▶ Health Care Costs/Health Care Mitigation

2005—

A Pivotal Year for Managing Retiree Medical Benefit Costs

by Ron Fontanetta

With Medicare set to begin offering a prescription drug benefit in 2006, employers that provide medical coverage to retirees aged 65 and older have a unique opportunity to redefine their programs and financial commitments for the long term. The new Medicare Part D drug benefit poses a range of alternatives for employers to consider—from eliminating post-65 drug benefits altogether to maintaining or modifying their current programs to qualify for the 28% federal tax subsidy for eligible drug costs. In deciding on a course of action, companies need to consider a host of complex issues, including workforce needs and demographics, employee relations, plan design and administration—in addition to the long-term financial and accounting implications. This article reviews the alternatives available to employers with the advent of Medicare Part D and highlights some of the key factors employers should consider as part of this decision.

During 2005, every organization that maintains a medical plan for Medicare-eligible retirees faces the need to address a number of complex new financial, communication, administrative and compliance decisions in preparation for the Medicare Part D benefit taking effect January 1, 2006. Companies' responses to Medicare Part D will vary widely this year. Some have immediately seized the chance to rethink their retiree medical plans and broader total retirement strategies for the long term, while others are taking a cautious approach and have decided to do the minimum necessary to comply with the Medicare Part D regulations in 2005 while they wait to see how the new Medicare drug benefit reshapes the market for retiree coverage. Many other employers are somewhere in between.

Even companies that elect to make no significant changes in their retiree medical plans for 2006 face a variety of actuarial, communication, administrative and other tasks that have to be accomplished before the end of this year. But, what's important for all employers to recognize is that the introduction of a new, far-reaching Medicare prescription drug benefit provides a unique opportunity to step back and undertake a strategic reassessment of company-sponsored retiree medical benefits in the context of the company's broader HR, talent management and cost-management strategies. Among other opportunities, for example, the Medicare Modernization Act (MMA) makes it possible for employers to implement tax-favored health savings accounts for active employees that can help companies redefine their financial commitments to providing employee and retiree health care and support more consumer-focused health care strategies. These accounts also may be attractive to companies that offer no retiree medical benefits currently, allowing them to enhance their total reward programs by implementing new tax-favored saving programs that help employees pay future medical costs.

What's immediately clear, however, is that the new Medicare drug benefit amounts to a major opportunity for many employers to reduce their cash costs for retiree medical coverage, as well as accounting costs under FAS 106.

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CHOOSING A PATH

The final regulations issued by the Centers for Medicare and Medicaid Services (CMS) present employers offering retiree medical coverage with three main alternatives regarding whether and how to provide drug benefits to Part D-eligible retirees in 2006 and beyond:

- Provide a drug benefit that is at least actuarially equivalent to the standard prescription drug coverage under Part D and collect the tax-free government subsidy on behalf of those covered individuals who are eligible for—but who do not enroll in—a Medicare Part D prescription drug plan.
- Encourage retirees to enroll in a prescription drug plan or a Medicare Advantage prescription drug plan—both types will be available in most major markets nationwide—and provide an employer supplement. One way to do this may be to provide enhanced benefits specifically for the employer's retirees through direct negotiations with a specific Part D plan, although an employer can choose to sponsor its own prescription plan for its retirees. Alternatively, companies can offer drug plans that provide wrap-around coverage that would be secondary to any Medicare Part D plan, similar to how many employer plans interact with Parts A and B of Medicare.
- End plan sponsorship; end employer financial support for retiree drug or medical coverage or both (the exit strategy).

TAKING THE SUBSIDY

Initially, it appears that many employers that provide retiree drug benefits that meet the new actuarial equivalence test are likely to decide to take the tax-free federal subsidy and maintain their plans—at least for 2006 while they see how the prescription drug plan and Medicare Advantage prescription drug plan marketplace evolves. Since the new Medicare law provides enhanced financial support for Medicare Advantage (formerly Medicare+Choice) plans, it is expected to revitalize and greatly expand the geographic reach of these plans beginning next year.

