CalPERS’ New Total Cost of Care Guarantee Terms in PPO Contracts Align Incentive to Lower Health Care Trend

CalPERS contracts with both health maintenance organizations (HMOs) and preferred provider organizations (PPOs) to provide health care coverage to more than 1.5 million California state and other public employees and retirees. The majority of those insured receive coverage through one of the 10 HMOs that CalPERS contracts with on a fully insured or flex-funded basis. Under those financial arrangements, the health plan stands to lose money if costs come in higher than anticipated. The contracts also limit the ability of health plans to make undue profits as CalPERS reviews their proposed premiums to ensure they are prudent and justified by underlying costs.

The underlying bottom-line accountability for health care costs and the competitive nature of how CalPERS members select their health plan encourages carriers to have as low a price as possible. As a result, the HMO carriers are aligned with CalPERS' financial interests in providing the best possible care while controlling health care costs. In addition, both CalPERS' HMOs and its PPOs have substantial financial guarantees related to delivering high quality health care.

Historically, CalPERS' PPO, which has been self-funded has had little to no financial incentive to lower trend or improve quality. As a self-funded arrangement, CalPERS takes all the risk of health care costs coming in higher than expected, while the health plan it has contracted with as its "third party administrator" is paid a monthly fee to manage the plan which does not vary whether costs go up or down.

New Total Cost of Care Terms Align Health Plan with CalPERS Commitment to Lower Costs

Starting with the 2025 plan year, CalPERS’ self-funded PPO contracts will include performance guarantees on cost and quality, in which the vendors will put hundreds of millions of dollars at-risk if they do not meet set goals. The goals align with CalPERS’ commitment to provide affordable and sustainable high-quality care with both the health plan of its self-funded PPO and the independent population health manager that helps its members navigate the health care system. The details of the program are laid out below and cover Basic PPO medical claims for approximately 250,000 CalPERS active employees and early retirees:[1]

1. **Hundreds of Millions of Dollars in Fees Could be At-Risk**: CalPERS pays for the services of its self-funded PPO health plans and the member navigation assistance of its population health firm on a per member/per month administrative service fee (ASF). Under the terms of the five-year contract,

[1] CalPERS has separate cost and quality targets for its members enrolled in its Medicare Supplement coverage.

52.5% of the ASF paid to the vendors is at-risk under the total cost of care guarantee if they fail to meet the agreed-upon cost management targets. An additional 22.5% of each of the two firms' ASF is at risk for meeting quality targets, bringing the total amount at-risk to 75% of the ASF. The contract calls for putting more of the fees at-risk in the early years to protect against transition concerns. The payment structure described in this fact sheet refers to the final terms that will be in place by 2028.

2. **Trend Target Pushes to Lower Health Cost Increases with Prospective Fixed Trend Benchmark**: The cost trend benchmark is based on a prospective fixed rate, meaning it is determined in advance rather than retrospectively, which allows for better alignment of goals. In 2025, the fixed trend is set at the projected current trend – as determined by an independent actuary – minus 1% to reflect the value of improved care management by the two contracted entities. The target trend lowers by about 0.6% each year until 2029, when the trend target is fixed at 3%. The contractual trend target aligns with the trend target established for health care costs for the state set by California's Office of Health Care Affordability.[2]
3. **Gainsharing Potential**: There is an opportunity for gainsharing, where vendors can share up to half the amount of the ASF at-risk if they perform better than the cost guarantee. The gainsharing is "asymmetric" from the cost guarantee, acknowledging that CalPERS bears the ultimate financial risk if claims exceed the contract limits.
4. **Risk-Free Corridor**: The total cost guarantee includes a risk-free corridor of +/- 1.5% around the cost trend benchmark, providing a range within which the actual costs can vary from the projected costs without triggering penalties or rewards (*see Tables 1 and 2. CalPERS Total Cost of Care Guarantee for Self-Funded PPO Contracts*, 2029).
5. **Shared Cost Guarantee Terms between Firms**: The health plan and the navigation assistance population health firm are held to the same guarantees, using the same cost trend benchmark and calculation method. The shared accountability reflects that fact that while the health plan is responsible for the network of facilities and clinicians, including their pricing, the navigation/population health firm focuses on managing patient care. Their responsibilities overlap in areas critical to cost management. For example, the navigation/population health firm can influence observed network pricing by guiding patients toward more cost-effective care options, while the health plans can help the navigation/population health firm be more effective by providing timely data, enabling early intervention. The total cost of care guarantee ensures both vendors work together toward the common goal of cost management without the need for additional performance metrics.

