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The Financial Risks and Subsidized Rewards for Providing Retiree Rx Coverage: A Plan Sponsor's Guide to Plan Design Issues in Light of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003¹

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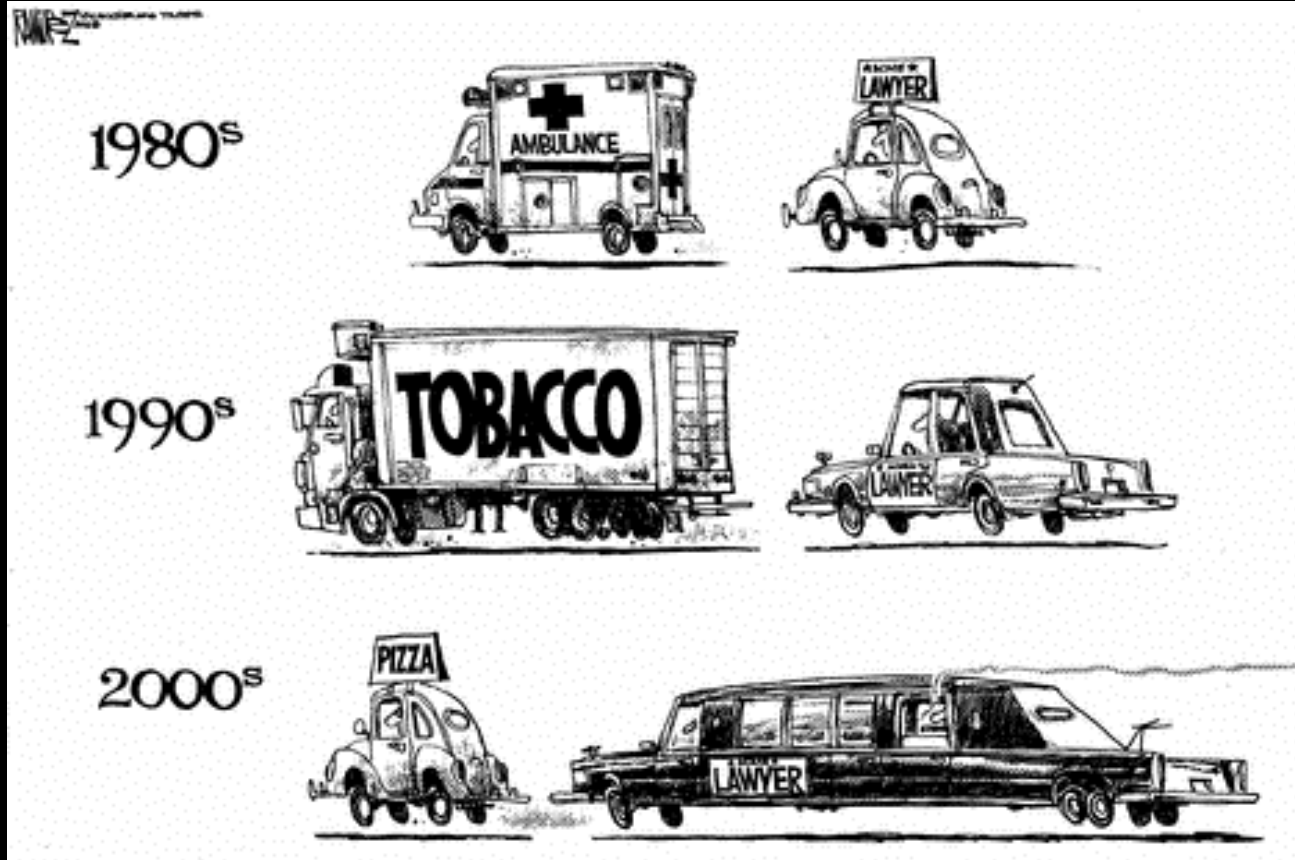
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Employee Benefits And Executive Compensation Practice

- Advise clients with respect to all types of:
 - employee welfare benefit arrangements, including group medical plans providing coverage to active and retired employees,
 - employee pension plans, including
 - profit sharing plans,
 - stock bonus plans,
 - 401(k) plans, and
 - defined benefit pension plans, and
 - executive compensation programs, including non-qualified excess plans and deferred compensation arrangements and equity compensation.