The amount of the subsidy equals up to 28% of prescription drug claims between $250 and $5,000 per person, with a maximum of $1,330 on behalf of each covered retiree. We estimate that, for most large plan sponsors, the subsidy will average from $500 to $650 per individual, which is equivalent to $750 to $1,000 pretax, assuming a 35% marginal rate.

To qualify for the subsidy, an annual application accompanied by an attestation of actuarial equivalence must be filed with CMS. (For 2006, this application must be filed by September 30, 2005.) To demonstrate actuarial equivalence, employers must satisfy a two-part test. Specifically, the first part is a *gross value test,* under which the expected amount of paid claims for Medicare beneficiaries in the employer's plan must be at least equal to the expected amount of paid claims for the same beneficiaries under Part D standard coverage. The second part is a *net value test,* which takes into account the impact of retiree contributions to the plan, as well as the impact that the employer's wrap-around coverage has on the value of Part D catastrophic coverage.

ALTERNATIVES TO THE SUBSIDY

Other employers will decide to have the Medicare Part D plan shoulder the primary-payer responsibility. If the employer chooses to negotiate special arrangements for its retirees with a Part D plan, a waiver from CMS is required. A CMS waiver is also required for employers that choose to become their own Part D plan sponsor.

If the plan sponsor decides to purchase integrated coverage through a prescription drug plan or Medicare Advantage prescription drug plan, retiree enrollment in Medicare Part D will be handled by the prescription drug plan or the Medicare Advantage plan. By contrast, when employers provide wrap-around coverage through a separate plan, they or their plan administrators will need to handle enrollment for that coverage and retirees will be responsible for enrolling to obtain the Part D coverage of their choice.

This approach is likely to entail significant operational and administrative challenges for companies with large, geographically dispersed retiree populations. For example, it will require them to manage data exchange and coordinate benefits with a large number of prescription drug plans (with variations in plan design and drug formularies) that retirees may enroll in.

NEW PROCEDURES REQUIRED

Even plan sponsors that choose to make no changes in their current medical plans for Medicare-eligible retirees must take a number of actions this year. These may include:

- Determining the effects of the Medicare Part D regulations on accounting disclosures and cost measurements under FAS 106, including future cost projections that will have to be reported in financial statements
- Determining eligibility for the federal subsidy and developing a process to certify eligibility to the government
- Communicating the *creditable* status of their coverage to Medicare-eligible retirees who are enrolled in, or are seeking to enroll in, company-sponsored coverage that provides prescription drug benefits (Coverage is generally considered *creditable* if it satisfies the gross value actuarial equivalence test; participating in creditable coverage enables the individual to avoid Part D late-enrollment penalties.)
- Preparing and disseminating communications to help retirees assess the relative advantages of the employer's plan compared to standalone prescription drug plans and any Medicare Advantage plans available to them
- Preparing HR managers and call center representatives for the flurry of retiree inquiries likely as CMS and the Part D plans communicate with Medicare beneficiaries about their coverage alternatives in 2006
- Developing and implementing a process to provide the enrollment and claims information necessary to obtain the federal subsidy from CMS
- Assessing the impact of the new benefit program on claim costs, including the effect of the subsidy if the organization is eligible.

LONG-RANGE ASSESSMENT

Apart from the near-term actions that companies need to take if they plan on offering a prescription drug benefit to Medicare-eligible retirees in 2006, many companies will want to explore the broader implications of the new Medicare law for their long-term retiree and active health care strategies. Key considerations include:

- How much of a financial commitment to retiree medical benefits can the company afford, given future business needs and financial objectives?
- What types of cost-sharing arrangements are appropriate for current and future retirees, taking into account what they can afford?
- What's the most efficient way to deliver benefits to Medicare-eligible retirees, and how are the company's benefit offerings and vendors going to be managed?
- What are the implications for the organization's near-term and long-term talent needs and workforce management strategy?

Without question, the Medicare prescription drug benefit is going to have a huge impact on employer-sponsored retiree medical plans and on how those plans fit with broader company objectives. Regardless of which strategic path companies follow with respect to prescription drug coverage for the long term, companies face a host of significant plan design, vendor management, communication and administrative challenges this year to be ready for 2006. ◀

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