

MEDICARE GETS A "D"

LOOKING BEYOND THE DISASTROUS STARTUP OF THE NEW MEDICARE DRUG PLAN, BROKERS CAN SUGGEST THE BEST WAY TO REDUCE CLIENTS' HEALTH CARE COSTS.

Fast Focus

- **Brokers can advise employers on how best to save on retiree drug costs with Medicare's prescription drug plan.**
- **While taking a government subsidy holds most appeal for now, it has hidden costs, and other options yield greater savings.**

By Molly Butler Hart

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The day after the stock market crash of 1929, *Variety*, the inveterate show business newspaper, shouted its most famous headline: "Wall Street Lays an Egg." "Washington Lays an Egg" could very well have been the headline the morning after the Medicare Part D prescription drug plan debuted on Jan. 1. The much heralded linchpin of the Bush Administration's health care initiative received decidedly poor early reviews. Confusion reigned as seniors sorted out the "doughnut holes" through which they were going to have to pay for their prescription drugs and states scrambled to pick up the tab for Medicaid recipients who fell through the cracks during the transition.

Overlooked through all the problems is the very real fact that the new program can be a real cost saver for employers that provide prescription drug benefits to retirees, and brokers play a key role in assisting and advising employers on how best to achieve those savings.

"The bulk of the early problems were not really in the employer-sponsored benefit market," says Sam Fleet, CEO of National Employee Benefits Co. (NEBCO), a benefits wholesaler and third-party administrator that offers a Medicare prescription drug plan for employers. "The issues of seniors unable to pay for their medications were primarily the result of Medicaid being phased into the program at the same time." Yet prescription benefits have been a nagging problem for employers, and Medicare Part D, used properly, can alleviate some of the pain. Pharmacy costs are rising at about 18% a year, and they are expected to remain the fastest-growing component of health benefits spent this year.

"Cagy risk managers will cut to the bottom line and see the advent of Medicare Part D for what it offers: a golden opportunity for all employers to stabilize costs and, for larger employers both private and public, to satisfy credit-rating agencies," Fleet says. The challenge for benefit brokers and their employer-clients will be deciding which of the Medicare Part D options best suits their needs.

D is for Drugs

Medicare Part D is the new prescription drug benefit for seniors created by the controversial Medicare Modernization Act of 2003. The basic annual benefit requires beneficiaries to pay a \$250 deductible; the federal government then pays 75% of their prescription drug costs between \$251 and \$2,250. The beneficiaries pay 100% of costs between \$2,251 and \$3,600. For costs beyond that, the government picks

up 95% of the tab. The program is funded by the government but implemented through private insurers known as “prescription drug plans” or PDPs.

The program includes incentives and different options to encourage employers to continue offering prescription drug coverage to retirees—a benefit that was fast disappearing.

- Employers that keep existing coverage could receive a 28% tax-free subsidy of the “permitted drug costs” for each employer plan participant who is eligible for, but not enrolled in, Medicare Part D. The employer plan must be “actuarially equivalent” to the Medicare prescription drug benefit.
- The employer plan could be modified to supplement the Part D benefit with a “wraparound” plan, in which the individual’s Medicare coverage would be the primary coverage for prescription drugs.
- Employers could subsidize the monthly beneficiary premium for any Medicare Part D prescription drug plan or Medicare Advantage plan with prescription drug coverage chosen by the retiree or his or her dependent. This is the approach some employers take for Medicare Part B premiums, which provide optional coverage for doctors’ bills and outpatient services. (Medicare Advantage plans are managed care, PPO, fee for service or specialty Medicare plans offered through private insurers.)
- The employer could sponsor a Medicare prescription drug plan, either under contract with a private prescription drug plan provider or by setting up its own.
- Employers seem to be going for the subsidy—at least for now.

A survey by Deloitte Consulting showed that as of November, 90% of employers offering their retirees prescription drug coverage intended to continue offering some form of drug coverage once that Medicare D drug coverage became available. Of those, 55% had either decided or were leaning toward receiving the 28% subsidy offered for those benefits. Larger firms are even more inclined to do so. According to a new survey of 300 mega-firms by Kaiser Family Foundation and Hewitt Associates, a whopping 79% of large firms will accept the 28% subsidy this year, while 10% are supplementing Medicare’s benefit with a wraparound plan. Nine percent are discontinuing their retiree drug plan, and 2% are turning their plan into a Medicare plan.

