



State of California—Health and Human Services Agency  
Department of Health Care Services



TOBY DOUGLAS  
*Director*

Edmund G. Brown Jr.  
*Governor*

**Revised**

June 17, 2011  
Ms. Margaret Liston, Chief  
Financial Management Section

Dear Ms. Liston,

The California Department of Health Care Services (DHCS) is tasked with the development of actuarially sound capitation rate ranges for the Partnership Health Plan operating in Marin and Mendocino Counties contract for the period July 1 2011 through June 30 2012 (FY 11/12). This letter presents an overview of the analyses and methodology used in the development of actuarially sound and appropriate managed care rate ranges and payment amounts, and for the purpose of satisfying the requirements of the Centers for Medicare and Medicaid Services (CMS). In my opinion, the capitation rate ranges are developed from an actuarially sound process and should, along with Managed Care Organization (MCO) investment income and any reinsurance or stop-loss cash flows, provide for all reasonable, appropriate and attainable costs.

If you have any question on the above, please contact me.

ORIGINAL SIGNED BY ARLENE LIVINGSTON

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July 1, 2011

**Partnership Health Plan  
operating in Marin and  
Mendocino Counties  
Fiscal Year 2011 – 2012  
Rate Range Development and  
Certification**  
State of California

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# 1

## **Rate methodology**

### **Overview**

Capitation rate ranges for DHCS' Partnership Health Plan operating in Marin and Mendocino Counties managed care program were developed in accordance with rate-setting guidelines established by the Centers for Medicare and Medicaid Services (CMS). For rate range development for the Partnership Health Plan operating in Marin and Mendocino Counties contract, we primarily used fee-for-service data for calendar year 2008 (CY2008).

Adjustments were made to the selected base data to match the covered population risk and the State Plan approved benefit package for the fiscal year 2011/2012 (FY11/12) contract period. Additional adjustments were then applied to the selected base data to incorporate:

- Allocations or re-allocations of health care costs to the standard categories of services
- Prospective and historic (retrospective) program changes not reflected (or not fully reflected) in the base data
- Observed changes in the population case-mix and underlying risk of the Partnership Health Plan operating in Marin and Mendocino Counties contract from the base data period
- Trend factors to forecast the expenditures and utilization to the contract period
- Administration and Underwriting Profit/Risk/Contingency loading
- Addition of 2.35% premium tax

The **spenddown** amount for expenses that are the recipient's liability is contained in a data field in the database. The regular method is employed. Until the spenddown amount is incurred by the recipient, no Medicaid expenses are paid. Paid amounts on the database used for base rates reflect the spenddown liability in that the recipient is not certified for Medicaid until the total spenddown amount has been incurred. After the spenddown amount has been incurred, the recipient is certified

and medical expenses after certification are accumulated for base costs that are eligible for FFP.

No **DSH** payments are included in these rates. DSH payments are not part of the data collected in the database used for rate setting. DSH payments go directly through the State Controller's payment system and are not part of medical expenses claimed for FFP in the capitation rates.

**Data Smoothing** – Fee-for-Service data included large populations so data smoothing was not necessary since all categories of Aid Codes and Services were credibly represented.

**Special Populations** were included at 91% of Fee-for-Service cost since the plan would be responsible for these populations.

**Cost-neutral data smoothing** – because all categories of Aid Codes and Services were credibly represented, no cost-neutral data smoothing was necessary and was not done.

**Risk-Adjustment** – The Aid Code categories represent our risk adjusted categories. Fee-for-Service data contains credible amounts of all represented Aid Code categories so no other risk adjustments were necessary and were not done.

The State does not offer **Stop loss, reinsurance or Risk-Sharing** arrangements to the Partnership Health Plan operating in Marin and Mendocino Counties.

The State does not utilize **risk corridor arrangements** with the Partnership Health Plan operating in Marin and Mendocino Counties.

The State does not have an **incentive arrangement** with the Partnership Health Plan operating in Marin and Mendocino Counties.

A single and consistent process of developing capitation rate ranges was used for the Partnership Health Plan operating in Marin and Mendocino Counties program. The Partnership Health Plan operating in Marin and Mendocino Counties has the opportunity and responsibility to independently review the rates offered by DHCS, and to determine whether the rates are acceptable based on their individual financial requirements.

The various steps in the rate range development are described in the following paragraphs.

## **Base data**

The information used to form the base data for the Partnership Health Plan operating in Marin and Mendocino Counties rate range development was primarily the 2008

fee-for-service data. The Base Period that was used for rate development was Calendar Year 2008 (CY2008).