Reasons For The Passage Of The Medicare Prescription Drug, Improvement, And Modernization Act Of 2003²

“[T]he total cost of providing retiree health benefits increased by an estimated 13.7 percent, on average, between 2002 and 2003.... This growth rate is slightly lower than the 14.7 percent growth in the cost of providing health benefits to active workers observed in a different sample of large employers, during the same time frame.”³



²All references to the term Act are to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. 108-173 (amending, among other federal laws, title XVIII (Medicare) of the Social Security Act of 1965, P.L. 89-97, as amended by, among other acts of Congress, the Act, (hereinafter SSA)).

³Frank McArdle, Terry Kirkland, Dale Yamamoto, Michelle Kitchman, Tricia Neuman, Retiree Health Benefits Now and In the Future: Findings from the Kaiser/Hewitt 2003 Survey on Retiree Health Benefits viii (2004).

Another Reason For The Passage Of The Act

“The costs associated with retiree health obligations appear to be a significant concern for company CEOs, with 92 percent of all respondents reporting that their CEO is very or somewhat concerned about retiree health care costs.”⁴

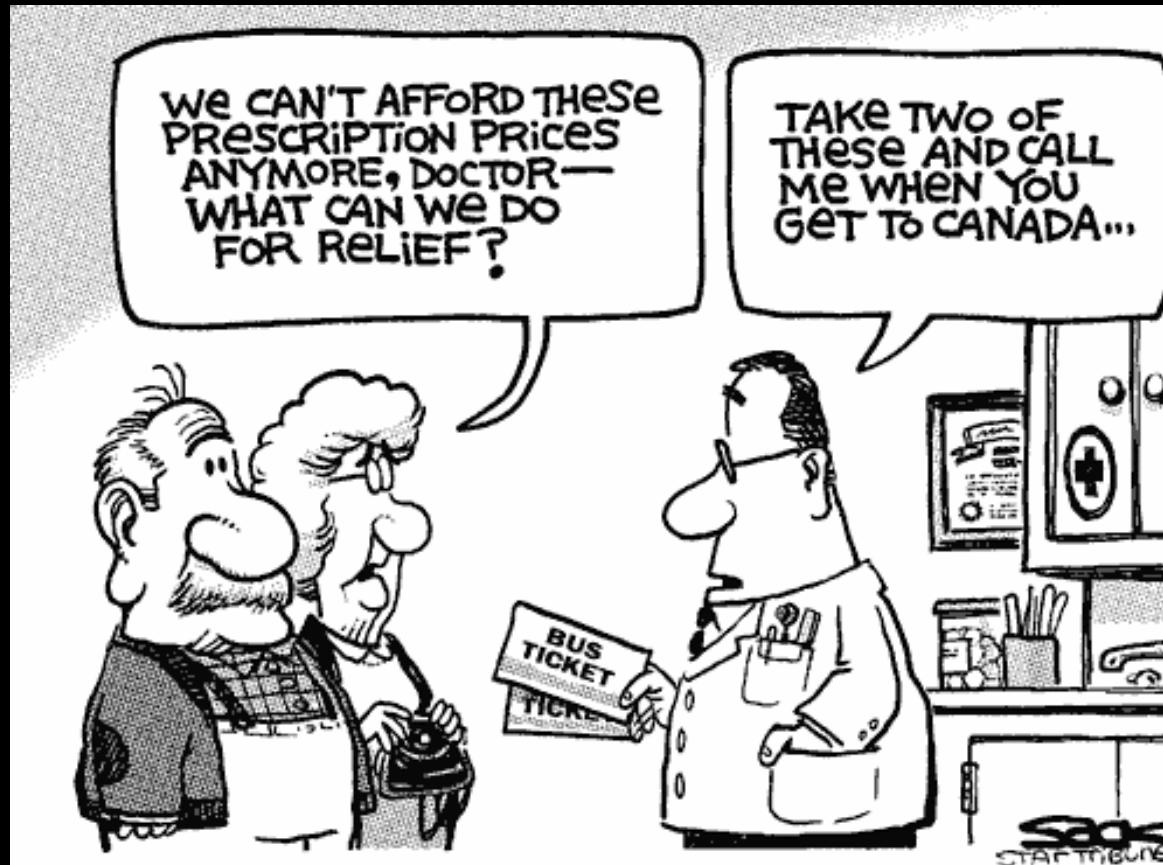


⁴*Id.*

Yet Another Reason...



