

March 1, 2020

The Honorable David Gowan
Chairman, Joint Legislative Budget Committee
1700 W Washington
Phoenix, Arizona 85007

Dear Senator Gowan,

Pursuant to a footnote in the General Appropriation Act, the Arizona Health Care Cost Containment System (AHCCCS) is required to report to the Joint Legislative Budget Committee (JLBC) by March 1 annually “on the preliminary actuarial estimates of the capitation rate changes for the following fiscal year along with the reasons for the estimated changes. For any actuarial estimates that include a range, the total range from minimum to maximum may not be more than 2%.”

In accordance with Federal regulations, capitation rates paid to managed care organizations (MCOs) must be actuarially sound, meaning they must cover all anticipated costs for providing medically necessary services to AHCCCS members. As such, capitation rates are developed to reflect the costs of services provided as well as utilization of those services. Capitation rate trends reflect a combination of changes in cost and utilization, calculated as a per-member per month (PMPM) expenditure to AHCCCS Contractors (including other state agencies, the Arizona Department of Economic Security/Developmental Disabilities (DES/DD) and the Department of Child Safety/Comprehensive Medical and Dental Program (DCS/CMDP)).

The capitation rates for contract year ending (CYE) 2021 will be developed in the summer of 2020 and begin October 1, 2020. Actuarial review of the most current medical cost and utilization trend data has not yet begun and so AHCCCS actuaries are unable to provide specific actuarial estimates for capitation rate growth at this time. However, the AHCCCS program continues to be impacted by significant medical cost drivers that are anticipated to continue into the next year. In order to inform the budget decision-making process, AHCCCS is providing an estimated range of capitation rate growth and a summary of the key factors that are anticipated to be addressed in the capitation rate development process.

The actual capitation rates and accompanying actuarial certifications will be provided to JLBC for review in advance of implementation on October 1, 2020.

Preliminary Estimates for Capitation Rate Growth

Based on a preliminary review of historical medical cost and utilization trend data, AHCCCS estimates a statewide weighted average capitation rate increase of 3.9% to 5.5% for contract year ending CYE 2021. The low end estimate of 3.9% is consistent with actual capitation rate growth in CYE 2020. The high end estimate of 5.5% is based on long-term national health expenditure

forecasts. These estimates are limited to existing services and do not include impacts from any pending legislation or ongoing litigation.

The Executive Budget recommendation for FY 2021 assumes baseline capitation rate growth of 5.5% for DES/DD and 3.9% for all other AHCCCS programs. In contrast, the JLBC baseline assumes capitation rate growth of 2.0% for DES/DD based on historic growth and 2.6% for all other AHCCCS programs based on a five-year average of the medical care component of the Consumer Price Index (CPI). To the extent that the JBLC baseline forecasted growth rate is based on medical inflation only, it does not account for cost increases attributable to utilization, which are anticipated to continue to impact capitation rates. If the FY 2021 appropriation funds lower capitation rate growth than is ultimately required to ensure actuarial soundness it may result in a need for supplemental funding.

Nationally, the Centers for Medicare and Medicaid Services (CMS) Office of the Actuary estimates that Medicaid spending per enrollee will increase by 4.0% in 2021, with higher growth rates ranging from 5.0% to 6.0% in the period 2022 to 2027. The CMS estimates, unlike the medical care component of the CPI, account for projected costs attributable to both inflation and utilization.

Table I. CMS Office of the Actuary, Medicaid Spending Per Enrollee, Forecast Growth

Year	2021	2022	2023	2024	2025	2026	2027
Forecast	4.0%	5.0%	5.0%	5.0%	5.3%	6.0%	5.0%

Unit Cost and Utilization Drivers

Anticipated growth in spending per enrollee is a function of both changes in unit cost and changes in utilization, including shifts in services. Unit costs may increase for a variety of reasons, including: provider rate increases, the impact of inflation on the price of medical services, and a shift in utilization patterns when members access more costly services. Similarly, costs associated with utilization may increase for a number of reasons, including shifts in service mix and intensity of service use.

ALTCS EPD Medical Cost Trend Pressures

The capitation rate growth experienced by the Arizona Long Term Care System (ALTCS) Elderly and Physically Disabled (EPD) program in CYE 2020 provides an illustration of how unit cost and utilization trends both contribute to overall medical costs. Individuals eligible for ALTCS are among the state's most vulnerable populations and must be at risk of institutionalization in order to qualify for the program. In CYE 2020, overall capitation rate growth for ALTCS/EPD was 13.7%, of which 6.8% was attributable to both proposition and

legislatively-mandated provider reimbursement increases and 6.9% was attributable to baseline medical cost trends.

In addition, baseline medical costs for ALTCS EPD have been driven by higher acuity members, which is reflective of larger demographic trends. Over one third of ALTCS EPD members are age 80 and above and over 11% are age 90 and above. Arizona is anticipated to be No. 1 in the nation for proportional increases in instances of Alzheimer's and dementia between now and 2025.¹ Alzheimer's is now the fourth leading cause of death in the state of Arizona.² In alignment with these statistics, ALTCS EPD members are living longer with increasingly acute conditions which translate directly to increased costs. Over the past few years:

- NF placements have increased in acuity as evidenced by greater than a 6% shift from Level 1 placements to Level 2 or higher. Level 2 and higher placements cost on average 31.2% more than Level 1.
 - Included in this shift was an almost 8% increase in NF specialty placements which cost on average 126.5% more than Level 1. Specialty placements include care for wandering dementia and behavioral health needs.
- HCBS utilization is also shifting, from home to community settings reflecting almost an 11% shift in such placements and, while still less costly than institutional settings, community settings cost on average about 11% more than home placements
- Acute medical costs have increased by 13%, reflecting higher acuity associated with treating members with increasingly complex conditions.
 - Costs include increases of nearly 40% for hospice and 31% for treating individuals with behavioral health needs.