The fee-for-service data was reviewed for consistency and reasonableness. It was also reviewed for consistency and compatibility with specific financial reporting (required by DMHC). The base data included utilization and unit cost detail by category of aid (COA) and by 12 consolidated provider types or categories of service (COS) including:

- Inpatient Hospital
- Outpatient Facility
- Emergency Room
- Long Term Care (LTC)
- Lab/Radiology
- Primary Care Physician
- Specialty Physician
- Pharmacy
- Federally Qualified Health Center (FQHC)
- Other Medical Professional
- Transportation
- All Others

Utilization and unit cost information from the fee-for-service data was reviewed at the COA and COS detail levels for reasonableness.

We examined the reasonable and appropriate levels of utilization, unit cost, and pmpm amounts that were established in last year's (CY 09/10) fee-for-service preliminary rate development process, within each COA. In general, the pmpm amounts from the fee-for-service data were compared to the pmpm amounts by COS within each COA. The allocation by COS within each COA was examined, and compared to the FY 09/10 relative costs by COS. When the CY 2008 fee-for-service pmpm amounts were unreasonable by COS, they were re-allocated based on the FY 09/10 base period data; however, the re-allocation did not alter the overall CY 2008 fee-for-service pmpm amounts within a given COS (no net dollar impact).

All selected base data was adjusted (as appropriate) to reflect the impact of historical program changes within this period. This is discussed further in the Program Changes section. The financial reporting Revenue, Expenses and Net Worth exhibits for the Partnership Health Plan operating in Marin and Mendocino Counties contract that were available at the time the rate ranges were determined, were reviewed and analyzed by DHCS.

Base cost data was run with a six month lag so categories of service such as hospital inpatient, physician services, and other medical professional services require an estimation of the future run out (IBNR) of claims. Lag factors are included in the unit cost section of the base costs (column (C) on the rate sheets).

A requirement of 42 CFR 438.6(c)(4)(ii) is that all payment rates under the contract are based only upon services covered under the State Plan to Medicaid-eligible individuals. As described above, fee-for-service data served as the starting base data for rate setting. Base period Partnership Health Plan operating in Marin and Mendocino Counties eligibility (described below) and fee-for-service data were pulled consistent with service code mappings from DHCS, including lists of excluded services such as abortion. DHCS has relied on financial data and other information provided by the Partnership Health Plan operating in Marin and Mendocino Counties in the development of these rate ranges. We have reviewed the data and information utilized for reasonableness, and we believe the data and information to

be free of material error and suitable for rate range development purposes for the populations and services covered under the Partnership Health Plan operating in Marin and Mendocino Counties contract. DHCS did not audit the financial data or information and, if the data or information is materially incomplete or inaccurate, our conclusions may require revision. However, DHCS did perform alternative procedures and analysis that provide a reasonable assurance as to the data's appropriateness for use in capitation rate development under the State Plan.

### **Category of Aid (Aid Code) groupings**

The base data sets used to develop the COHS FY10/11 capitation rate ranges were divided into cohorts that represent consolidated COA (or Aid Code) groupings which inherently represent differing levels of risk. These 8 COA cohorts are (alphabetically):

- Aged/Dual Eligible
- Aged/Medi-Cal Only
- BCCTP
- Disabled/Dual Eligible
- Disabled/Medi-Cal Only
- Family (including Adult)
- LTC/Dual Eligible
- LTC/Medi-Cal Only

Because the Partnership Health Plan operating in Marin and Mendocino Counties program is structured such that only one MCO operates in the county, the distribution of risk between multiple plans is eliminated. Also, coverage is mandatory for virtually all COAs within a COHS county, which also eliminates any selection bias concerns on the part of the participating MCO.

### **Graduate Medical Education**

Regarding Graduate Medical Education (GME) costs and 42 CFR 438.6(c)(5)(v) (along with item AA.3.8 of "Appendix A. PAHP, PIHP and MCO Contracts Financial Review Documentation for At-risk Capitated Contracts Ratesetting, Edit Date: 7/22/03"), there are no provisions in the Partnership Health Plan operating in Marin and Mendocino Counties managed care contract regarding GME. The Partnership Health Plan operating in Marin and Mendocino Counties does not pay specific rates that contain GME or other GME-related provisions. As fee-for-service data serves as the base data, GME expenses are not part of the Partnership Health Plan operating in Marin and Mendocino Counties capitation rate development process.