And Yet Another Reason...



Make No Mistake, However, The Upcoming Implementation Of New Part D Of Medicare Will Have Profound Effects On Your Retiree Rx Drug Benefits



How Does All Of This Work?

© Cartoon



*"I've thrown in some prescription
drugs that don't interact well."*



New Part D Rx Drug Coverage

- Includes an Rx drug discount card program in which Medicare-eligible individuals enroll and, for an annual enrollment fee of no more than \$30, individuals will be able to receive savings CMS estimates will be from 20 to 25 percent, but this is only “transitional relief.”
- Effective January 1, 2006, new Part D will provide Rx drug coverage to Medicare eligible individuals or a subsidy to employers that provide “actuarially equivalent” retiree Rx drug coverage for each Medicare eligible individual who does not elect to participate in new Part D Rx drug coverage, but is instead covered by the employer-sponsored plan.



The New Medicare Discount Rx Drug Card



The New Medicare Discount Rx Drug Card

- Enrollment is expected to begin as early as May 2004.
- Almost everyone with Medicare can choose to join a Medicare-approved drug discount card. It doesn't matter whether you have Original Medicare (Part A and/or Part B), a Medigap policy, a Medicare managed care plan, or another kind of Medicare health plan. The only people who can't enroll in a Medicare-approved drug discount card are those who have outpatient drug coverage through Medicaid.⁵
- If an individual's income is no more than \$12,569 as a single person, or no more than \$16,862 for a married couple, he/she might qualify for a \$600 credit to help pay for your Rx drugs and he/she won't have to pay the annual enrollment fee for the discount card.⁶
- The subsidy is not available if the individual has employer-provided Rx drug coverage.
- No real penalties for late enrollment.

⁵Center for Medicare & Medicaid Services, Answer ID 1488 (2004), available at <http://medicare.custhelp.com>.

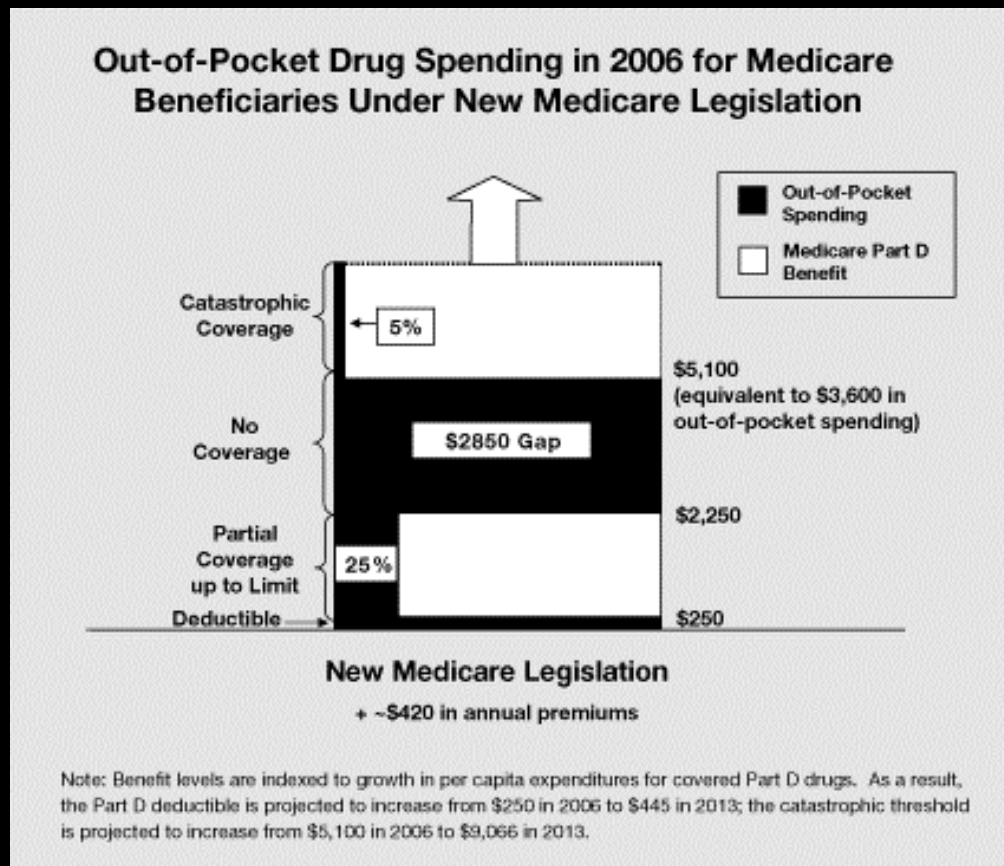
⁶Center for Medicare & Medicaid Services, Answer ID 1492 (2004), available at <http://medicare.custhelp.com>.

