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Mr. David Reese
Chief Financial Officer
Arizona Department of Health Services
Division of Behavioral Health Services
150 N. 18th Avenue, Suite 200
Phoenix, AZ 85007

April 15, 2011

Subject: Behavioral Health Services State Fiscal Year 2012 Capitation Rates for the Title XXI Program

Dear Mr. Reese:

The State of Arizona Department of Health Services (ADHS), Division of Behavioral Health Services (BHS) contracted with Mercer Government Human Services Consulting (Mercer) to develop actuarially sound capitation rates for each of its Regional Behavioral Health Authorities (RBHAs) for State Fiscal Year 2012 (SFY12). Rates were developed for the Title XXI program.

Provider reimbursement and other population and benefit adjustments

AHCCCS is anticipating implementation of significant reductions to provider reimbursement via rate reductions, and several population and benefit adjustments, effective October 1, 2011. Many of these adjustments are likely to impact behavioral health capitation rates as well. For clarity, none of the potential adjustments described within this paragraph are included in what follows.

I. Introduction/Background

ADHS BHS contracted with Mercer to develop actuarially sound capitation rates for each of its RBHAs for SFY12. Rates were developed for the Title XXI (TXXI) program.

The Children's Health Insurance Program (CHIP), titled "KidsCare" and also known as Title XXI, provides health insurance to uninsured children under 19 years of age whose family's gross income is at or below 200% of the federal poverty level. Individuals 19 years of age who are Seriously Mentally Ill are also covered under the program. The KidsCare benefit package is identical to what is offered to TXIX Medicaid members.

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There are four RBHAs for which actuarially sound capitation rates were developed, covering six geographic service areas. They include:

| RBHA | Area(s) Served |
|---|--|
| Community Partnership of Southern Arizona (CPSA) | Pima County |
| Cenpatico Behavioral Health of Arizona (Cenpatico 2, Cenpatico 3 and Cenpatico 4) | Yuma, LaPaz, Pinal, Gila, Graham, Greenlee, Santa Cruz, and Cochise counties |
| Northern Arizona Regional Behavioral Health Authority (NARBHA) | Mohave, Coconino, Apache, Navajo and Yavapai counties |
| Magellan Health Services (MHS) | Maricopa County |

Actuarially sound capitation rates were developed for each of the following population and RBHA combinations, shown in the tables below:

Title XXI

| Cenpatico 3 | CPSA | Cenpatico 2 | NARBHA | Cenpatico 4 | MHS | Statewide |
|-------------|----------|-------------|---------|-------------|---------|-----------|
| \$ 23.10 | \$ 39.07 | \$ 24.01 | \$25.34 | \$29.41 | \$19.54 | \$23.65 |

The rate development schedules are shown in Attachment A.

II. Base costs

Mercer has developed capitation rates for the TXXI population for SFY12. Because the membership in this population is quite low, and has been decreasing rapidly, encounter data from their claims is not sufficient. Based upon review of historical financial statements, TXXI individuals' claim costs generally represent about 40%–50% of Title XIX (TXIX) claim costs. Based on this observation, BHS and Mercer agreed to use the TXIX claim cost per-member-per-month (PMPM) values as the base data for the TXXI rates.

From these base PMPMs, Mercer applied an acuity adjustment factor to the PMPMs to derive the TXXI capitation rates. The overall acuity adjustment factor was 0.48 for the TXXI population. The individual RBHA acuity factors varied. They were adjusted based on symmetrical bands of medical loss ratio (MLR) experience for each RBHA. A final adjustment was applied to make the entire process budget neutral.

III. Interpretive services administration

The actuarially sound capitation rates developed include provisions for RBHA interpretive services administration. Interpretive services are covered by TXXI and are provided by the RBHAs to TXXI members. The interpretive services administrative factor was determined based on weighted average of the TXIX interpretive services administration percentages for children and adults, weighting on TXXI eligibility for children and adults. A consistent percentage (1.10%) was applied to each RBHA.

The statewide impact to the program for interpretive services is an increase of approximately \$42,704.

IV. Administration and underwriting profit/risk/contingency

The actuarially sound capitation rates developed include provisions for RBHA administration. Mercer used its professional experience in working with numerous state Medicaid behavioral health and substance abuse programs in determining appropriate loads for administration and underwriting profit/risk/contingency. Mercer also reviewed current RBHA financial reports. The component for administration and underwriting profit/risk/contingency is calculated as a percentage of the final capitation rate. A 9% load was added across all populations, which is the same as was applied to the SFY11 rates.

