STATE OF NORTH CAROLINA
DEPARTMENT OF HEALTH AND HUMAN SERVICES

ROY COOPER
GOVERNOR

MANDY COHEN, MD, MPH
SECRETARY

October 1, 2017

SENT VIA ELECTRONIC MAIL

The Honorable Louis Pate, Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 311, Legislative Office Building
Raleigh, NC 27603

The Honorable Josh Dobson, Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 301N, Legislative Office Building
Raleigh, NC 27603

The Honorable Donny Lambeth, Chair
Joint Legislative Oversight Committee on
Health and Human Services
North Carolina General Assembly
Room 303, Legislative Office Building
Raleigh, NC 27603

Dear Chairmen:

Session Law 2017-57, Section 11F.2.(f), requires the Secretary of the Department of Health and Human Services to submit an initial report to the Joint Legislative Oversight Committee on Health and Human Services and Fiscal Research Division on each LME/MCO determined to be at risk of failing financially, identifying the reasons for each LME/MCO's vulnerable financial position. This report is due no later than October 1, 2017. Pursuant to the provisions of law, I am pleased to submit the attached report.

Should you have any questions about this report, please contact Jason Vogler, Director for the Division of Mental Health, Development Disabilities and Substance Abuse Services, at Jason.Vogler@dhhs.nc.gov or 919-733-7011.

Sincerely,

Mark T. Benton

for Mandy Cohen, MD, MPH
Secretary

cc: Jason Vogler
Theresa Matula
Susan Jacobs
reports@ncleg.net
Christen Linke Young
Denise Thomas
Rod Davis
Leah Burns
Mark Benton
Marjorie Donaldson
Joyce Jones
LT McCrimmon
Susan Perry-Manning
Kolt Ulm
Pam Kilpatrick
Ben Popkin
Lisa Wilkes

STATE OF NORTH CAROLINA
DEPARTMENT OF HEALTH AND HUMAN SERVICES

ROY COOPER
GOVERNOR

MANDY COHEN, MD, MPH
SECRETARY

October 1, 2017

SENT VIA ELECTRONIC MAIL

Mr. Mark Trogdon, Director
Fiscal Research Division
Suite 619, Legislative Office Building
Raleigh, NC 27603-5923

Dear Director Trogdon:

Session Law 2017-57, Section 11F.2.(f), requires the Secretary of the Department of Health and Human Services to submit an initial report to the Joint Legislative Oversight Committee on Health and Human Services and Fiscal Research Division on each LME/MCO determined to be at risk of failing financially, identifying the reasons for each LME/MCO's vulnerable financial position. This report is due no later than October 1, 2017. Pursuant to the provisions of law, I am pleased to submit the attached report.

Should you have any questions about this report, please contact Jason Vogler, Director for the Division of Mental Health, Development Disabilities and Substance Abuse Services, at Jason.Vogler@dhhs.nc.gov or 919-733-7011.

Sincerely,

Mark T. Benton

for Mandy Cohen, MD, MPH
Secretary

cc:
Jason Vogler
Theresa Matula
Susan Jacobs
reports@ncleg.net
Christen Linke Young
Denise Thomas
Rod Davis
Leah Burns
Mark Benton
Marjorie Donaldson
Joyce Jones
LT McCrimmon
Susan Perry-Manning
Kolt Ulm
Pam Kilpatrick
Ben Popkin
Lisa Wilkes

Local Management Entity-Managed Care Organization (LME/MCO) Solvency Standards

Report to
Joint Legislative Oversight Committee on Health and Human Services
and
Fiscal Research Division

Session Law 2017-57, Section 11F.2.(f)

October 1, 2017

North Carolina Department of Health and Human Services

Local Management Entity-Managed Care Organization (LME/MCO) Solvency Standards

October 1, 2017

North Carolina Session Law 2017 – 57, Section 11F.2.(f), sets for the following reporting requirement:

> *Secretary shall evaluate the financial position of each LME/MCO relative to the solvency standards to be developed… and included in the Strategic Plan for Behavioral Health Services.*

Executive Summary

This report describes the changes that the Department of Health and Human Services (DHHS) proposes to implement to the fiscal structure and reporting process of the Local Management Entities/Managed Care Organizations (LME/MCOs) relative to:

- the Medicaid Risk Reserve;
- the accumulation and use of Fund Balances; and
- the application of a reliable Solvency Standard to quantify the fiscal stability of each LME/MCO.

