

**UPDATE ON THE FINANCIAL STATUS
OF MICHIGAN MANAGED CARE ORGANIZATIONS**

by

**Steve Angelotti, Fiscal Analyst
John S. Walker, Chief Analyst**

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Gary S. Olson, Director
Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536
Telephone (517) 373-2767
TDD (517) 373-0543
Internet Home Page <http://www.senate.state.mi.us/sfa/>

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TABLE OF CONTENTS

	Page
OVERVIEW	1
THE OVERALL HMO PICTURE	2
MEDICAID HMOs (QHPs)	3
CONCLUSION	5

OVERVIEW

In May 2000, the Senate Fiscal Agency (SFA) released an issue paper entitled "Medicaid and the Financial Status of Michigan Managed Care Organizations". The paper noted that, in calendar year 1999, Michigan Qualified Health Plans (QHPs) suffered significant losses on Medicaid, in the range of \$32 million, as well as overall losses of \$46 million. In comparison, in 1998, the Medicaid losses totaled \$10 million while overall losses were \$85 million. The paper noted that the worsening financial situation in regard to Medicaid (from a \$10 million total loss to \$32 million) was mostly related to the financial problems of two QHPs: Wellness Plan and Great Lakes Health Plan, which experienced a combined loss of \$34 million on Medicaid.

There were two key reasons for the worsening financial situation for Medicaid QHPs: First, due to multiyear contracts, there was no increase in Medicaid QHP rates between 1998 and 1999. Second, due to increased use of new and potentially more beneficial (but expensive) psychotropic medications, Medicaid QHP psychotropic pharmaceutical costs increased by about \$32 million from the level assumed when the QHP contracts were bid out.

The State took action to alleviate both of these problems: The fiscal year (FY) 1999-2000 Department of Community Health (DCH) budget included funding for a 4% increase in QHP rates and, effective February 1, 2000, QHPs were no longer financially liable for the costs of psychotropic medications. These two changes were expected, at the time, to lead to a significant improvement in the financial status of QHPs for that fiscal year. In addition, for FY 2000-01, the State increased Medicaid QHP rates by 11.7% effective October 1, 2000.

The prior SFA issue paper made a specific forecast about QHPs in calendar year (CY) 2000: "For the record, this analysis projects that, in calendar year 2000, the QHPs will just about break even on Medicaid." The paper went on to forecast that a 6.6% increase would be sufficient to enable QHPs to break even in FY 2000-01. Given the 11.7% rate increase implemented for FY 2000-01, the SFA's analysis would indicate a 5% profit for QHPs in FY 2000-01.

While FY 2000-01 data are not yet available, the SFA has examined the filings that health maintenance organizations (HMOs) have sent to the State Office of Financial and Insurance Services (OFIS) for the first three quarters of CY 2000 (or the last three quarters of FY 1999-2000). The data from these filings indicate that HMOs are showing a profit in the current year of over \$37 million. With respect to FY 1999-2000, the HMOs just about broke even, compared with losing \$22 million during FY 1998-99.

Furthermore, while Medicaid costs and revenues are not reported separately in the quarterly reports, the SFA's model indicates that the Medicaid QHPs had estimated profits of over \$12 million (or about 1.8% on costs) on Medicaid services in the first three quarters of CY 2000.

The SFA would note that the estimated profit of \$12 million is within a reasonable range of the estimate of QHPs breaking even in 2000. This result indicates that the FY 2000-01 Medicaid QHP profit will likely exceed the 5% profit that the SFA forecast in spring 2000.

THE OVERALL HMO PICTURE

There are two ways to examine the data: as overall costs and revenues or as costs and revenues per member month. Both of these are relevant in this situation: The overall profit/loss data show the global picture and the costs and revenues per member month adjust for changes in the number of people receiving services through managed care in Michigan and thus indicate cost and revenue trends.

Again, the overall data indicate a \$37 million profit for Michigan HMOs in the first three quarters of 2000. Over 80% of the HMOs improved their financial situations between 1999 and the first three quarters of 2000, and the others are only slightly worse off. It is clear that, nearly across the board, HMOs are much healthier financially than they were in 1999.

