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Our first care is your health care
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

January 13, 2010

The Honorable Russell Pearce
Chairman, Joint Legislative Budget Committee
Arizona State Senate
1700 W. Washington
Phoenix, AZ 85007

Dear Senator Pearce:

Pursuant to the requirements of Laws 2008, Chapter 288, please find the enclosed quarterly financial reports for Healthcare Group for the quarters ending June 30, 2009 and September 30, 2009. I would be happy to answer any questions or provide any additional information. Please feel free to contact me at (602) 417-4711.

Respectfully,

A handwritten signature in black ink, appearing to read 'T. Betlach', with a stylized flourish at the end.

Thomas Betlach
Director

cc: The Honorable John Kavanagh, Arizona House of Representatives
Beth Kohler Lazare, Office of Governor Brewer
John Arnold, Office of Strategic Planning and Budgeting
Richard Stavneak, Joint Legislative Budget Committee



**JLBC Report
FY09, Fourth Quarter, April 1, 2009 to June 30, 2009**

Financial trends for Healthcare Group (HCG) for the year have been positive. For Fiscal Year 2009, HCG is reporting a preliminary net gain from Operations of \$3.248 million compared to the net gain from operations in Fiscal Year 2008 of \$0.22 million.

| Healthcare Group of Arizona Income Summary State Fiscal Year Ending June 30, 2009 | | | | | |
|---|---------------|----------------|---------------|---------------|-----------|
| | QE 9/30/08 | QE 12/31/08 | QE 3/31/09 | QE 6/30/09 | FY09 |
| Income Before Reconciliation, Transfers and Other Expense Item | 363,915 | 1,030,357 | 1,587,379 | 1,097,466 | 4,079,117 |
| FY09 Reconciliation Expense | 590,956 | -795,046 | 294,336 | 57,304 | 147,550 |
| FY09 Utilization Management Standards Accrual | 0 | 0 | 619,431 | 578,772 | 1,198,203 |
| FY08 Reconciliation Expense Adjustments (Favorable) | -33,140 | -444,879 | -13,833 | -23,216 | -515,068 |
| Income Before Transfers and Extraordinary Item | -193,901 | 2,270,282 | 687,445 | 484,605 | 3,248,431 |
| Other Expense | 0 | 0 | 0 | 928,000 | 928,000 |
| Income Before Transfers | -193,901 | 2,270,282 | 687,445 | -443,395 | 2,320,431 |

Average Medical-Loss Ratio (MLR) for the fourth quarter alone, as shown in the table below, was 77%; however, in the third quarter cumulative MLR was 62%. Increases in the proportion of paid claims in the HMO plans near the end of the year are likely a contributing factor to the increase in MLR for the fourth quarter.

| Medical Loss Ratios by Plan - Fourth Quarter Fiscal Year 2009 | | | | | |
|---|-----------|-----------|-----------|---------|------------|
| | Care1st | Mercy | UPH | PPOS | Total |
| Medical Expense Reported on Unaudited Health Plan Income Statement* | 1,146,123 | 4,624,227 | 3,122,138 | 876,389 | 9,768,877 |
| Total Premium (Not Including Dental/Vision) | 1,303,901 | 5,672,431 | 4,995,309 | 766,650 | 12,738,291 |
| Medical Loss Ratio | 88% | 82% | 63% | 114% | 77% |

*Includes estimations for claims that are incurred but not reported (IBNRs)