### **Trend**

Trend is an estimate of the change in the overall cost of medical services over a finite period of time. Trend factors are necessary to estimate the expenses of providing health care services in a future period. As part of the FY11/12 rate range development for the Partnership Health Plan operating in Marin and Mendocino Counties program, DHCS relied on fee-for-service trend data. Trend rates were developed for each provider type or COS, separately by utilization and unit cost components.

Trend information and data were gathered from multiple sources including Partnership Health Plan operating in Marin and Mendocino Counties financial statements, Medi-Cal fee-for-service experience, historical California Medical Assistance Commission (CMAC) adjustments, Consumer Price Index (CPI) and multiple industry reports. Also, professional judgment based upon experience in working with other managed care programs was used. Base data used was trended forward 36 months to the mid-point of the rating period.

The specific upper bound trend levels by utilization and unit costs for the 12 categories of service are displayed in columns (E) and (F) of the capitation rate calculation sheets. Note trends for the LTC provider type are 1.0% for both utilization and unit cost. Due to the high level of legislatively-mandated changes surrounding LTC, DHCS has handled the majority of LTC trends through the program changes portion in the methodology. The range for the claim cost trend component is 91% per year for the midpoint utilization and unit cost components of the upper bound trend and is 90% per year for the lower bound utilization and unit cost components of the upper bound trend. Calculations are based upon the upper bound of fee-for-service due to the State requirement that managed care rates be equal to or less than 100% of the fee-for-service rates.

### **Program changes/other adjustments**

Program change adjustments recognize the impact of benefit or eligibility changes that took place during or after the base data period. As part of the FY11/12 rate range development for the Partnership Health Plan operating in Marin and Mendocino Counties program, DHCS relied on Program Changes that applied to Fee-for-service data. Following are the program changes (with effective dates) that were viewed to have a material impact on capitation rates, and which were reviewed, analyzed and evaluated by the DHCS' Managed Care Division and Fiscal Forecasting and Data Management Branch staff:

- Anti-Fraud Expansion – multiple dates
- LTC rate adjustments – multiple dates
- Hospice rate increases – multiple dates
- Mirena IUC – July 2008
- Provider payment reduction – July 2008 (reflects all refinements (i.e., injunctions] through March of 2010)
- Post-stabilization services reduction – October 2008
- Discontinuation of adult optional benefits – July 2009
- H1N1 Vaccine – October 2009
- Reinstatement of optometry services – July 2010

Any program changes with an effective date prior to January 1, 2009, were treated as retrospective changes.

The following exhibit describes these changes in more detail.

**Exhibit A**  
**Certification Exhibit – Program Change Chart**  
**Managed Care Adjusted FFS Program Changes**

DHCS – Programmatic change – Marin & Mendocino Rates Effective July 1, 2011 to June 30, 2012							
No	Program Change	Description	Effective Date	COA Impacted	COS Impacted	Geographic Area	Impact
1	44 May 2009	MIRENA INTRA-UTERINE CONTRACEPTION	Jan-06	All	Pharmacy	Marin & Mendocino	0.2%
2	151 Nov 2008	ANTI-FRAUD EXPANSION FOR 2007-08	Jul-07	All	All	Marin & Mendocino	(0.3%)
3	7 May 2007	NF-B 2007-08 RATE CAP ADJUSTMENT	Aug-07	All	All	Marin & Mendocino	1.4%
4	41 May 2007	DRUG REIMBURSEMENT REDUCTION	Sep-07	All	Pharmacy	Marin & Mendocino	(0.8%)
5	152 May 2009	ANTI-FRAUD EXPANSION FOR 2008-09	Jul-08	All	All	Marin & Mendocino	(0.4%)
6	86a May 2009	Reduction to Provider Payments by 10%	Jul-08	All	Transportation	Marin & Mendocino	(1%)
7	86b May 2009	Reduction to Provider Payments by 10%	Jul-08	All	Other Professional	Marin & Mendocino	(0.8%)
9	86c May 2009	Reduction to Provider Payments by 10%	Jul-08	All	All Others	Marin & Mendocino	(0.5%)
10	181 May 2009	CA PHAR PROVIDER PAYMT INJUNCTION	Apr-09	All	Pharmacy	Marin & Mendocino	2%
11	145 May 2009	ANTI-FRAUD EXPANSION FOR 2009-10	Jul-09	All	All	Marin & Mendocino	(0.7%)
12	164 May 2009	Discontinue Adult Optional Benefits	Jul-09	All	FQHC & Other Professional	Marin & Mendocino	(7.1%)
13	186 May 2009	ANTI-FRAUD INITIATIVE	Jul-09	All	Prim. & Spec Physician, Pharmacy, and All Others.	Marin & Mendocino	(0.7%)
14	202 May 2009	ESTIMATED ACQUISITION COST PHARMACY SAVINGS	Jul-09	All	Pharmacy	Marin & Mendocino	(1.1%)
15	77 May 2010	H1N1 VACCINE	Oct-09	All	Pharmacy	Marin & Mendocino	1.2%
16	85 May 2010	HOSPICE RATE INCREASES	Oct-09	All	Other	Marin & Mendocino	1.7%
17	202 May 2010	POST-STABILIZATION SERVICES REDUCTION	Oct-08	All	Hospital Inpatient	Marin & Mendocino	(2.1%)
18	215 May 2010	REINSTATEMENT OF OPTOMETRY SERVICES	Jul-10	All	Other Medical Professional Services	Marin & Mendocino	0.3%

