Lab Test Payment Rates – Background

- The Protecting Access to Medicare Act (PAMA) of 2014 requires reform of the payment system for clinical laboratory (lab) tests—the first such reform in 3 decades.

- Current Lab Test Payment Rate
  - Based on 1984 data, adjusted annually for inflation.
  - 57 regional fee schedules.

- Key points:
  - Base rates have not been updated since 1984 to reflect changes in test methods.
  - Medicare pays the lower of lab charges, regional payment rate, 74% of the median rate for each lab test across the 57 fee schedules, or the national limitation amount (cap).
Price Reform: What Factors Drove PAMA?

- 2010 and 2013 OIG study showed that Medicare paid between **18 and 30** percent more than other insurers for 20 high-volume and/or high-expenditure lab tests.

  Was deep discounting the result of aggressive contracting by commercial laboratories or health plans having leverage?

- Proposed Legislation: The current payment rates will be replaced with recent rates paid by private payers.
## Comparison of Medicare Payment Systems for Lab Tests

<table>
<thead>
<tr>
<th>Description</th>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year Implemented</td>
<td>1984</td>
<td>2017</td>
</tr>
<tr>
<td>Basis of Payment Rates</td>
<td>Lab charges in 1984-1985; adjusted annually to account for inflation</td>
<td>Private payer rate data; updated every 3 years using then-current data</td>
</tr>
<tr>
<td>Number of Fee Schedules</td>
<td>57 regional fee schedules</td>
<td>Single national fee schedule</td>
</tr>
</tbody>
</table>
Clinical Laboratory Spend Facts

2014 Actual – $7.0 billion

- 451 million lab tests performed
  - $15.52 per test average
- Top 25 lab tests comprised $4.2 billion in 2014
  - 63,730 labs received Medicare payments
  - 14% or $1.0 billion of Part B spend goes to top 3 labs

## Top 25 Lab Tests Based on Medicare Part B Payments in 2014

<table>
<thead>
<tr>
<th>Test Description</th>
<th>CPT Code</th>
<th>Medicare Allowable</th>
<th>Total Medicare Payment (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blood Test, Thyroid-stimulating Hormone (TSH)</td>
<td>84443</td>
<td>$22.93</td>
<td>$477</td>
</tr>
<tr>
<td>Comprehensive Metabolic Panel</td>
<td>80053</td>
<td>$14.41</td>
<td>$453</td>
</tr>
<tr>
<td>Complete Blood Cell Count</td>
<td>85025</td>
<td>$10.61</td>
<td>$431</td>
</tr>
<tr>
<td>Lipid Panel</td>
<td>80061</td>
<td>$18.27</td>
<td>$386</td>
</tr>
<tr>
<td>Vitamin D-3 level</td>
<td>82306</td>
<td>$40.40</td>
<td>$323</td>
</tr>
<tr>
<td>Hemoglobin A1C level</td>
<td>83036</td>
<td>$13.24</td>
<td>$236</td>
</tr>
<tr>
<td>Drug Screen</td>
<td>G0431</td>
<td>$99.20</td>
<td>$193</td>
</tr>
<tr>
<td>Opiates (Drug Measurement)</td>
<td>83925</td>
<td>$26.54</td>
<td>$173</td>
</tr>
<tr>
<td>Gene Analysis</td>
<td>81226</td>
<td>$451.59</td>
<td>$166</td>
</tr>
<tr>
<td>Basic Metabolic Panel</td>
<td>80048</td>
<td>$11.54</td>
<td>$137</td>
</tr>
<tr>
<td>All Other</td>
<td></td>
<td></td>
<td>$1,251</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>$4,226</strong></td>
</tr>
<tr>
<td><strong>Percent of Medicare Spending on CLFS</strong></td>
<td></td>
<td></td>
<td><strong>60%</strong></td>
</tr>
</tbody>
</table>

Medicare Payment Reform – Reporting Requirements

**Applicable Laboratories**
1. Laboratories as defined by CLIA
2. Unique Tax ID (TIN)
3. Greater than 50% of all Medicare Revenue from CLFS or Physician Fee Schedule (PFS)
4. Exempt if < $50,000

**CMS**
- CMS calculates weighted median private payer rate for each test
  - CMS does not expect hospital-based laboratories to meet definition due to revenue criteria.
  - CMS estimates that 52 percent of independent laboratories and 94 percent of physician laboratories will not meet definition.

