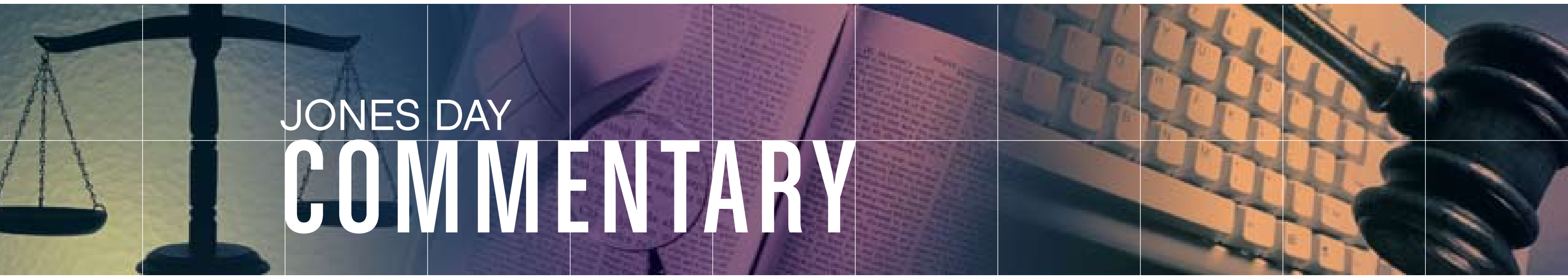
JONES DAY

OCTOBER 2005



MEDICARE PART D RETIREE PRESCRIPTION DRUG COVERAGE: EMPLOYER OPTIONS

On December 8, 2003, President George W. Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (“MMA”). The MMA established Part D, which is the retiree prescription drug benefit program that becomes effective January 1, 2006. On January 28, 2005, Part D final rules (the “Rules”) were promulgated by the Centers for Medicare and Medicaid Services (“CMS”) pursuant to the MMA and will offer retirees’ prescription drug coverage in varying ways.

Employers offering prescription drug coverage to retirees may take advantage of Part D by applying to CMS directly for a federal subsidy if their health plans offer coverage that is at least as generous as the standard Part D benefit described in the Rules. Alternatively, Part D coverage is available to retirees through insurers who have contracted with Medicare to provide a Part D plan. Such Part D plans include prescription drug programs (“PDPs”), which are regulated by Part D; fallback PDPs; private fee-for-service plans; Medicare Advantage prescription drug programs (“MA-PD”), formerly Medicare+Choice, which are regulated by Medicare Part C; Medicare cost-reimbursement plans; and Part D reimbursement programs such as PACE.

To the extent that employers intend to apply to CMS for the federal subsidy, they need to do so by *October 31, 2005.*

EMPLOYER OPTIONS

An employer has the following options under the Part D Rules:

- Receive a tax-free government reimbursement for a portion of drug costs for retirees who elect to remain in the employer prescription health plan (as long as the plan is at least as generous as the standard Part D benefit).
- Design its own prescription drug plan so that Part D coverage is the primary payor for certain drug costs (and the employer can also provide supplemental coverage).

- Contract with a prescription drug insurer to enroll retirees in Part D coverage, in which case retiree premiums may be reduced to reflect government subsidy payments to the insurance carrier.
- Provide Part D supplemental coverage itself.
- Pay retirees' monthly Part D premiums without contracting with prescription drug plans.
- Choose to eliminate entirely prescription drug coverage for retirees who can obtain it through Medicare.

PRESCRIPTION DRUG PLAN ALTERNATIVES

Tax-Free Subsidy. An employer may choose to provide prescription drug coverage that is at least as generous as (actuarially equivalent to) a Part D plan and receive a tax-free federal subsidy for retirees who elect to remain part of the employer health plan rather than electing to participate in a Part D plan.

The subsidy payment is 28 percent of prescription drug costs between $250 and $5,000 annually for each retiree who has Medicare Part A or Part B but is not enrolled in the Part D prescription drug benefit. It is estimated that the subsidy will average approximately $668 per participant in 2006. Additionally, the tax-free nature of this subsidy makes it more valuable. For example, based on a tax rate of 35 percent, a $668 tax-free payment equates to a $1,028 taxable payment.

Among a host of other requirements, implementation of the tax-free subsidy approach includes actuarial equivalence testing that must be reported annually. The Rules include a two-part test for plan sponsors to determine whether actuarial equivalence has been met. CMS is allowing employers (and union plans) to apply the actuarial equivalence standard on an aggregate basis when there are several plans with different benefit options and designs, as long as each of the benefit options meets the "gross value test" of being at least as comprehensive as the Part D drug benefit.

Additionally, an employer may not receive the subsidy for any participant who enrolls in a PDP or MA-PD plan. As a result, employers may want to inform retirees about the benefits of enrolling in their health plans rather than PDPs or MA-PDs.

An employer would receive a tax-free subsidy equal to 28 percent of the cost of a prescription drug if: (1) the prescription plan is determined to be a "Qualified Retiree Prescription Drug Plan," (2) the drug is for a plan participant who is determined to be a "Qualifying Covered Retiree," and (3) the drug cost is determined to be an "Allowable Retiree Cost." Each of these designated terms is described in the Rules, and these conditions must be met for the subsidy to be realized.

