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June 8, 2018

Ms. Rachel Butler
Chief Actuary
Health and Human Services Commission
4900 North Lamar
Austin, Texas 78751

Re: STAR Rate Amendment UMCC 529-12-0002 V2.25.1

Dear Ms. Butler:

This letter amends the report titled State of Texas Medicaid Managed Care STAR Program Rate Setting State Fiscal Year 2018 and dated July 10, 2017 which was amended in the letters titled STAR Rate Amendment dated October 10, 2017 and STAR Rate Amendment dated January 5, 2018.

Summary of the Revisions

HHSC's Vendor Drug Program (VDP) has recently implemented numerous changes to the Preferred Drug List (PDL) as part of the cost containment initiative. These changes include some of the program's highest expenditure drugs and will have a significant impact on managed care pharmacy cost that was not contemplated at the time the original fiscal year 2018 (FY2018) managed care capitation rates were developed. The PDL changes are outlined below:

- Nasonex was changed from preferred to non-preferred status effective July 27, 2017.
- Suprax was changed from preferred to non-preferred status effective February 1, 2018.
- Abilify Tablet was changed from preferred to non-preferred status effective March 9, 2018.
- Aripiprazole (generic Abilify) tablet was changed from non-preferred to preferred status effective March 9, 2018.
- Fanapt was changed from preferred to non-preferred status effective March 9, 2018.

- Oseltamivir (generic Tamiflu) was changed from non-preferred to preferred status effective March 9, 2018.
- Antihistamines First Generation was added as a new PDL class effective March 9, 2018.
- Pediatric Vitamins was added as a new PDL class effective March 9, 2018.

In Texas Medicaid, the managed care organizations (MCOs) are financially responsible for the delivery of pharmacy services and appropriate provision for the cost of those services is included in the capitation rates. The state retains the responsibility for the development and management of the formulary, PDL and any prior authorization requirements. In their delivery of pharmacy services, the MCOs are required to follow protocols developed by the state.

While VDP makes PDL revisions throughout the year, most have a relatively small cost impact and, as a result, do not warrant capitation rate action. The changes described above are unusual in that they include the program's highest expenditure drug and three perennial top 20 drugs. In addition, the drugs and drug categories included in the PDL revisions were identified for modification in reports prepared by both the MCO's trade association and the state's consulting actuary. These PDL changes will significantly reduce the cost of pharmacy services from that contemplated in developing the original FY2018 capitation rates.

The rate revisions described in this correspondence impact only the pharmacy component of the STAR capitation rates. The revised pharmacy rates were calculated using identical methods and assumptions as those described in the above-mentioned report with one exception. We added a new PDL adjustment factor to recognize the reduction in MCO pharmacy cost generated by the PDL changes. In the sections below, we will document how we derived the new adjustment factors.

This correspondence uses the following terminology to define the two sets of capitation rates discussed herein.

- Original FY2018 Pharmacy Capitation Rates. These are the pharmacy component rates currently being paid to the MCOs. They were originally developed for FY2018 in the summer of 2017.
- Revised FY2018 Pharmacy Capitation Rates. These are the original pharmacy rates adjusted for the PDL changes. These rates were determined based on the assumption that they would be effective for the entire FY2018 period.

PDL Adjustment Factors

For each of the drugs impacted by the PDL changes described above, we developed an assumption regarding the utilization of services after implementation of the change. For example, for Abilify, we assumed that, on average, 80% of the utilization during the period March 9, 2018 through

August 31, 2018 would move to Aripiprazole (generic Abilify) and 20% would remain with Abilify. In deriving these utilization assumptions, we relied on input from VDP and Magellan Health, the agency's pharmacy benefits consultant.

Please note that we assumed total pharmacy utilization would remain unchanged. We only changed the mix of services. We also compared our utilization assumptions to results from previous PDL changes and found the assumptions to be reasonable. In addition, our analysis considered the potential impacts of seasonality and progressive utilization shift (ramp-up).

