

Committee on Finance
The United States Senate

Hearing:
Finding the Right Fit: Medicare, Prescription Drugs and Current
Coverage Options

Testimony of:
Steve Coppock, Principal
Andrew Zebrak, Consultant
Hewitt Associates, LLC

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Summary of Oral Testimony

Current Status of Retiree Health Benefits

- Employer-sponsored retiree health coverage is the largest source of supplemental health insurance for Medicare beneficiaries, providing coverage to 36 percent (13.8 million Medicare beneficiaries) of the non-institutionalized Medicare population in 1998.
- Employers are the largest source of prescription drug coverage for Medicare beneficiaries, with 33 percent (12.4 million) of non-institutionalized Medicare beneficiaries receiving drug coverage through employer-sponsored retiree health plans in 1998.
- Of all Medicare beneficiaries with drug coverage (27.8 million beneficiaries in total), nearly 45 percent (12.4 million beneficiaries) have employer-sponsored retiree drug coverage.
- Large employers are the primary sponsors of retiree health care coverage and the proportion of employers offering retiree coverage decreases with firm size.
- Medicare-eligible retirees appreciate the value of their employer-sponsored health benefits. Employer-sponsored retiree health insurance typically offers more generous coverage than other private health insurance, such as providing unlimited drug benefits with no caps. Retirees in employer-sponsored plans receive more in drug benefits and pay less in out-of-pocket expenses than beneficiaries in Medicare+ Choice plans and Medigap plans.
- Medicare-eligible retiree drug benefits are typically part of retiree health coverage and do not have separate premiums.
- In an effort to balance access, choice, quality and affordability in retiree drug coverage, employers use several tools to control utilization and costs, such as mail-order programs, disease management programs, and pharmacy benefit managers (PBMs).

Trends in Coverage

- Even with these tools, Medicare-eligible retiree drug expenditures have been growing more rapidly than other health expenditures and are projected to continue to rise with at least 15 percent annual trend expected from now until 2003. Prescription drug benefits represent a significant portion—40 to 60 percent—of the total cost of the retiree health care benefit for Medicare-eligible retirees after accounting for Medicare, and will increase to as much as 80 percent of Medicare-eligible retiree health costs by 2003.
- In the aggregate, employers will spend approximately \$22.5 billion on prescription drug coverage for Medicare-eligible retirees in 2003, increasing to \$37.1 billion in 2009.
- The prevalence of employer-sponsored health coverage for Medicare-eligible retirees has declined in recent years, with some employers dropping coverage and few newer employers adding retiree

health coverage. However, in the vast majority of cases where large employers have terminated retiree health coverage, the change was made on a prospective basis, for future retirees only.

- A Hewitt survey of large employers indicates that 36 percent of large employers are considering cutting back on prescription drug coverage for Medicare-eligible retirees over the next three to five years.

Medicare Prescription Drug Benefit Proposals

- Discussing the effects of a new Medicare drug benefit on employer-sponsored plan benefits and the retirees who receive them is difficult without knowing specific details about the new Medicare drug coverage.
- It is probably in the common interest of Medicare, of retirees, and employers if some positive incentives were added to encourage the retention of these employer-sponsored retiree health programs because of the high levels of employer spending on drugs for retirees, and the relatively generous benefits retirees in these plans enjoy.
- After accounting for proposed Medicare drug benefits, employers would still spend approximately 71-77 percent of their current total per retiree cost in 2003 for Medicare-eligible retiree drug benefits when wrapping-around a proposed drug benefit, and employer spending would be even higher if they pay all or part of any retiree premium required for the Medicare drug benefit. Employers would achieve limited financial relief because the proposed Medicare drug coverage represents a minority portion of the more generous employer-sponsored retiree coverage.
- If a \$4,000 federal stop-loss provision is added that would somewhat reduce employer spending, but even then employers would still be spending approximately 66 percent of the total drug cost per retiree in 2003.
- Most of those employers (80 percent) currently providing retiree health benefits have indicated in surveys that they would most likely retain drug coverage in response to the creation of a new Medicare drug benefit.
- The preferred employer response to a new Medicare drug benefit would be to wrap-around, or supplement, the new drug benefit and the specifics of the proposed drug benefit coordination should require the least amount of administrative complexity and expense.
- Retiree out-of-pocket costs would be dependent on the subsidy level in the Medicare program, with retiree out-of-pocket costs decreasing as the subsidy levels increase under Medicare.
- Employers base their decisions regarding their retiree health programs on many factors, besides a potential Medicare drug benefit, so the Committee may wish to consider additional ways of encouraging employers to sponsor retiree health programs.

STATEMENT OF STEVE COPPOCK AND ANDREW ZEBRAK

Thank you for the opportunity to testify on the current prescription drug environment for Medicare beneficiaries with employer-sponsored coverage, and the implications of a new Medicare prescription benefit on that environment. I am Steve Coppock, a principal at Hewitt Associates, which is a global management consulting and benefits delivery firm and the largest employee benefit consulting firm in the U.S., by revenue.

Hewitt primarily works with large employers that have 1,000 or more employees. For example, Hewitt clients include more than two-thirds of the *Fortune 500* employers. Our testimony will draw from a report Hewitt prepared for The Henry J. Kaiser Family Foundation, "The Implications of Medicare Prescription Drug Proposals for Employers and Retirees" (July 2000). It will also draw from other Hewitt data and from our experiences in working with large employers in attempts to better position their retiree health benefits, including prescription drug benefits.

A widely acknowledged shortcoming of the Medicare program is its exclusion of outpatient prescription drug coverage. Prescription drug expenditures represent a growing portion of Medicare beneficiaries' health costs, especially for beneficiaries without supplemental health insurance.

