WAGE INDEX FIX? CMS PROPOSES CHANGES FOR LOW WAGE HOSPITALS AND RURAL FLOOR

On April 23, 2019, the Centers for Medicare & Medicaid Services ("CMS") released the Federal Fiscal Year ("FFY") 2020 Medicare Inpatient Prospective Payment System ("IPPS") proposed rule ("IPPS Proposed Rule"). Among many other changes, CMS proposed several changes to address disparities between high and low wage index areas and fixing the so-called "rural floor." CMS did not provide an assessment of the impact of these changes, but, based on the IPPS Proposed Rule data, we have estimated that these changes will shift more than $200 million/year of Medicare IPPS payments to hospitals in the lowest quartile of wage areas, all on a budget neutral basis. Below is a brief overview of the Medicare wage index system as well as the changes to the wage index in the IPPS Proposed Rule. The IPPS Proposed Rule is scheduled to be published in the Federal Register on May 3, 2019.

BACKGROUND OF WAGE INDEX SYSTEM

The IPPS is designed to pay hospitals for services provided to Medicare beneficiaries based on a national standardized amount adjusted for the patient's condition and related treatment. Further, Social Security Act Section 1886(d)(3)(E) requires that the standardized amount be adjusted for differences in hospital wage levels, which CMS implemented through the wage index system. CMS also uses the hospital wage index for the Outpatient Prospective Payment System and prospective payment systems for inpatient rehabilitation facilities, inpatient psychiatric facilities, long-term care hospitals, home health agencies, hospices, ESRD facilities, ambulatory surgical centers and skilled nursing facilities.

In computing the wage index, CMS calculates an average hourly wage ("AHW") for each urban and rural area (total wage costs divided by total hours for all hospitals in the geographic area) and a national AHW (total wage costs divided by total hours for all hospitals in the nation). A labor market area's wage index value is the ratio of the area's AHW to the national AHW.

The wage indexes applied to urban hospitals in a state cannot be lower than the rural area wage index for that state. This provision is called the "rural floor." The rural floor was created to correct the "anomaly" of "some urban hospitals being paid less than the average rural hospital in their states." CMS must apply the rural floor in a manner that is budget neutral on a national level, which means that for any increase in wage indexes for hospitals based on getting the rural floor, CMS must lower wage indexes nationally by applying a rural floor budget neutrality factor. In a previous article, we discussed the history of previous wage index reform, including a recent OIG report on the vulnerabilities of the wage index system.

PROPOSED HIGH/LOW WAGE INDEX ADJUSTMENT

In the 2019 IPPS Proposed Rule, CMS invited comments on potential changes to the Medicare wage index system. Commenters weighed in on numerous issues with the wage index system, some supporting wage index reform and others cautioning CMS to study the issue further before making changes. In addition, some commenters pointed out that the wage index is intended to recognize differences in the cost of labor between different parts of the country and there are (and should be) payment differences because of this fact.

Many of these responses reflected a common concern that the current wage index system creates and perpetuates the disparities between high and low wage index hospitals. In essence, because of their higher Medicare payments, hospitals in high wage index areas can afford to pay higher wages to employees, which allows them to continue as higher wage index areas. However, hospitals in lower wage index areas are forced to cut costs (including wages), which lowers their future wage index. CMS refers to this situation as the "downward spiral."

To help address this issue, CMS proposed to increase the wage index for hospitals with a wage index value in the lowest quartile (i.e., those below the 25th percentile wage index), which was 0.8482 based on the IPPS Proposed Rule. For any hospitals in this group, CMS would increase their wage indices by 50 percent of the difference between the otherwise applicable wage index value for that hospital and the 25th percentile wage index value (0.8482). To illustrate how this adjustment will work, CMS gave the following example:

> [A]ssume the otherwise applicable final FY 2020 wage index value for a geographically rural hospital in Alabama is 0.6663, and the 25th percentile wage index value for FY 2020 is 0.8482. Half the difference between the otherwise applicable wage index value and

> the 25th percentile wage index value is 0.0910 (that is, (0.8482 - 0.6663)/2). Under our proposal, the FY 2020 wage index value for such a hospital would be 0.7573 (that is, 0.6663 + 0.0910).

It is important to note that CMS considered other methodologies for addressing low wage index disparities, such as establishing a national wage index floor but believed it was important to preserve the rank order of wage index values.

