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to: **Sandy White-Gallardo** date: **July 30, 2007**

from: **Sandi Hunt** subject: **Geographic Factors**

Overview

Based on the methods that have been employed in the development of FCHP capitation rates for a number of years, this memo addresses which Medicare geographic cost factors should be used in developing capitation rates for hospital services for the Oregon Health Plan.

Background

OHP capitation rates for FCHPs are calculated on a statewide basis, and then adjusted for variations in Centers for Medicare and Medicaid (CMS) hospital cost factors (for labor, non-labor, and capital costs) and a variety of risk factors. The geographic adjustments are calculated to be budget neutral to the state. In other words, a relatively high geographic factor for one plan is offset by a relatively low factor for another plan so that the statewide average capitation rate is unchanged.

In prior years the Medicare geographic factor for the coming year was published in the Federal Register on or about August 1st of each year, and the published factors were used to develop the capitation rates for the next contract period. However, for Federal Fiscal Year (FFY) 2005, interim factors were published in August 2004, and a correcting amendment was published in December 2004. For FFY 2006, the final rules were published in August 2005, but a corrected version was published at the end of September. Most recently, draft FFY 2007 factors were published in August, but the final FFY 2007 factors were published on October 11, 2006.

In addition to the geographic factors, CMS publishes information on hospitals that have requested reclassification to a higher cost area. This information is provided in the form of a number of tables that must be cross-referenced to determine the geographic cost factors that applies to each hospital. The reclassification is temporary, and subject to review on a periodic basis.

OHP policy is to establish capitation rates for a one-year period, with changes in those rates resulting only from changes in covered services or plan coverage areas. Consequently, changing capitation rates mid-year should the published factors change before the end of the year would be inconsistent with that policy, and would introduce instability in the payment rate.

Health plan contracts and rates must be submitted to CMS by November 15th of each year to ensure approval before they go into effect on January 1st. Draft rates are provided to the plans by October 1st, and final rates by November 1st.

Options

We have discussed two options for establishing which CMS geographic factors would be used in the capitation rate development to be most consistent with the policy of establishing capitation rates once per year and satisfy the criteria of actuarially sound rates:

1. A prospective approach, where DHS would use the wage index factors published by CMS that are available no later than September 1st of each year for developing the draft capitation rates. A further check for final index factors would be made two weeks before the final capitation rates are distributed, and the final factors would be used if available.

2. A retrospective approach, where DHS would use the CMS wage index factors in effect on September 1st for developing both the draft and final capitation rates.

In both cases the capitation rate would remain the same for the entire year and would not be changed for CMS adjustments made after October 15th for contracts effective during the upcoming contract year. PwC or DHS would be responsible for researching the wage index value in September of each year and two weeks before the final rates. Plans would be provided information on the values used and the geographic assignment of hospitals, and asked to review this information for accuracy as part of their review of the draft rates. Plan comments received by October 10th would be reviewed for adjustments that may be necessary in developing the final capitation rates.

Under ***Option 1***, the capitation rates would be based on the most recent available information and would reflect any changes in circumstances that may have occurred since the prior year analysis was completed. However, the timing of CMS's publication of the values, as well as corrections that may be made, introduces some amount of uncertainty regarding whether the wage factors would remain unchanged throughout the contract period.

Under ***Option 2***, the capitation rates would be set based on the actual factors in effect at the time the rates are developed. However, any changes in classification or relative costs would lag the CMS cost factors by at least a year.

Recommendation

We believe Option 1 is most consistent with the general OHP rate setting methodology and with the definition of actuarially sound rates, as it uses the most recent available

information. Factors that are published by CMS with a "final" designation for the upcoming year provide the most reliable information on the classification of hospitals and the relative costs of providing care. Specifically, this option would use the information on cost differences that most closely correlates with the contract period, and would reflect any recent updates. We believe the risk that CMS will make material corrections to the factors during the year is relatively low, and is lower than the risk that factors from the prior year will remain unchanged for an additional year.

However, if draft factors are published by September 1, but have not been finalized, DHS will need to decide whether to use the draft values or revert to the final wage factors from the prior year. We recommend that a review be conducted to assess the degree of change that has been made to the geographic factors and hospital assignments between the draft and final version assuming that CMS publishes the final version prior to signature of the managed care contract by health plan representatives. Until that review is conducted, we believe an approach that relies only on final published values is most consistent with OHP policy to date.