As Congress considers proposals to reform Medicare and develop a prescription drug benefit for Medicare beneficiaries, this Committee is to be commended for its efforts to understand the impact of these proposals on employer-sponsored retiree health coverage. Many Medicare beneficiaries have employer-sponsored retiree health benefits with generous drug coverage, which is of significant value to them.

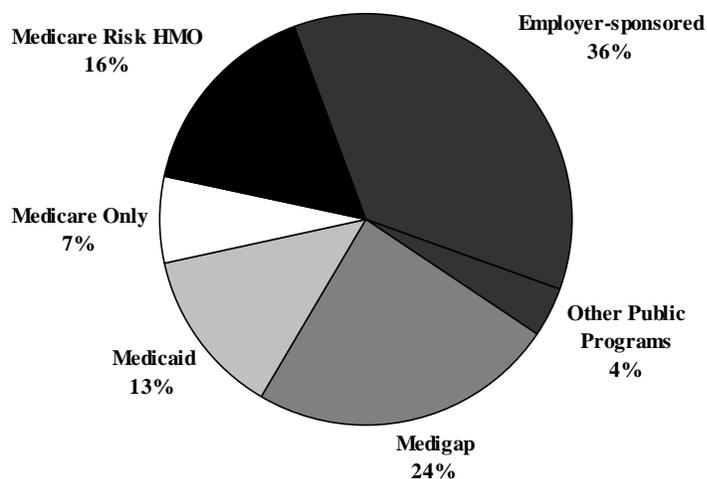
Our testimony will begin with a description of what employers provide to retirees in terms of prescription drug benefits and recent trends in coverage. Then, we will address the potential impact a Medicare prescription drug benefit could have on employer-sponsored retiree coverage and on retirees included under this coverage.

Current Status of Employer-Sponsored Retiree Health Coverage for Medicare Beneficiaries

Largest Source of Supplemental Coverage to Medicare

Employer-sponsored retiree health coverage is the largest source of supplemental health insurance for Medicare beneficiaries. The most recent Health Care Financing Administration (HCFA) data available (1998 Medicare Current Beneficiary Survey) indicates that 13.8 million Medicare beneficiaries, 36 percent of the non-institutionalized Medicare population, had employer-sponsored supplemental coverage. The 13.8 million includes some beneficiaries with both retiree coverage and individually purchased Medigap insurance (Figure 1).

Figure 1: Supplemental Health Insurance of Medicare Beneficiaries, 1998



Total = 38.1 million non-institutionalized Medicare beneficiaries, 1998

Note: Numbers may not add to 100 percent due to rounding.

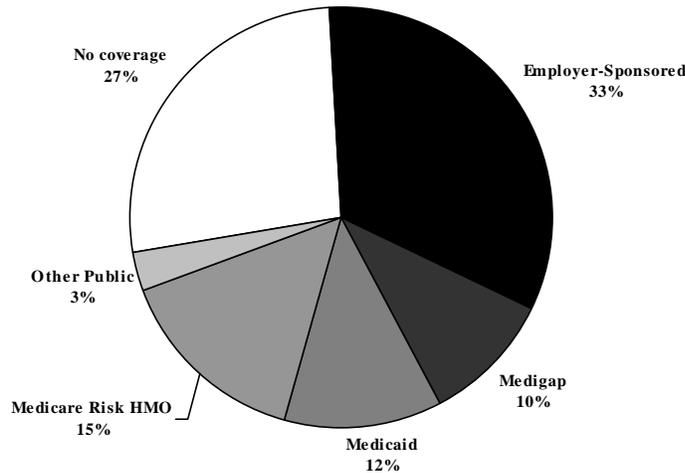
Source: Poisal, John, and Murray, Lauren, "Growing Differences Between Medicare Beneficiaries With and Without Drug Coverage," Health Affairs, March/April 2001.

Largest Source of Prescription Drug Coverage

Furthermore, employers are the largest source of prescription drug coverage for Medicare beneficiaries. According to the same HCFA data (1998 Medicare Current Beneficiary Survey), 90 percent of beneficiaries with employer-sponsored retiree health coverage had prescription drug coverage. Among the large employers in the Hewitt database, the percentage is even higher, with more than 95 percent of the large employers providing drug coverage as part of retiree health plans.¹ In total, 33 percent of non-institutionalized Medicare beneficiaries received prescription drug coverage through employer-sponsored retiree health plans in 1998 (Figure 2). Retirees with employer-sponsored prescription drug coverage comprise nearly 45 percent (12.4 million beneficiaries) of all Medicare beneficiaries with prescription drug coverage (27.8 million beneficiaries in total).

¹ Hewitt has monitored the benefit provisions of major employers since 1972 through annual updates to its database of client companies. The 2000-2001 Hewitt Associates SpecBook™ summarizes the benefits offered to salaried employees of 1,020 major U.S. employers, including 85 percent of the Fortune 100 and 58 percent of the Fortune 500 companies. In Hewitt's experience as a consultant to large employers, the retiree health coverage among employers in the database is generally representative of the Fortune 500 employers. The database represents coverage offered by large employers, which are the prime sponsors of retiree health coverage.

Figure 2: Prescription Drug Coverage of Medicare Beneficiaries, 1998



Total = 38.1 million non-institutionalized Medicare beneficiaries, 1998

Note: Numbers may not add to 100 percent due to rounding.

Source: Poisal, John, and Murray, Lauren, "Growing Differences Between Medicare Beneficiaries With and Without Drug Coverage," *Health Affairs*, March/April 2001.

Typical Employer-Sponsored Retiree Health Coverage

Hewitt estimates that absent any changes in law and assuming the continuation of current coverage, employers will spend in the aggregate approximately \$22.5 billion on prescription drugs for Medicare-eligible retirees in 2003, increasing to \$37.1 billion in 2009.