**New Rates**
1. Weighted median of private payer rates/test volume
2. Updated every 3 years

Phase-in of large reductions for each test:
- (10%) 2017-2019
- (15%) Year 2020-2022
### Impact of Hospital Exclusion from Applicable Laboratory Reporting Group

<table>
<thead>
<tr>
<th>Test Description</th>
<th>CPT Code</th>
<th>Medicare Allowable</th>
<th>Commercial Lab Rates&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Hospital-Based Rates&lt;sup&gt;2&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blood Test, Thyroid-stimulating Hormone (TSH)</td>
<td>84443</td>
<td>$22.93</td>
<td>$17.20</td>
<td>$45.86</td>
</tr>
<tr>
<td>Comprehensive Metabolic Panel</td>
<td>80053</td>
<td>$14.41</td>
<td>$10.81</td>
<td>$28.82</td>
</tr>
<tr>
<td>Complete Blood Cell Count</td>
<td>85025</td>
<td>$10.61</td>
<td>$7.96</td>
<td>$21.22</td>
</tr>
<tr>
<td>Lipid Panel</td>
<td>80061</td>
<td>$18.27</td>
<td>$13.70</td>
<td>$36.54</td>
</tr>
<tr>
<td>Vitamin D-3 level</td>
<td>82306</td>
<td>$40.40</td>
<td>$30.30</td>
<td>$80.80</td>
</tr>
<tr>
<td>Hemoglobin A1C level</td>
<td>83036</td>
<td>$13.24</td>
<td>$9.93</td>
<td>$26.48</td>
</tr>
<tr>
<td>Drug Screen</td>
<td>G0431</td>
<td>$99.20</td>
<td>$74.40</td>
<td>$198.40</td>
</tr>
<tr>
<td>Opiates (Drug Measurement)</td>
<td>83925</td>
<td>$26.54</td>
<td>$19.91</td>
<td>$53.08</td>
</tr>
<tr>
<td>Gene Analysis</td>
<td>81226</td>
<td>$451.59</td>
<td>$338.69</td>
<td>$903.18</td>
</tr>
<tr>
<td>Basic Metabolic Panel</td>
<td>80048</td>
<td>$11.54</td>
<td>$8.66</td>
<td>$23.08</td>
</tr>
</tbody>
</table>

<sup>1</sup>Average commercial reimbursement assumes 75% of Medicare.

<sup>2</sup>Assumes a hospital-based fee schedule of 6 times Medicare and private payer rate of 33% of charges.

Did CMS design “applicable laboratories” to exclude hospital-based laboratories to mitigate more favorable pricing hospitals typically receive from health plans?
## What is the Weighted Median?

<table>
<thead>
<tr>
<th>Blood test, thyroid-stimulating hormone (TSH) 84443</th>
<th>Median Payment Rate – Unweighted</th>
<th>Median Payment Rate – Weighted</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Private Payor Rate</strong></td>
<td><strong>Current CLFS</strong></td>
<td><strong>Volume</strong></td>
</tr>
<tr>
<td>Lab A</td>
<td>$11.47</td>
<td>$22.93</td>
</tr>
<tr>
<td>Lab B</td>
<td>$20.64</td>
<td>$22.93</td>
</tr>
<tr>
<td>Lab C</td>
<td>$17.20</td>
<td>$22.93</td>
</tr>
<tr>
<td>Lab D</td>
<td>$13.76</td>
<td>$22.93</td>
</tr>
<tr>
<td>Lab E</td>
<td>$22.93</td>
<td>$22.93</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Weighted Median is row 5,501 = $13.76 or 40% – reduction limited to 10% in 2017-2019 and 15% in 2020-2022**
## PAMA Phase-In Reduction Example