## **Administration and Underwriting Profit/Risk/Contingency loading**

DHCS requested FY 11/12 that Mercer recommend amounts for administration and profit/risk/contingency loading.

The administration load factor is expressed as a percentage of the capitation rate (i.e., percent of premium). These percentages were developed from a review of the MCOs' historical reported administrative expenses. Experience and professional judgment were utilized in determining that the percentages were reasonable. DHCS reviewed the Mercer recommended amounts, and determined that a Lower Bound administration allowance of 4% for the Partnership Health Plan operating in Marin and Mendocino Counties program is reasonable and consistent with the Mercer recommended amounts. The range for the Administration component is +0.4 percent for the upper bound from the lower-point value.

The Underwriting Profit/Risk/Contingency load is 2.0 percent at the lower-point, 2.2 percent at the upper bound. The cost of capital has implicitly and broadly been considered within the rating assumptions.

## **Premium Tax**

The Partnership Health Plan operating in Marin and Mendocino Counties must pay a "premium tax" of 2.35% of total capitation payments (including the premium tax). So, all capitation payment pmpm amounts must include an additional amount for the premium tax.

## **Rate ranges**

DHCS calculated rate ranges, which were developed using an actuarially sound process. The COA-specific rate ranges were developed using a combination of a modeling process which varied the medical expense (i.e., risk) trend, the administration loading percentage, and the Underwriting/Profit/Risk/Contingency loading percentage to arrive at both an upper and lower bound capitation rate. The final contracted rates agreed to between DHCS and Partnership Health Plan operating in Marin and Mendocino Counties will fall within the rate ranges.

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## **Rate range certification**

In preparing the rate ranges described, I have used and relied upon enrollment, eligibility, claim, reimbursement level, benefit design, and financial data and information supplied by our staff at DHCS and by the Partnership Health Plan operating in Marin and Mendocino Counties. DHCS staff has reviewed the data and information for internal consistency and reasonableness, but we did not audit it. In my opinion the data used for the rate development process is appropriate for the intended purposes. If the data and information are incomplete or inaccurate, the values shown in this report and associated exhibits may need to be revised accordingly.

I certify that the Partnership Health Plan operating in Marin and Mendocino Counties FY11/12 rate ranges were developed in accordance with generally accepted actuarial practices and principles. I am an actuary meeting the qualification standards of the American Academy of Actuaries for the populations and services covered under the managed care contract.

Rate ranges are actuarial projections of future contingent events. Actual results will differ from these projections. DHCS has developed these rate ranges and payment amounts to demonstrate compliance with the CMS requirements under 42 CFR § 438.6(c) and in accordance with applicable law and regulations. Partnership Health Plan operating in Marin and Mendocino Counties is advised that the use of these rate ranges, or the resulting final rates within these ranges, may not be appropriate for their particular circumstance and DHCS disclaims any responsibility for the use of these rate ranges or rates by the Partnership Health Plan operating in Marin and Mendocino Counties for any purpose. DHCS recommends that the Partnership Health Plan operating in Marin and Mendocino Counties when considering to contract with DHCS should analyze its own projected medical expense, administrative expense and any other premium needs for comparison to these rate ranges and resulting rates before deciding whether to contract with DHCS. Use of these rate ranges and resulting rates for any purpose beyond that stated may not be appropriate.

This certification letter assumes the reader is familiar with the Medi-Cal program, Medi-Cal eligibility rules and actuarial rating techniques. It is intended for DHCS and CMS, and should not be relied upon by third parties. Other readers should seek the advice of actuaries or other qualified professionals competent in the area of actuarial rate projections to understand the technical nature of these results.

*ORIGINAL SIGNED BY ARLENE LIVINGSTONE*

Arlene Livingston, F.S.A., M.A.A.A.