Evidence that employers really will save significant dollars in retiree pharmaceutical costs has been lost in the early uproar over Medicare Part D participants’ confusion over the new plan. The Society of Actuaries has found that companies this year can save as much as 80% in costs, depending on which option they choose. Those businesses that drop their drug plans but pay retirees’ Part D premiums could save about 83% in costs this year. Meanwhile, companies that wrap their programs around the Part D plan could save from 31% to 49% in pharmaceutical costs, and those who keep their plans and take the government subsidy could save 18% to 41%, depending on the plan structure used, as well as receive special tax benefits.

Frank McArdle, manager of Hewitt’s Washington, D.C., research office, says employers felt they had the most control in taking the subsidy as opposed to other options, and they liked the tax benefits of the subsidy. The trend may change as employers analyze the actual costs and paybacks of each option. McArdle predicts

that in the next few years, as companies realize the administrative hurdles to qualifying for the subsidy, supplementing Medicare's drug benefit with a wraparound plan will become more common.

In this scenario, the employer supplements the Part D coverage, similarly to how employers now supplement Medicare Parts A and B. Retirees would enroll in both the company plan and Medicare, with the employer choosing whether to pay the Part D premiums. The employer would contract with one or more pharmacy benefit managers, directing retirees to enroll in those plans.

Depending on the plan design, the employer would make up some or all of the difference between what the retiree pays and what Medicare pays. Once a retiree reaches the so-called "doughnut hole" —the \$2,850 gap where he is liable for all drug expenses—the employer would pay 80% of the cost while the retiree pays 20%. Once the retiree pays \$3,600 out of pocket, Medicare starts paying 95% of the expenses.

McArdle cautions that there are difficulties with wraparounds that are not found with the subsidy, however. Simply by virtue of the fact that Medicare and, if fully insured, a private drug benefit management company are involved in the plan's administration, the employer does not have as much control.

But the control the subsidy offers also comes at a price. "In short, what looks like a no-brainer—having the federal government send you a 28% subsidy—can actually be very costly," warns Fleet. His rationale? To receive the subsidy, the employer must provide a costly "attestation" each year, proving that its plan is actuarially equivalent to the Part D benefit. The employer also must be prepared to defend its claim in potential federal audits. With the average subsidy expected to be about \$611 per retiree, the cost to apply for the subsidy may outstrip the return for many small and even medium-sized employers.

Receiving the subsidy also means that employers must track their retirees' prescription expenditures to account for the \$250 deductible and the gap when retirees pay full costs. In addition, since the subsidy is not paid for retirees who enroll on their own in Medicare Part D, employers must also determine the status of their retirees and help educate them about making the right choices.

Instead, Fleet, whose firm began offering a Medicare prescription drug plan in January, suggests that brokers review the option of contracting with a plan. "On the con side, you will not receive the federal subsidy. You will also have to educate retirees about their best options under your approach to Medicare Part D and deal with any resulting confusion, but the benefits significantly outweigh these," he insists. The key is that the employer can shift risk to the insurer.

Going Public

One segment of the market that is particularly ripe for benefit broker prospecting, says NEBCO's Fleet, is public employers. "I find that many public risk managers are behind their private sector peers when it comes to understanding their options and the implications of the decisions they make," he says.

Their vulnerability is exacerbated by the onslaught of GASB 45, a government accounting standard, that requires public employers to reflect on the balance sheets

the promise of retiree benefits during the working years of the employees. It's an obligation that private sector and nonprofit employers have already been dealing with. Accruing the cost of these future benefits and making them part of their financial statements has had a dramatic impact on many corporations, draining away profits on paper and sharply affecting their stock prices. Witness the woes of GM, United Airlines, and other high-profile meltdowns that can be partially attributed to huge retiree health care liabilities.

While public employers need not worry about stock prices, they do have to be concerned with what credit-rating agencies say about their financial health. Maintaining a top rating is key to their ability to get economical, long-term financing. Investors avoid municipal and state bonds from entities that are clearly in trouble, or they demand a premium return that drives up costs.

"If you haven't heard much about GASB 45 yet, there's a reason," says Fleet. The largest public sector employers are not required to begin meeting its mandates until the first tax reporting period after December 15, 2006. Their smaller brethren have until 2008. Many states and municipalities already know what they are facing. "The others will soon find out."

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Contracting with a Prescription Drug Plan

Allows employers to:

- Shift risk to the private insurer and the federal government;
- Retain the ability to design a benefits package that will disrupt retirees as little as possible;
- Convert an unfunded liability to a current, quantifiable cost, thus protecting the employer's credit rating and ability to sell bonds;
- Take advantage of labor agreements that allow alignment with Medicare to reshape a benefits package, including promoting more retiree cost sharing;
- Steer clear of annual attestations and increased actuarial expense;
- Eliminate the most costly and volatile segment of the retiree health care program.