

DATE: May 25, 2018

ACTION: Notice of Rulemaking Action
Title 28, California Code of Regulations

SUBJECT: Financial Solvency of Risk Bearing Organizations; Amending sections 1300.75.4, 1300.75.4.1, 1300.75.4.2, 1300.75.4.5, 1300.75.4.7, 1300.75.4.8, and 1300.76 to title 28, California Code of Regulations; Control No. 2017-5216.

PUBLIC PROCEEDINGS:

Notice is hereby given that the Director of the Department of Managed Health Care (Department) proposes to adopt the proposed regulations under the Knox-Keene Health Care Service Plan Act of 1975 (Knox-Keene Act) clarifying standards and requirements to ensure risk-bearing organizations (organizations) comply with financial solvency standards as well as eliminating outdated and obsolete language to provide greater clarity to these regulations.

This rulemaking action proposes to amend sections 1300.75.4, 1300.75.4.1, 1300.75.4.2, 1300.75.4.5, 1300.75.4.7, 1300.75.4.8, and 1300.76, in Title 28, California Code of Regulations (the Regulations). Before undertaking this action, the Director of the Department (Director) will conduct written public proceedings, during which time any interested person, or such person's duly authorized representative, may present statements, arguments, or contentions relevant to the action described in this notice.

PUBLIC HEARING:

No public hearing is scheduled. Any interested, person, or his or her duly authorized representative, may submit a written request for a public hearing pursuant to Government Code section 11346.8(a). The written request for a hearing must be received by the Department's contact person, designated below, no later than 15 days before the close of the written comment period.

WRITTEN COMMENT PERIOD:

Any interested person, or his or her authorized representative, may submit written statements, arguments or contentions (hereafter referred to as comments) relating to the proposed regulatory action by the Department. Comments must be received by the Department, Office of Legal Services, **by 5 p.m. on July 9, 2018**, which is hereby designated as the close of the written comment period.

Please address all comments to the Department of Managed Health Care, Office of Legal Services, Attention: Jennifer Willis, Senior Counsel. Comments may be transmitted by regular mail, fax, email or via the Department's website:

Website <http://www.dmhc.ca.gov/LawsRegulations.aspx#open>
Email: regulations@dmhc.ca.gov
Mail: Department of Managed Health Care
Office of Legal Services
Attn: Regulations Coordinator
980 9th Street, Suite 500
Sacramento, CA 95814
Fax: (916) 322-3968

Please note: if comments are sent via the website, email or fax, there is no need to send the same comments by mail delivery. All comments, including via the website, email, fax, or mail, should include the author's name and a U.S. Postal Service mailing address so the Department may provide commenters with notice of any additional proposed changes to the regulation text.

Please identify the action by using the Department's rulemaking title and control number, **Financial Solvency of Risk Bearing Organizations, Control No. 2017-5216** in any of the above inquiries.

CONTACTS: Inquiries concerning the proposed adoption of these regulations may be directed to:

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OR

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AVAILABILITY OF DOCUMENTS:

The Department has prepared and has available for public review the Initial Statement of Reasons, text of the proposed regulation and all information upon which the proposed regulation is based (rulemaking file). This information is available by request to the Department of Managed Health Care, Office of Legal Services, 980 9th Street, Sacramento, CA 95814, Attention: Regulations Coordinator.

The Notice of Proposed Rulemaking Action, the proposed text of the regulation, and the Initial Statement of Reasons are also available on the Department's website at <http://www.dmh.ca.gov/LawsRegulations.aspx#open>.

You may obtain a copy of the Final Statement of Reasons once it has been prepared by making a written request to the Regulation Coordinator named above.

AVAILABILITY OF MODIFIED TEXT:

The full text of any modified regulation, unless the modification is only non-substantial or solely grammatical in nature, will be made available to the public at least 15 days before the date the Department adopts the regulation. A request for a copy of any modified regulation(s) should be addressed to the Regulations Coordinator. The Director will accept comments via the Department's website, mail, fax, or email on the modified regulation(s) for 15 days after the date on which the modified text is made available. The Director may thereafter adopt, amend or repeal the foregoing proposal substantially as set forth without further notice.