DHHS Contracts with LME/MCOs

NC DHHS executes contracts with LME/MCOs through the Divisions of Medical Assistance (DMA) and the Division of Mental Health, Developmental Disabilities and Substance Abuse Services (DMHDDSAS). LME/MCOs are funded by DHHS to provide a system for the management of delivering behavioral health services to the citizens of North Carolina. The contract between DMA and the LME/MCOs specifically requires the LME/MCOs to function as a -prepaid inpatient health plan (PIHP) managing services for Medicaid recipient members in a capitated funding environment.

Medicaid Risk Reserve Fund

The Centers for Medicaid and Medicare (CMS) requires states to establish risk mitigation for PIHPs. DMA determined the establishment of a Medicaid Risk Reserve Fund would be used to accumulate and protect funds equal to 15% of the total managed care contract, to preserve payments to providers in the event an LME/MCO experienced a catastrophic loss or failure. The initial decision by DHHS was to require each LME/MCO to maintain a separate Risk Reserve Fund and the funding required to generate the Risk Reserve has been incorporated into the Per Member Per Month (PMPM) payments to the LME/MCOs. The funds that have been provided to generate the Risk Reserve must be allocated to the Risk Reserve; the LME/MCO may not use this funding for any purpose (unless DMA authorizes use in the event of a catastrophic loss or failure).

As the General Assembly considers changes to the behavioral health care system, it could consider alternatives to the Risk Reserve. For example, one alternative would be to establish a state-level Risk Reserve account and remove the risk reserve funds from the individual LME/MCOs and place the funds in the state account. Under this approach, DHHS would not continue to include the Risk Reserve as part of the PMPM to each LME/MCO reducing the total PMPM paid and, thereby, also reducing the state match dollars necessary to support the PMPM (Appendix A). While the state would have to pay back the

federal share of the Risk Reserve removed from the individual LME/MCOs, the state level Risk Reserve funds would continue to be available for use by DHHS for any catastrophic failure to any part, or all, of the system. In addition, the state match dollars saved through the reduction of the PMPM would be available to support other services.

Accumulation and Use of Fund Balances

In addition to the Risk Reserve, LME/MCOs have additional funds available. These funds are designated as spendable and non-spendable (See Appendix B for additional details). Amounts are designated as non-spendable if they are necessary for specific fixed expenses (ex: property and casualty insurance), or if the LME/MCO intends to use the funds for a specific reinvestment project. The remaining funds are designated as spendable.

LME/MCO should maintain the Spendable Fund Balance at an amount no more than the equivalent of forty-five (45) days of operating expense.

The General Assembly could direct DHHS to establish a process to require the review and approval of the uses of spendable funds in excess of 45 days of operating expenses. Plans for the use of the remainder of the Spendable Fund Balance would be subdivided into the following three (3) categories and submitted annually to DHHS for approval:

1. Investments in fixed assets.
2. Board restrictions for non-reinvestment items such as buildings, retirement payments, etc.
3. Reinvestments to grow and expand direct care services.

When the plan for use of Spendable Fund Balance is approved by DHHS, the funding to implement the plan is considered committed and will be labeled as Non-spendable Fund Balance.

Solvency Standard

DHHS has, and will continue to use, the Defensive Interval as a measure of solvency for LME/MCOs. The Defensive Interval calculation is described below; it accounts for both Spendable and Non-spendable Fund Balances.

> Defensive interval: Cash plus current investments divided by the total of operating expense minus non-cash expense (See Appendix C). This calculation is done using all funding sources (Medicaid and non-Medicaid) and the result is a number that represents the number of days that an LME/MCO could continue to pay bills if there was no income. This measure is recognized as an industry standard and translates into a description of LME/MCO financial standing that is relevant for understanding solvency and communicating the significance of maintaining sufficient cash reserves.

DHHS has applied the defensive interval calculation to the seven (7) current LME/MCOs: Alliance, Cardinal, Eastpointe, Partners, Sandhills, Trillium and Vaya. At the time of this report, all of the LME/MCOs have sufficient funds to satisfy the defensive interval solvency standard (Appendix C).

Summary

The LME/MCOs report financial data to DHHS monthly and the reports are reviewed and analyzed to monitor the fiscal performance of each. The financial report for the close of state fiscal year 2016, indicated that all seven (7) LME/MCOs were within the expectations for the financial performance requirements as currently defined.

There are other non-Medicaid funding types and state reserve fund requirements that contribute to the perceived cash reserves of the LME/MCOs (10A NCAC27A.0111; G.S.122C-112,144,146; GS143B-10 and GS159-8(a)). These funds also include county funds, funds appropriated by the General Assembly in response to federal Department of Justice settlements (Transition to Community Living and Children with Complex Needs), and other special categorical appropriations and grants that are included in the total budget.