To make this adjustment budget neutral, CMS is proposing to decrease the wage index for hospitals with a wage index in the top quartile (i.e., those above the 75th percentile wage index), which was 1.0351 based on the IPPS Proposed Rule. Specifically, CMS will decrease the wage index of these hospitals by a uniform factor based on the distance of a hospital's otherwise applicable wage index from the 75th percentile wage index to maintain budget neutrality. For FY 2020, CMS estimated that the proposed budget neutrality adjustment factor would be 4.3 percent. Note that the IPPS Proposed Rule preamble stated that the adjustment factor was 3.4 percent, but the IPPS Proposed Rule Tables reflected an adjustment of 4.3 percent. We confirmed with CMS that the IPPS Proposed Rule preamble was a misprint and 4.3 percent was the correct value.

To illustrate how the adjustment to high wage index hospitals to maintain budget neutrality will work, CMS gave the following example:

> [F]or example, if high wage index Hospital A had an otherwise applicable wage index value of 1.7351, the distance between that hospital's wage index value and the 75th percentile is 0.7000 (that is, 1.7351 - 1.0351) ... Therefore, ... the distance between Hospital A's wage index value and the 75th percentile would be reduced by 0.0238 (that is, the prior distance of 0.7000 * 0.034), and therefore the wage index for Hospital A after application of the proposed budget neutrality adjustment would be 1.7113 (that is, 1.7351 - 0.0238).

CMS proposed that this policy would be effective for at least four years, beginning in FFY 2020, to allow wage increases implemented by low wage hospitals sufficient time to be reflected in the wage index calculation.

PROPOSED CHANGES TO RURAL FLOOR

As stated above, the rural floor policy states that the wage index applied to urban hospitals in a state cannot be lower than the rural area wage index for that state. One of the concerns that commenters and CMS expressed is that an urban hospital could reclassify as rural under 42 C.F.R. §412.103 to raise the rural floor, which could also raise the wage index of urban areas in the state for hospitals that did not reclassify as rural. Further, because the rural floor policy is budget neutral, this can create the situation where urban hospitals in states with a high rural floor get an increase in their wage index, which is paid for by all hospitals throughout the country.

While urban hospitals would still be able to reclassify as rural, to fix this issue, CMS proposed removing urban to rural hospital reclassifications from the calculation of the rural floor wage index value beginning in FY 2020. Under the proposed policy, CMS will not raise the wage index for urban hospitals that have not reclassified as rural, including hospitals with no reclassification as well as those with an MGCRB reclassification, based on an increased wage index due to one or more urban hospitals reclassifying as rural under 42 C.F.R. §412.103. Based on data in the IPPS Proposed Rule, this policy change will impact the calculation to the rural floor in several states, including Arizona, California, Connecticut and Hawaii.

Notably, the Social Security Act requires that CMS establish the rural floor policy but does not specify how the rural floor is to be calculated. CMS stated that it is adopting these changes based on its concern that its inclusion of rural reclassified hospitals in the rural floor calculation could increase the disparities between low and high wage index areas.

TRANSITION FOR NEGATIVELY IMPACTED HOSPITALS

To smooth payment decreases due to these wage index changes, CMS proposed a 5 percent cap on any decrease in a hospital's wage index from its final wage index for FFY 2019. In other words, a hospital's final wage index for FFY 2020 would not be less than 95 percent of its final wage index for FFY 2019, which allows the effects to be phased in over two years. It is important to note that there would be no cap on decreases for FFY 2021. To maintain budget neutrality for the transition policy, CMS will apply a budget neutrality factor of 0.998349 to the FFY 2020 standardized amount.

PRACTICAL TAKEAWAYS

If CMS's proposals are adopted in the final rule, due out in August, then beginning October 1, 2019 the following principles will apply:

- Hospitals with a wage index value in the lowest quartile (below 0.8482 in the IPPS Proposed Rule) would receive a wage index

adjustment of 50 percent of the difference between the otherwise applicable wage index value for that hospital and the 25th percentile wage index value (0.8482).

- CMS will decrease the wage index for hospitals in the top quartile (above 1.0351 based on the IPPS Proposed Rule) by a uniform budget neutrality factor based on the distance of a hospital's otherwise applicable wage index from the 75th percentile wage index to maintain budget neutrality. For FFY 2020, CMS estimated that the proposed budget neutrality adjustment factor would be 4.3 percent.
- The low and high wage adjustments will be in effect for at least 4 years.
- Hospitals with an urban to rural reclassification under 42 C.F.R. §412.103 will no longer be included in the calculation of their state's rural floor wage index value beginning in FY 2020.
- CMS will apply a transition cap of 5 percent for any decreases in wage index from these policy changes.

As the single largest adjustment to Medicare's national hospital inpatient and outpatient payment rates, there are as many vested interests in preserving the status quo as there are in making revisions to the system. Interested parties have until June 24, 2019 to submit their comments. Stay tuned.

If you have any questions about these proposals or how they may affect your facility, please contact:

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