FINAL STATEMENT OF REASONS

Proposed Amendment to Amend Sections 599.500 and 599.508 of Article 1 of Subchapter 3, Chapter 2 of Division 1 of Title 2 of the California Code of Regulations (CCR).

UPDATE OF INITIAL STATEMENT OF REASONS

Changes were made to the text of the proposed regulations to clarify minimum standards for health benefit plans as they pertain to risk adjustment and related definitions. The Initial Statement of Reasons has been updated with an Addendum, which provides a clarification that the proposed regulatory changes are substantive in nature and explains the purpose and necessity of the amendments to the proposed regulation text that were made available after the 45-day comment period conducted from January 1, 2021 through February 15, 2021, and during the 15-day comment period conducted from August 19, 2021 through September 3, 2021. The Addendum to the Initial Statement of Reasons was posted on the California Public Employees' Retirement System (CalPERS) website and attached to the 15-day Notice of Modifications to Text of Proposed Regulations, which was mailed to CalPERS' employers and to interested parties.

The changes made to the proposed regulation text are as follows:

- Deleted language in section 599.500(a)(8)(A) requiring that the risk assessment method selected by CalPERS be consistent with industry best practices and reinserted the original regulatory language that the risk adjustment methodology selected by CalPERS be consistent with industry best practices and similar to risk adjustment methodologies used by the U.S. Department of Health and Human Services and other state and federal agencies. The reinsertion is now in section 599.508(a)(8).
- Reinserted in section 599.508(a)(8) the original regulatory language requiring CalPERS to provide health benefit plans its risk adjustment methodology at least 90 days prior to the public announcement of the following year health benefit plan premiums.

- Deleted the provision in section 599.508(a)(8)(B) permitting the CalPERS Board to exclude certain health benefit plans from having their premiums risk adjusted.
- Clarified and added criteria to the provision in section 599.508(a)(8)(C) permitting the Board to phase-in a risk adjustment calculation to all or specific health benefit plans over a period as determined by the Board. Due to other deletions, this revised provision is now in section 599.508(a)(8)(B).
- Specified in section 599.508(a)(8)(D) that risk adjustment does not apply to CalPERS Medicare health benefit plans. Due to other deletions, this revised provision is now in section 599.508(a)(8)(C).

Along with providing an explanation for the necessity of the proposed regulation changes, the Addendum to the Initial Statement of Reasons clarified that the proposed regulations were substantive in nature. When CalPERS initially proposed these regulatory amendments, it thought that they were non-substantive, since existing law already permits the CalPERS Board to implement a risk adjustment program. These proposed changes do not impact CalPERS authority to risk adjust but they do, however, propose to amend regulatory requirements for the processes used for health benefit plan risk adjustment.

SUMMARY OF PROPOSED REGULATION

Government Code Section 22864 gives CalPERS the authority to risk adjust health benefit plan premiums. Government Code Section 22850 further requires that risk adjustment procedures implemented by the CalPERS Board must be based on rules and regulations adopted by the Board.

Under current regulations, after CalPERS establishes a risk adjusted health benefit plan premium, it is required to use a back-end reconciliation process where health benefit plan premium dollars are transferred among health benefit plans to account for any changes in the health risk scores of individuals enrolled in the plans over a health benefit plan year. The proposed regulations delete the back-end reconciliation process and make other technical changes to align the regulations with current and best practices regarding health benefit plan risk adjustment.

SUMMARY OF REGULATORY EVENTS

A Notice of Proposed Regulatory Action was published in the California Regulatory Notice Register 2021, No. 1-Z, File No. Z2020-1221-02, on January 1, 2021. The 45-day comment period commenced on January 1, 2021, and closed February 15, 2021.

CalPERS received one written public comment during the public notice period. This comment was submitted via email on December 31, 2020 from Mr. Joseph John Jelincic.

On March 16, 2021, the Pension and Health Benefits Committee recommended approving the final regulation package to the CalPERS Board. On March 17, 2021, the Board adopted this recommendation and approved the final regulation package to be submitted to the Office of Administrative Law.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL PUBLIC NOTICE PERIOD OF JANUARY 1, 2021 THROUGH FEBRUARY 15, 2021

COMMENT: Mr. Jelincic stated that the proposed regulation changes would lead to increased costs since a specific risk adjustment program selected by CalPERS in the future could potentially align with an actuarial model that favors insurers over members. Mr. Jelincic stated that this potential model would reward insurance companies that negotiate against the best interest of CalPERS Health members. Mr. Jelincic requested the CalPERS Board to not approve the proposed regulatory changes.

