THE 2024 FFS NORMALIZATION FACTOR COULD OFFER A GLIMPSE OF GOOD NEWS FOR MEDICARE ADVANTAGE PLANS

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If FFS Normalization Factor is lower, MA plans will realize revenue boost

Medicare Advantage (MA) plans are facing a few significant headwinds for Payment Year 2024 (PY 2024). For example, as COVID relief measures expired, there was a general decline in overall 2024 Payment Year (PY) Star Ratings across Medicare Advantage contracts. Additional variables, described in other Wakely briefs, point toward probable revenue pressure on the MA front (e.g. upcoming RADV ruling, potential for reduced benchmark rates due to suppressed FFS expenditure levels, etc.) Despite the gloomy outlook, the FFS normalization factor is one area that *could* result in a tailwind for 2024 MA plan revenues. The remainder of this brief describes the purpose of and methodology for calculating this factor and provides some commentary on the potential for it to offset some of the aforementioned headwinds.

What is the FFS Normalization Factor and why does it matter?

CMS uses statistical models to calculate risk scores, which are intended to predict individual beneficiaries' health care expenditures relative to those of the average beneficiary. The risk scores that result from these models are used to adjust payments up or down depending on risk level (e.g. higher rates for sicker patients and lower rates for healthier patients). Before being applied to MA plan payments, raw risk scores (made up of both demographic and disease relative factors) are adjusted by a couple of key factors as demonstrated in the formula below:

*Since the risk score model is "calibrated" to 1.0 based on a historical year, CMS divides payment year MA risk scores by the **FFS normalization factor** in an attempt to bring the MA risk score back to an average of 1.0 in the payment year.*

*Risk score applied to payments = (Raw risk score / **PY FFS normalization factor**) × (1 – PY coding intensity factor)*

This brief focuses on the FFS normalization factor in this formula. This factor is intended to control for risk score trend (due to changes in coding or population characteristics) between the model's denominator year, for which the average risk score is 1.0, and the payment year. Since the risk score model is "calibrated" to 1.0 based on a historical year (2015 in this case), CMS divides payment year MA risk scores by the FFS normalization factor in an attempt to bring the MA risk score back to an average of 1.0 in the payment year.

The higher the FFS normalization factor is, the lower MA plan revenue becomes (because the risk score applied to MA payments is divided by this factor).

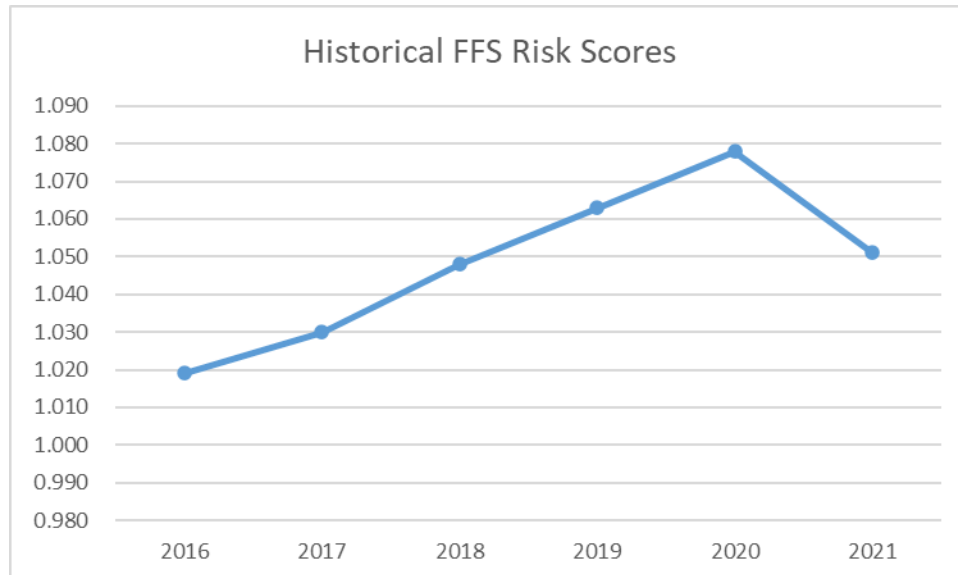## How is the FFS Normalization Factor Calculated?

In the past, CMS has used five years of historical FFS risk score data to calculate a slope that gets applied from the denominator year to the payment year as follows $(1+X)^n$, where X is the slope calculated from the trend of historical FFS risk scores, and the exponent n is the number of years between the denominator year and the payment year. For PY2024, assuming CMS uses its historical approach, the data years will be 2018 through 2022. The slope calculated using these historical years will be applied for 9 years, from 2015 through 2024.

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For payment year 2023, the historical years would have been 2017 through 2021, but CMS used 2016 through 2020 (just like the prior year) because the 2021 risk scores were significantly impacted (i.e. reduced) due to decreases in utilization (and therefore captured diagnosis codes) in 2020 resulting from the pandemic. As a reminder, MA risk scores are prospective in nature meaning that prior year diagnoses affect current year risk scores. CMS elected to exclude this likely anomalous phenomenon in calculating the prospective trend in an attempt to avoid underestimating the FFS normalization factor for PY 2023.

Figure 1

How Might CMS Approach the PY 2024 Normalization Factor?

Assuming CMS relies on the historical method for calculating the FFS normalization factor, without any special adjustments, the calculated slope for PY 2024 will rely on the five-year historical period of 2018 through 2022. Since the 2021 data point is relatively low compared to other years, and since this data point is included in this range, the calculated slope will be lower than it would be if 2021 was a more

"normal" year. Additionally, the projected FFS risk score for 2024 will be heavily dependent on where the 2022 risk score lands.