AUTHORITY AND REFERENCE:

Pursuant to Health and Safety Code section 1341, subdivision (a), the Department "has charge of the execution of the laws of this state relating in to health care service plans... including, but not limited to, those laws directing the department to ensure that health care service plans provide enrollees with access to quality health care services and protect and promote the interests of enrollees."

Health and Safety Code section 1341.9, vests the Department with all duties, powers, purposes, responsibilities, and jurisdiction as they pertain to health care service plans (health plans) and health plan business.

Health and Safety Code section 1344 grants the Director authority to adopt, amend, and rescind such rules, forms, and orders as are necessary to carry out the provisions of the Knox-Keene Act.

Health and Safety Code section 1345, subdivision (f)(1), defines a "health care service plan" as "any person who undertakes to arrange for the provision of health care services to subscribers or enrollees, or to pay for or to reimburse any part of the cost of those services in return for a prepaid or periodic charge paid by or on behalf of subscribers or enrollees."

Health and Safety Code section 1346 vests in the Director additional powers to administer and enforce the Knox-Keene Act, including but not limited to, the power to study, investigate, research and analyze matters affecting the interests of health plans, subscribers, enrollees and the public, and to promote and establish standards of ethical conduct for the administration of health care service plans.

Health and Safety Code section 1375.4 requires the Director adopt regulations to implement the required provisions for contracts between a health plan and an organization. Pursuant to

subdivision (b), these regulations shall include a process for reviewing the financial solvency of organizations, a process for corrective action plans (CAPs) to correct deficiencies, disclosure of enrollment and risk arrangement information from health plans, reports by the health plans to the Director that include information concerning the organizations, and the confidentiality of financial and other records produced, disclosed, or otherwise made available under this section.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW:

Purpose of the Regulation:

The purpose of this rulemaking action is to clarify and interpret the rights and responsibilities of organizations as to their financial solvency. Specifically, the proposed amendments and additions will allow the Department to consistently implement the provisions of Health and Safety Code section 1375.4, including clarifying the definition of an organization, how these organizations report financial solvency, and the financial solvency standards that an organization shall meet. These changes will allow the Department to ensure that organizations are financially capable of taking on the weight of their risk-based agreements to provide health care services. Without such oversight, delivery and quality of healthcare for California healthcare consumers could be disrupted and the healthcare marketplace negatively impacted through these types of contractual delegations. The proposed amendments build on current regulations to remedy identified inconsistencies and ambiguities that negatively impact health plan enrollees and the healthcare marketplace. The proposed regulatory action will benefit California residents and also protect public health by securing California enrollee access to healthcare by amending regulations that ensure the viability of the healthcare marketplace, which enables enrollee health to be better managed and protected.

Summary of Existing Laws and Regulations:

The Department does not directly regulate organizations, as defined in Health and Safety Code section 1375.4, subdivision (g)(1), and section 1300.75.4, subdivision (b), of the Rules. Rather, the Department's authority over organizations stems from the Department's authority to regulate health plan contracts with organizations. The Knox-Keene Act gives the Department authority to obtain financial, enrollment, and other information from organizations that contract with licensed health plans or arrange for the health care services of a health plan's enrollees; the Department also has authority to require organizations to meet various financial thresholds to help ensure the organizations have the necessary resources to provide health care services to enrollees. The language of Health and Safety Code section 1375.4 of the Knox-Keene Act gives the Department authority to oversee sub-delegated organizations in the same way the Department oversees organizations that contract directly with health plans.