RESPONSE: CalPERS disagrees with this comment and will proceed with the proposed regulatory changes. Risk adjustment programs do not favor insurers over their insureds. Instead, they correct the imbalance among insurers when some attract a disproportionate share of unhealthy individuals compared to other insurers. For CalPERS, risk adjustment ensures that (1) its less healthy members are not penalized for their health status by paying higher health plan premiums and (2) its health plans with more unhealthy members are not penalized by having to charge higher premiums and thus be less competitive. The proposed changes will, among other things, update the definition of risk adjustment to reflect current actuarial science, which will assist CalPERS in fulfilling these objectives.

Prior to Office of Administrative Law final approval, CalPERS further modified the proposed regulation changes and clarified their necessity along with declaring they were substantive in nature. Doing so warranted an additional 15-day comment period which commenced on August 19, 2021 and concluded on September 3, 2021.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE PUBLIC NOTICE PERIOD OF AUGUST 19, 2021 THROUGH SEPTEMBER 3, 2021

COMMENT NO. 1: Mr. Jelincic, in his capacity as Director of Health Benefits for the Retired Public Employees' Association of California (RPEA) commented that CalPERS incorrectly used the terms methodology and methods and suggested CalPERS review and correct the regulation.

The commentor stated that proposed regulation changes to Title 2, California Code of Regulations (2 CCR), section 599.500, subdivision (x) focus on expected insurance company outlays, not on medical conditions.

The commentor argued that pursuant to 2 CCR, section 599.508, subdivision (a)(8), the analytical framework, or methodology, should not be subject to annual changes unless there is a significant change in either statistical analysis or a significant change in medical science and believes 90 days is not enough time for the public to comment on the adequacy and impact of the chosen framework.

The commenter also asserted that CalPERS has chosen a risk adjustment methodology that considers insurance company outlays and is therefore inconsistent with risk adjustment methodologies consistent with industry best practices and similar to those used by the United States Department of Health and Human Services. He claims that CalPERS' chosen methodology protects insurance companies as it encourages increased medical costs by subsidizing plans with high costs while penalizing plans with low costs and higher cost controls.

The commentor mentioned that CalPERS is removing language changes to 2 CCR, section 599.508, subdivision (a)(8)(C) that were initially proposed. He believes CalPERS should not limit the Board's authority to exclude specific plans.

The Commentor also expressed:

- it is CalPERS stated intention to eventually combine the preferred provider organizations and the health maintenance organizations into one risk pool even though they are two very different products;
- that the last time CalPERS risk adjusted health benefit plan premiums it established that the fee for service model was more cost efficient than the HMO model, which has been almost universally rejected by medical researchers and the academic community; and
- CalPERS' chosen risk adjustment methodology will further intensify the focus on protecting insurance companies from both adverse selection and adverse vendor negotiations. Consequently, members that purchase from cost effective vendors, even at the cost of narrower networks, should not be asked to subsidize those who chose otherwise for whatever reason.

RESPONSE NO. 1:

Response to comment that CalPERS incorrectly used the terms methodology and methods:

CalPERS believes the usage of the terms "methodology" and "method" are appropriate in the proposed regulations. There are various risk adjustment methodologies that the CalPERS Board should be able to consider before choosing a specific method or model. In some instances, these terms already exist in regulations and are not being proposed to be modified. The commenter declined to provide specific examples. In reviewing the application of each term, we believe they are appropriate in their relative usage.

Response to comment that 2 CCR section 599.500, subdivision (x) focuses on expected insurance company outlays and not on medical conditions:

The commenter does not identify specific issues with the proposed language changes. Proposed language changes intend to update the definition of "risk adjustment" to adhere to industry standards. CalPERS extracted this precise definition from an Actuarial Standards of Practice Board publication. This update is critical to reflect current best practices.

Response to comment that the analytical framework, or methodology, chosen by CalPERS in accordance with 2 CCR section 599.508, subdivision (a)(8) should not be subject to annual changes and should be reviewed when there is a significant change in either statistical analysis or a significant change in medical science:

CalPERS disagrees with this statement since it would limit CalPERS' ability to adopt the most current risk adjustment methodologies. Consequently, CalPERS does not recommend changing the language in this section.

Response to comment that providing CalPERS chosen analytical framework, or methodology, to the public at least 90 days before public announcement of premiums for the next plan year, as required under 2 CCR section 599.508, subdivision (a)(8), is not enough time for the public to comment on the adequacy and impact of the chosen framework:

CalPERS disagrees with this concern, and commentor has not suggested an alternative time window. Moreover, this requirement is currently contained in existing regulations. Consequently, CalPERS does not recommend changing the language in this section.

Response to comment that the risk adjustment methodology chosen by CalPERS is inconsistent with industry best practices and similar to those used by the United States Department of Health and Human Services:

This comment is not directed at CalPERS proposed action or to the procedures followed by CalPERS in proposing or adopting the action and is therefore not relevant to the proposed regulation change.

