INTERNATIONAL CEBS SOCIETY

TOWERS PERRIN
HR SERVICES

UPDATE

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EMPLOYERS MAKE PROGRESS PREPARING FOR MEDICARE PRESCRIPTION DRUG BENEFIT

Employers sponsoring post-65 retiree medical programs are making progress in preparing their organizations to take advantage of the Medicare Part D prescription drug benefit that becomes available next year, but some plan sponsors are apparently missing opportunities that could bring significant cost savings.

These are some of the key findings in a nationwide survey developed by Towers Perrin and conducted by the International Society of Certified Employee Benefit Specialists (ISCEBS). The survey, which was completed in July, drew responses from nearly 200 companies and nonprofit organizations, including 137 currently offering coverage for retiree health care. Among those offering coverage, most (89%) provide a benefit to both Medicare-eligible retirees and non-Medicare eligibles. Nearly half are manufacturers.

Time is running out for employers to decide on a retiree medical drug strategy and take the steps required to become eligible under the Medicare Modernization Act for the subsidy payments that will be available in 2006 from the Centers for Medicare and Medicaid Services (CMS). Companies that expect to offer a prescription drug benefit and receive the subsidy must file their application and supporting data on their retiree populations by September 30 (although those that begin an application before then may seek an extension until October 30).

MOVING AHEAD, FOR THE MOST PART

According to the survey, most employers are moving ahead with plans to continue providing a prescription drug benefit within their retiree medical plans, but they appear to be unsure precisely what form their response will be, and others are moving forward with a tentative strategy for 2006 — apparently while they assess the emerging Part D marketplace.

Nearly a third (32%) of the organizations surveyed said they still have not decided on a response to Medicare Part D, although most of the respondents in this group did say they were actively studying the matter. Presumably, by now, some of these have moved ahead by selecting an overall strategy.

Among the respondents that have decided on a course of action, only 14% have determined and finalized their response for 2006 and the foreseeable future. The remaining organizations are split in terms of where they are in the planning process (see *Exhibit 1*).

EXHIBIT 1
Responses to Medicare Part D

Not yet begun to study	6%
In process of conducting study	26%
Have determined a preliminary response for 2006 and beyond	21%
Have determined a preliminary response for 2006 while deferring any decision for 2007 and beyond	18%
Have a definite course of action for 2006 but no long-term response for 2007 and beyond	15%
Have determined and finalized response for 2006 and the foreseeable future	14%

SUBSIDY IS LEADING CHOICE

Not surprisingly, 70% of respondents indicated that they intend to continue their retiree medical plans and collect the retiree drug subsidy in return for providing drug coverage that is at least actuarially equivalent to Part D (for retirees who do not enroll in a Part D plan). Only 6% said they plan to integrate, or coordinate, drug coverage under their own plan with a Part D plan in which their retirees would enroll, and even fewer (3%) said they plan to arrange to offer a specific Part D plan or plans for their retirees. Interestingly, none of those surveyed showed an interest in the employer-sponsored option, which involves contracting directly with CMS to sponsor an employer-specific Part D drug plan (see *Exhibit 2*).

EXHIBIT 2

Employer Plans for Providing Health Care Coverage for Medicare-Eligible Retirees in 2006

Continue the plan and collect the federal subsidy	70%
Integrate (coordinate) with Part D plans	6%
Arrange to offer a specific Part D plan or plans	3%
Contract with CMS to sponsor own Part D plan	0%
Eliminate some coverage	8%
Eliminate all coverage	3%
Other	10%

Towers Perrin estimates that prescription drug subsidy payments per retiree in 2006 will average approximately $500. These payments are free from federal income tax, which significantly increases their value to plan sponsors that pay taxes. Employers that become eligible for the retiree drug subsidy payments can anticipate cash payments equal to 28% of allowable drug expenses between $250 and $5,000 in 2006. These payments should help ease some of the burden of rapidly rising drug prices and growing usage of the benefit by many retirees.

