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2015 Medicare Advantage rates: Perspectives for payors

On April 7, the Centers for Medicare and Medicaid Services (CMS) released the final 2015 Rate Announcement and Call Letter for Medicare Advantage (MA) and Part D programs. Although the provisions announced in the Final Notice are slightly more advantageous for payors than those proposed in the Advance Notice (February 2014), our calculations indicate that they are likely to have a 3.2- to 3.4-percent negative impact on MA capitation rates. The key differences between the proposed and final provisions are:

- Downward revision of the MA and fee-for-service (FFS) per-capita growth rates
- Reduced weight of the new (2014) CMS-HCC[1] model (used to calculate risk scores) and adjustment of the FFS normalization factor
- Postponement of the proposed change to exclude from payment determinations diagnoses that are made only on home visits
- Postponement of the new Rx-HCC model for Part D plans

Our analyses also suggest that the impact of the new provisions on 2015 MA margins will be strongly influenced by a health plan's Star rating.[2] Plans with fewer than 4 Stars may experience about a 1.5-percent reduction in margins, even if they take steps to optimize revenues and control costs.[3] Conversely, plans having 4 or more Stars may experience up to a 2.5-percent bonus that can be used to lower premiums, enhance benefits, expand margins, or some combination of all three.

In this Intelligence Brief, we will discuss the likely impact of the provisions contained in the Final Notice on both MA capitation rates and MA margins.

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[1] Hierarchical Condition Category.

[2] Rates will also vary based on a number of additional factors, such as geographic location.

[3] Plans that for three consecutive years have less than 3 Stars may see their contracts terminated.

Impact of the Final Notice on MA capitation rates

The decrease in the per-capita MA growth rate included in the Final Notice (3.4 percent) is larger than the 1.9-percent decrease outlined in the Advance Notice. According to CMS, the adjustment was made to close the gap between previously estimated and actual cost trends for 2003-2013; the majority of the adjustment related to the 2011-2012 period. Similarly, the 3.4-percent decrease in FFS growth rates in the Final Notice is more than twice the size of the 1.65-percent decrease that had been given in the Advance Notice. This change may negatively affect providers' Medicare margins.

In keeping with provisions in the Affordable Care Act, the Final Notice continued moving county benchmarks to percentages of FFS cost, which is likely to have a 2.4 percent negative impact on capitation rates. In addition, two other changes made outside of the Final Notice will negatively affect capitation rates. The health insurance tax will lower those rates by approximately 0.7 percent, and a 0.25-percent increase in the coding-intensity adjustment will bring that adjustment to a cumulative negative 5.16 percent. These changes are part of current law and were known to the market in advance.

The negative impact of these provisions will be partially offset by changes CMS made in its risk-adjustment methodology. For example, it reduced the weight of the new (2014) CMS-HCC model used to calculate risk scores, the result of which is likely to be a 1.1 percent increase in 2015 rates. In addition, it altered the mechanisms through which MA risk scores are normalized to FFS risk scores; this change should result in a net increase in the risk scores and, as a result, in MA reimbursement (by about 4.3 percent). However, CMS did not extend the Star Quality Bonus Demonstration, which would have provided rate relief of about 1.9 percent.

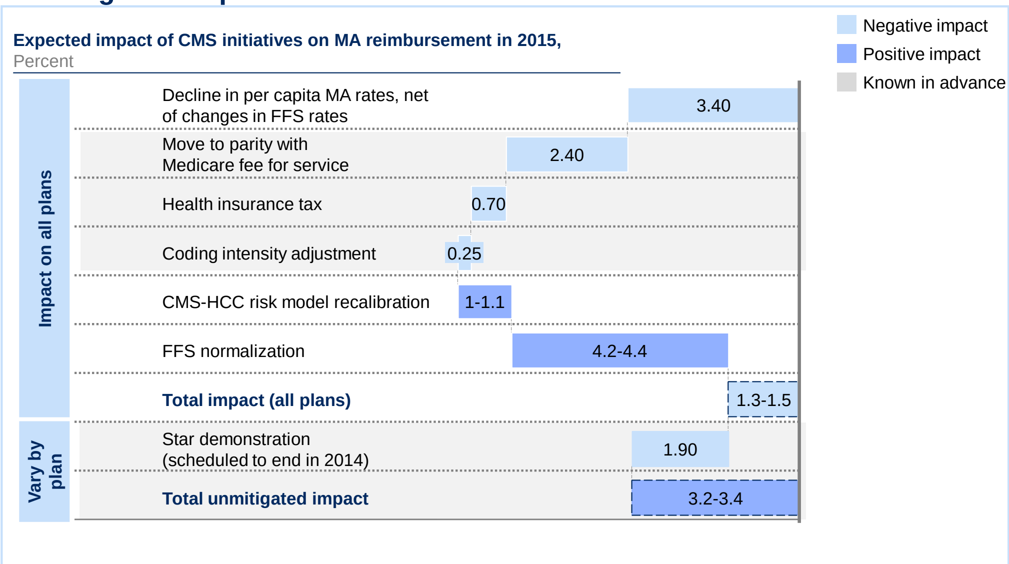
In the Final Notice, CMS also announced several other provisions that could potentially affect MA revenues and MA cost-management programs beyond 2015. For example, it did not finalize its provision requiring that HCC codes collected through home health assessment programs – the basis for members' risk scores – be supported by physician visits. This will likely have a positive impact on MA risk revenues in 2015. However, CMS has indicated that it will continue to assess this provision and may implement it for 2016.