Response to comment about removing the proposed language in 2 CCR section, 599.508, subdivision (a)(8)(C) that would have given the Board flexibility to include and exclude health plans:

Mr. Jelincic mentions that removing this initially proposed language should not limit the Board's authority to exclude specific plans. CalPERS determined that the specific language to exclude unidentified plans was not prudent for the application of risk adjustment. Therefore, CalPERS instead is proposing to be very specific about which plans can be excluded from risk adjustment. The specific plan types are now in the amended proposed language.

Response to comment that it is CalPERS stated intention to eventually combine the preferred provider organizations and the health maintenance organizations into one risk pool even though they are two very different products:

This comment is not directed at CalPERS proposed action or to the procedures followed by CalPERS in proposing or adopting the action and is therefore not relevant to the proposed regulation change.

Response to comment that the last time CalPERS risk adjusted health benefit plan premiums it established that the fee for service model was more cost efficient than the HMO model, which has been almost universally rejected by medical researchers and the academic community:

This comment is not directed at CalPERS proposed action or to the procedures followed by CalPERS in proposing or adopting the action and is therefore not relevant to the proposed regulation change.

Response to comment that CalPERS chosen risk adjustment methodology will further intensify the focus on protecting insurance companies from both adverse selection and adverse vendor negotiations. Consequently, members that purchase from cost effective vendors, even at the cost of narrower networks, should not be asked to subsidize those who chose otherwise for whatever reason:

This comment is not directed at CalPERS proposed action or to the procedures followed by CalPERS in proposing or adopting the action and is therefore not relevant to the proposed regulation change.

COMMENT NO. 2: Mr. Jelincic, as an individual, commented on proposed amendments to 2 CCR section 599.500, subdivision (x). He asserts that the change to the definition of “risk adjustment” results in an adjustment from health risk considerations to an adjustment for financial considerations, and that this change protects the insurance companies, not from unhealthy populations, but from bad provider rate negotiations. He also claims that the term “risk assessment” will no longer have any role in “risk adjustment’ due to the proposed changes. He further contends that changing the definition of “risk adjustment” is not a non-substantive change. Finally, Mr. Jelincic states that a policy that rewards carriers for high medical costs unrelated to risk characteristics of the insured population is a policy that will lead to ever increasing medical reimbursement rates, which is good for providers and bad for purchasers.

RESPONSE NO. 2:

Response to comment that there is a change from adjustment for health risk considerations to an adjustment for financial considerations, and that this change protects insurance companies:

CalPERS disagrees with this comment. Proposed language changes update the definition of “risk adjustment” to adhere to industry standards. CalPERS extracted this precise definition from an Actuarial Standards of Practice Board publication. This update is critical to reflect current best practices.

Response to comment that the term “risk assessment” will no longer have any role in “risk adjustment” due to the proposed changes:

CalPERS disagrees with this comment. The term “risk assessment” is used in the regulatory provisions governing risk adjustment, specifically 2 CCR section 599.508, subdivision (a)(8)(A).

Response to comment that changing the definition of “risk adjustment” is not a non-substantive change:

CalPERS agrees with this comment. CalPERS clarified in this current 15-day comment period that the proposed changes in this action are substantive in nature.

Response to comment that a policy that rewards carriers for high medical costs unrelated to risk characteristics of the insured population is a policy that will lead to ever increasing medical reimbursement rates, which is good for providers and bad for purchasers:

This comment is not directed at CalPERS proposed action or to the procedures followed by CalPERS in proposing or adopting the action and is therefore not relevant to the proposed regulation change.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED AT PUBLIC HEARING

While CalPERS allowed interested parties to request a public hearing from January 1, 2021 to February 1, 2021 no such requests were made, and therefore a hearing was not scheduled.

REASONS FOR REJECTING ANY PROPOSED ALTERNATIVES THAT WOULD LESSEN ADVERSE ECONOMIC IMPACT ON SMALL BUSINESS

The proposed regulation changes will not impact small businesses because they would only apply to CalPERS when CalPERS risk adjusts health plan premiums. The proposed regulation would have no statewide adverse economic impact directly affecting these businesses including the ability of these small businesses in California to compete with businesses in other states.

ALTERNATIVES DETERMINATION

CalPERS has determined that no alternative it considered, identified, or was brought to its attention would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the proposed actions, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The Board approved the proposed regulations at its November 18, 2020 Board meeting and adopted these regulations at its March 17, 2021 Board meeting. The adoption of the regulations is necessary to delete a back-end health benefit plan premium reconciliation process and make other technical changes to align the regulations with current and best practices regarding health benefit plan risk adjustment.

LOCAL MANDATE DETERMINATION

The proposed regulation does not impose any mandate on local or state agencies.