

# CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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## ***It Relied Heavily on Blue Shield of California's Exclusive Provider Network Analysis, an Analysis That Is Reasonable in Approach but Includes Some Questionable Elements and Possibly Overstates Estimated Savings***

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### **Audit Highlights . . .**

*Our review of the decision by the California Public Employees' Retirement System (CalPERS) board of administration (board) in May 2004 to approve an exclusive provider network for CalPERS members in the Blue Shield of California (Blue Shield) health maintenance organization (HMO) found the following:*

- Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources.*
- Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network.*
- Blue Shield's estimate of \$31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health-care plans.*

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**California Public Employees' Retirement System's response as of September 2005**

The Joint Legislative Audit Committee requested the Bureau of State Audits to examine the California Public Employees' Retirement System (CalPERS) decision to discontinue contracting with certain hospitals through the Blue Shield of California (Blue Shield) health maintenance organization (HMO) provider network. Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources. In addition, Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network. Also, Blue Shield's estimate of \$31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health care plans. Further, Blue Shield did not adequately address a recommendation to investigate differences in emergency room assumptions for one health system. According to our consultant, Blue Shield's hospital savings estimate of \$20.6 million could drop to only \$8.9 million if the model-review actuary's assumptions were used. Moreover, the CalPERS board, health benefits committee (committee), and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network. Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of \$36.3 million related to the 38 hospitals;

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- ☑ *The CalPERS board, health benefits committee, and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network.*
- ☑ *Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of \$36.3 million related to the 38 hospitals; thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate.*
- ☑ *In one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.*

thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate. Finally, in one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.

**Finding #1: CalPERS relied primarily on Blue Shield's summary of its analyses and presentations in making the decision to exclude hospitals.**

A provision of the contract between CalPERS and Blue Shield specifies that Blue Shield cannot disclose information to CalPERS that would cause it to breach the terms of any contract to which it is a party. According to Blue Shield, the terms of the contract between it and providers in its network specifically prohibit the disclosure of certain information, including rates of payment. Consequently, CalPERS health benefits branch staff did not have access to hospital rates, nor could they review Blue Shield's cost model. As a result, CalPERS was unable to verify the accuracy of Blue Shield's cost comparison data.

We recommended that the Legislature consider enacting legislation that would allow CalPERS, during its contract negotiation process, to obtain relevant documentation supporting any analyses it will use to make decisions that materially affect the members of the health benefits program established by the Public Employees' Medical and Hospital Care Act.

*Legislative Action: Unknown.*

**Finding #2: CalPERS did not fully consider all of the findings and recommendations made by the actuary hired to perform a third-party review prior to approving the exclusive provider network.**

CalPERS health benefits branch staff directed Blue Shield to hire an independent actuary (model-review actuary) to conduct a third-party review to resolve differences between Blue Shield's and a health system's analyses. Blue Shield's contract with the model-review actuary also required him to review the cost savings projections for the exclusive provider network. The model-review actuary issued his final report to Blue Shield and CalPERS in April 2004, which contained numerous findings and recommendations. Although the board and committee discussed Blue Shield's savings estimate in meetings held before the board voted to approve the exclusive provider network in May 2004, our review of the transcripts found that they did not

discuss all of the model-review actuary's findings and recommendations or the impact of the findings and recommendations on the CalPERS board's decision. Without fully addressing all of the concerns raised by the model-review actuary, CalPERS had no assurance from an independent source that Blue Shield's savings estimate, as well as other aspects of its model, were accurate.

We recommended that, to ensure its decisions are in the best interests of CalPERS members, CalPERS should require its health benefits branch staff to evaluate fully the findings and recommendations of third-party reviews and present their results to the board and committee.

***CalPERS' Action: Corrective action taken.***

CalPERS stated that, effective September 1, 2005, it implemented procedures to formalize its criteria for analyzing and reporting on third-party reviews. These procedures require CalPERS' management to designate a staff Third-party Review Coordinator to oversee reviews. The procedures also require the coordinator to monitor, evaluate, and report to CalPERS' management the outcomes and efficacy of analyses performed in third-party reviews, including any deficiencies or limitations. Finally, the procedures require CalPERS' management to ensure that the coordinator reviews, approves, and presents all findings to the board and its committees.

CalPERS further stated that its third-party review procedures address the bureau's concerns in the audit report. Specifically, CalPERS stated that the procedures provide a clear statement of work, a thorough review of work by staff and management, documentation, and clear channels of communication of the results of the review to CalPERS' management and the board.