Cost factors were developed for each drug on the PDL change list. These factors represent the average gross pharmacy cost (ingredient cost plus dispensing fee) for the combination of drugs assumed to be utilized after implementation of the PDL changes (80% Aripiprazole and 20% Abilify, in our example above) to the average gross cost before implementation. Attachment 14 - Exhibit A presents the calculation of the cost factor for the Abilify change. A similar analysis was performed for each of the drugs and drug categories on the PDL change list. Attachment 14 - Exhibit B presents a summary of the cost factors for all of the impacted drugs. Adjusted cost factors were developed for each drug depending on the implementation date of the particular PDL change.

The adjusted cost factors were applied to all claims incurred during the base period (generally calendar year 2016) for drugs included on the PDL change list. Attachment 14 - Exhibit C presents a summary of this analysis. The resulting factors are the PDL adjustment factors. The PDL adjustment factors were then applied to the projected FY2018 pharmacy incurred claims from the original rate calculation worksheets. The remainder of the capitation rate calculation formula (administrative fees, risk margin and premium tax) used to determine the revised rates is identical to the original rate calculation. The resulting rates are defined as Revised FY2018 Pharmacy Capitation Rates. These are the rates that would have been applicable for the entire FY2018 had the PDL changes been known at the time the original rates were developed.

Revised FY2018 Pharmacy Capitation Rates

The rate revisions described in this correspondence are effective September 1, 2017 and applicable for the entire FY2018. HHSC is currently unable to administer a retrospective rate change. In order to approximate the FY2018 capitation amounts payable under the Revised FY2018 Pharmacy Capitation Rates, HHSC will pay the MCOs based on an adjusted set of rates for the period August 1, 2018 through August 31, 2018. These adjusted rates are determined such that the overall average FY2018 capitation rate paid to each MCO is estimated to be equal to that under the Revised FY2018 Pharmacy Capitation Rates. HHSC will also conduct a reconciliation process to ensure that the total FY2018 capitation paid is equal to actual FY2018 caseload applied to the Revised FY2018 Pharmacy Capitation Rates for each MCO.

The Revised FY2018 Pharmacy Capitation Rates are presented below under Section V. Summary and Attachment 1.

Uniform Hospital Rate Increase Program (UHRIP)

After finalization of the UHRIP premium add-on for the period March 1, 2018 through August 31, 2018, HHSC staff identified two incorrect National Provider Identifiers (NPIs) included in the UHRIP applications along with a third facility whose hospital class was misidentified. The applicable utilization data was collected and corrected for these three hospitals and the UHRIP adjustment factors were recalculated to determine the revised UHRIP premium add-on. In addition, as a result of the moratorium on the Health Insurance Provider's Fee, the fee provision included in the original March 1, 2018 UHRIP premium add-on has been removed.

The UHRIP adjustment factors have been calculated using identical methods as those utilized in the original March 1, 2018 UHRIP calculation. The reimbursement increases by hospital class are unchanged and all MCOs continue to be required to uniformly increase their contracted hospital reimbursement rates by the following amounts which vary by hospital class:

SDA	Children's	Non-Urban Public	Rural Private	Rural Public	State-owned	Urban Public	Other
Bexar	1%	24%	12%	0%	0%	37%	22%
Dallas	2%	53%	13%	0%	0%	58%	58%
El Paso	2%	0%	0%	0%	0%	33%	25%
Harris	0%	44%	15%	18%	0%	49%	49%
Hidalgo	0%	0%	0%	14%	0%	0%	37%
Jefferson	0%	0%	7%	7%	0%	0%	56%
Lubbock	0%	0%	16%	20%	0%	53%	53%
Nueces	0%	44%	15%	18%	0%	49%	49%
Tarrant	2%	0%	20%	24%	0%	65%	65%
Travis	0%	0%	0%	0%	0%	0%	0%
MRSA Central	0%	0%	20%	23%	0%	0%	63%
MRSA Northeast	0%	0%	18%	21%	0%	0%	58%
MRSA West	0%	61%	21%	25%	0%	67%	67%