⁷SSA § 1860D-31(b)(2)(B).

⁸Center for Medicare & Medicaid Services, Answer ID 1484 (2004), available at <http://medicare.custhelp.com>.



Basic Coverage Principles



Source: Kaiser Family Foundation, New Medicare Benefit At-A-Glance Chart (2003), available at <http://www.kff.org/medicare/medicarebenefitatanaglance.cfm?>

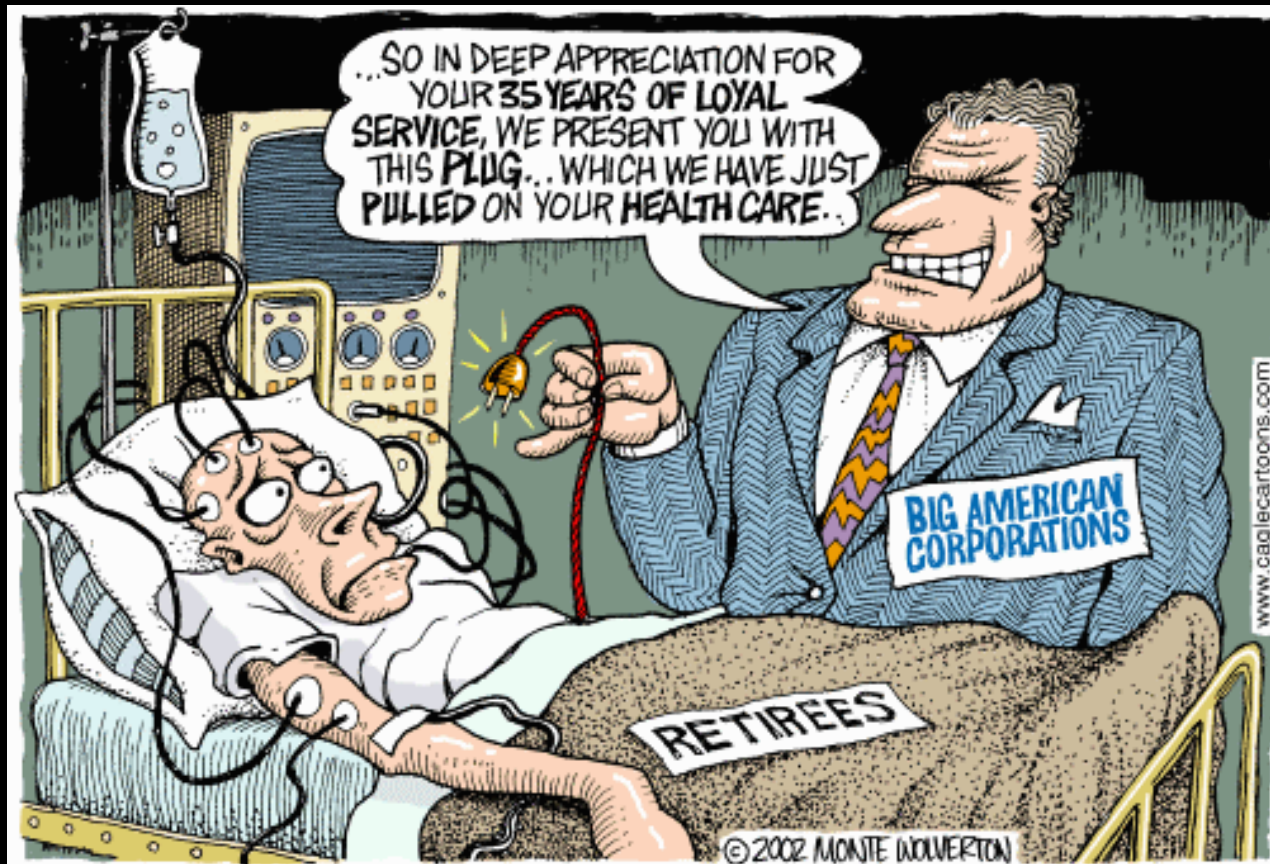


A Couple of Basic Principles to Keep in Mind

- If you so choose, you can provide a post-65 retiree Rx drug benefit that is “actuarially equivalent” to new Part D of Medicare and, if a participant elects your coverage instead of Part D coverage, you may receive a Federal subsidy for providing such benefits for that participant, which will help offset the cost of such coverage.
- As an employer, you are not prevented by new Part D of Medicare from terminating your existing retiree Rx drug benefits. If you choose to terminate or significantly reduce your coverage (*i.e.*, to a level that isn’t actuarially equivalent to new Part D benefits), participants can seek retiree Rx drug coverage under new Part D, but you obviously won’t receive the Federal subsidy. You may also adopt a new program that is designed to supplement new Part D Rx drug coverage, but, again, you won’t receive the Federal subsidy.



You Need to Decide Whether to Amend or Terminate Retiree Rx Drug Benefits



A Word Of Caution!

- Although the Act did not restrict your ability to unilaterally reduce or terminate retiree medical benefits, you need to remain mindful that there may be legal limitations on your ability to unilaterally reduce or terminate retiree medical benefits, including retiree Rx drug coverage.
- Before you make unilateral changes, you are encouraged to contact experienced benefits counsel.



Will You Take the Subsidy and Run?

- Subsidy payments will equal 28% of gross covered retiree plan-related Rx drug costs greater than \$250 but not greater than \$5,000, adjusted annually by the percentage increase in Medicare per capita prescription drug costs.



At What Cost Will The Subsidy Come?



On A More Serious Note

- If you take the subsidy, you will be required to:
 - provide the Secretary with a “certification” of “actuarial equivalence” at least annually and as may be required by the Secretary;
 - provide “records” required by the Secretary for audit and “other oversight activities necessary to ensure the adequacy of [Rx] drug coverage and the accuracy of payments made under” new Part D of Medicare;
