data processing costs. Portions of AHCCCS staff salaries are also allocated to HCG, including services provided by accounting, actuarial, and information technology staff.

HCG Uses Several Methods To Ensure Its Financial Stability

Our Office was also directed to compare HCG's financial reserves to those required for private insurers. Reserves are a sum of money set aside to pay for future obligations, such as participants' claims. HCG maintains reserves as one method of ensuring financial stability.

Reserve requirements vary—There is no universal standard regarding the amount of reserves insurance companies must maintain. Requirements vary based on specific regulatory requirements, the size or type of insurance company, and the type of benefit plans offered. Insurance companies use actuaries to establish appropriate reserves. Similarly, HCG uses actuaries to determine and monitor its reserve amounts. In doing so, HCG's actuaries use industry-recognized

guidelines and monitor the reserves on a monthly basis. Further, HCG establishes its reserves by its HMO and PPO benefit plan types.

An actuary is a trained mathematician who analyzes costs and risks associated with providing insurance.

HMO reserves—The HMOs that HCG contracts with are responsible for paying the enrolled paraticipants' healthcare claims. To ensure that these HMOs have the financial means to pay for these services, HCG requires that they have an equity amount for each member ranging from $100 to $150 per person. In addition, HMOs must have a performance bond.

HCG also provides a "stop-loss" backup for the HMO contractors. For example, for some benefit plans, if the cost of medical services provided by an HMO is greater than 86 percent of the total capitation amount, HCG will pay the HMO to reduce the amount paid to 86 percent of capitation. If, on the other hand, an HMO's cost for medical services provided is less than 80 percent of the capitation amount, the HMO must repay HCG an amount to bring the HMO's claims cost up to 80 percent of its total capitation amount.

HCG may also use its HMO reserve to pay for cost fluctuations due to new products, coverage changes, or future expansion. As of December 31, 2005, HCG had almost $2.78 million in HMO reserves.

PPO reserves—Reserves are especially important for the PPO plans because HCG has the responsibility to pay its members' medical claims. About 250 people are enrolled as members of PPOs. HCG reserves some of its PPO premiums to pay for claims that have been incurred but not submitted for payment. In addition, it reserves about 10 percent of PPO premiums for things such as unanticipated events that may result in excessive claims. As of December 31, 2005, HCG's PPO reserves totaled about $80,000.

In addition, HCG has accumulated net assets of $1.1 million that are not designated for specific purposes and could be used to pay HMO or PPO claims if needed.

HCG uses other methods to minimize risk—HCG has established a lifetime maximum benefit amount for members. A lifetime maximum benefit is the maximum dollar amount of covered healthcare services that HCG will provide in the member's lifetime. This amount is $2 million for HMOs and $3 million for PPOs.

HCG also purchases reinsurance to reduce the risk of a catastrophic loss due to a need for extraordinary medical services. If a member incurs healthcare costs above $100,000 in a year, the reinsurance will pay 50 to 90 percent of the excess up to the member's lifetime maximum.

In addition to these measures to minimize risk, HCG is able to increase premiums during the coverage year to address higher-than-expected claims. It must provide enrolled businesses with a 60-day notice. HCG had an across-the-board premium increase in February 2003 on the advice of an actuarial study done for HCG.

HCG Does Not Enroll Recently Insured Applicants

Finally, our Office also reviewed HCG's enforcement of the statutory "bare period" provision. Statutory changes made in 2004 prohibit HCG from enrolling a small business that had group healthcare coverage within the previous 6 months. The Legislature established this period so that businesses would not drop coverage just to enroll with HCG. Exceptions to this restriction include instances where the insurer dropped the business, or the business owner or employees had their own individual coverage or were covered under a spouse's plan.

HCG process ensures compliance with "bare period"—This process includes training its sales representatives and requiring each small business applicant to certify in writing that the business has not offered group healthcare coverage within the past 6 months.

Auditors took a random sample of 30 small business applications, and each file contained the signed certification form. In addition, a Phoenix law firm's external review, commissioned by the Department of Administration, found no evidence substantiating allegations that HCG staff had encouraged applicants to circumvent the "bare period" requirement. Finally, we found that the Department of Insurance does not maintain information on individuals or businesses who are insured with Arizona-licensed insurance companies that could be used to determine prior coverage.

TO OBTAIN MORE INFORMATION

A copy of the full report can be obtained by calling (602) 553-0333

or by visiting our Web site at: www.azauditor.gov

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