

February 26, 2021

The Honorable Regina Cobb
Chairman, Joint Legislative Budget Committee
1700 W Washington
Phoenix, Arizona 85007

Dear Representative Cobb,

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 Health Plan (DCS/CHP)).

The capitation rates for contract year ending (CYE) 2022 will be developed in the summer of 2021 and begin October 1, 2021. 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, 2021.

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 3.0% to 5.0% for contract year ending CYE 2022. The high end estimate of 5.0% is based on the Centers for Medicare and Medicaid Services (CMS) Office of the Actuary projected national growth rate of 4.7% for 2022. This does not include ongoing costs associated with COVID-19 that could increase capitation rates by an additional 0.3% or more, for a combined impact of 5.0%. These estimates are limited to existing services and do not include impacts from any pending legislation or ongoing litigation.

The low end estimate of 3.0% is consistent with the JLBC baseline estimate for Fiscal Year (FY) 2022. The Executive Budget recommendation for FY 2022 assumes baseline capitation rate growth of 4.2% for all AHCCCS programs, which is within the range estimated by AHCCCS. If the FY 2022 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 CMS Office of the Actuary projects annual growth rates averaging 4.9% in the period 2022 through 2028. The CMS estimates account for projected costs attributable to both inflation and utilization. These projections do not take into account the impacts of COVID-19 because of the timing of the report and the highly uncertain nature of the pandemic.

Table I. CMS Office of the Actuary, Medicaid Spending Per Enrollee, Forecast Growth¹

Year	2021	2022	2023	2024	2025	2026	2027	2028
Forecast	4.0%	4.7%	4.6%	4.1%	5.1%	5.9%	4.8%	4.8%

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 changes in the ability of members to access services and changes in the types of services members receive.

COVID-19 Impacts to Capitation Rates

The COVID-19 pandemic has dramatically impacted the health care landscape and introduced unprecedented uncertainties to be considered in setting risk-based capitation payments. Due to significant lags in the submission of encounter data, relatively complete data is only now becoming available to help evaluate the impacts to utilization experienced during the onset of the pandemic, in the period March 2020 through September 2020. It is unclear how utilization will continue to be impacted during the current CYE 2021.

At this time, AHCCCS is generally anticipating a return to more normal pre-COVID utilization patterns beginning CYE 2022; however, there are significant, uncertain factors that could impact this overall assumption, and so other key assumptions may need to be made. AHCCCS is currently evaluating the extent to which a variety of factors may impact CYE 2022 capitation rate development in order to determine potential capitation rate impacts and risk mitigation options.

¹ Table 17, "Health Insurance Enrollment and Enrollment Growth Rates, Calendar Years, 2012-2028," Medicaid Spending per Enrollee. Office of the Actuary in the Centers for Medicare & Medicaid Services. "NHE Projections 2019-2028." Accessed February 4, 2021. <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected>

Specifically, ongoing annual costs associated with COVID-19 vaccine administration will likely result in increased capitation rates in CYE 2022 and forward. On January 20, 2021, the incoming federal administration announced its American Rescue Plan, which proposes potential changes to the funding of COVID-19 vaccine administrative costs, including expanding the Federal Medicaid Assistance Percentage (FMAP) to 100% for the administration of vaccines, in order to ensure that all Medicaid enrollees are vaccinated. As additional federal guidance becomes available, AHCCCS will determine how it will implement the associated funding for MCOs, including the extent to which it will be funded in capitation.

Proposition 206 and Proposition 414

HCBS and NF provider rates will be increased January 1, 2022 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 recently published health care cost forecast, this percentage increase is currently projected to be 2.3%, which would result in an increase in the minimum wage from \$12.15 to \$12.45. Under Proposition 414, effective January 1, 2022, the Flagstaff minimum wage is planned to increase from \$15.00 to \$15.50, representing a 3.3% increase in this locale. In accordance with A.R.S. § 35-113, AHCCCS delineates specific costs related to that wage increase in its budget requests.

Pharmacy Costs

In CYE 2021, the largest driver of overall medical cost trends was pharmacy cost growth, which was projected to grow at an annual trend rate of 6.0% and accounted for 0.6% 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 2021 capitation rates, AHCCCS continued to recognize savings based on its analysis that revaluing MCO data to the lesser of the MCO paid amounts or the AHCCCS Fee-for-Service amounts would result in annual savings of \$68.2 million or 5.6% of pharmacy spend across all programs. AHCCCS first assumed pharmacy savings in the CYE 2020 capitation rates based on this analysis. Recognizing that the full savings amount may not be reasonably achievable in a single year, only 33% of the total estimated potential savings was assumed in CYE 2020. In CYE 2021, AHCCCS has assumed an additional 33% of the total estimated potential savings, or a total of 66%. Based on continued analysis, further adjustments may be made to phase-in additional savings amounts in subsequent contract periods.

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.

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, 2021. Capitation rates for CYE 2021 include additional funding needed by MCOs to pay these higher wages for nine of the 12 months of the contract year. Annualizing the CYE 2021 adjustment for minimum wage in the CYE 2022 capitation rates will require an estimated \$6.3 million Total Fund.

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, 2021 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 David Gowan, Arizona Senate
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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