COST-SAVING OPPORTUNITIES

Nonetheless, one of the survey's more striking findings is that employers with retiree medical plans may be overlooking opportunities to cut costs. Only one-quarter (25%) of respondents currently offer Medicare-eligible retirees Medicare Advantage plans that combine coverage of all Part A and Part B benefits and, beginning in 2006, Part D as well. The remaining 75% of respondents do not expect to offer these plans. This suggests that many organizations may be overlooking an opportunity to reduce retiree medical costs, including prescription drug costs. According to the survey, only 30% of the organizations were considering offering Medicare-eligible retirees Medicare Advantage plans in the future. The remaining 70% said they were not.

It's possible that some companies may not be fully aware of the ongoing resurgence of the Medicare Advantage marketplace (formerly Medicare+Choice). With its higher government payments to plans, the addition of the prescription drug benefit and a growing number of plans across the country, Medicare Advantage is becoming a more attractive approach for delivering health care to retirees. In many places, these plans offer a more generous benefit package than the one that retirees currently receive in their employer-sponsored plan.

Companies that go this route, of course, forgo the federal subsidy, but the cost savings could still outweigh the residual cost of continued coverage, even taking into consideration the employer subsidy. This would be the case even for companies that opt to retain the employer drug subsidy, which is what most plan to do. Only 14% said they expected to share any federal payments in 2006 with retirees, while nearly half (48%) said they would not. The remaining 36% said they were undecided, but many of these will likely end up in the "no" camp. The survey does not attempt to capture actions that employers might have taken in 2006 if not for the arrival of the subsidy (e.g., increasing retiree contributions or terminating retiree medical coverage).

FUTURE UNCERTAINTY

Despite the apparent lure of the retiree drug subsidy for employers, there is a strikingly low level of confidence among employers in the long-term prospects of the new prescription drug program. When we asked what changes employers see in Medicare Part D in the future, the responses varied but were not generally optimistic, especially in terms of the main public policy goal of managing drug costs.

- Only 12% believe prescription drug costs will be successfully controlled using private Part D plans competing in the marketplace.
- More than half (56%) expect the federal government eventually will replace Part D plans with prescription drugs price-controlled by CMS.
- Another 14% expect Part D will be repealed and that Medicare will drop coverage of prescription drugs.

Given these attitudes, and ongoing cost concerns, it's no surprise that some employers are planning to reduce prescription drug benefits or terminate coverage. Of those anticipating continued health care coverage for Medicare-eligible retirees in 2006, 11% indicated an intention to scale back or eliminate prescription drug benefits. Specific options for these employers include:

- Eliminate prescription drug coverage and offer a retiree medical plan that coordinates coverage with Medicare Parts A and B.
- Eliminate the employer medical plan for Medicare-eligible retirees and continue financial support by reimbursing some or all premium payments for Parts B or D, or for a Medicare Advantage plan or Medigap coverage.
- Eliminate all medical coverage and financial support for Medicare-eligible retirees.

Regarding the type of financial support that each organization currently provides for its Medicare-eligible retirees, the survey found that there are a number of approaches and, again, no clear favorite. Responses ranged from no employer support at all to capped contributions (see *Exhibit 3*).

EXHIBIT 3

Types of Financial Support Provided for Medicare-Eligible Retirees

No employer financial support (coverage on an access-only basis)	13%
Employer pays at least 70% of plan cost for most retirees	20%
Employer pays less than 70% for most retirees	13%
Employer contributions are a percent of plan cost and vary based on age and/or service	16%
Employer contributions are capped at a uniform dollar amount for most retirees	12%
Employer contributions are capped and vary based on age and/or service	14%
Other	13%

GETTING READY

So how are employers that plan to collect the subsidy doing in their preparations to meet CMS requirements? The answers are mixed, depending on the task involved, according to the survey:

- About half (51%) said they have identified the intended process and responsible parties for submitting claims and census data to CMS. This is an important step — and a big one in terms of the work required to collect the information and deliver it to CMS. Plan sponsors can go to the Web site of the Retiree Drug Subsidy (RDS) Center to obtain the retiree list file layouts that are required when plan sponsors transmit census data to CMS. The drug subsidy application and the initial retiree file must be submitted by September 30, 2005.

