Pension and Health Benefits Committee
Agenda Item 8

August 15, 2017

Item Name: Risk Adjustment of CalPERS' Health Plan Rates – History and Experience

Program: Health Benefits

Item Type: Information

Executive Summary

This agenda item provides an overview of the sequence of events between 2012 and the present leading to risk adjustment of the California Public Employees' Retirement System (CalPERS) health plan rates. In addition, it summarizes the risk adjustment methodology for plan years 2014-2018.

Strategic Plan

This item supports the 2017-22 Strategic Goal of "Health Care Affordability: Transform health care purchasing and delivery to achieve affordability."

Background

Risk adjustment is an actuarial tool used to calibrate payments to participating health plans based on the relative health of the at-risk populations. The entire process involves health risk assessment, premium adjustment, and cost neutral risk adjusted payment transfers. The risk adjustment process involves measuring risk of a health plan's CalPERS members relative to the average risk for all CalPERS members in the plans, and then modifying premium payments to reflect differences among the groups. For example, if a plan has a sicker population (and therefore higher utilization risk), the plan's premiums go down as a result of risk adjustment, and the plan will receive fund transfers from other plans with healthier populations.

The CalPERS risk adjustment model uses hospital diagnosis coding from inpatient claims, as a measure of morbidity (illness) in each health plan's population, to predict medical and pharmacy costs. It uses a phased allowance for improvements in diagnoses coding. The risk adjustment process uses individual health data, family size and geographic cost variances to assess risk and calculate transfer payment amounts. Premiums are risk-adjusted prior to being published and transfer payments to participating plans are adjusted during the Plan Year (PY) as CalPERS receives updated health claims and enrollment data.

History of Risk Adjustment at CalPERS

In January 2012, CalPERS staff presented to the Board of Administration (Board) a list of strategies and 21 initiatives, which included risk adjustment. The Board supported each of these initiatives and directed staff to move forward with further exploration.

In the process of pursuing this initiative, the following emerged as reasons to risk adjust CalPERS health benefit plan premiums:

- Allows the Board and its health plan carriers flexibility to differentiate without adverse impact to member financially;
- Addresses cherry-picking, i.e., health plan carriers pricing their premiums to attract the healthiest members, and regional pricing concerns;
- Is invisible to CalPERS' members;
- Is supported by the Premium Normalization Study conducted by CalPERS from 2008 – 2010;
- Is currently being done by the University of California (UC) and other major providers in California; and,
- Provides for an opportunity for the risk adjustment methodology to evolve to align with UC and Health Benefit Exchange (Covered California).

In September 2012, Assembly Bill 2142 was signed into law. This allowed the Board to implement risk adjustment across plans and to adjust premiums accordingly. CalPERS created regulations to implement the law[1] which became operative in July 2013.

Between September 2012 and February 2013, the CalPERS Board received reports on the 2014 to 2018 Health Maintenance Organization (HMO) and Preferred Provider Organization (PPO) procurement strategies, including risk adjustment.[2] In February 2013, the CalPERS team presented the Health Premium Risk Adjustment Proposed Methodology.[3] This document included risk models, risk pools to mitigate adverse selection, risk adjustment benefits, what it is, how it works, purchasers that use risk adjustment, and industry best practice. It identified that the goals of risk adjustment are fourfold:

- Provide Choice of Plan;
- Control Cost Trend:
- Better Data & Transparency: and
- Better Disease Management.

The proposed risk adjustment methodology was applied to only the Basic Health Plans, and the HMO and PPO plans were risk adjusted as separate pools. The Association Health Plans are excluded from risk adjustment. The Health Premium Risk Adjustment meeting of April 4, 2013, provided the opportunity to the Health Plans to comment on the proposed methodology.

In June 2013, with the adoption of the 2014 Health Plan premiums for the PPO and HMO Health plans, premiums were risk adjusted for the single statewide rates and contracting agency regional rates.[4] On November 14, 2013, a risk adjustment Question and Answer, All Carrier Meeting was held to review risk adjustment methodology with Anthem Blue Cross, Blue Shield of California, Health Net, Kaiser Permanente, Sharp Health Plan, and United HealthCare and to

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[1] Health Premium Risk Adjustment – Adoption of Regulations. CalPERS Pension and Health Benefits Committee, February 20, 2013, Agenda Item 9b.
[2] Request for Proposal 2012-6334 (HMO) and Request for Proposal 2012-6376 (PPO)
[3] Health Premium Risk Adjustment – Proposed Methodology. CalPERS Pension and Health Benefits Committee, February 20, 2013, Agenda Item 9a.
[4] See:

- Approval of 2014 Health Maintenance Organization Plans Benefits and Rates. CalPERS Pension and Health Benefits Committee, June 18, 2013, Agenda Item 6a.
- Approval of 2014 Preferred Provider Organization Plans Rates. CalPERS Pension and Health Benefits Committee, June 18, 2013, Agenda Item 6b.

update the CalPERS risk adjustment process. The following year, a Risk Adjustment Reconciliation meeting was held on November 5, 2014, with all carriers, and the updated risk adjustment process was distributed and request for feedback solicited. On November 24, 2014, the risk adjustment reconciliation process was finalized.