Large employers are the primary sponsors of retiree health care coverage. Research indicates that very large employers are much more likely to sponsor retiree health insurance than other employers, with the percentage of firms offering retiree health coverage decreasing as the size of the firm decreases. Retiree health coverage is least prevalent among small group health plans. For example, 52 percent of jumbo employers (5,000+ employees) offered retiree health benefits in 2000, compared with 35 percent of midsize firms (200-999 employees) and 7 percent of small firms (10-24 employees).² According to U.S. Labor Department data, in 1997, 43 percent of all full-time employees in private medium and large firms (100 or more employees) had retiree health coverage available, compared to only 16 percent of full time employees in firms with fewer than 100 employees (1996).³

² The Henry J. Kaiser Family Foundation/Health Research and Educational Trust, *Employer Health Benefits*, 2000.

³ U.S. Department of Labor, *Employee Benefits in Medium and Large Private Industry Establishments, 1997; Employee Benefits in Small Private Industry Establishments, 1996*.

Employer-sponsored retiree health insurance typically provides more generous drug coverage than other private health insurance. Large employers usually provide unlimited drug benefits, whether the benefit is provided by a fee-for-service Medicare supplement or through Medicare+ Choice (M+ C) plans. In the latter case, employers negotiate for their retiree group coverage and add drug benefits to the standard coverage otherwise available to individual retirees through the M+ C plan. However, individual coverage through M+ C plans and Medigap plans generally impose annual (or quarterly) prescription drug benefit limits.

According to Hewitt data, roughly 97 percent of employer-sponsored plans have no annual drug benefit caps. In 1999, 95.5 percent of large employers had unlimited drug benefits available through their M+ C plan offerings, about 4 percent had limits of \$1,000 or more, and less than 1 percent had limits under \$1,000, according to the Hewitt Health Value Initiative (HHVI) database.⁴ Annual drug caps are even less common under employer-sponsored fee-for-service supplemental policies than under employer-sponsored M+ C plans.

The majority of employer-sponsored retiree health plans contain specific provisions for prescription drug coverage separate from the specific deductibles, copayments or coinsurance for other medical expenses. For example, an indemnity plan may have a \$250 deductible and 20 percent coinsurance for non-drug medical expenses, with a separate \$5 copayment per prescription. HHVI data indicates that over 95 percent of large employer plans have separate prescription drug benefit designs. However, employers virtually never charge retirees a separate premium for the drug coverage.

Retiree health plans typically have a fixed amount, or copay, that a beneficiary pays when purchasing a drug, to help control costs. Copays may vary by major categories of drugs, i.e., generic versus brand name drugs, or whether the drug is on an approved list under the program (called a formulary). Generic drugs would have the lowest copay requirement and brand name drug copayments would have a higher copay. The generic/brand copay arrangement is the most common approach currently used with retirees, but three-tier copays are increasingly being introduced (as discussed further below).

Although there is some variation among retiree plans, more than half have copays of \$5 for generics and \$10 or more for brand name drugs, according to HHVI data. Approximately 7 percent of plans have no copay requirements for brand name or generic prescription drugs. The most common copay structure (in 1999) is \$5 for generic drugs and \$10-\$14 for brand-name drugs.

A growing number of employers are using three-tiered copayment systems—with different copayment amounts for different categories of medications—to influence utilization of more cost effective medications, e.g., generic and formulary drugs, while still allowing access to non-formulary products at higher patient copays. Under a three-tier arrangement, the lowest copay would again be for the generic drugs, e.g., \$5. Brand name drugs are then categorized depending on whether they are on the formulary or not. The formulary brand copay would then be higher than the generic copay, e.g., \$15, and the non-formulary copay would be even higher still, e.g., \$35 to \$50. But a wide difference may exist in the spread between the formulary and non-formulary copays, depending on the plan. Large

⁴ Hewitt Health Value Initiative™ is an annual study that collects plan costs, designs, health plan performance measures and employee satisfaction survey results for over 300 large employers. It includes plan design information for 1,000 plans and one million lives for post-65 retiree health plans.

employers who have adopted three-tier programs have done so in an effort to balance access, choice, quality and affordability, saying that without a three-tier approach, affordability would have suffered.⁵

Three-tier copays may become even more common in retiree health plans over the next several years as employers and Medicare+ Choice plans seek additional ways of managing sharply rising expenditures on retiree prescription drugs.⁶

Formularies

Retiree health plans typically use formularies as part of the drug benefit and have been shifting in recent years from open formularies to closed and partially closed formularies.⁷ A survey of health plans (including current employees and retirees) indicates that 25 percent of employers used an open formulary, 19 percent used a closed formulary, and the majority (56 percent) used a “selective/partially closed formulary.”⁸

Pharmacy Benefit Managers

A majority of employers have discontinued their reliance on medical insurance carriers to process claims for prescription drugs. Instead, Hewitt's Health Value Initiative™ data indicate that approximately 70 percent of self insured employers use a pharmacy benefit manager (PBM) to manage the pharmacy network and process those claims. Under the PBMs' administration, over 98 percent of claims for prescription drugs are submitted electronically by the pharmacy that fills the prescription. The PBMs typically adjudicate the claims through a standardized process within 60 seconds or less.

The PBMs apply consistent discounted reimbursement formulae for all claims. In addition, employers also receive a portion of the rebates that PBMs earn from pharmaceutical manufacturers.

In addition to serving as the systems and financial management arm, PBMs also provide a myriad of cost management programs for employer-sponsored retiree health plans. These programs can range from basic activities, such as requiring prior authorization for specific prescription drugs to designing and implementing disease management programs that can be applied for an employer's retiree population. For example, many PBMs are heavily involved in prescription-drug focused clinical treatment programs for conditions such as diabetes, asthma and depression.

⁵ Shelly Reese, “New Concepts in Health Benefits: Three-tier drug copays,” *Business & Health*, April 2000.

