ADDENDUM TO THE INITIAL STATEMENT OF REASONS

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 of Title 28, California Code of Regulations

(Control No. 2017-5216)

Necessity

45-Day Comment Period

Section 1300.75.4.2(b)(1)(B) – This amendment is necessary for situations where the Department determines there are potential solvency issues with the organization or its affiliate. In these types of situations, the Director must have the ability to separate out the financial information of the organization or its affiliate and determine whether the organization or affiliate has financial adequate solvency or is potentially having problems that could jeopardize its ability to conduct business. Having a separate Quarterly Financial Survey Report Form to review will benefit the Department when determining the overall financial health of the organization or affiliate.

Section 1300.75.4.2(b)(4) – This amendment is necessary for accurately ascertaining whether the organization has positive tangible net equity (TNE). By excluding unsecured affiliate receivables, which have no collateral backing, and therefore are not an asset the organization will necessarily procure, the Department can ensure that the information it is given by the organization truly and accurately represents its TNE. This benefits the Department in understanding the true nature of the organization's financial solvency.

Section 1300.75.4.2(b)(4)(A)(ii)a. – This amendment informs the organization that it may have one (1) fiscal year to reduce its liabilities or increase its cash for purposes of calculating its TNE, working capital and cash-to-claims ratio through the use of a sponsoring organization. It is important for the organization to be able to use a sponsoring organization, if necessary, to reduce its liabilities or increase its cash to maintain financial solvency. Maintaining the financial solvency of the organization is the goal of the Department and helps to ensure a stable healthcare market place. However, the use of a sponsoring organization does signal to the Director that the financial solvency of the organization needs to be monitored more closely to ensure its financial health. The Department is only allowing the organization to request a single one (1)-year extension of the use a sponsoring organization because if the organization is not able to fix its solvency issue within this time period, then this could indicate a larger financial solvency issue that the Department needs to address. Therefore, the use of the sponsoring organization to reduce the organization's liabilities or increase its cash for purposes of calculating its TNE, working capital and cash-to-claims ratio must be limited so that the organization does have time to address any underlying financial issues but still is required to fix its solvency problem.

Section 1300.75.4.2(b)(4)(A)(ii)c. - This amendment informs the organization that it may have only a single one (1) year extension of the use of a sponsoring organization. This amendment is necessary because if an organization needs to use a sponsoring organization to reduce its liabilities or increase its cash for these purposes, then this is an early indication that the organization may be having financial difficulties. Likewise, if the organization needs to extend the use of the sponsoring organization for an additional year, then this means the organization is continuing to have financial difficulties. This signals to the Director that the financial solvency of the organization needs to be monitored more closely to ensure its financial health. By limiting the extension to only a single one (1) year extension, the Department ensures that it has a clear understanding of the true nature of the financial stability and solvency of the organization separate from its sponsoring organization.

Section 1300.75.4.2(c)(1)(B) - This amendment is necessary for situations where the Department determines there are potential solvency issues with the organization or its affiliate. In these types of situations, the Director must have the ability to separate out the financial information of the organization or its affiliate and determine whether the organization or affiliate has adequate financial solvency or is potentially having problems that could jeopardize its ability to conduct business. Having a separate Annual Financial Survey Report Form to review will benefit the Department when determining the overall financial health of the organization or affiliate.

Section 1300.75.4.2(c)(3) - This amendment is necessary for accurately ascertaining whether the organization has positive tangible net equity (TNE). By excluding unsecured affiliate receivables, which have no collateral backing, and therefore are not an asset the organization, the Department can ensure that the information it is given by the organization truly and accurately represents its TNE. This benefits the Department in understanding the true nature of the organization’s financial solvency and determining its financial health.

Section 1300.75.4.2(c)(3)(A)(ii)a - This amendment informs the organization that it may have one (1) fiscal year to reduce its liabilities or increase its cash for purposes of calculating its TNE, working capital and cash-to-claims ratio through the use of a sponsoring organization. It is important for the organization to be able to use a sponsoring organization, if necessary, to reduce its liabilities or increase its cash to maintain financial solvency. Maintaining the financial solvency of the organization is the goal of the Department and helps to ensure a stable healthcare market place. However, the use of a sponsoring organization does signal to the Director that the financial solvency of the organization needs to be monitored more closely to ensure its financial health. The Department is only allowing the organization to request a single one (1)-year extension of the use a sponsoring organization because if the organization is not able to fix its solvency issue within this time period, then this could indicate a larger financial solvency issue that the Department needs to address. Therefore, the use of the sponsoring organization to reduce the organization’s liabilities or increase its cash for purposes of calculating its TNE, working capital and cash-to-claims ratio must be limited so that the organization does have time to address any underlying financial issues but still is required to fix its solvency problem.

Section 1300.75.4.2(c)(3)(A)(ii)c. - This amendment informs the organization that it may only have a single one (1) year extension of the use of a sponsoring organization. This amendment is necessary because if an organization needs to use a sponsoring organization to reduce its liabilities or increase its cash for these purposes, then this is an early indication that the organization may be having financial difficulties. Likewise, if the organization needs to extend the use of the sponsoring organization for an additional year, then this means the organization is continuing to have financial difficulties. This signals to the Director that the financial solvency of the organization needs to be monitored more closely to ensure its financial health. By limiting the extension to only a single one (1) year extension, the Department ensures that it has a clear understanding of the true nature of the financial stability and solvency of the organization separate from its sponsoring organization.