 - provide a certain disclosure to the Secretary and the participant, which must “provide for disclosure, in a form, manner, and time consistent with standards established by the Secretary, to the Secretary and part D eligible individuals of whether the coverage...” is actuarially equivalent and, if the coverage is not actuarially equivalent, such a disclosure “shall include information regarding the fact that because such coverage does not meet such requirement there are limitations on the periods in a year in which the individuals may enroll under a prescription drug plan or an MA-PD plan and that such enrollment is subject to a late enrollment penalty under this subsection; and¹⁰
 - conform with the system for payments as established by the Secretary of Health and Human Services and to provide information in order to obtain the payment of the subsidy.¹¹

¹⁰SSA § 1860D-22(a)(2) and SSA § 1860D-13(b)(6)(B). The importance of this rule cannot be overstated, because the participant will face some dire consequences when the sponsor of a retiree prescription drug benefit fails to meet the actuarial equivalency test set forth in SSA section 1980D-13(b)(6)(C). Such a participant may ultimately be forced to apply to the Secretary of Health and Human Services for an exception to the creditable coverage provisions that operate much like those required by HIPAA’s creditable coverage provisions, which are addressed in detail in Treasury regulation 54.9801-5 and Labor regulation 2590.701-4.

¹¹SSA § 1860D-22(a)(5). With respect to the payment systems, SSA section 1860D-15(d)(1) gives the Secretary of Health and Human Services the ability to determine the rules applicable to payments. Likewise, the Secretary of Health and Human Services appears to have by virtue of SSA section 1860D-15(d)(2)(A) broad authority to established the type of information required.



No Doubt, The Regulatory Framework Will Be Complex: Remember HIPAA's Privacy Rule?



Turning Your Back on the Subsidy May Mean You Get to Design a Supplemental Retiree Rx Drug Benefit That Meets Everyone's Needs



Design Approaches Designing Wrap-around Retiree Rx Coverage

- If you continue to provide retiree Rx coverage, SSA section 1860D-2(b)(4)(C)(ii) apparently stretches the point at which an individual will hit the various out-of-pocket points.