Revised March 1, 2018 – August 31, 2018 UHRIP Premium Rates

The rate revisions described in this correspondence for the UHRIP component of the premium are effective March 1, 2018 through August 31, 2018. As noted above, HHSC is currently unable to administer a retrospective rate change. In order to provide the appropriate capitation amounts to the MCOs, HHSC will pay the MCOs based on an adjusted set of rates for the period August 1, 2018 through August 31, 2018. These adjusted rates are determined such that the overall average

FY2018 UHRIP capitation rate paid to each MCO is estimated to be equal to the Revised FY2018 UHRIP Capitation Rates. HHSC will also conduct a reconciliation process to ensure that the total FY2018 capitation paid is equal to actual FY2018 caseload applied to the Revised FY2018 UHRIP Capitation Rates for each MCO.

Report Amendments

This section details any revisions to the original actuarial report dated July 10, 2017 and the rate amendments dated October 10, 2017 and January 5, 2018.

Section I. Introduction

No changes applicable to this section. The same data sources were utilized in the calculation of these revised rates.

Section II. Overview of Rate Setting Methodology

No changes applicable to this section. The rates have been calculated for the same service delivery areas, risk groups and services as outlined in the original report using the same general methodology. The revisions to the methodology described for UHRIP in the October 10, 2017 and January 5, 2018 rate amendments continue to be applicable.

Section III. Adjustment Factors

This section is amended to include the narrative and attachments presented above regarding the PDL Adjustment Factors.

The revisions to the methodology described for UHRIP in the October 10, 2017 and January 5, 2018 rate amendments continue to be applicable.

Section IV. Administrative Fees, Taxes and Risk Margin

The following information amends the information included in this section of the actuarial report.

The UHRIP component of the rate will have separate administrative fees, taxes and risk margin from the medical and pharmacy components of the rate. These amounts are defined as follows:

- Administrative Fee – 2.5% of premium
- Risk Margin – 5.0% of premium
- Premium Tax – 1.75% of premium
- Health Insurance Providers Fee Non-Exempt – 0.0% of premium
- Health Insurance Providers Fee Exempt – 0.0% of premium

The 2.5% administrative fee was developed based on discussions between HHSC, the MCOs and the contracted hospitals. While there is an expectation of increased administrative cost associated with the UHRIP program as a result of contract negotiations, claims processing and other system changes, it is not expected that this increased burden will be significant. As a result, the standard 5.75% of premium applicable to the overall rate development was reduced to 2.5% for the UHRIP component only.

The 5.0% risk margin is larger than the 1.5% risk margin applicable to the overall rate development because the MCO will be at greater risk of utilization shift between the hospital classes, between the facilities and between the MCOs. The MCO will be required to increase their reimbursement rates according to the defined increases and could experience deviations from historical utilization patterns that are beyond their control.

The 1.75% premium tax remains unchanged from the overall rate development.

The revised UHRIP premium rates exclude provision for the ACA Health Insurance Providers Fee due to the moratorium that was announced after the original UHRIP premium rates were finalized.

No changes are applicable to this section for services other than UHRIP. The same administrative fee, taxes and risk margin assumptions have been applied in these revised rates.

Section V. Summary

The tables in this section are replaced in their entirety with the capitation rates presented in the attached exhibit titled "Section V-STAR". The exhibit includes three rate tables covering the periods (i) September 1, 2017 through November 30, 2017, (ii) December 1, through February 28, 2018 and (iii) March 1, through August 31, 2018. Please note that the medical and pharmacy components of the capitation rate are the same in each time period. The only difference in the rates between time periods is the amount of the UHRIP add-on.