Section 1300.75.4.2(e) – This section requires a hard copy verification with an original signature be submitted to the Department. A hard copy verification with an original signature is necessary to ensure that the document is true and correct and that the Department can verify the correct person from the organization, or the affiliate, has signed. This gives the Department more legal authority if there are questions surrounding either the information provided to the Department by the organization or affiliate or the identity of the principle officer who signed the verification stating that the information was true and correct.

Section 1300.76(c)(1) – Section 1300.76(c)(1) – This amendment is necessary because health plans are not responsible for paying providers if RBOs received payment from the health plans for services provided to health plan enrollees. In this case, the RBOs are responsible for paying providers for services. If these payments to providers do not occur because of inadequate financial reserves or solvency issues surrounding the organization, this disrupts the healthcare market place and enrollees may not receive services. The current regulations require the RBO to have positive TNE, which is $1 or more. When an RBO becomes non-compliant with this requirement, it can be difficult for an RBO to make the necessary operational changes or infusions of cash to obtain compliance with the solvency criteria. This in turn can cause a disruption in services to enrollees and non-payment to providers.

The increase in the TNE requirement is necessary to reflect increases in reserves that are associated with protecting the interests of enrollees. A significant amount of time has passed since the regulation was originally adopted and the Department's knowledge has increased with respect to the amount of financial resources and operational needs that are necessary for an RBO to obtain and maintain compliance with the solvency criteria. It must be noted that the current TNE amounts before this proposed regulation amendment are over 15 years old. The requirements in the current regulation no longer accurately represent the reality of financial solvency of organizations who are responsible for paying health care providers and ensuring enrollees receive access to medically necessary health care.

Based on an analysis of Fiscal Year 2015, the Department's most recent fully reported and analyzed fiscal year, approximately six (6) out of twenty-seven (27) organizations were noncompliant with the current TNE requirement. This means that these organizations did not have sufficient tangible equity in the business and had the potential to not pay providers and/or ensuring access to care for enrollees. Further, the amount of TNE that these organizations had was not sufficient to wind down operations/pay providers if necessary because of insolvency.

The proposed requirement for an organization's TNE was reached by examining the requirements placed on a full service health plan and by examining how such a proposal would impact the healthcare market place. The TNE calculation significantly mirrors the TNE calculation for full service health plans. However, the percentages applied to the revenue and expense calculations were reduced by 50% because the RBOs take less financial risk. 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 TNE amount. The increased TNE amounts more accurately reflect the tangible equity in the business if an organization was forced to wind down its operations and protect providers, enrollees and the healthcare market place.

2nd Comment Period

Section 1300.75.4.1(a)(1) – The Department revised the reporting time period from ten (10) calendar days to fifteen (15) calendar days after information from stakeholders indicated that the information could not be obtained during the shorter time period. Because the Department does not want to place the health plan or the organization in a situation where they are unable to comply with the law, the Department reconsidered the time period. This change is necessary to ensure the Department receives accurate reporting information while balancing the need of the health plan or organization to have sufficient time to gather the information. This longer period of time will benefit both the Department and the organization in ensuring that the information gathered is accurately reported and accurately reflects the risk arrangement between the parties.

Section 1300.75.4.1(a)(2) – The Department revised the reporting time period from ten (10) calendar days to fifteen (15) calendar days after information from stakeholders indicated that the information could not be obtained during the shorter time period. Because the Department does not want to place the health plan or the organization in a situation where they are unable to comply with the law, the Department reconsidered the time period. This change is necessary to ensure the Department receives accurate reporting information while balancing the need of the health plan or organization to have sufficient time to gather the information. This longer period of time will benefit both the Department and the organization in ensuring that the information gathered is accurately reported and accurately reflects the risk arrangement between the parties.

Section 1300.75.4.1(c) – The addition of the language "percentage of premium arrangement" was added because this information is necessary to understand the financial solvency of the organization if such an arrangement is used. This amount must be accurately reported to the Department as an indication of the monies collected by the organization to maintain its financial solvency and indicate its financial health through its arrangements with either health plans or other sub-delegated organizations.

4th Comment Period

Section 1300.75.4(f) – The term "plan receivables" has been amended to "HMO capitation receivables" for the purposes of calculating the cash-to-claims ratio. This amendment is necessary because organizations receive capitation amounts (per member/per month) on a monthly basis from health plans. These HMO capitation receivables are used by the organization to calculate its solvency compared to the organization's unpaid claims. This amended definition more accurately reflects the cash-to-claims ratio and indicates the financial solvency of the organization for the Department. The Department has also added language requiring that the organization may only report those HMO capitation amounts the organization reasonably believes will be received during the monthly time period reported. The Department made this change because it received information previously that did not accurately reflect monies the organization would be receiving during the reporting time-period and, therefore, the Department was not able to clearly determine the financial solvency of the organization. This standard will help the Department receive more accurate information from the organization that can be reviewed to determine the financial health of the organization when reviewing its cash-to-claims ratio.

Section 1300.76(c)(2) – This amendment to the text has been made to provide consistency with the calculation of tangible net equity within the Knox-Keene Act and regulations. By deleting the old language and cross referencing back to the definition of tangible net equity in section 1300.76, subdivision (c), the Department is ensuring organizations will clearly understand how to calculate their tangible net equity versus having confusion if the old definition and the new definition do not match. This consistency will benefit the Department when reviewing the tangible net equity of an organization to determine whether it has sufficient solvency to conduct its business and meet its obligations pursuant to its risk arrangements.

Documents Relied Upon

Please note that the Department is deleting the following documents erroneously listed as documents relied upon. These documents were instead incorporated by reference in the rulemaking package:

- Annual Financial Survey Reporting Form
- Quarterly Financial Survey Reporting Form
- Corrective Action Plan Form