Broad Objectives and Benefits of the Regulation:

Pursuant to Government Code section 11346.5(a)(3)(C), the broad objectives and benefits of this regulation are to clarify and make specific state law relevant to the financial solvency of organizations. The Department is proposing to amend 1300.75.4 to clarify that organizations

include those that contract directly with a health plan as well as those that arrange for the health care services of a health plan's enrollees despite not having a direct contractual relationship with the health plan. The Knox-Keene Act defines an organization as an entity that "contracts directly with a health care service plan or arranges for health care services for the health care service plan's enrollees." This statutory language gives the Department authority to oversee sub-delegated organizations in the same way the Department oversees organizations that contract directly with health plans. However, the current regulations do not clearly address sub-delegated organizations and the reporting requirements of these organizations. The Department is also proposing to amend 1300.75.4 to add definitions for "sponsoring organization" and "sub-delegating organization". In defining "sponsoring organization" the amendment is implementing section 1375.4, subdivision (b)(1)(B), which allows use of a sponsoring organization. In defining "sub-delegating organization" the regulation implements Health and Safety Code section 1375.4, which applies to both organizations that contract directly with a health plan and those that arrange for the health care services of a health plan's enrollees through a contract with another organization. By defining these terms, the amendments ensure that all parties clearly understand their obligations and requirements in a sub-delegation arrangement.

The amendment also simplifies the methodology by which organizations calculate health plan receivables by removing obsolete and unnecessary language and implementing an industry standard of 30-calendar days. Additionally, this amendment eliminates obsolete phase-in provisions, which were fully-implemented approximately 10 years ago, to provide greater clarity to the required financial reserves of an organization and prevent confusion with outdated language. The intent of this regulation is to clarify this section of the Regulations by removing obsolete provisions and strengthening the reporting requirements of these organizations.

The Department is proposing to amend section 1300.75.4.1 of the Rules to revise an organization's financial reporting requirements to provide greater clarity to the type of risk arrangements that shall be disclosed by the health plan to the organization, and to incorporate the current payment models used by Medicare for consistency. Additionally, the proposed regulation makes technical changes to update obsolete language and to make clear the role of a sub-delegating organization.

Proposed section 1300.75.4.2 of the Rules removes the quarterly reporting distinction between organizations that serve at least 10,000 covered lives under all risk arrangements and those that serve less than 10,000 covered lives. The proposed section allows for a one-year phase in period for organizations to comply with the revised cash-to-claims definition set forth in section 1300.75.4. The proposal also incorporates by reference the "DMHC Quarterly Financial Survey Report Form" and the "DMHC Annual Financial Survey Report," which implement the financial reporting requirements pursuant to Health and Safety Code section 1375.4 and amended section 1300.75.4.2. Although these forms have been used by regulated entities for years, the Department has not completely incorporated them up until this time. The proposed section clarifies how an organization may rely on a sponsoring organization guarantee by making clear that the term of the guarantee can be no longer than one year unless an extension is granted by the Department. The amended regulation provides the Department the means to enforce the

financial solvency criteria of organizations while providing organizations flexibility when they need additional funds to demonstrate solvency.

Amended section 1300.75.4.5 clarifies that any financial information a health plan or sub-delegating organization contracts to receive from an organization shall be reviewed as a part of the health plan's and organization's duty to ensure their risk-sharing arrangements are financial viable.

Amended section 1300.75.4.8 streamlines the CAP finalization process by requiring a shorter turnaround by health plans and sub-delegating organizations raising objections and allowing the Department to assist in resolving objections at an earlier stage of the process. This will allow CAPs to be finalized more quickly, moving the struggling organization towards faster compliance. This helps to ensure a stable healthcare marketplace. The proposal also incorporates by reference the "DMHC Correction Action Plan (CAP) Form," which allows organizations to report the financial information required pursuant to section 1300.75.4.8 on a form that will allow the Department to analyze the data effectively and efficiently.

The proposed amendment to section 1300.76 clarifies what "positive tangible net equity" (TNE) is for purposes of calculating the TNE an organization must have to be compliant with the Solvency Regulations, as defined by section 1300.75.4, subdivision (e), of the Rules. The proposed regulation allows for a one-year phase in period for organizations to comply. The proposed regulation balances the need for organizations to have some level of financial reserves to demonstrate solvency while minimizing disparate impact on smaller organizations that may have more difficulty maintaining the required amount.

The remaining non-substantive amendments are technical changes to update obsolete or incorrect language.

ALTERNATIVES CONSIDERED:

Pursuant to Government Code section 11346.5(a)(13), the Department must determine that no reasonable alternative considered by the Department or has otherwise been identified or brought to the attention of the Department would be more effective in carrying out the purpose for which the above action is proposed or would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

The Department invites interested persons to present statements or arguments with respect to alternatives to the requirements of the proposed regulations during the written comment period.

