

## OVERVIEW OF RETIREE DRUG SUBSIDY OPTION

**Introduction:** The Medicare retiree drug subsidy represents a particularly important strengthening of health care coverage for Medicare-eligible retirees, given the continuing erosion in the availability and generosity of employment-based retiree drug coverage that has already been taking place. The positive benefits from the new Medicare retiree drug subsidy program derive from the subsidy payments it will make available to plan sponsors, the special tax-favored status of the subsidy payments, and the flexibility provided to plan sponsors in using the subsidy to support their own retiree drug plans.

The retiree drug subsidy is one of several options available under Medicare that enables employers and unions to continue assisting their Medicare eligible retirees in obtaining more generous drug coverage. The final regulation reflects CMS' four objectives:

- maximizing the number of retirees benefiting from the special retiree drug subsidy;
- assuring that plan sponsors contribute to retiree drug coverage at least what Medicare pays on retirees' behalf;
- minimizing administrative burden while maximizing flexibility for employers and unions; and
- remaining within budget estimates.

This summary provides an overview of provisions in the final regulation of interest to plan sponsors relating to the Medicare retiree drug subsidy program.

**Overview of the Medicare Retiree Drug Subsidy:** Subsidy payments equal 28 percent of each qualifying retiree's allowable prescription drug costs attributable to gross prescription drug costs between the applicable cost threshold and cost limit (that is, in 2006, drug spending between \$250 and \$5,000 for 2006). Gross costs are costs incurred for Part D, which are any drugs that can be covered under the Medicare Prescription Drug benefit. Gross costs include dispensing fees, but exclude administrative costs. Allowable costs are actual incurred costs (i.e., net of discounts rebates, and similar price concessions). Subsidy payments are tax exempt.

We estimate plan sponsors that choose to participate in the retiree drug subsidy program will receive \$668 on average in annual per capita retiree subsidy payments. For plan sponsors subject to taxation, we estimate that the \$668 tax-free retiree drug subsidy would be equivalent to about \$891 of taxable income for employers with a marginal tax rate of 25 percent and about \$1,028 of taxable income for employers with a marginal tax rate of 35 percent.

Plan sponsors that participate in the retiree drug subsidy program retain the option of making certain arrangements with Medicare Advantage (MA) organizations that offer MA plans without prescription drug coverage. For retirees who receive their Part A and Part B benefits through an MA plan, the plan sponsor can arrange with the MA organization to supplement those benefits. In addition, the sponsor may have a private contract with the MA organization, unrelated to the organization's contract with Medicare under Parts A and B, under which the MA organization underwrites the sponsor's retiree drug benefit.

***Actuarial Equivalence:*** To qualify for the subsidy, a plan sponsor must show that its coverage is “actuarially equivalent” to (i.e., at least as generous as) defined standard coverage under the new Medicare prescription drug benefit. The final regulation includes a two-part test for plan sponsors to determine whether this standard, referred to as “actuarial equivalence,” has been met.

The first part of this test is the total or “gross” value test. To meet this requirement, the expected amount of paid claims for Medicare beneficiaries in the retiree drug coverage offered by the sponsor must be at least equal to the expected amount of paid claims for the same beneficiaries under the defined standard coverage. The second part of this test is the “net” value test, which takes into account the sponsor’s contribution toward the financing of the retiree drug coverage. The net value of the sponsor’s retiree plan, which is calculated by subtracting the expected retiree premium from the expected amount of paid claims under the sponsor’s drug program, must be at least equal to the net value of the Part D standard drug benefit.

The final rule provides that in calculating the net value of standard Part D drug coverage, one takes into account the impact of having an employer’s or union’s coverage supplement a retiree’s standard Part D coverage (in addition to subtracting the beneficiary premiums from the gross value of Part D). This would lower the amount of the expected paid claims under Part D because, under the true-out-of-pocket (TrOOP) requirements, having supplemental coverage will raise the spending threshold when Part D catastrophic coverage begins. Together, both parts of the test present a good balance of preventing windfalls being paid to sponsors and allowing as many sponsors to qualify for the subsidy as possible.

***Other Highlights of the Final Rule:*** Although a detailed discussion is beyond the scope of this brief summary, the final rule contains numerous provisions that significantly improve the flexibility and workability of the retiree drug subsidy program, including (but not limited to) rules for: dealing with multiple coverage options, non-calendar year plans, integrated premiums, and alternative timing of data submission and payments.

***Anticipated Future Guidance:*** CMS anticipates publishing additional guidance on actuarial equivalence, simplified actuarial methods, the subsidy application process, and other issues at a later date.

***For More Information:*** Please visit the RDS website at <http://rds.cms.hhs.gov/>.