The design of the LME/MCO function was intended to both stabilize the predictability of spending for Medicaid services and to generate savings that could be reinvested in the development of the service delivery system. As the LME/MCOs have matured in their fiscal performance by demonstrating both stability and savings, and in keeping with the requirements of Session Law 2017-57, Section 11F.2.(f), the General Assembly could consider alternatives related to these funds.

The following appendices provide additional explication:

Appendix A: PMPM Risk Reserve Analysis

Appendix B: Fund Balance and Risk Reserve

Appendix C: Defensive Interval: All Funding Sources

APPENDIX A

PMPM Legislative Financial Impact

SFY 2017 Actual and SFY 2018 Projected

	LME/MCO's							
	Alliance	**Cardinal**	**Eastpointe**	**Partners**	**Sandhills**	**Trillium**	**Vaya Health**	**Total**
SFY'17 Member Months - Actual	2,905,757	6,053,819	2,435,995	1,880,873	2,352,821	2,356,481	2,091,697	**20,077,443**
SFY'18 Member Months - Projected	2,992,929	6,235,434	2,509,075	1,937,300	2,423,406	2,427,175	2,154,448	**20,679,766**
SFY'17 Risk Reserve PMPM	$ 2.87	$ 1.90	$ 2.30	$ 2.83	$ 2.33	$ 2.91	$ 3.09	
SFY'17 Calculated Member Months - Actual	**$ 2,905,757**	**$ 6,053,819**	**$ 2,435,995**	**$ 1,880,873**	**$ 2,352,821**	**$ 2,356,481**	**$ 2,091,697**	**$ 20,077,443**
SFY'17 Risk Reserve Deposits - Actual	**$ 8,339,522**	**$ 11,502,256**	**$ 5,602,788**	**$ 5,322,872**	**$ 5,482,073**	**$ 6,857,359**	**$ 6,463,345**	**$ 49,570,215**
SFY'18 Risk Reserve PMPM	$ 2.91	$ 2.08	$ 2.43	$ 2.94	$ 2.31	$ 2.94	$ 3.23	
SFY'18 Calculated Member Months - Projected	**$ 2,992,929**	**$ 6,235,434**	**$ 2,509,075**	**$ 1,937,300**	**$ 2,423,406**	**$ 2,427,175**	**$ 2,154,448**	**$ 20,679,766**
SFY'18 Calculated Risk Reserve - Projected	**$ 8,709,425**	**$ 12,969,702**	**$ 6,097,051**	**$ 5,695,661**	**$ 5,598,067**	**$ 7,135,895**	**$ 6,958,868**	**$ 53,164,669**
SFY'17 - $ Impact - Federal FMAP ~ *0.6672*	**$ 5,564,129**	**$ 7,674,305**	**$ 3,738,180**	**$ 3,551,420**	**$ 3,657,639**	**$ 4,575,230**	**$ 4,312,344**	**$ 33,073,247**
SFY'17 - $ Impact - State FMAP ~ *0.3328*	**$ 2,775,393**	**$ 3,827,951**	**$ 1,864,608**	**$ 1,771,452**	**$ 1,824,434**	**$ 2,282,129**	**$ 2,151,001**	**$ 16,496,967**
SFY'18 - $ Impact - Federal FMAP ~ *0.6743*	**$ 5,872,765**	**$ 8,745,470**	**$ 4,111,242**	**$ 3,840,584**	**$ 3,774,777**	**$ 4,811,734**	**$ 4,692,365**	**$ 35,848,936**
SFY'18 - $ Impact - State FMAP ~ *0.3257*	**$ 2,836,660**	**$ 4,224,232**	**$ 1,985,810**	**$ 1,855,077**	**$ 1,823,290**	**$ 2,324,161**	**$ 2,266,503**	**$ 17,315,733**

Notes:

1 All MCO's contribute the required Risk Reserve estimate of 2.0% except Cardinal Innovations, due to legacy counties reaching the required 15% there contribution is 1.6%.