⁶ “The movement toward three-tier plans is so pervasive that last year alone the percentage of commercial health plan members enrolled in such programs nearly doubled to 57 percent from 29 percent, according to Caredata's annual survey of nearly 25,000 members. Most self-insured plans are not among the early adopters.... Only about one in five self-insured plans currently uses a three-tier plan,” Shelly Reese, “New Concepts in Health Benefits: Three-tier drug copays,” *Business & Health*, April 2000. In a separate but similar report, 67 percent of health plans offered a three-tiered copayment option to their members in fall 1999, up from 36 percent in spring 1998, according to Scott-Levin, *Managed Care Formulary Drug Audit*.

⁷ Open formularies provide coverage for virtually all drugs with no financial penalty, regardless of whether they are on the formulary list. A closed formulary means that a drug that is not on the formulary list is not a covered benefit. Partially closed formularies cover formulary drugs and selected non-formulary drugs for which coverage is determined by prior authorization.

⁸ Novartis Pharmaceuticals, *Pharmacy Benefit Report: Trends and Forecasts*, 1998 Edition.

Mail-Order

Another tool offered by PBMs and commonly utilized by employer plans is mail-order programs. These mail-order programs may contain costs through increased use of generic drugs and lower prices for covered drugs via volume discounts. Approximately 70 percent of plans in the Hewitt database (HHVI) offer mail order programs to retirees. Mail-order programs are appropriate for many retirees that use maintenance medications for chronic conditions and provide several advantages to retirees such as home delivery, lower costs than in a retail pharmacy, and lower copays for a 90-day supply than the copays would be for three 30-day supplies.

Value to Retirees

Medicare beneficiaries with employer-sponsored retiree drug coverage receive higher drug benefits and pay less in out-of-pocket drug expenditures than beneficiaries in Medicare+ Choice (M+ C) plans and Medigap plans. Thus, retirees are highly satisfied and value their employer-sponsored health care coverage and drug benefits. Data from the Medicare Current Beneficiary Survey (MCBS) illustrates the more generous coverage under employer-sponsored plans compared with M+ C and Medigap plans.

For example, based on HCFA MCBS data, average drug expenditures per person in 1998 were \$1,072 for beneficiaries with employer-sponsored coverage, \$682 for beneficiaries in M+ C plans, and \$947 for beneficiaries with Medigap coverage. (These employer-sponsored spending amounts would be about 50 percent larger if trended forward to 2001). Retirees with employer-sponsored coverage paid proportionately less out-of-pocket in 1998 (29 percent), than beneficiaries in M+ C plans (40 percent) or beneficiaries with Medigap coverage (58 percent). Between 1995 and 1998 alone, retiree out-of-pocket expenses grew considerably faster under M+ C plans and Medigap than for those with employer-sponsored coverage, where the retiree out-of-pocket share actually declined from 31 percent to 29 percent.

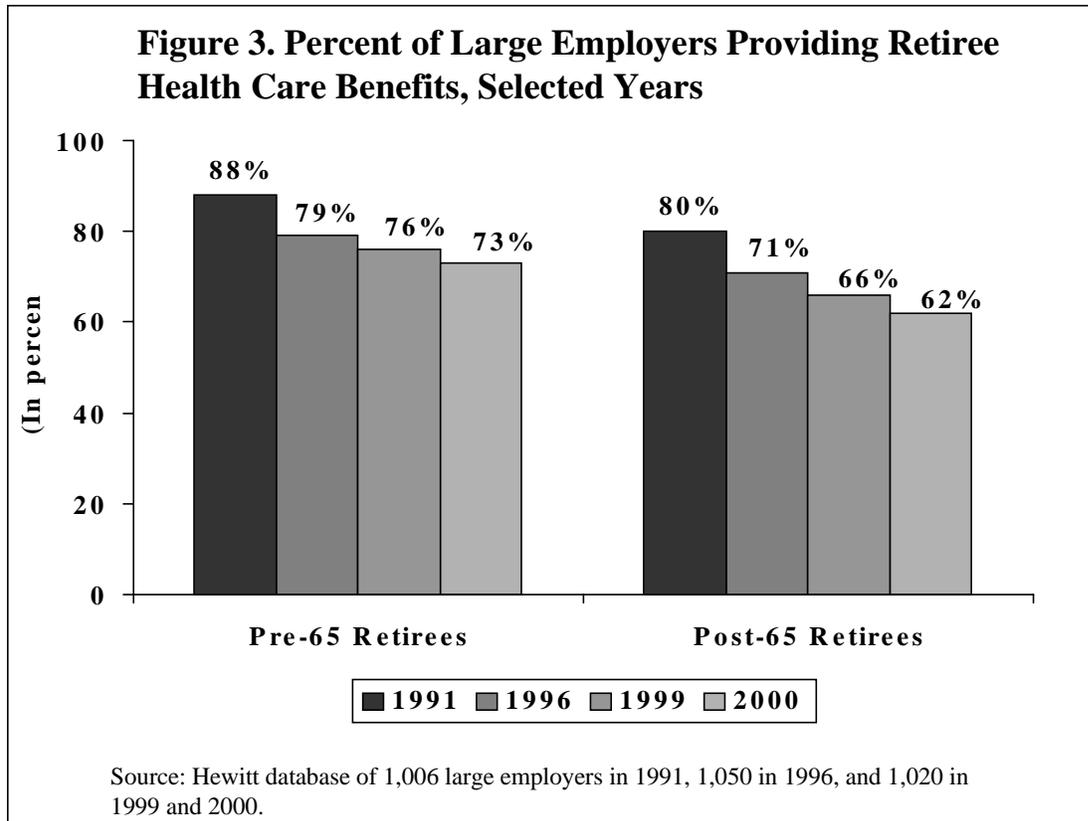
Table 1. Average Drug Expenditures Per Person for Medicare Beneficiaries, By Type of Supplementary Drug Insurance.

