

The new Medicare

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Millions of potential new customers. An estimated \$724 billion in federal spending over the next 10 years.

And big business poised for a piece.

The new Medicare drug benefit represents more than expanded coverage for seniors. It's a profit-making chance for a large swath of the health care sector.

Come Jan. 1, the Medicare health insurance program will offer broad prescription drug coverage for the first time. But the private sector, not the government, will deliver the drug coverage to seniors and other eligible Medicare recipients, who will have access to two or more drug plans no matter where they live.

In the months before the benefit kicks in, industry is gearing up to make the most of it. The prime players are the health insurers and pharmacy benefit managers, who will provide and administer the benefit, and the drug stores and pharmaceutical manufacturers, who could see a wave of new drug buyers.

Critics say the private sector's hands are all over the law that begat the Medicare expansion. One aspect frequently cited as a gift to the pharmaceutical industry is that the regulations prevent the government from directly negotiating drug prices. But many questions about its effect on business remain, especially how many people will take the voluntary benefit. Although 43 million people are expected to receive Medicare next year, government officials and financial analysts project far fewer will participate in the drug benefit. Some already get drug benefits through different channels such as their former employers, and others just will not sign up.

"Congress made a very specific decision that it's going to be a private delivery system," said John Richardson of consulting firm Avalere Health in Washington.

"The only unanswered question is, what are Medicare beneficiaries going to think about this? Everyone is holding their collective breath to see if anyone is going to sign up."

Here's an overview of the five groups at the core of the benefit: health insurers, pharmacy benefit managers, drug companies, pharmacies, and employers that offer their retirees prescription drug coverage.

Health insurers

Health insurers stand to be the main providers of the new drug coverage - and in the eyes of some analysts, may benefit the most.

"The potential Medicare [prescription drug] opportunity is enormous, and represents one of the last sources of untapped managed-care growth," Carl McDonald, an analyst with CIBC World Markets, wrote in a June report to investors.

Most Medicare recipients receive their health-care insurance through the federal government, although some receive it from private plans, which contract with the government.

Companies will offer the drug benefit in two ways: as a standalone coverage, which would supplement the

recipient's government plan, or as a component of their privately run Medicare plans, known as Medicare Advantage plans, which could grow as a result.

Companies had to apply to the government by March 23 to provide the benefit nationally or regionally, and bids for prospective prescription drug plans were due last month.

But because the bidding process is private, the amounts of the bids are unknown, making it difficult to determine the potential profitability. The winning bids are expected to be announced in September.

"My strong sense is, there is some room to make money," said Sheryl Skolnick, an analyst with Fulcrum Global Partners.

"How much room, I don't know."

Pharmacy benefit managers

These behind-the-scenes middlemen in prescription drug transactions are poised to do with Medicare what they do in the commercial market - act as administrators for the drug benefit.

Through their sheer size, defined by the number of members, they leverage lower drug prices from drug makers for their clients - employers and health plans. Bringing in new members through Medicare potentially will add to that clout.

Mark Merritt, executive director of the pharmacy benefits managers' trade group, the Pharmaceutical Care Management Association, sees another benefit.

Merritt said the benefits managers' business model has been attacked by other businesses - such as pharmaceutical companies and drug stores - as well as consumer advocates who question how much they save their clients. Medicare's decision to allow many of the managers' cost-cutting methods - tiered co-payments, mail-delivery drugs and lists of preferred drugs designed to leverage discounts from manufacturers — gives a vote of confidence to the benefits managers, Merritt said.

"It's very important strategically to PBMs [pharmacy benefits managers] because it writes into law and focuses on using the core tools that PBMs have used successfully," Merritt said.

PBMs often are criticized for not being transparent about the rebates given by the pharmaceutical companies to get their products on coverage lists. That criticism could increase as the PBMs come more into the public eye in administering the Medicare drug benefit.

Although health insurers are expected to shoulder most of the coverage risk of ballooning drug costs, PBMs may take some of that load.

