The Medicare Advantage Fee-for-Service Normalization Factor: What It Is and Why It Matters

What Is the Normalization Factor?

Let's start by explaining the "risk score." A beneficiary's risk score reflects his or her predicted Medicare health costs compared to those of an average beneficiary.

The Centers for Medicare & Medicaid Services (CMS) uses claims from the Medicare fee-for-service (FFS) program to calculate risk scores, and then uses these risk scores to estimate payments for Medicare Advantage (MA).

Each year, the average risk score changes due to trends in the health of the Medicare population and differences in how disease are coded. The current CMS risk model, developed based on 2015 FFS data, was designed to generate an average risk score of 1.0 for FFS beneficiaries for 2015. Accordingly, CMS applies a "normalization" factor so that the average expected risk score in the payment year – in this case, 2018 – will also be 1.0.

CMS divides each MA plan's average risk score by this normalization factor to calculate the final risk score, which determines plan payments. Thus, the higher the normalization factor, the lower the risk score – and the lower the payments to the MA plan.

Fee-for-Service Normalization

-1.9% Reduction in MA funding levels due to change in normalization factor proposed by CMS.

What is CMS Proposing in the Advance Notice?

In the 2018 Advance Notice, CMS is using risk scores from the five-year period 2012 to 2016 to estimate FFS risk scores and thus the normalization factor for 2018. Under CMS' approach, the normalization factor is 1.017, which is a 1.9 percent increase from the normalization factor of 0.993 for 2017. Because plan risk scores are divided by the normalization factor, a 1.9 percent increase in the factor would correspond to a 1.9 percent decrease in payment for MA plans for 2018.

What Accounts for the Increase?

According to data from CMS, the average FFS risk score increased from 2015 to 2016 by 2.1 percent, which is three to 10 times larger than the risk score increases during each of the four earlier periods (from 2011 to 2015). The higher 2016 risk score may be due to technical changes caused by the migration from ICD-9 to ICD-10 coding that began in October 2015, rather than a real indication of higher coding in FFS Medicare.* This anomalous data point is causing CMS to predict a much higher average 2018 FFS risk score than if CMS disregarded the 2016 data.

What Should CMS Do?

Because the increased average FFS risk score for 2016 is likely a result of changes in coding – and not because of any changes to beneficiary health – CMS should recalculate the normalization factor using only data from 2011 to 2015. This would result in a more accurate prediction of the normalization factor.