Source of Coverage	Total Drug Expenditure	Percentage Out-of-Pocket
Employer-Sponsored	\$1,072	29%
Medicare+ Choice	\$682	40%
Medigap	\$947	58%

Source: Medicare Current Beneficiary Survey, 1998.

Trends in Retiree Health Coverage for Medicare Beneficiaries Employer Sponsorship is Declining

The prevalence of retiree health coverage has declined in recent years, with some employers dropping coverage and few newer employers adding retiree health coverage. In the Hewitt large employer database, there was an 18-percentage point drop in the proportion of large employers offering retiree health coverage to age 65+ retirees between 1991 and 2000 (Figure 3).



However, the decline in the share of large companies that sponsor retiree health coverage is not solely attributable to employers dropping retiree health coverage. The decline also reflects turnover among employers in the database and the addition of newer and smaller-size employers without retiree coverage, often in high-tech or other industries in which retiree health care has little appeal to a predominantly young workforce with short tenure.

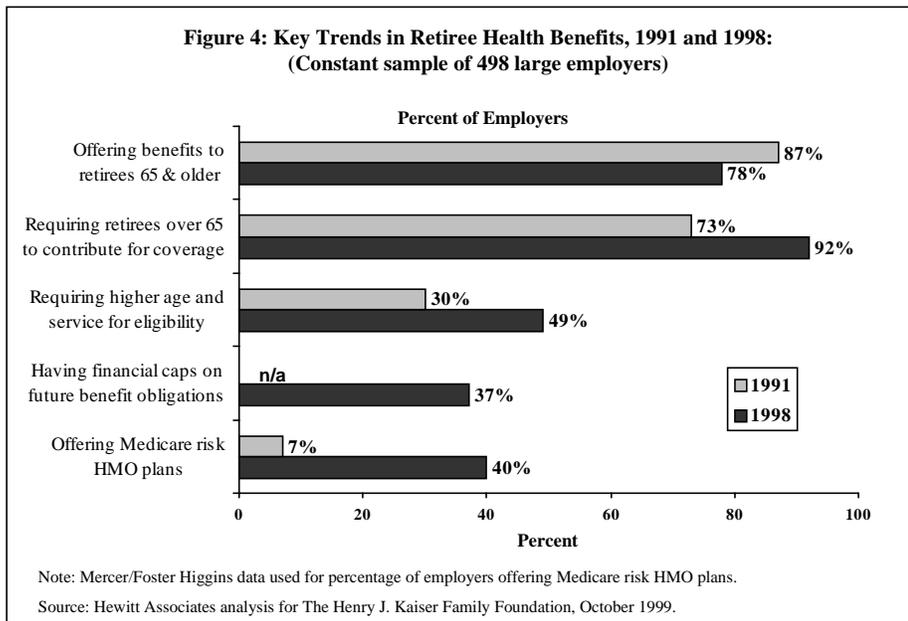
In the vast majority of cases where large employers terminated retiree health coverage, the change was made on a prospective basis, for future retirees. Thus, current retirees and those close to retirement (if not all employees) are usually “grandfathered” into the current program. Also, the elimination of retiree medical coverage may often be accompanied by increases in retirement or other benefits.

Retiree Coverage Tightening

Hewitt analyzed trends in the retiree health benefits offered by a constant sample of employers in the Hewitt database between 1991-1998.⁹ For the constant sample of 498 employers, several trends in retiree health benefits emerged (Figure 4):

Fewer employers offer post-retirement health benefits,¹⁰

- Employers require retirees to contribute for health benefits,
- Financial caps are often placed on employers' future obligations,
- Eligibility for benefits narrowed, and
- More employers offer Medicare managed care plans.



⁹ Hewitt Associates, *Retiree Health Coverage: Recent Trends and Employer Perspectives on Future Benefits*, October 1999.

¹⁰ The percentage of employers offering retiree health benefits is higher in the constant sample than in the overall Hewitt database because the constant sample contains a higher percentage of large employers than the full database, and large employers are more likely to offer retiree health benefits. Also, the constant sample represents the experience of more mature, stable companies.

Drug Benefit Consuming Retiree Health Benefit

The cost of the prescription drug benefit for employers has been growing more rapidly than other health expenditures and is projected to continue to rise in double-digit rates for the short-term, with at least 15 percent annual trend expected from now until 2003. Prescription drug benefits represent a significant portion—40 to 60 percent—of the total cost of the retiree health care benefit after accounting for Medicare. Furthermore, Hewitt projects that drug expenditures will represent as much as 80 percent of retiree health costs in 2003. In comparison, prescription drugs comprise approximately 15 percent of total health care costs for active employees.

As noted previously, Hewitt estimates that absent any changes in law and assuming the continuation of current coverage, employers will spend in the aggregate \$22.5 billion on prescription drugs for the age 65+ retirees in 2003, increasing to \$37.1 billion in 2009.

Employer Coordination with Medicare Fee-for-Service

Employers offering retiree health coverage use one of three methods to integrate their indemnity plan coverage with Medicare coverage of the same claim when Medicare is the primary payer. Employers could coordinate with a new Medicare drug benefit for fee-for-service beneficiaries in following the same techniques they currently use to integrate with fee-for-service Medicare:

1. **Full Coordination of Benefits (Full COB)**—The plan pays all eligible charges in excess of the Medicare reimbursement amount, or the amount it would have paid in the absence of Medicare, if less.
2. **Exclusion**—The plan applies its normal reimbursement formula to the eligible charges remaining after Medicare reimbursements have been deducted from total eligible charges.
3. **Carve-Out**—Medicare reimbursements are deducted from plan payments (which are calculated using the normal reimbursement formula and without regard to Medicare).

