January 13, 2020

Calder Lynch, MHSA
Acting Deputy Administrator and Acting Director Center for Medicaid & CHIP Services
Centers for Medicare & Medicaid Services
7500 Security Blvd
Baltimore, MD 21244

Submitted electronically via email to Calder.Lynch@cms.hhs.gov

Re: Use of Underwriting Gain Assumption Models & Suggested Additions to 2020-2021 Medicaid Managed Care Rate Setting Development Guide

Dear Acting Director Lynch:

The Medicaid Health Plans of America (MHPA) is the national trade association representing 94 member health plans that contract with state Medicaid agencies in 37 states plus the District of Columbia to provide comprehensive, high quality health care to more than 23 million Medicaid beneficiaries in a coordinated and cost effective way. Our member plans offer comprehensive, coordinated care that supports the health care needs of Medicaid beneficiaries while also managing costs for our state and federal partners.

For managed care organizations (MCOs) serving Medicaid populations, the underwriting gain (i.e., risk margin and cost of capital) assumption included in capitation rates, is not only a necessity for financial viability, but also a regulatory requirement[1] and a broadly accepted component of managed care capitation rates. Additionally, the Actuarial Standards Board's Actuarial Standard of Practice No. 49 (ASOP 49) requires that actuarially sound capitation rates include a provision for underwriting gain in order to provide compensation for the risks assumed by an MCO.[2]

Historically, the capitation rate development processes, as documented in various actuarial rate certifications and memoranda, have contained little to no details on the derivation of the underwriting gain assumption. Further, guidance pertaining to Medicaid managed care rate development does not suggest or require the calculation techniques that should be used to develop the underwriting gain assumption. These shortcomings are likely because a generally accepted method for quantifying underwriting gain has not existed.

Recently, however, a Medicaid managed care underwriting gain model was developed, reviewed with actuaries at the Society of Actuaries Annual Health Meeting, and released to the

[1] Federal Register, Vol. 81, No. 88, 42 C.F.R. §438.5 (e).
https://www.federalregister.gov/documents/2016/05/06/2016-09581/medicaid-and-childrens-health-insurance-program-chip-programs-medicaid-managed-care-chip-delivered
[2] "The underwriting gain provision provides compensation for the risks assumed by the MCO." Actuarial Standards Board (ASB). 2015. Actuarial Standards of Practice (ASOP) No. 49: Medicaid Managed Care Capitation Rate Development and Certification, Section 3.2.12 b. *http://www.actuarialstandardsboard.org/wp-content/uploads/2015/03/asop049_179.pdf*.

public. The transparent model and detailed paper are currently posted on the MHPA website.[3] The model and paper were developed (independent of MHPA) by a group of experienced Medicaid actuaries and use economic concepts and statistical modeling to develop underwriting gain assumptions for managed Medicaid capitation rates.

Given the importance of the underwriting gain assumption for financial stability of the managed Medicaid programs and the existence of a transparent and publicly available model to develop underwriting gain, we recommend that CMS:

- **Require a model-based approach to the development of underwriting gain assumption in Medicaid managed care capitation rates.** This should entail use of the newly released model or another model similar in that it uses public and health plan data and includes details on the methodology, assumptions, and statistical projection(s) of the components (i.e., cost of capital and risk margin).

- Update the 2020-2021 Medicaid Managed Care Rate Setting Development Guide for Medicaid Capitation Rates (the "Guide")[4] to **require additional transparency regarding the development of the underwriting gain assumption.** In the table below, we offer suggested language to support the additional requirements in the Guide.

[3] MHPA Announces Actuarial Model Developed to Provide Additional Transparency in Managed Medicaid Rate-Setting. *https://www.medicaidplans.org/press-releases/title/mhpa-announces-actuarial-model-developed-to-provide-additional-transparency-in-managed-medicaid-rate-setting*.
[4] https://www.medicaid.gov/medicaid/managed-care/downloads/guidance/2019-2020-medicaid-rate-guide.pdf

Guide Section	2019-2020 Guide Language	2020-2021 Suggested Guide Language
I.5.B.i Appropriate Documentation (re: describing the development)	The rate certification and supporting documentation must describe the development of the projected non-benefit costs included in the capitation rates in enough detail so CMS or an actuary applying generally accepted actuarial principles and practices can identify each type of non-benefit expense that is included in the rate and evaluate the reasonableness of the cost assumptions underlying each expense in accordance with 42 CFR §438.7(b)(3). To meet this standard, the documentation must include:….(a) – (c) … ”	Add (d) to the list: … (d) A statistically based model used for the Underwriting Gain assumption; including the two major components of cost of capital and risk margin.
I.5.B.ii Appropriate Documentation (re: estimating the projected costs)	States and actuaries should estimate the non-benefit costs for each of the following categories of costs: (a) Administrative costs. (b) Taxes, licensing and regulatory fees, and other assessments and fees (c) Contribution to reserves, risk margin, and cost of capital (d) Other material non-benefit costs	Replace (c) with the following: (c) Underwriting gain assumptions, including cost of capital, contributions to reserves, and risk margin including the impact of contractual requirements such as minimum MLRs that impact the underwriting gain.
I.1.A.vi.	… The capitation rates may be developed in such a way that the MCO, PIHP, or PAHP would reasonably achieve a medical loss ratio standard greater than 85 percent, as calculated under 42 CFR §438.8, as long as the capitation rates are adequate for reasonable, appropriate, and attainable non-benefit costs.	Add the following sentence after this sentence: The actuary should include a projection of the estimated pre-tax net income for the capitation rate year to support the capitation rates are adequate for reasonable, appropriate, and attainable non-benefit costs.

