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Alert

Life Sciences Health Industry

If you have questions or would like additional information on the material covered in this Alert, please contact the author:

Debra A. McCurdy
Health Policy Analyst,
Falls Church
+1 703 641 4283
dmccurdy@reedsmith.com

…or the Reed Smith lawyer with whom you regularly work.

Medicare and Sequestration – What Happens Now?

Due to continuing budget gridlock in Washington, sequestration has been triggered – meaning automatic cuts to a wide range of federal programs, including Medicare payments to providers and health plans. While the Centers for Medicare & Medicaid Services has not yet announced detailed plans for implementing the sequester requirements for its programs, this Alert answers some basic questions about sequestration and how it will impact the Medicare program.

What is sequestration and why is it happening? Sequestration is a budget process under which spending is cut across-the-board (with certain exceptions) to meet budget goals. The Budget Control Act of 2011 (BCA) mandated that if legislation were not enacted by January 2013 to meet budget targets, sequestration would be triggered to achieve a total of $1.2 trillion in deficit reduction over nine years. The spending cuts were required to be apportioned equally among fiscal years (FYs) 2013 through 2021, and divided evenly between defense functions and non-defense functions (including Medicare provider payments, subject to a cap).

While Congress and the Administration failed to reach agreement on alternative budget savings to take the place of sequestration, the American Taxpayer Relief Act of 2012 (ATRA), which was signed into law in January 2013, included a two-month sequestration delay. The ATRA also reduced the total FY 2013 sequestration target from $109 billion to about $85 billion (although the Congressional Budget Office recently estimated that actual federal outlays will fall by only about $42 billion during the rest of FY 2013). Because there was no subsequent agreement on legislation to block or further delay sequestration, President Obama signed the sequestration order on March 1, 2013, as required by law.

The prospect of these steep, largely indiscriminate cuts was intended to force Congress and the Administration to find a more thoughtful solution to the nation's budget problems. It did not work out that way.

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What Medicare spending is impacted by sequestration? Under special sequestration rules for Medicare, sequestration only cuts Medicare payments to providers and health plans. Moreover, sequestration reductions are capped at 2 percent of payments to providers and plans for each year of sequestration (this 2 percent Medicare cut compares to an almost 8 percent cut to non-exempt defense spending and about a 5 percent reduction in other non-exempt non-defense programs for the remainder of FY 2013, as estimated by the Office of Management and Budget[1]).

More specifically, sequestration applies to individual provider payments under Medicare Parts A and B, along with monthly payments under Part C (Medicare Advantage) and Part D prescription drug plan contracts. Payment reductions must be made at a uniform rate across all programs and activities subject to a sequestration order.

Sequestration reductions will be disregarded for purposes of computing adjustments to Medicare payment rates, including the Part C growth percentage, the Part D annual growth rate, and application of risk corridors to Part D payment rates.

Also specifically exempt from sequestration are Part D low-income subsidies, Part D catastrophic subsidies, and payments to states for Qualified Individual premiums.

Note that under the sequestration rules, when Part B services are provided on an assigned basis (that is, where the provider accepts the Medicare rate as payment in full), the reduced payment will be considered payment in full, and the provider cannot increase charges to the Medicare beneficiary to make up for the reduced Medicare payment.

When will the Medicare cuts start? Sequestration generally applies to Medicare Part A and B payments for services furnished beginning April 1, 2013 (the first day of the first month beginning after the date the sequestration order is issued). Thus, payments for Part A and B services furnished before April 1 but received after April 1 generally are not impacted. There is an exception for inpatient services, however; those services are considered to be furnished on the date of the patient's discharge from the inpatient facility. As a result, the reduction could apply to payments for services furnished prior to April 1 if the patient is discharged after April 1. Likewise, for services paid on a reasonable cost basis, the reduction will be applied to payments for services incurred at any time during each cost reporting period during the sequestration period, pro-rated for the portion of the cost reporting period that occurs during the sequestration period.

The sequestration law does not provide a special start date for cuts in monthly payments to Medicare Advantage and prescription drug plans; those cuts presumably will be applied to the next monthly payment to plans, and reflected in the CMS annual reconciliation of plan payments. CMS had previously permitted plans to take into account the possibility of sequestration in their calendar year 2013 bids as a temporary increase in the plan's risk margin. CMS also instructed plans to ensure that their projection of medical expenses reflected the expected impact of sequestration on provider payments to both contracting and non-contracting providers.

How long will sequestration last? Under current law, sequestration is scheduled to last almost nine years, through FY 2021. Congress and the Administration could reach a deal at any time to end sequestration, however, either by finding alternative savings or simply by repealing or otherwise modifying the sequestration requirement.

How much will Medicare spending be cut? The CBO estimates that Medicare spending will be reduced by $9.9 billion if sequestration remains in effect for the rest of FY 2013 (through September 30, 2013). Because reductions in Medicare will begin in the month after the sequestration order is issued, some of the effect on outlays is delayed until the following fiscal year, according to the CBO. Although the CBO has not released an updated estimate of sequestration's impact on Medicare through 2021 since the ATRA was enacted, the CBO previously estimated that sequestration would result in a total of $123 billion in Medicare cuts if applied over the full FY 2013 to 2021 period (the cuts would have been more than twice as much if it were not for the 2 percent cap).

Can Congress later reverse the effects of sequestration (and retroactively pay providers for lost revenue)? There is no formal mechanism under the statutory sequestration rules to make retroactive payments if sequestration is "reversed," although Congress could revise the terms of the sequestration rules through future legislation if it so chooses. It also would be possible for Congress to provide agencies with additional flexibility to achieve savings in a more targeted manner, but that approach was rejected by the Senate on February 28, 2013.

Are other HHS programs affected by sequestration? Sequestration impacts a wide range of programs administered by the Department of Health and Human Services, including activities of the Office of Inspector General, the Food and Drug Administration, the National Institutes of Health, the Centers for Disease Control and Prevention, and the Health Resources and Services Administration. This spending is not capped at 2 percent – instead, it is subject to the general non-defense discretionary sequestration.

Note that certain mandatory programs are exempt from sequestration, include, among others, Social Security, Medicaid, and the Children's Health Insurance Program (CHIP).

Sequestration also would impact financing of the expansion of health coverage under the Affordable Care Act, although different types of subsidies are subject to different sequestration rules. For example, coverage expansion through expansion of Medicaid and CHIP would be exempt from sequestration, while cost-sharing subsidies available to certain individuals and families purchasing insurance through health exchanges and certain other discretionary spending would be subject to sequestration.

Does this mean the budget wrangling is over and other Medicare cuts are off the table? No – sequestration does not even address all the budget issues facing Congress this month. Unless Congress and the Administration act, the federal government is facing a shutdown on March 27, 2013, when spending authority runs out. Sequestration also leaves untouched the larger entitlement reforms that are expected to be a part of any grand debt reduction deal, and which could have a far more significant impact on federal spending on Medicare and Medicaid, including provisions directly impacting reimbursement for prescription drugs.

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We will continue to report on sequestration and other budget developments impacting the Medicare program at www.healthindustrywashingtonwatch.com. In the meantime, please let us know if you have any questions or need additional information.

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[1] See http://www.whitehouse.gov/sites/default/files/omb/memoranda/2013/m-13-06.pdf. Note that the Office of Management and Budget stated in a February 27, 2013 memo to agency heads that because these cuts must be achieved over the remaining seven months of the fiscal year, it estimates that the effective percentage reductions are approximately 9 percent for affected non-defense programs and 13 percent for affected defense programs.