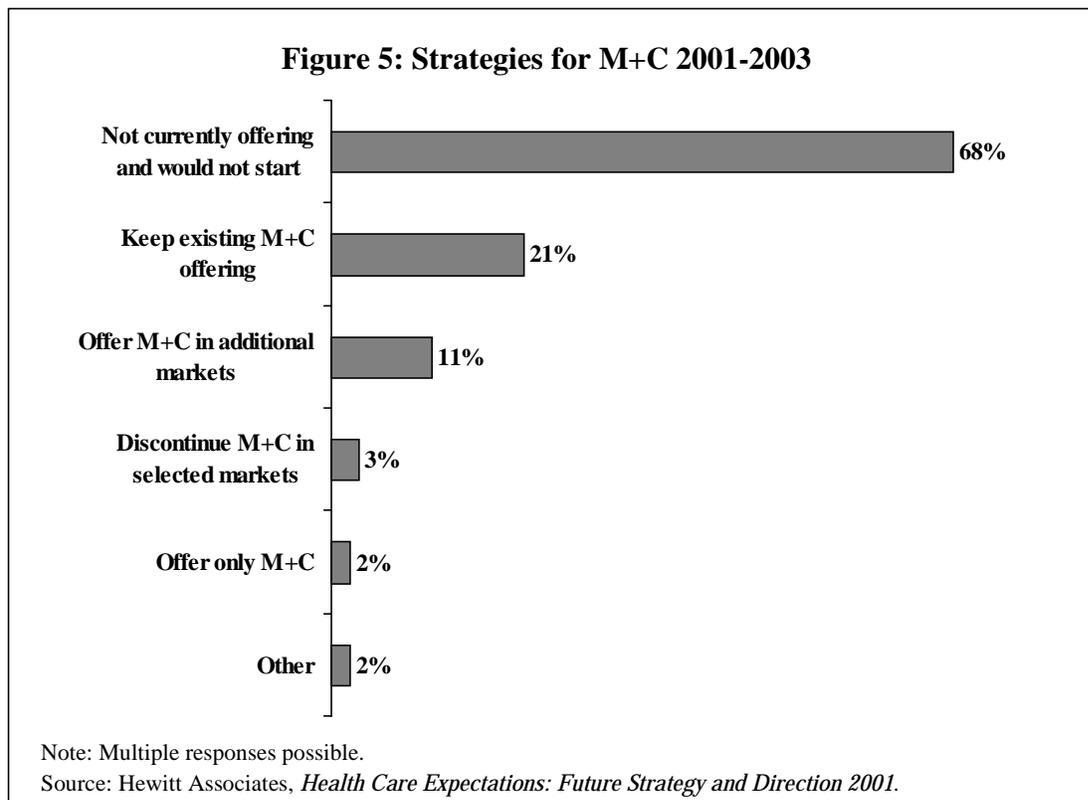
The method of integrating with Medicare has significant effects on the amount the employer plan pays in addition to Medicare, as well as on the retiree out-of-pocket cost for the same claim.

Employer-sponsored retiree coverage has shifted in recent years toward use of the carve-out approach. In 2000, 5 percent used a COB approach, 28 percent used the exclusion approach, and 57 percent used a carve-out approach, while the remaining 10 percent used some other approach (e.g., the integration varies depending on the health plan option selected by the retiree), according to the Hewitt database.

Employer Coordination with Medicare+ Choice (M+ C)

Employers could coordinate with a new Medicare drug benefit following the same techniques they currently use to integrate with Medicare+ Choice (M+ C) plans. Under M+ C, retirees agree to obtain all Medicare-covered services from the M+ C plan they join. This also occurs when an employer sponsors a M+ C plan for retirees. Employers usually coordinate with M+ C plans by negotiating with the health plan for any additional benefits and services for their retiree group and the corresponding premiums for the supplemental benefits. For example, employers usually negotiate for unlimited prescription drug coverage for their retirees, who would then receive the drug benefit through the M+ C plan. The employer typically contributes a flat dollar amount per month toward the premium for the supplemental benefits.

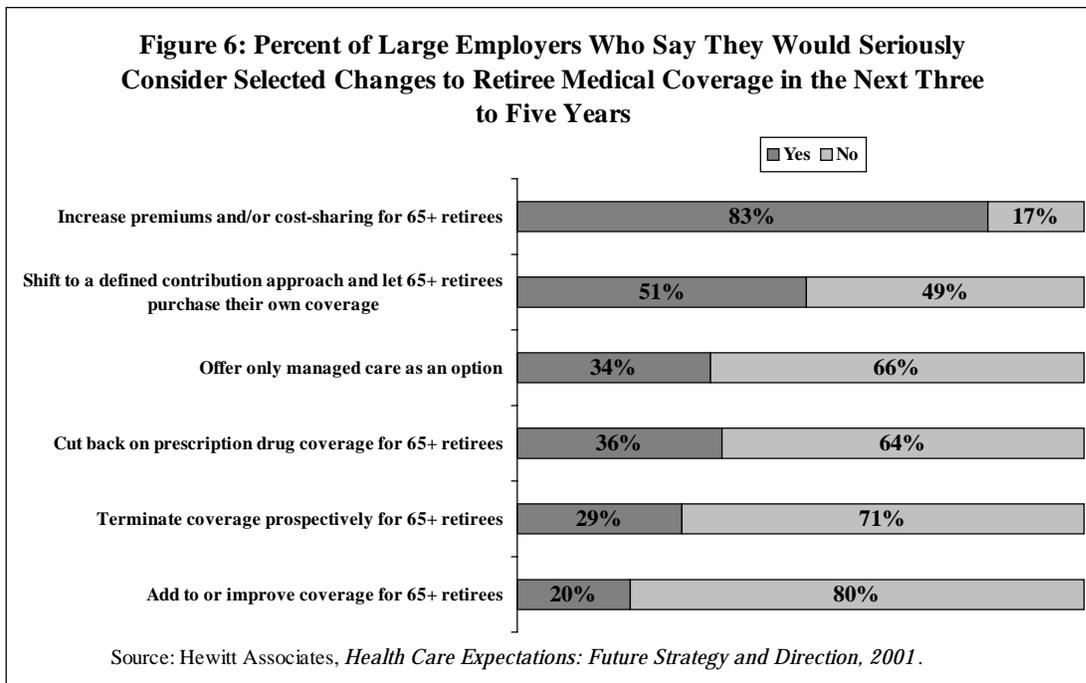
However, while the M+ C program originally seemed promising to employers, lower than expected health plan participation has made the M+ C program less appealing than employers originally had hoped. For example, 68 percent of large employers indicate they do not currently offer M+ C plans and do intend to offer them in the future (Figure 5).