As lives are extended through improved medical treatment, and as Arizona continues to be a state experiencing population growth in part due to in-migration, we would expect to see the utilization and cost trends impacting the CYE 2020 rates continue.

Proposition 206 and Proposition 414

HCBS and NF provider rates will be increased January 1, 2021 in order to address continued increases to the minimum wage under Proposition 206 and Proposition 414. ALTCS capitation rates will be adjusted to account for these wage pressures. Specifically, under A.R.S. 23-363, effective January 1, 2021, the statewide minimum wage will increase by the percentage increase in the CPI from August of the previous year. Based on the most recent published health care cost forecast, this percentage increase is currently projected to be 1.8%, which would result in an increase in the minimum wage from \$12.00 to \$12.20. Under Proposition 414, effective January 1, 2021, the Flagstaff minimum wage is planned to increase from \$13.00 to \$15.00, representing a 15% increase in this locale.

Pharmacy Costs and High Cost Specialty Drugs

¹ <https://www.alz.org/media/documents/alzheimers-facts-and-figures-2019-r.pdf>;
<https://www.alz.org/media/Documents/arizona-alzheimers-facts-figures-2019.pdf>

² <https://www.cdc.gov/nchs/pressroom/states/arizona/arizona.htm>

In CYE 2020, the largest single driver of overall medical cost trends was pharmacy cost growth, which was projected to grow at an annual trend rate of 7.2% and accounted for 0.8% of overall capitation rate growth. Unfortunately, national trends in pharmaceutical pricing and utilization are anticipated to continue to impact the AHCCCS program. Specifically, AHCCCS anticipates that the more frequent introduction of high cost specialty pharmaceuticals approved by the U.S. Food and Drug Administration (FDA) will place increasing pressure on both capitation rates paid to MCOs and the AHCCCS reinsurance program.

In recognition that pharmacy costs are a significant driver of overall medical expense trends, for the CYE 2020 capitation rates AHCCCS analyzed pharmacy reimbursement by MCO to determine if savings were achievable. Based on this analysis, AHCCCS determined that MCO pharmacy reimbursement was on average greater than reimbursement would be under the AHCCCS Fee-for-Service program and assumed savings of \$22.5 million, Total Fund, in the CYE 2020 capitation rates. AHCCCS intends to complete an updated analysis of pharmacy reimbursement data in order to determine if additional savings can be achieved in CYE 2021.

Beginning CYE 2020, AHCCCS also implemented new requirements for MCOs to engage in more transparent Pharmacy Benefit Manager (PBM) subcontracts that separately disclose the portion of pharmacy reimbursement that is attributable to PBM administrative costs. This information will allow AHCCCS to more closely monitor and evaluate the appropriateness of these costs.

In addition, AHCCCS has recently negotiated a value based contract with the manufacturer of Zolgensma, which is a high-cost gene therapy used to treat children with spinal muscular atrophy. Under this contract, if treatment is not successful over a five year period, the state would be entitled to a refund of some or all of the cost of the treatment.

AHCCCS will continue its efforts to identify opportunities to contain pharmacy costs with the intent to lower the cost trend.

Other Changes

Annualize the Provider Rate Adjustment for Minimum Wage

As described previously, AHCCCS adjusted provider rates to reflect the minimum wage increase effective January 1, 2020. Capitation rates for CYE 2020 include additional funding needed by MCOs to pay these higher wages for nine of the 12 months of the contract year. Annualizing the CYE 2020 adjustment for minimum wage in the CYE 2021 capitation rates will require an estimated \$15.3 million Total Fund.

Health Insurer Provider Fee

Under the Affordable Care Act, beginning on January 1, 2014, health insurers including Medicaid health plans are required to pay a health insurer provider fee (HIPF) due by September 30th of each year. Assessments are based on each insurer's market share of the previous year's revenue as calculated by the U.S. Treasury Department, and increase each year. Certain exceptions apply. AHCCCS intends to update capitation rates annually on a retroactive basis after the Treasury Department notifies each entity of its Health Insurer Provider Fee payable – such notification will occur after the capitation rates for the new contract year are already established.

The actuarial analysis for the rate adjustments will continue throughout the spring, and will be based on the most up-to-date encounter data and contractor financial statements available. Mandated or court-ordered program changes that occur prior to October 1, 2020 may result in changes to these estimates.

Please direct any questions regarding this letter to Matthew Isiogu at Matthew.Isiogu@azahcccs.gov or (602) 417-4168.

Sincerely,

Jami Snyder
Director

Cc: The Honorable Regina Cobb, Arizona House
Matthew Gress, Office of Strategic Planning and Budgeting
Richard Stavneak, Joint Legislative Budget Committee
Christina Corieri, Senior Policy Advisor, Office of the Governor
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