2 SFY'18 Projections based on SFY'17 actual and 3% inflationary factor.

APPENDIX B

Fund Balance Survey

Fund Balance-by funding source (Committed, Assigned, Unassigned)

June 2017	Alliance	Cardinal	Trillium	Partners	Sandhills	Vaya	Eastpointe	June Totals
Medicaid	$ 116,167,730	$ 231,373,962	$ 70,188,076	$ 74,493,318	$ 140,979,528	$ 88,038,709	$ 75,370,833	$ 796,612,156
State/Federal	130,585	26,788,432	(9,099,419)	24,508,562	13,247,062	(17,127,886)	10,223,866	48,671,202
Local	2,860,545	3,582,310	28,880,796	6,302,344	6,360,152	18,641,224	40,061,929	106,689,300
Total	**$ 119,158,860**	**$ 261,744,704**	**$ 89,969,453**	**$ 105,304,224**	**$ 160,586,742**	**$ 89,552,047**	**$ 125,656,628**	**$ 951,972,658**

YTD Fund Balance

June 2017	Alliance	Cardinal	Trillium	Partners	Sandhills	Vaya	Eastpointe	June Totals
Committed	59,634,343	2,500,000	32,198,971	78,983,906	45,000,000	-	-	218,317,220
Assigned		5,028,466	-	-	-	27,768,860	58,368,092	91,165,418
Unassigned	17,116,602	140,378,714	1,940,031	(12,872,398)	72,274,359	14,217,189	32,847,559	265,902,056
Investment in fixed assets	3,233,622	24,716,468	11,147,402	6,220,114	11,289,055	2,927,893	3,468,318	63,002,872
Other - Non Spendable	-	67,552	66,657	1,035,290	476,011	1,877,057	-	3,522,567
Restricted - Statutes and Prepaids	4,665,222	22,143,133	12,784,335	8,352,195	7,080,126	11,415,538	6,362,023	72,802,572
Restricted - Risk Reserve	34,509,071	66,910,371	31,832,057	23,585,117	24,467,191	31,345,510	24,610,636	237,259,953
Total Fund balance	**$ 119,158,860**	**$ 261,744,704**	**$ 89,969,453**	**$ 105,304,224**	**$ 160,586,742**	**$ 89,552,047**	**$ 125,656,628**	**$ 951,972,658**

YTD Fund Balance (Spendable, Non-Spendable)

June 2017	Alliance	Cardinal	Trillium	Partners	Sandhills	Vaya	Eastpointe	June Totals
Spendable [1]	17,116,602	140,378,714	1,940,031	(12,872,398)	72,274,359	14,217,189	32,847,559	265,902,056
Non - Spendable [1]	102,042,258	121,365,990	88,029,422	118,176,622	88,312,383	75,334,858	92,809,069	686,070,602
Total Fund balance	**$ 119,158,860**	**$ 261,744,704**	**$ 89,969,453**	**$ 105,304,224**	**$ 160,586,742**	**$ 89,552,047**	**$ 125,656,628**	**$ 951,972,658**

Surplus Spendable Fund Balance

June 2017	Alliance	Cardinal	Trillium	Partners	Sandhills	Vaya	Eastpointe	June Totals
Spendable [1]	17,116,602	140,378,714	1,940,031	(12,872,398)	72,274,359	14,217,189	32,847,559	265,902,056
Operating Expenses (45 days as of June 201	67,509,363	104,991,870	59,617,614	40,881,344	42,489,500	58,189,770	42,230,306	415,909,766
Surplus	**$ (50,392,761)**	**$ 35,386,844**	**$ (57,677,583)**	**$ (53,753,742)**	**$ 29,784,860**	**$ (43,972,581)**	**$ (9,382,747)**	**$ (150,007,710)**

Risk Reserve - FMAP Rate

June 2017	Alliance	Cardinal	Trillium	Partners	Sandhills	Vaya	Eastpointe	June Totals
Federal (FMAP Rate - .6672)	23,024,452	44,642,600	21,238,348	15,735,990	16,324,510	20,913,724	16,420,216	158,299,841
State (FMAP Rate - .3328)	11,484,619	22,267,771	10,593,709	7,849,127	8,142,681	10,431,786	8,190,420	78,960,112
Total Risk Reserve	**$ 34,509,071**	**$ 66,910,371**	**$ 31,832,057**	**$ 23,585,117**	**$ 24,467,191**	**$ 31,345,510**	**$ 24,610,636**	**$ 237,259,953**

Fund Balance Definitions

Spendable

- **Unassigned**: Fund balance that has not been reported in any other classification.

Non-spendable

- **Committed**: Amounts designated for use for specific purposes by government or the Board of Directors (must be designated by someone at the highest level of authority).
- **Assigned**: Amounts are also designated for specific purposes but authority to assign has been delegated to a person with lower level of authority.
- **Investment in fixed assets:** Fund balance set aside for investment in fixed assets.
- **Non-spendable**: Amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.
- **Restricted**: Amounts that cannot be spent due to creditor obligations or due to state, federal, or local statutes.

(1) DHHS has not approved the items in the spendable and non-spendable categories.

APPENDIX C

All Funding Sources