Looking at the costs and revenues per member month (Table 1), for HMOs as a whole (Medicaid and non-Medicaid), one can see that the key to this improved situation is the change in premiums per member month. Premiums have increased from an average of \$149 per member month in 1999 (and \$145 per member month in the first three quarters of 1999) to about \$164 per member month in the first three quarters of 2000. That represents a 10% increase over the full year of 1999 and a year-to-year increase from the first three quarters of 1999 to the first three quarters of 2000 of 13%. Media reports of significant HMO rate increases are verified by these data.

Table 1

Michigan HMO Financial Picture, Costs and Revenues per Member Month			
	First Three quarters <u>1999</u>	First Three quarters <u>2000</u>	Percent <u>Change</u>
Number of Member Months	23,572,400	23,859,552	1.2%
Premiums	\$145.37	\$164.37	13.1
Co-Pays and Recoveries	0.53	1.58	198.1
Medical Expenses	(133.48)	(149.49)	12.0
Premiums in Excess of Medical Expenses ..	12.42	16.46	32.5
Administrative Expenses	(16.84)	(17.43)	3.5
Net Income from Operations	(4.42)	(0.97)	-83.0
Other Expenses	(0.03)	(0.12)	300.0
Subtotal	(4.45)	(1.09)	-75.5
Other Income	3.42	2.69	-21.4
Net Income	(\$1.03)	\$1.60	

Note: Because this table is designed to give an “apples to apples” fair comparison of HMOs from year to year, the data included reflect only the 22 HMOs that reported full-year data for 1999 and three quarters-year data for 2000; thus, the numbers in this table are not fully comparable to those that appeared in the May 2000 SFA issue paper.

The HMOs that did not report 1999 data had a net income of about \$3,000,000 (or \$7 per member month) in the first three quarters of 2000. Including their data would increase the net income for the first three quarters of 2000 from \$1.60 per member month to \$1.70.

Source: Annual and Quarterly Health Maintenance Organization Filings with the Michigan OFIS

Net medical costs (after recoveries) also have increased, from \$136 per member month in 1999

(and \$133 per member month in the first three quarters of 1999) to about \$149 per member month in the first three quarters of 2000. That represents a 10% increase over the full year of 1999 and a year-to-year increase from the first three quarters of 1999 to the first three quarters of 2000 of 12%.

It should be noted that both the premium and cost increases may well be related to demographic changes. Historically, it was believed that HMOs catered to younger and healthier enrollees, thus the lower premium when compared with traditional indemnity plans. As HMOs matured and more employers offered these types of plans, however, it is reasonable to assume that older and possibly less healthy persons are enrolling in HMOs. If this is the case, then some of these increases could reflect individuals with higher costs moving into managed care, which would drive up both average premiums and average costs.

These increases in premiums and costs may appear to be quite similar, but the gap between them is enough to make a significant difference in the net financial status of Michigan HMOs. When combined with administrative costs, which have consistently remained at about \$17 per member month in both years, the financial situation shifts from a \$2 loss per member month in 1999 (and a \$1 loss per member month in the first three quarters of 1999) to a \$1.60 profit per member month after three quarters of 2000.

To summarize, Michigan HMOs, thanks to rate increases (both commercial and Medicaid, as well as the State's assuming of the cost of Medicaid psychotropic medication), have gone from net losses to net profits. It appears that this trend will continue into 2001.

MEDICAID HMOs (QHPS)

Because quarterly HMO reports do not break down data based on whether a client is a Medicaid enrollee, Medicare patient group, etc., it is more difficult to determine the financial status of the QHPs for their Medicaid services (although the annual report, due early in 2001, does break data down by payer).

By looking at the individual data by HMO in the quarterly reports, however, one can create a basis for modeling the Medicaid profit and loss picture. Most HMOs have either a heavy Medicaid volume or a very small Medicaid volume, so one can adjust the quarterly data based on Medicaid volume to model the QHP situation. One advantage of this model is that the financial changes from year to year should closely track differences caused by changes in the QHP Medicaid profit/loss picture. It must be conceded, however, that this modeling process is not as accurate as using the actual year-end data.

The modeled Medicaid data reveal a clear and significant improvement in the financial status of QHPs. In 1999, the QHPs lost a net of \$38 million on Medicaid; in the first three quarters of 2000, the QHPs showed an estimated \$12 million profit on Medicaid. This is not surprising given the 4% QHP rate increase that took effect on October 1, 1999, as well as the February 1, 2000, decision to remove psychotropic medication costs from the QHPs, which reduced QHP costs by at least \$32 million annually.