If 2021 scores (2020 diagnoses) were truly an anomaly, and scores get right back on track with the historical trend rate, the FFS normalization factor applicable for PY 2024 would land at or around 1.107, resulting in an increase to plan revenue of approximately 1.8%, all else equal. This is calculated as the change in FFS normalization factors from the one published for PY 2023 and the one referenced in this example: [1 / 1.107] / [1 / 1.127] - 1 = 1.8%. Please see the grey line in the graphic below for an illustration.

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However, what if 2021 code capture doesn't return all the way to pre-pandemic levels and 2022 risk scores are slightly lower?

scores are slightly lower? Our review of client data and emerging 2022 Direct Contracting data shows that this is a plausible result. That is, many of our clients realized a slower return to pre-pandemic coding levels. If the 2022 FFS risk score lands at 1.098, for example, the 2018 to 2022 trend would come down and the 2024 projected risk score would be lower as a result. Please see the orange line in the graphic below for an illustration. If this 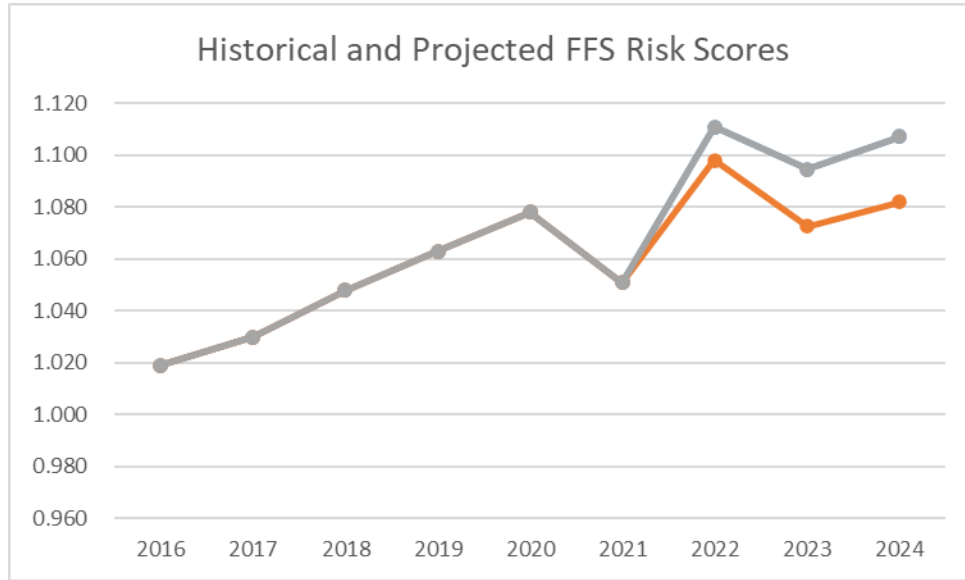scenario were to play out and if CMS continues with its existing methodology of using a five-year range to project results, the lower PY 2024 FFS normalization factor would result in an even more significant increase to MA plan revenues, all else equal. **In the example below (in orange), the FFS normalization factor applicable to PY 2024 would be 1.082 and the resulting impact to plan revenue would be an increase of about 4.2%** (calculated as the change in FFS Normalization factors from the one published for PY 2023 and the one referenced in this example: [1 / 1.082] / [1 / 1.127] - 1 = 4.2%). The following table displays the two scenarios described above.

Table 1

2022 Scenario		
Year	In line with 2016-2020	Slightly Lower than 2016-2020 implied trend
2015	1.000	1.000
2016	1.019	1.019
2017	1.030	1.030
2018	1.048	1.048
2019	1.063	1.063
2020	1.078	1.078
2021	1.051	1.051
2022	1.111	1.098
2018-2022 Annual Rate	**1.14%**	**0.88%**
2024 PY FFS Normalization Factor	**1.107**	**1.082**
Year-to-year Revenue Impact	**1.8%**	**4.2%**

Figure 2

Historical and Projected FFS Risk Scores

Conclusion

The CMS Advance Notice, and ultimately the Final Rate Announcement, will provide the source of truth on how CMS plans project the 2024 FFS risk score (and FFS normalization factor). It is possible that the Office of the Actuary makes a change to existing methodologies. Absent a change, however, it would be reasonable to look forward to a modest to significant tailwind with respect to the revenue impact resulting from the change in FFS normalization factors from PY 2023 to PY 2024.

Please contact Kelsey Stevens at kelsey.stevens@wakely.com or Tim Courtney at tim.courtney@wakely.com with any questions.

OUR STORY

Five decades. Wakely began in 1969 and eventually evolved into several successful divisions. In 1999, the actuarial arm became the current-day Wakely Consulting Group, LLC, which specializes in providing actuarial expertise in the healthcare industry. Today, there are few healthcare topics our actuaries cannot tackle.

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Broad healthcare knowledge. Wakely is experienced in all facets of the healthcare industry, from carriers to providers to governmental agencies. Our employees excel at providing solutions to parties across the spectrum.

Your advocate. Our actuarial experts and policy analysts continually monitor and analyze potential changes to inform our clients' strategies – and propel their success.

Our Vision: To partner with clients to drive business growth, accelerate success, and propel the health care industry forward.

Our Mission: We empower our unique team to serve as trusted advisors with a foundation of robust data, advanced analytics, and a comprehensive understanding of the health care industry.

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