<table>
<thead>
<tr>
<th></th>
<th>Current CLFS</th>
<th>Weighted Median</th>
<th>FY2017 Rate 10% Reduction Cap</th>
<th>FY2018 Rate 10% Reduction Cap</th>
<th>FY2019 Rate 10% Reduction Cap</th>
<th>FY2020 Rate 10% Reduction Cap</th>
<th>FY2021 Rate Reduction Less than 15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>TSH 84443</td>
<td>$22.93</td>
<td>$13.76</td>
<td>$20.64</td>
<td>$18.57</td>
<td>$16.72</td>
<td>$14.21</td>
<td>$13.76</td>
</tr>
</tbody>
</table>
## Estimated Impact of PAMA Reductions on Medicare Spending for Clinical Lab Services (in Millions)

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 5</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit</td>
<td>($480)</td>
<td>($3,910)</td>
<td>($6,830)</td>
</tr>
<tr>
<td>Premium Offset(^A)</td>
<td>$120</td>
<td>$970</td>
<td>$1,690</td>
</tr>
<tr>
<td>Total</td>
<td>($360)</td>
<td>($2,940)</td>
<td>($5,140)</td>
</tr>
<tr>
<td>Payment Reduction</td>
<td>(6.0%)</td>
<td>(9.8%)</td>
<td>(8.5%)</td>
</tr>
<tr>
<td>Net Reduction</td>
<td>(4.5%)</td>
<td>(7.4%)</td>
<td>(6.4%)</td>
</tr>
</tbody>
</table>

### 5-Year Reduction Summary:
- Year 1: (6.0%)
- Year 2: (4.6%)
- Year 3: (0.9%)
- Year 4: 0.9%
- Year 5: 0.8%

**Total over 5 Years = 9.8%**

Source: Table 11, Federal Register, October 1, 2015.

\(^A\)Premium offset is an expected change in premium resulting from the proposed rule.
## Estimated Impact of PAMA Reductions on Providers

<table>
<thead>
<tr>
<th>Description</th>
<th>2013 Clinical Laboratory Spend</th>
<th>2014 Clinical Laboratory Spend</th>
<th>Projected Reductions Over 5 Years(^C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospital-based Laboratories</td>
<td>$4.6 billion(^A)</td>
<td>$1.7 billion(^B)</td>
<td>($0.95 billion)</td>
</tr>
<tr>
<td>Independent and Physician Office Laboratories</td>
<td>$5.1 billion</td>
<td>$5.3 billion</td>
<td>($2.96 billion)</td>
</tr>
<tr>
<td>Total</td>
<td>$9.7 billion</td>
<td>$7.0 billion</td>
<td>($3.91 billion)</td>
</tr>
</tbody>
</table>


\(^{C}\)Source: Calculated using data from Table 11, Federal Register, October 1, 2015.
What’s the Impact on Your Hospital-Based Laboratory?

Analysis 1: Obtain estimated annual Medicare lab outpatient reimbursement

- Apply estimated reduction percentages as defined
- Assume $20 million in annual Medicare lab outpatient reimbursement
  - 2017: (6.0%) X $20M = loss of ($1.2M)
  - 2018: (4.6%) X $20M = additional loss of ($0.92M)
  - 2019: (0.9%) X $20M = additional loss of ($0.18M)
  - 2020: 0.9% X $20M = gain of $0.18M
  - 2021: 0.8% X $20M = additional gain of $0.16M

Total Loss of ($9.7) Million over 5 Years
Year 5 Run Rate ($1.96M) Loss in Revenue
What’s the Impact on Hospital-Based Laboratories, including Outpatient?

Analysis 2: 60% of Medicare payments under the CLFS reflect the top 25 tests

- Obtain test mix by CPT code for Medicare outpatient lab testing
- Compare the same top 25 tests ([http://oig.hhs.gov/oei/reports/oei-09-15-00210.asp](http://oig.hhs.gov/oei/reports/oei-09-15-00210.asp)) to your overall test mix (exclude blood draws) = Your % mix
- Your % mix calculated divided by 60% times reduction %s
- For example: Your mix of Medicare’s top 25 tests reflect 65% of your entity’s volume; calculation equals 65% divided by 60% or 1.08 times reduction percentages
- 2017: (6.5%) X $20M = loss of ($1.30M)
- 2018: (5.0%) X $20M = additional loss of ($1.0M)
- 2019: (1.0%) X $20M = additional loss of ($0.2M)
- 2020: 0.9% X $20M = gain of $0.18M
- 2021: 0.9% X $20M = additional gain of $0.18M

*Total Loss of ($10.6) Million over 5 Years*

*Year 5 Run Rate ($2.14M) Loss in Revenue*
What’s the Impact on Hospital-Based Outreach Programs?