As was expected, membership continued to decline in the fourth quarter. As small businesses in Arizona endure the worsening economy, many look for ways to reduce their costs. The worsening economy is reflected in many groups declining further coverage with HCG, reducing staff, and/or closing their business altogether. Some go to other carriers, but many leave HCG with no other health insurance alternative. Pursuant to Laws 2008, Chapter 288 (HB2275), September 2008 was the last month that the PPOS program operated in Maricopa and Pima counties, resulting in an enrollment decrease of 46% in the PPOS from September to October. Total enrollment for the fiscal year is shown in the table below:

| HCG Enrollment - Fiscal Year 2009 | | | | | | | | | | | | |
|-----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | Jul 08 | Aug 08 | Sep 08 | Oct 08 | Nov 08 | Dec 08 | Jan 09 | Feb 09 | Mar 09 | Apr 09 | May 09 | Jun 09 |
| HMO | 18,782 | 18,186 | 17,306 | 17,059 | 16,477 | 16,037 | 15,571 | 15,164 | 14,727 | 14,375 | 14,106 | 13,896 |
| PPOS | 1,837 | 1,766 | 1,603 | 855 | 823 | 785 | 733 | 716 | 695 | 679 | 664 | 665 |
| Total | 20,619 | 19,952 | 18,909 | 17,914 | 17,300 | 16,822 | 16,304 | 15,880 | 15,422 | 15,054 | 14,770 | 14,561 |

The total number of employer groups enrolled in HCG HMO and PPOS plans during the fiscal year is shown below:

| HCG Employer Group Count - Fiscal Year 2009 | | | | | | | | | | | | |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| | Jul 08 | Aug 08 | Sep 08 | Oct 08 | Nov 08 | Dec 08 | Jan 09 | Feb 09 | Mar 09 | Apr 09 | May 09 | Jun 09 |
| Employer Groups | 7,597 | 7,366 | 6,956 | 6,655 | 6,424 | 6,263 | 6,046 | 5,894 | 5,748 | 5,640 | 5,533 | 5,421 |

As anticipated, HCG continued to have financial success in the final quarter, ending the year with Operating revenues of \$3.248 million. Effective January 1, 2009 all three HCG contractors agreed, in contract, that no future reconciliation costs will be recognized by HCG except for adjustments to the existing reconciliation for services rendered through December 31, 2008. Reconciliation expense for this six month period is \$147,550. For the second six months of the fiscal year, HCG contractors will be compensated for attaining Nationally Recognized Utilization Management Standards, as mandated by HB2275. This amount is based on a percentage of total premium revenue collected and will be no more than 6%. In January, HCG began a premium reserve for these anticipated payments and ended the year with \$1.198 million in reserve. If the contractors perform well, each will receive their corresponding payment of this reserve amount. If a health plan performs poorly, it will forfeit the reserved amount and HCG will retain the amount and apply it to any existing liabilities. By compensating the health plans based on a set amount of reserves already collected from member premiums, HCG then eliminates the potential for any unanticipated losses (or gains) from variation in HMO utilization. Determination and payment of these reserves will be made in December 2009.

At the beginning of the fiscal year, HCG carried liabilities of \$14.9 million for reconciliation amounts owed to its three health plans for Fiscal Year 2007 activities. As of June 30, 2009, HCG has disbursed \$5.3 million to the health plans to reduce reconciliation liabilities, leaving a remaining liability balance from Fiscal Year 2007 of \$9.6 million.

Also at the beginning of the fiscal year, HCG carried estimated liabilities of \$4.3 million for reconciliation amounts owed to its health plans for Fiscal Year 2008 activities. In the second quarter, HCG finalized these amounts and additional adjustments brought the balance, as of June 30, 2009, to \$3.8 million.

After the fiscal year ended, but before annual financial reports were produced, HCG took over the provider payment function from HCG's PPOS TPA. As a result of provider payment reconciliations and payment history research, HCG determined that approximately \$928,000 was currently owed to providers. This amount is reflected on the Income Summary as an Other Expense. HCG is currently working with AHCCCS legal counsel to resolve this ongoing issue and is seeking reimbursement for this loss.



**JLBC Report
FY10, First Quarter, July 1, 2009 to September 30, 2009**

From July 1, 2009-September 30, 2009, HCG is reporting a preliminary net gain of \$0.69 million before Transfers Out. The table below shows \$1.2 million in Income Before Adjustments, Utilization Management Standards Accrual, and Transfers. Prior year reconciliation adjustments include reinsurance recoveries. Per Laws 2009, Chapter 12, Section 44, HCG transferred \$361,900 to the State General Fund in September.