Future Changes in Retiree Health Benefits

A Hewitt survey of large employers provides insight into employer strategies on their retiree health benefits.¹¹ The survey indicates that large employers would “seriously consider” making significant changes in retiree health plans over the next three to five years, including placing limits on existing coverage and controlling costs (Figure 6).

- Eighty-three percent of respondents said they would consider increasing premiums and cost-sharing for 65+ retirees.
- Just over half of the respondents, 51 percent, would consider shifting to a defined contribution approach and allowing age 65+ retirees to purchase their own coverage.
- Thirty-four percent of employers said they would consider only offering a managed care plan as an option.
- Thirty-six percent of employers said they would consider cutting back on prescription drug coverage for 65+ retirees.
- Twenty-nine percent of employers would consider prospectively terminating 65+ coverage.
- Twenty percent of respondents report they would consider adding to or improving coverage for retirees.



¹¹ Hewitt Associates, *Health Care Expectations: Future Strategy and Direction, 2001*. The survey was conducted in September/October 2000. Survey participants included over 600 large companies (more than 1,000 employees).

Medicare Prescription Drug Benefit Proposals

In recent years, many proposals have been developed to provide outpatient prescription drug coverage to Medicare beneficiaries. Several of the primary proposals would add prescription drugs to the Medicare program as a covered benefit. The prescription drug benefit would be available to all beneficiaries (universal) on a voluntary basis. The design of a Medicare drug benefit and its rules related to retiree coverage would determine the likely effect on employers and retirees. This section of the testimony will discuss the probable impact a new Medicare drug benefit would have on employers and retirees.

Forecasting and discussing the effects of a Medicare drug benefit on employer-sponsored retiree health plans and retirees is difficult, especially without ascertaining the specific benefit levels that the drug benefit would provide. Other key information relates to how the benefit would be delivered to retirees, the subsidy levels (if any) provided to retirees and employers, and the coordination rules concerning employer-sponsored plans.

Employer Response Options

In response to the creation of a Medicare prescription drug benefit, employers would have several possible options for their retiree health benefits. Hewitt has modeled the potential impact a new Medicare drug benefit may have on employers and retirees based on five potential employer options.¹² The response undertaken by employers and the specific details of the Medicare drug benefit will determine the impact on employers and retirees.

These five employer responses are based on a Hewitt survey of approximately 327 large employers (1,000+ employees) in 1999, which asked for employers' likely responses to the Clinton Administration's Medicare drug plan.¹³ The responses serve as a proxy for how employers are likely to react to a new Medicare drug benefit.

The survey asked employers to select from a list of options regarding how they would most likely react if the Administration's drug proposal were enacted.

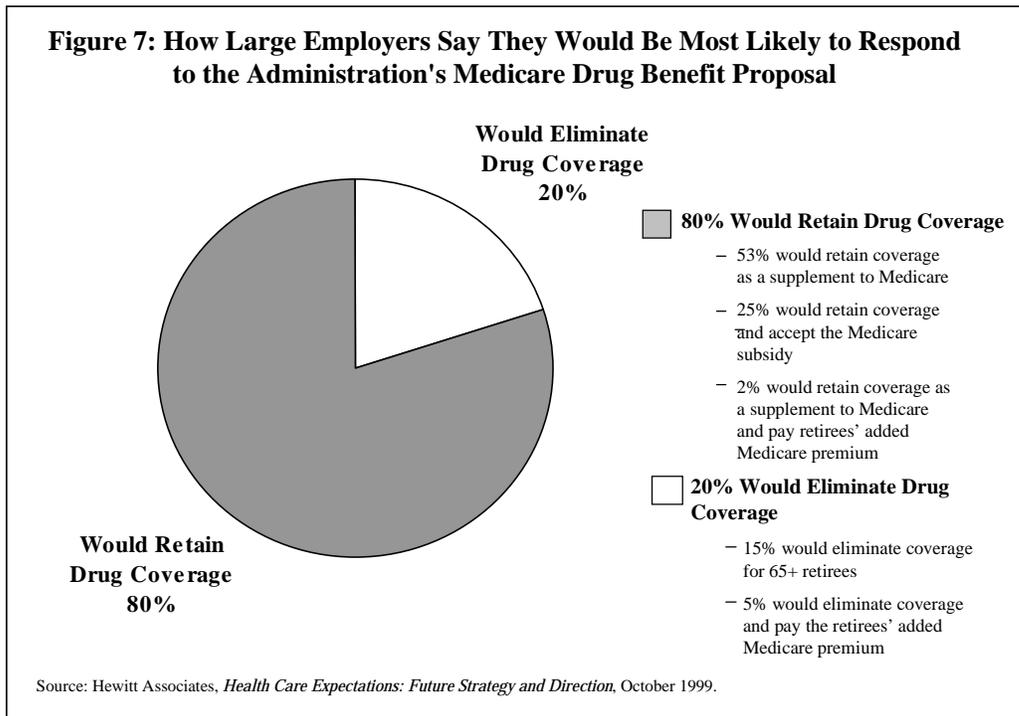
- Eighty percent of employers would retain their prescription drug coverage.
 - Fifty-five percent would retain prescription drug coverage as a supplement to the Medicare benefit, of which two percent would also pay for the retiree's added Medicare premium.
 - Twenty-five percent would retain primary prescription drug coverage and accept the subsidy from Medicare.
- Twenty percent of employers would eliminate prescription drug coverage for age 65+ retirees.
 - Fifteen percent would eliminate prescription drug coverage for 65+ retirees.

