Medicare ACO Shared Savings plans: Grading on a curve

Kent Roepke, ASA
Leigh Wachenheim, FSA

The Medicare Shared Savings Program is a mechanism for providers to create or participate in Accountable Care Organizations (ACOs) that serve Medicare Fee-for Service (FFS) beneficiaries. As of January 2014, there were 341 ACOs enrolled in the Shared Savings Program.[1] The program provides incentives for providers to reduce the trend in healthcare cost increases and improve care. A key incentive for ACOs enrolled in the program is the bonus they can receive if their trend is lower than a calculated benchmark.

There are many factors involved in the bonus calculation, but generally speaking the bonus is based on a benchmark that is calculated using historical cost data for the ACO, with some adjustments for trend. The trend adjustments are based on the increase in medical costs for all Medicare FFS recipients (i.e., not including those enrolled in Medicare Advantage). Because Shared Savings ACOs are counted in this trend, they are to a certain degree being "graded on a curve." If the program works, trend growth will be driven down. This is good news for medical costs, but it will likely lead to downward pressure on ACO bonuses, all other things being equal. In other words, ACOs will be competing against other ACOs in other service areas to lower trend—a form of competition that is all too familiar in the business world but brand new to most medical providers.

Small changes in Medicare FFS trend can mean significant changes in bonus payments

The bonus payments received by ACOs may be very sensitive to small changes in Medicare FFS trend. As an illustration, the following tables represent the impact that bending the cost curve could have on the shared savings bonus received by a particular ACO.

Consider a potential ACO that expects it would need to invest $14 million over a six-year period to be successful—$4 million in 2014 and $2 million each year thereafter. The six-year period will encompass two contract periods with CMS—2014 through 2016 and 2017 through 2019. The investors in our hypothetical ACO would like to recoup most, if not all, of that amount through shared savings payments over the same period.

The initial feasibility testing looks promising, showing shared savings payments of almost $22 million (see Table 1). Several critical assumptions underlie this result, including an average membership of 50,000 per month, an average claim cost of $1,000 per member per month as of 2011 (a 2013 baseline period), and declining cost trends due to improved efficiency and quality. In particular, our analysts assumed a baseline Medicare FFS trend rate of 4% and declining trend rates for the ACO with 2014 through 2016 at 3.5% and 2017 through 2019 at 3.0%. These are all reasonable assumptions.

TABLE 1: SHARED SAVINGS PAYMENTS — INITIAL FEASIBILITY TESTING

		ANNUAL TREND RATE		
YEAR	INVESTMENT (000's)	HYPOTHETICAL ACO	MEDICARE FFS AVERAGE	SHARED SAVINGS PAYMENTS
2014	$4,000	3.5%	4.0%	$ -
2015	2,000	3.5%	4.0%	-
2016	2,000	3.5%	4.0%	-
2017	2,000	3.0%	4.0%	-
2018	2,000	3.0%	4.0%	8,700
2019	2,000	3.0%	4.0%	13,200
Total	14,000			21,900

1 http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/sharedsavingsprogram/News.html (equal to the list of 218 plus 123 new).

However, what happens if Medicare FFS trend is lowered from 4.0% in each year to 3.9% in 2014 through 2016 and 3.8% in 2017 through 2019? In that case, the shared savings bonus payments would be reduced to under $11 million—more than $3 million less than the amount invested (see Table 2).

TABLE 2: SHARED SAVINGS PAYMENTS — REVISED FEASIBILITY TESTING

		ANNUAL TREND RATE		
YEAR	INVESTMENT (000's)	HYPOTHETICAL ACO	MEDICARE FFS AVERAGE	SHARED SAVINGS PAYMENTS
2014	$4,000	3.5%	3.9%	$ -
2015	2,000	3.5%	3.9%	-
2016	2,000	3.5%	3.9%	-
2017	2,000	3.0%	3.8%	-
2018	2,000	3.0%	3.8%	-
2019	2,000	3.0%	3.8%	10,500
Total	14,000			10,500

How could this happen? One reason is due to the 2% Minimum Savings Rate (MSR) that is built into the shared savings bonus payment formula. The MSR has a leveraging impact on the bonus payment. Another reason is due to competition. If ACOs continue to grow and are successful, they will reduce the aggregated Medicare FFS trend rate that is used to set the benchmark. In terms of our example, if 20% of the FFS market is able to reduce trend to levels assumed by our hypothetical ACO, the market average will come down to the levels shown in Table 2.

On the one hand, ACOs represent a relatively small proportion of the Medicare FFS universe. Even if they are successful at managing trend, their impact on the national average may be relatively minor. At the same time, it's entirely possible that Shared Savings ACOs will have a more significant impact on overall Medicare FFS trend than their raw numbers would predict. Medicare patients receiving primary care are assigned to ACOs retroactively, meaning that all patients within a participating provider network will be impacted by changing practice patterns, even if they are not formally attributed to a particular ACO. In addition, larger ACOs may have a ripple effect in their communities, spreading care and cost containment best practices beyond their walls.

Of course, the real world is more complex than a simplified model. But given the large investments ACOs are making to participate in the Shared Savings program, they should be aware of the possibility that small changes in FFS trend could significantly impact their results. And, they should know that their own success could be a significant contributing factor to those changes.

How ACOs deal with this phenomenon may depend on whether they have signed on for the "one-sided" model or the "two-sided" model. It may also depend on the start-up costs and expected benefits of participation, both direct and indirect. Either way, ACOs will need to consistently limit trend to a level that is lower than Medicare FFS. At the same time, other ACOs will be applying downward pressure on that very benchmark. ACOs would be well served to consider and model the effects that Medicare FFS trends could have on their future revenue, as those effects are not intuitively obvious in most cases.

Kent Roepke, ASA, is a consulting actuary with the Minneapolis office of Milliman. Contact him at kent.roepke@milliman.com.

Leigh Wachenheim, FSA, is a principal and consulting actuary with the Minneapolis office of Milliman.
Contact her at leigh.wachenheim@milliman.com.

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