In September 2016, CalPERS provided the "Report on the Risk Adjustment Program Plan Years 2014 to 2017" for the California State Legislature.[5]

CalPERS' Experience with Risk Adjustment

CalPERS' four phase risk adjustment process for each PY is as follows:

- Phase 1 uses past claim experience to estimate risk and forecast enrollment for the upcoming PY during the premium development stage. This is an integral part of CalPERS' annual rate development process.
- Phase 2 updates enrollment data after open enrollment, which establishes the basis for monthly inter-plan risk adjustment asset transfers. The total dollar adjustment for the system results in cost neutrality.
- Phase 3 reconciles risk adjustment with updated enrollment and risk after the middle of the PY. This modifies the monthly inter-plan risk adjustment asset transfers for the remaining months of the PY.
- Phase 4 conducts a final reconciliation of the risk adjustment transfers based on the actual data for the entire PY.

In April of each year, the CalPERS team negotiates, with its health plans, the unadjusted health premiums for the following calendar year. In May, the unadjusted premiums are risk adjusted in accordance with the methodology and process outlined on November 24, 2014, and presented to the Pension and Health Benefits Committee. The risk adjusted premiums are finalized in June of each year and approved by the CalPERS Board. During open enrollment, as members make plan selections, inter-plan migration can have an impact on each plans' risk pool, future premiums, and subsequent reconciliation phases.

There have been some positive aspects of risk adjustment. As a result of risk adjustment, CalPERS is receiving more data from its health benefit plan carriers than before 2014. There are more health benefit plan choices available to CalPERS' members since its implementation. And, risk adjustment may be partly responsible for the very modest premium increases CalPERS has been experiencing, especially for PY 2017 and 2018.

Implementing risk adjustment, however, has not been without its challenges, which include:

- The lack of uniform data submissions from the health plan carriers. Some carriers are better than others in capturing data that reflects membership health (or risk). This may lead to 'coding bias," where a carrier's ability to properly code disproportionately drives the risk score, rather than the health of plan's enrollees driving the score.
- The change from International Classification of Diseases (ICD) 9 to ICD 10 system diagnosis coding and reporting capabilities required of health plan carriers October, 2015, and different approaches to diagnostic coding from providers.

[5] https://www.calpers.ca.gov/docs/forms-publications/risk-adjustment-program-2016.pdf

- Difficulty in subsequent years of accurately predicting risk scores of new enrollees at the time when premiums are set due to the timing of open enrollment; unpredictability of plan risk scores due to inter-plan migration as a result of plan competition.

Summary

The CalPERS team experienced a difficult start to the program resulting from simultaneous implementation of multiple HMO plans, sensitivity of the model to changes in member migration, accuracy and completeness of diagnostic coding, and conversion of ICD from version 9 to 10.

Every risk adjustment phase and set of premium transfers have resulted in a more complete analysis of the morbidity and severity of illness risk carried in each plan's population. However, between 2012 and 2017, significant multiple tests of the risk models and phases, as well as extensive analysis by internal and external actuarial staff, have been necessary in order to provide a more complete picture of the CalPERS risk adjustment model and assumptions required to make the process fair and equitable to all plans.

The rationale for continuing risk adjustment through 2018 was that it would allow CalPERS team to continue to test the models, confirm the standardization of diagnosis coding practices consistently across all health plans, and ensure that risk scores and risk models reflect an accurate level of CalPERS population disease risk that is valid and reliable. At this time, the CalPERS team is conducting a separate evaluation of whether or not to continue risk adjustment into the 2019 health plan rate setting process and plan year.

Budget and Fiscal Impacts

CalPERS' risk adjustment process requires tests, exercises and model validations by external actuaries, complete and accurate documentation of each phase's set of calculations, and confidence that the diagnosis code reporting is consistent with industry standard coding practices. An external firm was engaged to conduct a validation of ICD 9 and ICD 10 coding for completeness, accuracy and timeliness across all health plans. The cost for these risk adjustment verification and validation efforts is estimated in excess of $500,000 to date.

Attachment

Risk Adjustment

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