EVALUATION OF CONSISTENCY/COMPATIBILITY WITH EXISTING STATE REGULATIONS

The Department evaluated the regulations for any other possible related regulations and has found that these are the only regulations concerning an organization's duties under the Solvency

Regulations and the proposed amendments are consistent with other areas of the Solvency Regulations that address more specifically health plan responsibilities. Therefore, these regulations are neither inconsistent nor incompatible with existing state regulations.

FORMS INCORPORATED BY REFERENCE:

The “DMHC Quarterly Financial Survey Report Form,” as dated May, 2018, “DMHC Annual Financial Survey Report Form, dated May, 2018, and “DMHC Corrective Action Plan (CAP) Form,” as dated May, 2018, is incorporated by reference pursuant to title 1, California Code of Regulations, section 20(c)(3), and as cited to in the Rules, sections 1300.84.06 and 1300.84.2, as amended by this rulemaking action.

SUMMARY OF FISCAL IMPACT:

- Mandate on local agencies and school districts: None.
- Cost or Savings to any State Agency: None.
- Cost to Local Agencies and School Districts Required to be Reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None.
- Other non-discretionary cost or savings imposed upon local agencies: None.
- Direct or Indirect Costs or Savings in Federal Funding to the State: None.
- Costs to private persons or businesses directly affected: Based on Fiscal Year 2016, the Department’s most recent fully reported and analyzed fiscal year, approximately 27 organizations will be noncompliant with the revised TNE requirement. These organizations will incur an average cost of \$670,211 in order to satisfy the updated TNE requirement, for a total of \$18,095,690 spread across approximately 27 organizations.
- Statewide adverse economic impact directing affecting business and individuals: Although the proposed action will directly affect business statewide, the Department concludes that the adverse economic impact, including the ability of California businesses to compete with businesses in other states, will not be significant.
- Effect on Housing Costs: None.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS (Government Code section 11346.3, subdivision (b)):

Creation or Elimination of Jobs Within the State of California:

the same time, the regulation replaces current terminology and interpretations that have proven to be problematic and unwieldy for the impacted parties. The one amendment with a substantive economic impact is the increase in financial reserves an organization must maintain under section 1300.76. The proposed requirements for an organization’s TNE was reached by examining the requirements placed on a health plan and by examining how such a proposal would impact the healthcare market. The proposed level balances the need for organizations to have some level of financial

reserves to demonstrate solvency while minimizing disparate impact on smaller organizations that may have more difficulty maintaining the required amount. The old TNE requirement is also outdated and does not accurately reflect the current financial reserves that are necessary to demonstrate fiscal solvency. The increase is not expected to be burdensome on affected organizations because they have a year phase-in to achieve total compliance and the updated TNE requirement is necessary in the current healthcare marketplace. In light of the technical nature of most of these amendments, and the reasonable and appropriate nominal economic impact of the increased deposit requirement, no jobs in California will be created or eliminated.

Creation of New Businesses or Elimination of Existing Businesses Within the State of California:

the same time, the regulation replaces current terminology and interpretations that have proven to be problematic and unwieldy for the impacted parties. The one amendment with a substantive economic impact is the increase in financial reserves an organization must maintain under section 1300.76. The proposed requirements for an organization's TNE were reached by examining the requirements placed on a health plan and by examining how such a proposal would impact the health care market. The proposed level balances the need for organizations to have some level of financial reserves to demonstrate solvency while minimizing disparate impact on smaller organizations that may have more difficulty maintaining the required amount. The old TNE requirement is also outdated and does not accurately reflect the current financial reserves that are necessary to demonstrate fiscal solvency. The increase is not expected to be burdensome on affected organizations because they have a year phase-in to achieve total compliance and the updated TNE requirement is necessary in the current healthcare marketplace. In light of the technical nature of most of these amendments, and the reasonable and appropriate nominal economic impact of the increased deposit requirement, no new businesses in California will be created or existing businesses eliminated.