Note that similar changes should be made to *Section III. New Adult Group Capitation Rates* of the Guide.

Below we have included additional information on why the underwriting gain assumption is especially important for Medicaid and the importance of a transparent, quantitative approach to developing the assumption.

WHY IS UNDERWRITING GAIN NECESSARY FOR MCOS?

Of chief importance, ASOP 49 requires that capitation rates include a provision for underwriting gain to provide for the risks assumed by the MCO.[5] This includes providing for cost of capital, but there are also other considerations that establish the need for underwriting gain in Medicaid capitation rates.

Medicaid managed care is unique from other health insurance in that the entity setting the capitation rates (price) is not usually the entity bearing the mispricing risk. Since the rate-setting actuaries do not bear the financial risk of mispricing, they do not have the same economic incentive to include margins for deviation as does a pricing actuary working in other lines of health insurance. Since Medicaid MCOs rely on the state's actuary to develop capitation rates at levels that adequately fund the program, even in years of adverse deviation, explicit inclusion of an adequate risk margin in the capitation rates is especially important.

Another unique aspect of Medicaid capitation rate setting is that the state actuary often develops rates for the program overall, rather than for each specific MCO, using the combined experience of all MCOs in the program. This further increases the risk that the rates for any one MCO within the program may not be adequate. Not only will actual results vary from expected results for the entire Medicaid program, but results will vary by each individual MCO. Some of the variation is due to factors that generally exist across all types of health insurance and are outside the MCOs' control, such as anti-selection or the inability of risk-adjustment mechanisms to fully capture membership risk, which further supports the need to include risk margin.

Finally, it is common to think of the underwriting gain components in the capitation rates as being equal to the expected MCO net income. However, Medicaid programs have changed such that there are now common limitations in Medicaid contracts (e.g., risk sharing and withholds) which cause the amount of underwriting gain in the rates to not result in the MCO percentage of net income. Therefore, a more precise analysis is required to determine an appropriate underwriting gain assumption.

USE OF A TRANSPARENT QUANTITATIVE APPROACH TO UNDERWRITING GAIN DEVELOPMENT IS NEEDED

Actuarially sound underwriting gain components of managed Medicaid capitation rates help ensure MCO solvency, stabilize Medicaid financial results, provide market-required rates of return on capital invested in the Medicaid programs, and allow for choice among MCOs due to the availability of competition. Methods for developing the underwriting gain assumption have not historically been shared publicly, so it is impossible to determine the statistical and economic validity of the models used today to develop the assumption.

Further, any models developed in the past are not appropriate for calculating the underwriting gain assumption today if they have not been modified to recognize current day Medicaid program contract structures such as withholds and risk sharing. These contract structures limit the potential gains or losses of the MCOs in the program and require use of rigorous modeling

[5] Actuarial Standards Board (ASB). 2015. Actuarial Standards of Practice (ASOP) No. 49: Medicaid Managed Care Capitation Rate Development and Certification, Section 3.2.12 b. *http://www.actuarialstandardsboard.org/wp-content/uploads/2015/03/asop049_179.pdf*.

approaches to determine the impact of these program requirements on expected underwriting gain.

The recently released model[6] is one potential approach to determine the appropriate level of underwriting gain for a Medicaid program. A requirement of a model-based underwriting gain assumption would improve transparency, encourage further research into the development of actuarial modeling for the underwriting gain assumption, and result in more appropriate rates. This can be achieved by including in the 2020-2021 release of the Guide requirements of the use of the newly released model or another similar statistically robust model for the development of the underwriting gain assumption in Medicaid managed care capitation rates, which will also further the CMS goals around program integrity and transparency.

Thank you for your consideration of the use of this model to create more robust managed Medicaid rate setting methodologies. Our member plans are committed to serving Medicaid beneficiaries. We believe the use of a more model-based approach to the underwriting gain assumption will ensure the financial sustainability of the Medicaid program. We welcome a meeting to discuss these recommendations. Should you need any additional information, please feel free to contact me at sattanasio@mhpa.org.

Sincerely,

Shannon Attanasio

Shannon Attanasio

Vice President, Government Relations and Advocacy

Cc: Chris Truffer

Alyssa Deboy

Melissa Harris

[6] MHPA Announces Actuarial Model Developed to Provide Additional Transparency in Managed Medicaid Rate-Setting. *https://www.medicaidplans.org/press-releases/title/mhpa-announces-actuarial-model-developed-to-provide-additional-transparency-in-managed-medicaid-rate-setting*.