CMS also postponed the application of a new Rx-HCC model for Part D plans. This was in response to multiple requests that MA plans and Part D plans need additional time to conduct impact analyses and communicate results to CMS. Plans could have their performance affected significantly if MA-Part D data are included in the Rx-HCC model because of the historical cost differences between MA-Part D and Part D plans.

Taken together, our calculations indicate that the provisions in the Final Notice should result in a decrease in MA reimbursement of between 3.2 percent and 3.4 percent (Exhibit 1). This decrease is less (by 0.7 to 1.1 percent) than what would have occurred had the provisions in the Advance Notice gone into effect.

EXHIBIT 1

Decline in in per capita MA growth rate partially offset by positive changes in risk scores still leaves MA plans with >3% negative impact on reimbursement



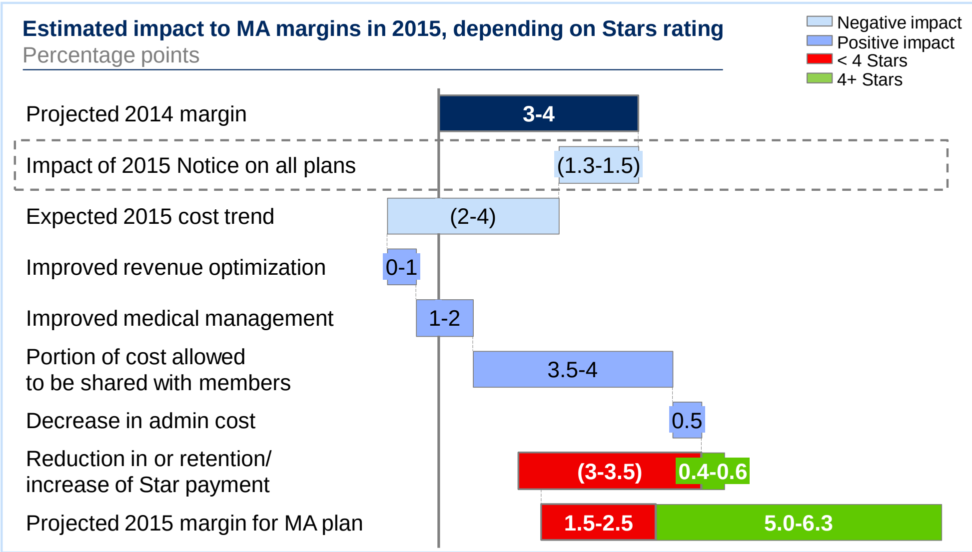
SOURCE: McKinsey analysis of CMS 2015 Final Notice

Analysis of the impact on MA margins

The financial impact that Star ratings will have on MA plans is likely to grow in both directions. Plans with ratings of 4 or more Stars will retain their bonus payments in 2015. By contrast, plans with lower ratings will lose all the bonus amounts they receive in 2014, due to discontinuation of the Star Quality Bonus Demonstration. For example, an MA plan with 4 Stars that is currently receiving a 5-percent bonus payment from CMS will also receive a 5-percent bonus in 2015. However, a 3.5-Star plan receiving a 3.5-percent bonus in 2014 will not receive any bonus at all in 2015. As a result, Star ratings will become a much more important factor affecting margins in 2015 (Exhibit 2).

EXHIBIT 2

In 2015, Star ratings are likely to strongly influence whether MA plans gain or lose margin



SOURCE: CMS 2015 Advance Notice; Bank analyst reports, McKinsey analysis

Additional observations

In the Final Notice, CMS increased the weighting of both Part C and Part D quality improvement metrics from 3 to 5 weighted. However, it excluded plans currently having 4 or more Stars from this change, thus underscoring the importance of improvement to 4+ Star ratings. CMS did not reduce the weighting of its drug adherence metrics (from the current 3 weighted to 1.5). As a result, those metrics remain very important for reaching a 4+ Star rating and usually require coordination between health plans, pharmacy benefits managers, and retail pharmacies.

CMS also indicated that any new MA plan from a parent organization that has had a contract with CMS within the previous three years will receive an enrollment-weighted average of the Star ratings earned by the parent organization's existing MA plans. Other new plans will start out with 3.5 Stars but will be given a quality-bonus-payment percentage of 3.5 percentage points.

In addition, CMS did not proceed with all of the changes in Part D plan regulations that it had listed in the Proposed Rule it released on January 10, 2014, except for the requirement that co-payments for 30-day prescriptions be equal in retail and mail fulfillment. In the Final Notice, CMS did not elaborate further on such topics as health and wellness incentives.