For covered Part D prescription drug incurred out-of-pocket expenses:

the plan will pay:

Up to \$250	0%
Over \$250 but not more than \$2,850	80%
Over \$2,850 but not more than \$5,100	80%
Over \$5,100	100%

- You can also provide for a cheaper benefit, but leave at least some burden for out-of-pocket costs on the participant.
- Consider designs where the costs are fixed through annual and/or lifetime maximums.



Innovative Design Approaches: Inserting Consumerism Into Retiree Medical Benefits



Innovative Design Approaches: Consider HRAs and/or HSAs

- For current and active employees expected to retire soon, HRAs probably work best as a transitional tool, because employers can continue to set aside or fund accounts even after an employee retires and so-called “high deductible coverage” is not needed when a contribution is made.
- For current employees not expected to retire until sometime in the future, consider using the newly-minted HSAs.



FAS 106: To Delay Or Not Delay

- Contact your auditor and actuary to discuss the current reporting requirements under FAS 106 and whether to take the Act into account or to delay its impact on your financials.



Timing Plan Changes

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"I've discovered a timing device on my wall."



Timing Your Changes

- If an entity elects deferral, that election may not be changed, and the deferral continues to apply until authoritative guidance on the accounting for the federal subsidy is issued, or until the guidance in the following sentence applied. The election to defer expires if, subsequent to January 31, 2004, but prior to the issuance of additional authoritative guidance, a significant event occurs that ordinarily would call for a remeasurement of a plan's assets and obligations – for example, a plan amendment, settlement or curtailment. *Upon the occurrence of such an event, the sponsor would account for that event pursuant to the guidance in Statement 106 and also should reflect in its accounting for the plan its best estimates of the Act, including the federal subsidy (if applicable based on the terms of the plan and the sponsor's analysis of generally accepted accounting principles) and any effects on participation rates and health care cost estimates.*¹²

¹²FSP 106-1 (emphasis added).



Parting Words Of Wisdom: Don't Forget *Variety*?



More Parting Words Of Wisdom: Don't Forget COBRA Continuation Coverage

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"Anubith? You find thomething humorouth?"



Yet More Parting Words Of Wisdom ...

- Begin assessing the effects of the Act upon your current retiree medical benefit plan(s), including, most importantly, retiree Rx coverage.
- Monitor legislative proposals to amend new Part D of Medicare.
- Monitor regulatory pronouncements from the Department of Health and Human Service's Center for Medicare & Medicaid Services, the Department of Labor and the Treasury Department.
- Consider potential changes to your pre-65 retiree Rx benefit structure (perhaps using the newly-minted "Health Savings Accounts" and/or the recently created "Health Reimbursement Arrangements" to transition current and future retirees into a consumer driven model that is built around new Part D) and the impact of means testing for Part B, but don't plan to rely on the new Medicare Rx drug discount card, because, generally, it will not be available to participants unless they are eligible to be or are enrolled in Part A of Medicare or are enrolled in Part B Medicare coverage.

Yet More Parting Words Of Wisdom ...

- If your pre-65 retiree medical benefits (*i.e.*, retiree Rx coverage and Part B-type benefits) are left in place, consider ways to minimize costs.
- If you are interested in reducing and/or eliminating your post-65 retiree Rx drug benefits (and possibly other retiree medical coverage), assess the likelihood that you will be able to successfully reduce and/or eliminate such coverage and whether you must bargain over such changes.
- Assuming you can terminate your retiree Rx drug coverage, determine whether you want to continue providing post-65 retiree Rx drug benefits beginning in 2006, which will leave current and future retirees with only new Part D retiree Rx drug coverage.
- If you plan to continue providing retiree Rx drug coverage, assess your ongoing costs (including potential risks) of continuing retiree Rx drug benefits for post-65 retiree medical plans beginning in 2006 and whether the Federal subsidization of such benefits outweighs the costs.

Yet More Parting Words Of Wisdom ...

- If you decide to continue providing post-65 retiree Rx drug coverage, but you aren't interested in the Federal subsidy, begin exploring whether to and the ways in which you may want to modify coverage to coordinate with new Part D.
- If you decide to significantly reduce or eliminate post-65 retiree Rx coverage, consider timing issues, HR communications and other current benefits issues, etc.
- Contact your auditor and actuary to discuss the current reporting requirements under FAS 106 and whether to take the Act into account or to delay its impact on your financials.