Medicare payments represent about 24 percent of a typical hospital laboratory outreach program’s collected revenue.

- **Step 1:** 24 percent x $19.79 x 9.8 percent = $0.47, or 2.3 percent as an overall reduction in net outreach revenue per test. This calculation assumes other payer group reimbursement stays constant.
- **Step 2:** Assuming a contribution margin for a laboratory outreach program of 25 percent, this will reduce it to approximately 22.6 percent.

<table>
<thead>
<tr>
<th>Description</th>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenue</td>
<td>$10.0M</td>
<td>$10.0M</td>
</tr>
<tr>
<td>PAMA Reduction</td>
<td>-</td>
<td>(0.24M)</td>
</tr>
<tr>
<td>Expense</td>
<td>7.5</td>
<td>7.5</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$2.5M</td>
<td>$2.26M</td>
</tr>
<tr>
<td><strong>%</strong></td>
<td>25%</td>
<td>22.6%</td>
</tr>
</tbody>
</table>
Recap – PAMA

- Most disruptive change to the payment system for laboratory tests since inception of payment rates in 1984.

- Estimated Benefit to CMS:
  - 2017: $360 million or -4.5%.
  - Over 5 years (2017-2021) = $2.94 billion or -7.4%.
  - 2017-2026 = $5.1 billion or -6.43%.

- Payment reform unfairly excludes hospitals from reporting group – impact of exclusion will carry the weight of the reduction.

- Strategies to Consider:
  - Aggressively review costs to improve outcomes.
  - Consider outreach as an alternative to mitigate margin loss.
Outreach Strategy and Value
Self-Fulfilling Prophecy of Outreach

IT’S DIFFERENT

+ IT’S COMPLICATED

+ IT’S A SMALL PORTION OF THE HOSPITAL BUSINESS

+ IT’S NOT A PRIORITY

Perceived as “non-core” business

Treated as a “cost” center

No systems or structure

Viewed as high volume, low margin business

Lack of transparency for profitability
Five Things Executives Do That (Inadvertently) Kill Outreach

1. Failing to identify outreach as an organizational priority.
2. Treating the outreach program like a “cost center.”
3. Charging hospital prices for community-based work.
4. Starving the program for capital.
5. Under-resourcing the program.
# Outreach Risk vs. Reward – The Venture Capitalist Test

## Does the Business Make Money?

- Range of $16-20 million in new operating margin over five years for new startups; ROI is 52-71 percent.
- Three factors that have the largest influence on range:
  - Number of employed/affiliated physicians not currently using hospital lab.
  - Spare capacity in staff and equipment.
  - Existing, competitive IT connectivity system.

## Do We Understand Risks and Rewards and Have an Exit Strategy?

- **Rewards:** New operating margin/ROI as indicated above.
- **Risk:** Low. If business environment or organizational priorities change, business can be easily monetized.
- **Exit Strategy:** Current multiples of 1.0-1.5 times revenue (can be higher for specialty labs). There are always willing buyers—both Quest and LabCorp have grown mostly by acquisition over the last few years.

## Do You Have a Better Plan?

- What other plan do you have that will make more money with less risk? If nothing comes to mind, you owe it to your organization to evaluate outreach with a fresh, objective perspective.
Downstream Benefits

In addition to the expected benefits of new revenue and margin, there are five important, but less obvious, advantages to consider:

1. Improved service (turnaround time) for all patient types.
2. Improved quality of results.
3. Unit cost lowered by 50 percent.
4. Improved population health management.
5. Increased productivity and utilization of spare capacity – why spend millions of dollars on equipment and only use 20 percent of capacity?
Closing Thoughts…

- In this perspective, no rational being can ignore the value of outreach.
- In fact, it is their fiduciary responsibility to consider it.
Kathy Murphy Book

The PROFIT MACHINE in the Hospital Basement

Turning Your Lab Into an Economic Engine

KATHLEEN A. MURPHY, PHD
Q&A

Bracing for Impact: PAMA Market Pricing Models

THANK YOU FOR ATTENDING!

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A powerful combination of all things lab