As in quarters three and four of Fiscal Year 2009, in Fiscal Year 2010, no future reconciliation costs will be recognized by HCG, rather contractors will be compensated for attaining Nationally Recognized Utilization Management Standards, as mandated by Laws 2008, Chapter 288, Section 5 (HB2275). This amount is based on a percentage of total premium revenue collected and reserved. If the contractors perform well, each will receive their corresponding payment of this reserve amount. If a health plan performs poorly, it will forfeit the reserved amount and HCG will retain the amount and apply it to any existing liabilities. Performance Standards are developed by Milliman Inc., customized to each health plans unique member population and further stratified by the level of medical management (i.e. Well Managed, Moderately Managed, and Loosely Managed). For the first quarter, HCG has expensed and reserved \$0.56 million for these anticipated costs.

| Healthcare Group of Arizona Income Summary YTD Quarter Ending September 30, 2009 | |
|--|------------|
| | QE 9/30/09 |
| Income Before Adjustments, Utilization Management Standards, and Transfers | 1,162,785 |
| Prior Year Reconciliation Adjustments (favorable) | -88,567 |
| FY09 Utilization Management Standards Accrual | 560,855 |
| Income Before Transfers | 690,498 |
| Transfer to General Fund | 361,900 |
| Change in Net Assets | 328,598 |

Average Medical-Loss Ratio (MLR) for the first quarter, as shown in the table below, was 79%. This compares quite favorably to the 88% MLR experienced in the first quarter of Fiscal Year 2009. MLR's for all health plans have decreased year over year. Most notably the PPOS went from 135% in the first quarter of fiscal year 2009 down to 82% this quarter; largely due to significant changes that took effect in September 2008, including premium increases and the elimination of the PPOS product in Maricopa and Pima Counties.

| Medical Loss Ratios by Plan - First Quarter Fiscal Year 2010 | | | | | |
|--|------------|------------|------------|------------|------------|
| | Care1st | Mercy | UPH | PPOS | Total |
| Medical Expense Reported on Unaudited Health Plan Income Statement* | 1,017,804 | 4,744,686 | 3,344,063 | 609,386 | 9,715,938 |
| Total Premium (Not Including Dental/Vision) | 1,126,939 | 5,433,499 | 4,973,944 | 740,166 | 12,274,548 |
| Medical Loss Ratio | 90% | 87% | 67% | 82% | 79% |

*Includes estimations for claims that are incurred but not reported (IBNRs)

As was expected, membership continued to decline in the first quarter. As small businesses in Arizona continue to endure the worsening economy, many look for ways to reduce their costs. The worsening economy is reflected in many groups declining further coverage with HCG, reducing staff, and/or closing their business altogether. Some go to other carriers, but many leave HCG with no other health insurance alternative.

Total enrollment for the fiscal year is shown in the table below:

| HCG Enrollment - YTD Fiscal Year 2010 | | | |
|--|---------------|---------------|---------------|
| | Jul-09 | Aug-09 | Sep-09 |
| HMO | 13,594 | 13,283 | 12,631 |
| PPOS | 644 | 610 | 561 |
| Total | 14,238 | 13,893 | 13,192 |

The total number of employer groups enrolled in HCG HMO and PPOS plans during the fiscal year is shown below:

| HCG Employer Group Count - YTD Fiscal Year 2010 | | | |
|--|---------------|---------------|---------------|
| | Jul-09 | Aug-09 | Sep-09 |
| Employer Groups | 5,265 | 5,123 | 4,815 |

On June 30, 2009 total Reconciliation Liability owed to contractors was \$13.4 million. As of September 30, 2009 total Reconciliation Liability was \$13.1 million. The \$287,041 YTD reduction is attributable to \$91,020 in accrual adjustments and reinsurance and \$196,021 in payments. Improvements to premium rates and continuous reductions in administrative expenses for the last two fiscal years allow HCG to continue to pay down the Reconciliation balance from operating revenues.