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Appendix

Data analyzed

We used the following data sources to develop our perspectives on the 2015 MA rates:

- Announcement of Calendar Year (CY) 2015 Medicare Advantage Capitation Rates and Medicare Advantage and Part D Payment Policies and Final Call Letter (published by CMS on April 7, 2014)
- Advance Notice of Methodological Changes for Calendar Year (CY) 2015 for Medicare Advantage (MA) Capitation Rates, Part C and Part D Payment Policies and 2015 Call Letter (published by CMS on February 21, 2014)
- Announcement of Calendar Year (CY) 2014 Medicare Advantage Capitation Rates and Medicare Advantage and Part D Payment Policies and Final Call Letter (published by CMS on April 1, 2013)
- Several industry reports, which we used as a point of reference for the likely impact of specific CMS provisions published in the 2015 Final Notice

Methodology

The methods used to calculate the impact of specific provisions in the 2015 Final Notice about MA reimbursement are as follows:

- The final estimate CMS gave to MA plans about the change in MA capitation rates (negative 3.4 percent) was a blend of the national per-capita MA growth percentage for 2015 (negative 4.07 percent, which included a historical adjustment of negative 4 percent) and the national Medicare FFS growth percentage for 2015 (negative 3.3 percent)
- To calculate the impact of the move to parity with FFS rates, we examined both the statutory component of the regional benchmarks and the transitional phase-in periods for the Affordable Care Act rates.[4] Based on county-level Medicare FFS costs, we estimated that the impact of phasing in the new benchmarks would be a negative 2.4 percent
- Calculation of the 0.7-percent negative impact of the health insurance tax was based on Section 9010 of the Affordable Care Act, which imposes an “annual fee” ($11.3 billion for 2105) for health insurance plans. The fee is allocated proportionally based on membership to individually- and employer-purchased insurance. (Excluded are employer self-insured plans, Medicare Supplement plans, and non-profit plans that derive more than 80 percent of their revenues from Medicare Advantage and/or Managed Medicaid)

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[4] The statutory component of the regional benchmarks, transitional phase-in periods for the Affordable Care Act rates, February 6, 2014

- We determined that the impact of the risk-coding intensity adjustment would be negative 0.25 percent by calculating the difference between the 2015 adjustment for MA coding pattern differences (5.16 percent) and the 2014 adjustment (4.91 percent). Any increase in the adjustment for MA coding pattern differences proportionally decreases the portion of MA reimbursement coming from risk adjustment of the MA rates
- The positive impact that recalibration of the CMS-HCC model would have was calculated based on two variables: CMS's estimate in the final notice that the 2014 CMS-HCC model produces risk scores that are 2.5 percent lower than those used in the 2013 CMS-HCC model, and the weight that the CMS-HCC model was given in 2014 and 2015. (In 2015, the weight of CMS-HCC model in the blend dropped to 33 percent, from 75 percent in 2014.) Therefore, the following equation was used to calculate positive impact: (33% -75%) × (-2.5%) = 1.05%
- The positive impact that changes in FFS normalization factors would have is based on the part of CMS's risk-adjustment methodology in which MA risk scores are divided by that year's FFS normalization factor to account for differences in risk codes between MA and FFS. For 2015 risk score calculations, CMS established the blended normalization factor for aged and disabled Medicare patients (patients with end-stage renal disease were excluded) as 67 percent of the 2013 normalization factor (0.992) plus 33 percent of the 2014 the normalization factor (0.978) to account for a larger number of retiring baby boomers. Thus, the 2015 FFS normalization factor equals 0.987, which is 0.0424, or 4.24 percent, lower than the FFS normalization factor applied in 2014 (1.02975). Therefore, MA risk-adjusted reimbursement increases by 4.24 percent
- Estimation of the negative impact that discontinuation of Star Quality Bonus Demonstration was taken from industry reports.[5] MA plans with less than 4 Stars will not receive any bonus payments
- To calculate the estimated impact of Star ratings to 2015 MA margins, we used our estimates of 2014 MA margin levels as well as projections of MA cost trends, the industry's potential for year-on-year risk-adjustment improvements, better medical management, and administrative cost reductions. We also took the following into account:
  - In the 2015 Final Notice, CMS is allowing MA plans to set total beneficiary cost (TBC), including premium and cost-sharing fees, at $32. Given the range of MA rates (approximately$800 to $900 per member per month), such a TBC translates to an opportunity for MA plans to shift 3.5 to 4 percent of cost to beneficiaries. However, the actual impact will vary based on a specific MA plan's rates and its decision about the share of cost to be shifted

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5 The statutory component of the regional benchmarks, transitional phase-in periods for the Affordable Care Act rates, February 6, 2014.

– As discussed above, MA plans with less than 4 Stars lose the added 3- or 3.5- percent payments they received from CMS. However, CMS will uniformly pay a 5-percent bonus to all plans with 4 or more Stars, rather than a bonus proportional to their Star rating.