V. Risk corridors and performance incentive

BHS has in place a risk corridor arrangement with the RBHAs that provides motivation for the RBHAs to appropriately manage expenses, yet provides financial protection against unmanageable losses. The risk corridor provides impetus for the RBHAs to operate efficiently and generate net income, but also provides for the return of any excessive profit to the State.

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The proposed SFY12 BHS risk corridor approach provides for gain/loss risk-sharing symmetry around the service revenue portion of the capitation rates. This risk corridor model is designed to be cost neutral, with no net aggregate assumed impact across all payments. The RBHA contract also provides for a potential 1% performance incentive. In Mercer's professional opinion, the risk corridor and performance incentive methodologies utilized by BHS are actuarially sound.

VI. Tribal fee-for-service claims estimate

Mercer received and reviewed projected SFY12 tribal claims data from BHS. Based on this information, Mercer and BHS project that Title XXI tribal claim costs for SFY12 will be approximately \$1.7 million.

VII. BHS Administration/Risk/Contingency

AHCCCS has placed BHS Administration at financial risk for the provision of BHS covered services for SFY12. Accordingly, the capitation rates were developed to include compensation to BHS for the cost of ensuring the delivery of all BHS covered services. The capitation rates paid to BHS include a 3.41% load, which was negotiated between AHCCCS and BHS Administration. The load represents 2% premium tax and a 1.41% administrative load for the BHS costs of ensuring the efficient delivery of services in a managed care environment.

VIII. Development of statewide capitation rates

Statewide capitation rates were developed by blending the SFY12 capitation rates for each RBHA using projected SFY12 member months, the estimated amount of SFY12 tribal claims and the administrative percentage add-on component for BHS.

The statewide capitation rates are shown in Attachment B.

IX. Certification of final rates

In preparing the rates shown above and attached, Mercer has used and relied upon enrollment, eligibility, claim, reimbursement level, benefit design, and financial data and information supplied by BHS and the RBHAs. BHS and the RBHAs are responsible for the validity and completeness of this supplied data and information. We have reviewed the data

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and information for internal consistency and reasonableness, but we did not audit it. In our opinion it is appropriate for the intended purposes. If the data and information are incomplete or inaccurate, the values shown in this report may need to be revised accordingly.

Mercer certifies that the above and attached rates, including risk-sharing mechanisms, incentive arrangements or other payments, were developed in accordance with generally accepted actuarial practices and principles, and are appropriate for the Medicaid covered populations and services under the managed care contract. The undersigned actuary is a member of the American Academy of Actuaries and meets its qualification standards to certify to the actuarial soundness of Medicaid managed care capitation rates.

Rates developed by Mercer are actuarial projections of future contingent events. Actual RBHA costs will differ from these projections. Mercer has developed these rates on behalf of BHS to demonstrate compliance with the CMS requirements under 42 CFR 438.6(c) and in accordance with applicable law and regulations. Use of these rates for any purpose beyond that stated may not be appropriate.

RBHAs are advised that the use of these rates may not be appropriate for their particular circumstance and Mercer disclaims any responsibility for the use of these rates by the RBHAs for any purpose. Mercer recommends that any RBHA considering contracting with BHS should analyze its own projected medical expense, administrative expense and other premium needs for comparison to these rates before deciding whether to contract with BHS.

This certification letter assumes the reader is familiar with the BHS program, Medicaid eligibility rules and actuarial rating techniques. It is intended for BHS and CMS, and should not be relied upon by third parties. Other readers should seek the advice of actuaries or other qualified professionals competent in the area of actuarial rate projections to understand the technical nature of these results.

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If you have any questions concerning our rate-setting methodology, please feel free to contact me at 602 522 6510.

Sincerely,

A handwritten signature in blue ink that reads "Michael E. Nordstrom ASA, MAAA". The signature is written in a cursive style.

Michael E. Nordstrom, ASA, MAAA
Partner

MEN:lgm

Enclosures

Copy:
Cynthia Layne, ADHS
Sundee Easter, Mercer
Mike Miner, Mercer
Rob O'Brien, Mercer