- More than two-thirds (69%) of respondents said they had completed an initial estimate of actuarial equivalence for 2006. The final statement of actuarial equivalence, which is a cornerstone requirement in the application process, must also be submitted by September 30.

ISSUES AWAITING ANSWERS

Clearly, there are many questions among employers about how the new Medicare Part D program will work, and how to make the choices that best suit a given organization's business and HR strategies. Companies seeking to determine which prescription drug approach will work best for them must be able to answer questions in four areas:

- How does the accounting treatment under FAS 106 for reflecting the cost of the benefit impact the employer's financial statements?

- How do the government's rules for determining eligibility, the amount of any subsidy payments, the creditable coverage notification requirements for employees and retirees, and other critical aspects of the overall Medicare Part D program apply?

- What will the Medicare Part D marketplace look like in terms of participating vendors, plan design options and cost?

- What are competitors and other employers doing?

Once the hurdles for 2006 have been successfully cleared, employers should be prepared to revisit their prescription drug strategy for the longer term, taking into account the role of retiree medical in workforce planning and the overall retirement package.

The FASB has issued guidance on the accounting issues so that companies can prepare their financial statements accordingly. In other areas of concern, however, many questions remain despite CMS' efforts to issue guidance aimed at helping prepare employers for the data management, reporting requirements and other tasks that must be accomplished. Employers also have a lot of work to do this year in order to make appropriate arrangements with vendors and communicate with plan participants to implement their 2006 strategy.

ISSUES AWAITING ANSWERS

At the same time, it's understandable that so many companies have not yet set a course beyond 2006. This approach allows time to learn more about how the Medicare Part D marketplace will work, see what other employers are doing and make tactical adjustments based on developments.

Nonetheless, employers can also make this an opportunity to improve their overall management of pharmacy benefits, especially in light of our finding that most (70%) companies plan to continue sponsoring a post-65 retiree medical plan with a prescription drug benefit. The efficiencies that can be realized from more prudent purchasing not only impact this group, but actives and pre-65 retirees as well. These opportunities are real in part because of the wave of patent expirations for several blockbuster drugs that occurred this year and will continue for the next several years, offering employers a chance to steer members more aggressively to lower-cost generic drugs or over-the-counter alternatives.

ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organizations around the world optimize performance through effective people, risk and financial management. The firm provides innovative solutions to client issues in the areas of human resource strategy, design and management; actuarial and management consulting to the financial services industry; and reinsurance intermediary services.

The firm has served large organizations in both the private and public sectors for 70 years. Our clients include three-quarters of the world's 500 largest companies and three-quarters of the *Fortune* 1000 U.S. companies.

Towers Perrin has offices in 25 countries.

Our businesses include HR Services, Reinsurance and Tillinghast.

The HR Services business of Towers Perrin provides global human resource consulting and related services that help organizations effectively manage their investment in people. We offer our clients services in areas such as employee benefits, compensation, communication, change management, employee research and the delivery of HR services.

ABOUT THE INTERNATIONAL SOCIETY OF CERTIFIED EMPLOYEE BENEFIT SPECIALISTS

The International Society of Certified Employee Benefit Specialists (ISCEBS) is a nonprofit educational association whose members have earned the Certified Employee Benefit Specialist (CEBS) designation, which is cosponsored by the International Foundation of Employee Benefit Plans and the Wharton School of the University of Pennsylvania. For more information on the Society or CEBS, please visit the ISCEBS Web site at *www.iscebs.org*.