MARYLAND
Department of Health

Larry Hogan, Governor · Boyd K. Rutherford, Lt. Governor · Robert R. Neall, Secretary

June 24, 2019

The Honorable Nancy J. King
Chair
Senate Budget and Taxation Committee
3 West Miller Senate Office Bldg.
Annapolis, MD 21401-1991

The Honorable Maggie McIntosh
Chair
House Appropriations Committee
121 House Office Bldg.
Annapolis, MD 21401-1991

Re: 2019 Joint Chairmen's Report (p. 119) – Report on Managed Care Rate-Setting Outlier Adjustment

Dear Chairs King and McIntosh:

Pursuant to the requirements of the 2019 Joint Chairmen's Report (p. 119), the Maryland Department of Health submits this report on:

> *The current managed care rate-setting outlier adjustment excludes costs in excess of 102% of the statewide average from base rate development with the intent of removing excess costs of inefficient managed care organizations from future rates. A recent consultant review of the rate-setting system noted that there are different tools that could be used to exclude outlier payments. The committees request that the Maryland Department of Health (MDH) ask its rate-setting contractor to explore the recommendations made by the consultant review and assess whether a different outlier methodology should be used and, if so, use that methodology in the calendar 2020 rate-setting cycle.*

Thank you for your consideration of this information. If you have any questions about this report, or would like additional information, please contact Chief of Staff Tom Andrews at (410) 767-1036 or Thomas.andrews@maryland.gov.

Sincerely,

Robert R. Neall
Secretary

cc: Sarah Albert, Department of Legislative Services

I. Executive Summary

As part of the Maryland Medicaid Program's annual rate setting process, the Maryland Department of Health (Department) assesses the operational costs of each of Maryland's nine managed care organizations (MCOs) and calculates their average costs. The Department uses the average MCO operational costs in determining what data will be included in the base (data set used in rate setting process). Historically, the Department has excluded costs exceeding 102% of the MCO average from the base (outlier adjustment). The outlier adjustment encourages increased efficiency and the reduction of costs incurred by Maryland's MCOs.

Consistent with the recommendations made in the Milliman, Inc. and Mannatt Health Strategies report (see attached), the Department decided to change the methodology used for the outlier adjustment. One MCO voluntarily agreed to have its costs excluded from base data used in the rate setting process because of its operating costs were much higher than the other eight MCOs. For the remaining eight MCOs, costs above 104% of the average will be removed from the base. This decision will result in a -0.9% decrease to the base, a decrease that is 50% greater than the average of the outlier adjustments for the past four years.

The Department believes that this new outlier adjustment methodology will encourage cost efficiency amongst all nine MCOs and will make better use of the State's existing resources. Moreover, the new methodology has been recommended by the Medicaid Program's actuary as actuarially sound[1].

II. Reporting Requirement

Pursuant to the requirements of the 2019 Joint Chairmen's Report (p. 119), the Department submits this report addressing the outlier adjustment used in managed care rate setting as requested. Specifically, this report addresses the Department's chosen outlier adjustment methodology for calendar year 2020 managed care rate setting.

The 2017 Joint Chairmen's Report limited funding in the Department's budget for a managed care rate setting study to "a review of potential improvements of the current rate-setting system used in Maryland and a review of innovations from other states in managed care payment systems similar to that in Maryland" not to include consideration of a competitive bidding process. Further, the General Assembly requested a summary of the study.

III. Outlier Adjustment Study Commissioned by the Department

The Department provided funding to the Hilltop Institute at the University of Maryland Baltimore County (UMBC) to procure and manage the study. A team from the consulting firms

[1] The definition of actuarial soundness is that they provide for all reasonable, appropriate, and attainable costs.

Milliman, Inc. and Mannatt Health Strategies was selected to conduct the study and produce a report. Work on the study was conducted in 2017 through early 2018, and in June 2018, the Department provided the resulting study to the General Assembly. Among the recommendations made by the Milliman and Mannatt team was the recommendation to "validate the existing outlier adjustment aligns with cost, quality, and value objectives" (see attached Milliman, Inc. and Manatt Health Strategies report, p. 43)

IV. What is an Outlier Adjustment

"Outlier adjustment" refers to the procedure where, historically, the Department's rate setting contractors exclude costs in excess of 102% of the statewide average from the base data used for managed care rate setting. In their report, the Milliman and Mannatt team had the following recommendations for evaluating the outlier adjustment: 1) analyze unit cost variances and their drivers; 2) evaluate the opportunity for managed care savings and provider-based quality incentives; and 3) monitor administrative expenses and relationship to medical costs.