Analysts say Franklin Lakes-based Medco, one of the largest PBMs, has appeared more willing than other PBMs to assume risk.

The company says it has an "innovative approach" to mitigate risk through agreements with drug manufacturers for lower prices in the event more drugs are used than expected.

A Medco spokeswoman said that Medco sees its main involvement in Medicare as supporting its insurer and employer clients as they provide the drug benefit.

Pharmacies

Drugstores will see more seniors walking through their doors because of the Medicare drug benefit.

To be sure, many seniors who previously avoided paying out of pocket for drugs now may have coverage, and are now potential new customers.

And not only will these seniors buy prescriptions, they will probably do other shopping at the stores once they're drawn in.

Potentially tempering that growth for pharmacies is the fact that those cash-paying Medicare recipients now will be buying lower-margin prescriptions because they are members of the drug plans.

The Medicare drug benefit also could become the newest front in the battle between pharmacies and benefit managers over often cheaper mail-order drugs.

Mary Ann Wagner, vice president of pharmacy regulatory affairs at the National Association of Chain Drug Stores, said a top priority with the implementation of the drug benefit is to make sure it provides the option for beneficiaries to get their drugs from their pharmacies.

"Congress certainly did not intend for them to push mail order," Wagner said.

Drugstore pharmacists are bracing to be on the front lines in explaining the benefit to seniors, no small task considering its complexity.

Pharmacies also may have another new role: helping patients with many prescriptions try to manage them through new programs created under Medicare.

Drug makers

Seniors who had to pay out of pocket for their medicines before will be covered - meaning more people buying prescription drugs.

Critics call the new drug benefit a boon for the pharmaceutical industry.

By preventing Medicare from bringing its clout to bargaining for lower drug prices, the legislation created an "unwarranted windfall" for the drug industry, said Ron Pollack, executive director of the health-care consumer group Families USA.

"They escaped any kind of price moderation," Pollack said.

"This system over time is simply unsustainable ... and it was the failure to take on the drug companies, in fact the caving in to the drug companies, that I think is going to lead to a fiscal crisis rather soon."

However, Kevin Barnett, a consultant specializing in the Medicare drug benefit, said to get on drug plans' lists of covered medicines, pharmaceutical companies will have to make tradeoffs by cutting their prices.

"The expectation is that it could place increasing pricing pressures on manufacturers," said Barnett, a senior vice president for the Campbell Alliance pharmaceutical consulting firm in Raleigh, N.C.

Barnett added that the Medicare drug benefit will have ripple effects on the industry's overall marketing, and

research and development.

For example, he said, the agency overseeing Medicare is emphasizing so-called evidence-based medicine.

So in the future, pharmaceutical companies may have to enroll more seniors in their clinical trials to attain Medicare coverage.

Employers

Lawmakers creating the benefit feared that it would spark employers to drop their prescription drug plans for retirees.

So they offered an incentive: money. For maintaining their benefit plan, employers can get a tax-free subsidy from the government for 28 percent of their prescription drug costs, or about \$600 a year for each member. Employers must apply by the end of September for the subsidy. To get the subsidy, employers must prove to the government that their plans provide equivalent coverage to Medicare.

A survey last year by the Kaiser Family Foundation and the Hewitt Associates consulting firm found that 58 percent of large companies planned to take the subsidy and continue to offer benefits.

Employers have other options. They could have applied to offer a prescription drug plan on their own, perhaps contracting with an insurer or PBM. They could provide coverage that supplements the new Medicare benefit, or provide an alternative, improved benefit plan. They could also make no changes to their plan. Or they could drop retiree coverage.

The proof required to get the subsidy could pose an administrative burden that dissuades some companies, particularly small to mid-size firms, from applying for it, said Sam Fleet, president of the National Employee Benefit Cos., a benefit administrator and consulting company.

"The cost of applying for the subsidy may outweigh what it's worth," Fleet said.

What employers do in the future remains unclear.

"From the large employers' perspective, I think this is sort of a temporary hold," Fleet said. 2006 "is going to be a kind of wait-and-see year."