¹² The five estimated employer response options to a Medicare drug benefit are: (1) retain retiree prescription drug coverage and accept the employer subsidy (if offered), (2) retain retiree drug coverage and coordinate with the new drug program, (3) retain retiree drug coverage, coordinate with the new drug program and pay for the retiree drug premium, (4) eliminate retiree drug coverage, and (5) eliminate retiree drug coverage and pay for the retiree drug premium.

¹³ Hewitt Associates, *Retiree Health Coverage: Recent Trends and Employer Perspectives on Future Benefits*, October 1999.

- Five percent would eliminate prescription drug coverage and pay for the retiree’s added Medicare premium.

The key finding is that eighty percent of respondents said they would most likely retain, and not eliminate, drug coverage for retirees. The majority would wrap their drug coverage around the Medicare drug benefit and achieve financial relief for drug expenditures as a result (Figure 7).



Impact on Employers

Depending on the design of the new Medicare drug program and benefits provided, employers could potentially experience some relief from rising prescription drug costs for retirees. Without financial relief from growing retiree health costs, coverage would most likely continue to erode at a more rapid rate than if there were Medicare-supported prescription drug coverage. The majority of employers with retiree health benefits would continue to offer prescription drug coverage to retirees and experience some easing of cost pressure from prescription drugs. The preferred employer strategy would be to wrap-around (coordinate with) the universal Medicare benefit and the retiree drug benefit.

After accounting for proposed Medicare drug benefits, employers would still spend approximately 71-77 percent of their current total per retiree cost in 2003 for Medicare-eligible retiree drug benefits when wrapping-around a proposed drug benefit, and employer spending would be even higher if they pay all or part of any retiree premium required for the Medicare drug benefit. Employers would achieve limited financial relief because the proposed Medicare drug coverage represents a minority portion of

the more generous employer-sponsored retiree coverage. Conversely, if a \$4,000 federal stop-loss provision is added that would somewhat reduce employer spending, but even then employers would still be spending approximately 66 percent of the total drug cost per retiree in 2003.

The design of the new Medicare drug program and how it allows employers to coordinate retiree coverage with the Medicare drug benefit is critical in determining the impact on employers. The new Medicare drug program could encourage employers to offer retiree health coverage by allowing employers to wrap-around the Medicare drug benefit. The specific details of the Medicare drug benefit should require the least amount of administrative complexity and expense. Prohibiting employers from wrapping-around the Medicare drug benefit could further the decline in employer-sponsored retiree health care. Although a direct subsidy for employers to offer retiree drug benefits is designed to encourage employers to offer drug coverage and would lower employer costs for retiree drug benefits, most employers would prefer to forego the direct subsidy and instead wrap-around the Medicare drug benefit.

Programs targeting low-income individuals, by their design, would offer little or no financial savings to employers. Low-income proposals would not have a significant impact on retirees with employer-sponsored health benefits because most of these retirees would not qualify for coverage. The majority of these retirees would have incomes well above the poverty level from a combination of higher benefits from Social Security and from employer-sponsored pension and savings plans.

Impact on Retirees

The potential impact of a new Medicare drug benefit on retirees depends on the design of the Medicare drug program and employers' response to the new benefit. Retiree out-of-pocket costs would be dependent on the subsidy level in the Medicare program. As the subsidy levels increase under Medicare, retirees' costs would decrease.

Employer reactions to the Medicare drug benefit and any subsequent modifications to employer-sponsored retiree health benefits would impact retirees. Retirees would maintain their current generous coverage levels if employers continued their retiree health benefits and wrapped-around the new Medicare drug benefit. The manner in which employers wrapped-around the new Medicare drug benefit would affect retirees' out-of-pocket costs, depending on whether employers paid for all or part of the retiree premiums for the new Medicare drug benefit.

Conclusion

In the short-term, the creation of a Medicare prescription drug benefit could slow (but probably not reverse) the erosion of retiree health care coverage among large employers because it could provide financial relief from rising retiree health costs. Hewitt estimates that the majority of employers with retiree health care benefits would maintain coverage by wrapping-around the Medicare drug benefit. Even though a new Medicare drug benefit would not immediately lead to the elimination of retiree drug coverage, it could encourage a gradual decline over the long-term, as retiree health care costs have been increasing for employers at double-digit rates and are a major source of concern.

Medicare drug coverage only represents one important consideration, as employers review their options regarding retiree health benefits. So longer-term, there is considerable uncertainty about how employers would make decisions regarding their retiree health programs. For example, economic and legal considerations would also be very important, as well as the employer's competitive position in a global economy. Such factors may lead to a continued gradual decline over the long-term. For that reason, the Committee may wish to consider other ways of encouraging retiree health programs. In a previous report,¹⁴ we outlined several technical possibilities, such as using surplus pension assets to fund retiree medical expenses for the same group of employees in the pension plan and making minor changes to the tax code, and there are others as well that merit review.

In closing, Medicare prescription drug coverage proposals must address the complex issues regarding interactions with employer-sponsored retiree health benefits, which are the largest source of drug coverage for Medicare beneficiaries. Policymakers should carefully consider the inter-relationships and incentives between a Medicare drug benefit and employer-sponsored retiree health care. The Senate Finance Committee is to be commended for conducting this hearing.

¹⁴ Hewitt Associates, *The Implications of Medicare Prescription Drug Proposals for Employers and Retirees*, prepared for the Henry J. Kaiser Family Foundation, July 2000.