The Hilltop Institute provided the Department with a summary of outlier adjustment options utilized in other States. The Hilltop Institute also provided the Department with an analysis which suggested one MCO had a combined loss ratio that was significantly higher than the HealthChoice MCO average combined loss ratio. The MCO in question had a higher loss ratio due to its staff model (their physicians are employees as opposed to being paid fee-for-service), and as this MCO is gaining increased market share, this additional cost to the HealthChoice program became a concern to both Hilltop and the Department.

V. Conclusion

The Department has decided to remove cost data associated with the high-cost MCO referenced above from the base data used for rate setting entirely. For the remaining eight MCOs, costs above 104% of the average across those eight MCOs will be removed. Combined, these two actions will result in a -0.9% decrease to the base, a decrease that is 50% greater than the average of the outlier adjustments for the past four years. This combined approach is strongly recommended by the certifying actuary for the 2020 HealthChoice rates.

IV. Data Supporting Report Conclusion

A. Removing one high cost MCO from the base

As the 2019 rate development process was concluding, it became clear that one MCO was affecting overall HealthChoice financial results in a significant way. This MCO represented roughly 5% of the base, however, per the exhibit below, its financial results moved the combined ratio of the total HealthChoice program from 97.85% to 96.90% based on audited 2017 financials.

Table 1. HealthChoice Combined Ratio Including and Excluding One MCO, 2017 (Audited)

	All MCOs	8 MCOs
Ratios (% of Net Premium):		
Net Medical Expenses	87.19%	86.26%
Gen. Admin. Expenses	6.88%	6.85%
Medical Management Exp.	1.77%	1.78%
Premium Tax	2.01%	2.01%
ACA Insurer Fee	0.00%	0.00%
Combined Ratio	97.85%	96.90%

This phenomena is largely due to the MCO in question's staff model and will only become more significant as the MCO gains market share, therefore the Department made the decision, with the MCO's cooperation, to remove that MCO's cost data from the rate setting base entirely for the 2020 rate setting process. This is expected to result in a downward adjustment to the base of -0.6%.

B.) Removing costs above 104% for remaining 8 MCOs

The Hilltop Institute and the Department evaluated various outlier and cost variance adjustment options to apply to the other eight MCOs after removing the one MCO from the base. Ultimately, the Department decided to remove all costs in excess of 104% of the average across the remaining MCOs. The effect of the adjustment is illustrated in the exhibit below.

Table 2. Effect of removing costs above 104% of the average across remaining MCOs, 2017 Final Audited

Costs removed from base	$ 14,637,091
% of base	-0.3%

C.) Total Adjustment to 2017 Base

Combined, the adjustments outlined above amount to a -0.9% adjustment to the base. The exhibit below compares that adjustment to prior years. Note that the adjustment to the 2017 base will be 50% greater than average adjustment to the base for the past four years.

Table 3. Historical Adjustment Levels (As % of Net Premiums)

2016 Rates:	-0.5%
2017 Rates:	-0.6%
2018 Rates:	-0.4%
<u>2019 Rates:</u>	<u>-0.7%</u>
Four Year Mean:	-0.6%

D.) Comparison to Previous Outlier Adjustment

If the across-the-board removal of costs above 102% of the statewide average was used with the 2017 base data for 2020 rate setting, the result would have been removal of over $69 million and a downward adjustment of -1.3 %. The Hilltop Institute and the actuarial firm that certifies the State's managed care rates both advised that such a large outlier adjustment would raise concerns with federal regulators as an indicator that the rates were not actuarially sound. Given that Maryland Medicaid has paid MCOs at or near the bottom of the range able to be certified as actuarially sound since 2015, this was a concern. The selected outlier adjustment still results in an adjustment 50% greater than the average of the four prior years with much more likelihood of approval by federal regulators. The selected outlier adjustment is also more targeted, with that MCO's cooperation, towards the MCO that is the greatest outlier, while also still holding the other eight MCOs accountable for controlling costs.