Expansion of Businesses Currently Doing Business Within the State of California:

the same time, the regulation replaces current terminology and interpretations that have proven to be problematic and unwieldy for the impacted parties. The one amendment with a substantive economic impact is the increase in financial reserves an organization must maintain under section 1300.76. The proposed requirements for an organization's TNE were reached by examining the requirements placed on a health plan and by examining how such a proposal would impact the health care market. The proposed level balances the need for organizations to have some level of financial reserves to demonstrate solvency while minimizing disparate impact on smaller organizations

that may have more difficulty maintaining the required amount. The old TNE requirement is also outdated and does not accurately reflect the current financial reserves that are necessary to demonstrate fiscal solvency. The increase is not expected to be burdensome on affected organizations because they have a year phase-in to achieve total compliance and the updated TNE requirement is necessary in the current healthcare marketplace. In light of the technical nature of most of these amendments, and the reasonable and appropriate nominal economic impact of the increased deposit requirement, no new businesses in California will be created or existing businesses eliminated.

Benefits of the Regulation to the Health and Welfare of California Residents, Worker Safety, and the State's Environment:

the same time, the regulation replaces current terminology and interpretations that have proven to be problematic and unwieldy for the impacted parties. The one amendment with a substantive economic impact is the increase in financial reserves an organization must maintain under section 1300.76. The proposed requirements for an organization's TNE were reached by examining the requirements placed on a health plan and by examining how such a proposal would impact the health care market. The proposed level balances the need for organizations to have some level of financial reserves to demonstrate solvency while minimizing disparate impact on smaller organizations that may have more difficulty maintaining the required amount. The old TNE requirement is also outdated and does not accurately reflect the current financial reserves that are necessary to demonstrate fiscal solvency. The increase is not expected to be burdensome on affected organizations because they have a year phase-in to achieve total compliance and the updated TNE requirement is necessary in the current healthcare marketplace. In light of the technical nature of most of these amendments, and the reasonable and appropriate nominal economic impact of the increased deposit requirement, no new businesses in California will be created or existing businesses eliminated.

DETERMINATIONS:

The Department has made the following initial determinations:

The Department has determined the regulation will not impose a mandate on local agencies or school districts, nor are there any costs requiring reimbursement by Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

The Department has determined the regulation will have no significant effect on housing costs.

The Department has determined the regulation does not impact small businesses. Relying on fiscal year 2016, the most recent fully reported and analyzed fiscal year, 179 organizations

currently report to the Department, of which 17 may be classified as small businesses pursuant to Government Code section 11342.610. None of the 17 small business organizations will be impacted by the proposed amendments to the regulations because they are already compliant with the revised TNE requirements contained in the proposed regulation.

Based on Fiscal Year 2016, the Department's most recent fully reported and analyzed fiscal year, approximately 27 organizations will be noncompliant with the proposed revised TNE requirement in the amended regulations. These organizations will incur an average cost of \$670,211 in order to satisfy the updated TNE requirement, for a total of \$18,095,690 spread across approximately 27 organizations. However, one organization significantly skews this average TNE deficiency rate because it contributes approximately \$3.5 million to the deficiency. The average TNE deficiency without this outlier organization would be \$559,319. Additionally, of the 27 organizations, 4 are currently noncompliant with the existing "positive" TNE rate.

As stated above, there will be no impact to the small business organizations by the proposed amendments to the regulations because they are already compliant with the revised TNE requirements contained in the proposed regulation.

The Department examined the impact of the TNE requirements on the organizations and balanced the need for the updated TNE requirements and the hardship organizations may initially face in coming to compliance. Accordingly, the Department proposes that organizations have a phase-in period of one year for compliance and during that year, the organizations must comply with the existing TNE requirements. The Department believes this approach balances the needs of all parties, while protecting the enrollees.

The Department has determined that this regulation will have no cost or savings in federal funding to the state.

BUSINESS REPORT:

These amendments to the existing regulation update the information contained within the regulation to clarify and update the requirements of organizations by clarifying, definitions, financial solvency reporting requirements, and financial solvency standards. The amendments to this regulation are necessary for the health, safety or welfare of the people of the state.