Section VI. Actuarial Certification of FY2018 STAR Capitation Rates

We, Evan L. Dial, Khiem D. Ngo and David G. Wilkes are principals with the firm of Rudd and Wisdom, Inc., Consulting Actuaries (Rudd and Wisdom). We are Fellows of the Society of Actuaries and members of the American Academy of Actuaries. We meet the Academy's qualification standards for rendering this opinion.

Rudd and Wisdom has been retained by the Texas Health and Human Services Commission (HHSC) to assist in the development of the STAR premium rates for the period September 1, 2017 through August 31, 2018 and to provide the actuarial certification required under Centers for Medicare and Medicaid Services (CMS) requirements 42 CFR 438.4.

We certify that the amended FY2018 STAR premium rates developed by HHSC and Rudd and Wisdom satisfy the following:

(a) The premium rates have been developed in accordance with generally accepted actuarial principles and practices;

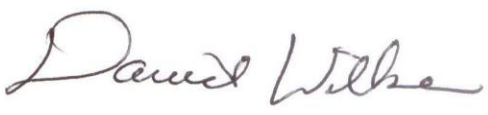
(b) The premium rates are appropriate for the populations and services covered under the managed care contract; and

(c) The premium rates are actuarially sound as defined in the regulations.

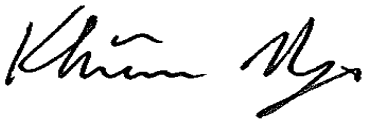
We have relied on historical experience data and program information provided to us by HHSC. We have reviewed the data for reasonableness but have not audited the data.

Please note that actual health plan contractor experience will differ from these projections. Rudd and Wisdom has developed these rates on behalf of the State to demonstrate compliance with the CMS requirements under 42 CFR 438.3(c), 438.3(e), 438.4, 438.5, 438.6 and 438.7. Any health plan contracting with the State should analyze its own projected premium needs before deciding whether to contract with the State.

Evan L. Dial, F.S.A., M.A.A.A.



David G. Wilkes, F.S.A., M.A.A.A.



Khiem D. Ngo, F.S.A., M.A.A.A.

Section VII. Attachments

The following sections indicate any revisions applicable to each of the attachments in the original actuarial report dated July 10, 2017 and the rate amendments dated October 10, 2017 and January 5, 2018.

Attachment 1 - *Summary of FY2018 STAR Rating Analysis*

Exhibit A. This exhibit is amended to include the Revised FY2018 Capitation rates.

Attachment 2 - *Individual Health Plan Experience Analysis*

No changes applicable to this section.

Attachment 3 - *Community Experience Analysis*

This section is amended to include the attached revised community rating exhibits for the pharmacy component of the FY2018 capitation rates.

Attachment 4 - *Trend Analysis*

No changes applicable to this section.

Attachment 5 - *Provider Reimbursement and Benefit Revisions Effective During FY2016, FY2017 and FY2018*

This section is amended to include the PDL Adjustment Factors section from above.

This section is amended to include the revised UHRIP premium calculation in Attachment 5, Exhibits N.1 and N.2.

Attachment 6 – *Family Planning Adjustment*

No changes applicable to this section.

Attachment 7 – *Third Party Recoveries*

No changes applicable to this section.

Attachment 8 – *Delivery Supplemental Payments*

No changes applicable to this section.

Attachment 9 – *Acuity Risk Adjustment*

No changes applicable to this section.

Attachment 10 – *Network Access Improvement Program (NAIP)*

No changes applicable to this section.

Attachment 11 – *Adoption Assistance or Permanency Care Assistance (AAPCA) Rate Development*

Attachment 11 - Exhibit B has been modified to include the PDL adjustment factors.
Attachment 11 - Exhibit F has been modified to include the revised UHRIP adjustment factors.

Attachment 12– *Pay for Quality Program*

No changes applicable to this section.

Attachment 13– *FY2018 STAR Rate Certification Index*

No changes applicable to this section.

Sincerely,

David G. Wilkes, F.S.A. M.A.A.A.