Employer as PDP or MA-PD. An employer may also choose to apply to CMS to provide drug coverage to retirees as a PDP. A similar procedure applies if an employer were to opt to apply for MA-PD status. The retiree would then enroll as a Part D participant, and the employer would receive payments from the government in return for providing the coverage.

In its capacity as a PDP (or MA-PD), the employer submits bids to CMS based on the projected costs for providing coverage. (The bid-submitting deadline has already passed for 2006.) In this scenario, CMS makes monthly premium payments to approved PDPs so that CMS subsidizes (on average) approximately 75 percent of the value of "Standard Part D Coverage," and enrollees pay the rest of the premiums.

The actual amount paid to an employer as a PDP is based on several factors, including the bid amount and variations in the health status of enrollees. The CMS payments include "reinsurance" coverage that pays 80 percent of an enrollee's annual incurred out-of-pocket costs above $3,600, but variations may occur. CMS estimates that on average it will pay PDPs $1,231 per non-low-income participant in 2006. Employers in their capacity as PDPs would be subject to numerous compliance obligations, including state licensing and reserve rules and a prescribed enrollment process, among other rules. Compared to other options, employers may find that this approach offers larger financial subsidies but at the cost of potentially greater CMS oversight and regulatory complexity to the extent not waived by CMS.

Contract with PDP or MA-PD. An employer may opt to offer its Medicare-eligible retirees access to prescription drug coverage beyond Medicare Part D offerings but may not want to assume the responsibility and risks of providing the drug coverage as a PDP (or MA-PD). If so, it may want to contract with a PDP to provide the supplemental coverage.

Under this scenario, the government subsidy is not paid to the employer but, rather, is paid to the contracted-out PDP. The PDP in turn passes some or all of the subsidy on to the employer through lower premiums. The employer pays the PDP premium and decides how much of the premium (if any) to collect from the retirees. An employer may even try to negotiate the amount of savings that a prospective PDP will pass on to it. In addition, an employer may increase savings by including the use of captive insurance companies to reinsure PDP benefits.

Some limitations in benefits exist under this scenario because PDPs can provide only limited variations in coverage from the Standard Medicare Part D Coverage design, and overall, the benefit must be actuarially equivalent.

Secondary Coverage. If a retiree has coverage through both a PDP and an employer plan, Medicare Secondary Payor rules generally would make employer coverage secondary to the PDP. This would enable employers to provide separate coverage that supplements Medicare Part D benefits available to retirees, without contracting with a PDP. This is often referred to as “supplemental” or “wrap-around” coverage.

Under this scenario, the government subsidy does not take the form of an outright cash payment; rather, it takes the form of lower claim payments. Drug costs previously paid by an employer plan would now be paid through a PDP. The most significant implementation challenge for an employer would be coordinating its benefits with numerous PDP and MA-PD plan designs.

Part D Premium Payor. Another option for employers is to pay all or part of retirees’ Medicare Part D premiums without entering into any specific arrangements with a PDP to offer prescription drug coverage. Some employers already take a similar approach by paying retirees’ Medicare Part B premiums. CMS estimates that Part D premiums will average $32 per month in 2006, but this will likely increase over time. If employers take this approach, they may choose to carve out Medicare Part D-covered drugs from of their health plans, or at least provide coverage on a secondary basis.

No Coverage. Given increasing health costs and compliance requirements by CMS, as well as the availability of Part D coverage, employers may consider eliminating retiree drug coverage entirely, to the extent possible. This would produce the largest employer savings of all the options and would eliminate government compliance obligations relating to the coverage.

SUBSIDY REIMBURSEMENT PROCESS

CMS opted to create a flexible payment system in which employers and unions could choose among multiple methods of receiving payment. CMS will allow a plan sponsor to receive payments on a monthly, quarterly, or annual basis.

Monthly or Quarterly Option. Under the monthly or quarterly option, a plan sponsor would provide aggregated actual gross covered retiree plan-related prescription drug costs incurred for all of its Qualifying Covered Retirees during the payment period for which a subsidy is being claimed. It would also provide an estimate of the difference between these gross costs and allowable costs (based on expected rebates and price concessions) and any other data CMS may require.

Annual Option. Under the annual payment approach, CMS offers two payment options: (1) a one-time final annual payment, in which a plan sponsor would submit actual cost and rebate, discount, or other price-concession data per retiree within 15 months of the end of the plan year; or (2) an interim annual payment, in which a plan sponsor, after the end of the plan year, would submit the aggregated actual gross drug costs incurred for all of its Qualifying Covered Retirees for which it is claiming a subsidy payment; an estimate of the difference between these gross costs and allowable costs (based on expected rebates and other price concessions); and any other data that CMS may require after the end of the plan year.

TIME FRAME

Originally, CMS required plan sponsors to apply for the subsidy no later than September 30, 2005, in order to be eligible for 2006, but now that has been extended to October 31, 2005, giving sponsors an extended window. Employers are no longer eligible to apply for PDP status for 2006 but may want to plan for 2007. Those who continue to provide coverage are required to send a notice to Medicare-eligible retirees before November 15, 2005, stating whether or not the employer plan provides creditable coverage. The Part D Rules are effective January 1, 2006.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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