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[2] Setting a fixed rate trend for five years comes with the risk that changes in the market could make these set rates unrealistic. CalPERS and its vendor partners have agreed to adjust the risk corridor for the TCOC guarantee payment side of the calculation for the upcoming plan year if the prospective National Health Expenditure (NHE) trend is more than 7% when the rates are set for the upcoming plan year. There is no adjustment to the risk corridor on the gainsharing side of the calculation.

6. **External Actuarial Calculation**: To ensure impartiality and accuracy, the calculation of whether the cost targets have been met will be conducted by an external actuary to prevent potential bias.
7. **Limited Adjustments**: All parties agree to limited adjustments to the cost trend calculation. While no members or services are excluded, high-cost claims are limited to very high qualifying thresholds. Care was taken to avoid adjustments that introduce bias, such as removing new treatments from the measurement year without also removing the old treatments from the baseline year.
8. **Exclusion of Pharmacy Costs**: CalPERS currently has a separate self-funded contract to provide pharmacy services for its PPO population and some of its HMO members. These costs are excluded from the total cost guarantee.

The tables below illustrate the value of this guarantee to CalPERS. Using the 2029 contract terms as an example for Table 1, at 4.0% over the trend benchmark, the TPA and PHM are responsible for 68% of the total amount of claims costs over the trend benchmark, or $62 million. The contract lowers CalPERS responsibility for an observed trend that is 4.0% over the benchmark, from $91 million to $29 million. Table 2 shows how much the vendors could benefit in gainsharing.

Table 1. CalPERS Total Cost of Care Guarantee (TCOC) for Self-Funded PPO Contracts, 2029

Observed Trend Compared to Benchmark	Amount of Overage Absorbed by TPA/PHM as TCOC Guarantee Payment	Amount of Pricing Guarantee Paid by TPA/PHM at Observed Trend Level	Total Cost to CalPERS Compared to Benchmark Prior to Pricing Guarantee	Total Cost to CalPERS Compared to Benchmark After Pricing Guarantee
5.5%	49%	$61,500,000	$124,800,000	$63,300,000
5.0%	54%	$61,500,000	$113,500,000	$52,000,000
4.5%	60%	$61,500,000	$102,100,000	$40,600,000
4.0%	68%	$61,500,000	$90,800,000	$29,300,000
3.5%	62%	$49,200,000	$79,400,000	$30,200,000
3.0%	54%	$36,900,000	$68,100,000	$31,200,000
2.5%	43%	$24,600,000	$56,700,000	$32,100,000
2.0%	27%	$12,300,000	$45,400,000	$33,100,000
1.5%	0%	$0	$34,000,000	$34,000,000
0.0%	0%	$0	$0	$0

Table 2. CalPERS Gainsharing Paid to Health Plan and the Navigation/Population Health firm Under the Total Cost of Care Guarantee (TCOC) for Self-Funded PPO Contracts, 2029

Observed Trend Compared to Benchmark	Amount of Savings Received by TPA/PHM as Gainsharing	Amount of Savings Paid to TPA/PHM as Gainsharing	Total Savings to CalPERS Compared to Benchmark Prior to Gainsharing	Total Savings to CalPERS Compared to Benchmark After Gainsharing
-1.5%	0%	$0	$34,000,000	$34,000,000
-2.0%	14%	$6,200,000	$45,400,000	$39,200,000
-2.5%	22%	$12,400,000	$56,700,000	$44,300,000
-3.0%	27%	$18,600,000	$68,100,000	$49,500,000
-3.5%	31%	$24,800,000	$79,400,000	$54,600,000
-4.0%	34%	$31,000,000	$90,800,000	$59,800,000
-4.5%	30%	$31,000,000	$102,100,000	$71,100,000
-5.0%	27%	$31,000,000	$113,500,000	$82,500,000
-5.5%	25%	$31,000,000	$124,800,000	$93,800,000