The data (Table 2) indicate that the estimated premium revenue per member month increased from \$139 in 1999 to \$150 in the first three quarters of 2000, for an 8% increase. Although this exceeds the rate increase, the greater increase in premiums (as well as medical costs) for both Medicaid and overall HMOs is most likely related to demographic shifts in the population

covered.

Table 2

Michigan HMO Financial Picture, Estimated Medicaid Costs and Revenues per Member Month			
	Full year 1999	First three quarters of 2000	Percent Change
Number of Member Months	5,948,200	4,722,000	N/A
Premiums	\$139.24	\$150.14	7.8%
Co-Pays and Recoveries	1.03	1.99	92.8
Medical Expenses	(128.99)	(131.52)	2.0
Premiums in Excess of Medical Expenses	11.28	20.61	82.7
Administrative Expenses	(19.07)	(19.61)	2.8
Net Income from Operations	(7.79)	1.00	
Net of Other Income and Other Expenses	<u>1.48</u>	<u>1.69</u>	13.9
Net Income	(\$6.31)	\$2.69	

Note: These data were adjusted for consistency. One HMO did not report administrative costs in the Medicaid column; others did not report "other income" in the Medicaid column. In each case the total amount was apportioned to Medicaid based on the percentage of Medicaid member months for those HMOs. Because this table is designed to give an "apples to apples" fair comparison of HMOs from year to year, the data included reflect only those HMOs that reported full year data for 1999 and three quarters-year data for 2000; thus, the numbers in this table are not fully comparable to those that appeared in the May 2000 SFA issue paper. The HMOs that did not report 1999 data saw net income of \$7 per member month for Medicaid services in the first three quarters of 2000.

Source: Annual and Quarterly Health Maintenance Organization Filings with the Michigan OFIS

Net medical costs for Medicaid HMOs went from an estimated \$129 per member month in 1999 to \$132 per member month (a 2% increase) in the first three quarters of 2000. While the SFA estimates that the psychotropic medication policy change reduced costs by about \$4 per member month from February 1, 2000, through September 30, 2000, it does not appear that the QHPs have seen major increases in medical costs even after adjusting for the psychotropic policy change. If this had been the case, these costs would have risen about 5% from 1999 through the first three quarters of 2000.

Another factor in the improved financial status of Medicaid QHPs was their apparent ability to hold the line on administrative costs, which remained at about \$19 per member month. Pieced together, the QHPs went from a loss of \$6 per member month in 1999 on Medicaid to a small profit of almost \$3 per member month by the fourth quarter of 2000.

Looking at the QHPs that had the most significant financial problems provides clear evidence that their situations have vastly improved. Great Lakes Health Plan has gone from a \$15 million loss in 1999 to a \$1.7 million profit in the first three quarters of 2000. The key factor appears to be a significant reduction in medical costs. Wellness Plan has gone from a \$24 million loss in 1999 to a \$1.2 million loss in the first three quarters of 2000. The key factor for Wellness appears to be that there was little change in medical costs.

CONCLUSION

While it is too early to predict a “Pollyanna-ish” future for Michigan HMOs and QHPs, it is clear that their financial situation has improved significantly. The data indicate that the commercial market premium increases that have taken effect over the last year have had a major impact on HMO finances. This, combined with medical cost increases smaller than the premium increases and no net increase in administrative costs, has returned Michigan HMOs to profitability.

In the Medicaid area, the SFA model would indicate that the largest factor in the improved situation has been the elimination of QHP financial responsibility for psychotropic medication. In addition, there have been other factors, most notably the 4% increase that took effect October 1, 1999, as well as a limited increase in other medical costs and little change in administrative costs, that have helped to stabilize the financial status of the QHPs. The situation for the two QHPs that faced the most financial problems, Great Lakes and Wellness, also has drastically improved.

In summation, the prediction in the previous SFA paper that QHPs would break even in the year 2000 appears to have been too conservative. While it is too early to come to a definitive conclusion for the current fiscal year, it also would appear that the SFA forecast that a 6.6% increase would be needed to bring QHP to a break-even point in FY 2000-01 also was too conservative. Thus, while the SFA will continue to forecast that QHPs should report at least a 5% profit on Medicaid costs during FY 2000-01, early indications are that the profit could be even higher.