



Medicare Part D

A Complex, But Golden, Opportunity

With GASB 45 breathing down their necks and rising retiree health care costs looming over their budgets, public employers could be forgiven for viewing Medicare Part D's entry on to the scene as just one more complicating factor that makes their life difficult. But the cagy public risk manager will cut to the bottom line and see the advent of Medicare Part D for what it offers you: a golden opportunity to stabilize costs and satisfy credit-rating agencies.

Unfortunately, as I travel the country to meet with both corporate and public leaders, I find that many public risk managers are behind their private-sector peers when it comes to understanding their options and the implications—both immediate and long term—of the decisions they are now being forced to make. Because of the convergence of GASB 45, rising pharmaceutical costs and Medicare Part D, even doing nothing is actually a choice—and a potentially costly one.

Even when you, as a savvy public risk manager, have a clear understanding of these issues, it is often difficult for you to get the attention of

your policy makers and bring them up to speed on an issue that looks more complicated than it is. Yet for all the confusion surrounding Medicare Part D, it is possible to cut through the clutter of detail, clarify benefits and risks, and lay out a menu of choices for public employers.

Covering the Basics

Let's start with a brief primer. GASB 45 requires public employers to reflect on the balance sheets the promise of retiree benefits during the working years of the employees. It's an obligation that private sector and nonprofit employers have had since the early 1990s. Accruing the cost of these future benefits and making them part of their financial statements has had a dramatic impact on many corporations, draining away profits on paper and sharply affecting their stock prices.

Public employers, of course, don't worry about stock prices plunging or investors fleeing. But you do have to be concerned about what credit-rating agencies say about your financial health. Maintaining a top rating is important to your ability to get economical long-term

financing. Just like stock buyers, investors avoid municipal and state bonds from entities that are clearly in trouble—or they demand a premium return that drives up your costs.

If you haven't heard much about GASB 45 yet, there's a reason. The largest public sector employers are not required to begin meeting its mandates until the first tax reporting period after Dec. 15, 2006; their smaller brethren have until 2008. Many states and municipalities already know what they are facing. The others will soon find out.

Turning to Health Care

What about Medicare Part D—where does it fit in? One of the largest future costs that you face is the rising price of meeting retirees' health care needs. Pharmaceutical costs alone are rising at about 18 percent a year.

Even if your policy makers are inclined to back away from this obligation as they hire new employees, you are constrained by a variety of factors. First, these future benefits are a valuable tool that helps you compete with the private sector to attract and retain talented employees. Second, public unions typically strongly defend these benefits.

Enter Medicare Part D. This is the new prescription drug benefit for seniors. The basic annual benefit requires beneficiaries to pay a \$250 deductible—the federal government pays 75 percent of their prescription drug costs

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between \$251 and \$2,250. The beneficiaries then pay 100 percent of costs between \$2,251 and \$3,600. For costs beyond that, the government picks up 95 percent of the tab. The program is government funded but is implemented through private insurers known as Prescription Drug Plans (PDPs).

There are other nuances—PDPs vs. the new Medicare Advantage Program, the permanent premium increase for enrollees after May 15, 2006, the annual opt-out process and deadline, the available 28 percent subsidy for employers who continue their prescription coverage, and much more. But let's keep it simple, and just focus on the fact that for the first time, seniors will be eligible to enroll to get federal government help for the cost of their prescriptions.

Looking at the Choices

What does Medicare Part D mean for you? It opens up several opportunities:

- To share the long-term risk of volatile health costs.
- To realign retiree health care benefits outside the framework of meet-and-confer requirements.
- To shift future liabilities off of today's balance sheet by converting them into current costs that will be viewed more positively by credit-rating agencies.

But taking advantage of the above opportunities without incurring added costs requires you to make smart choices that avoid the pitfalls. The following menu outlines these choices.

Do Nothing—This option may be attractive at first glance. It doesn't disrupt current benefits to retirees and avoids having to bear the cost of applying for the federal subsidy. But the disadvantages are clear, though subtle. By doing nothing, you are fully exposed to the GASB problem – future, mushrooming costs reported as current liabilities. You also forgo the potential benefits from risk sharing or receiving the federal subsidy.

Apply for 28 Percent Subsidy—The 28 percent subsidy for employers was built into Medicare Part D to compensate employers who continue to provide prescription drug coverage rather than abandoning the benefit and shifting the full responsibility to the federal government. But there are strings attached. Your plan must be

“actuarially equivalent” to the Part D benefit—and you have to prove that it is each year with a costly “attestation,” as well as be prepared to defend your claim in potential federal audits. With the average subsidy expected to be about \$611 per retiree, the cost to apply for the subsidy will outstrip the return for many small and even medium-sized employers.

Receiving the subsidy also means that employers must track their retirees' prescription expenditures to account for the \$250 deductible and the gap when retirees pay full costs. This will be a costly, added burden for your Human Resources function. In addition, since the subsidy is not paid for retirees who enroll on their own in Medicare Part D, employers must also determine the status of their retirees and help educate them about making the right choices. It should also be noted that the timing of subsidy payments is likely to lag behind the need to fund benefit payments, adding to upfront cash flow problems.

In short, what looks like a no-brainer—having the federal government send you a 28 percent subsidy—can actually be very costly.

Become a PDP—You have the option of applying for a waiver that allows you to become a PDP on your own. This option, however, is no longer available for 2006; the filing deadline is in April each year for the following year. The advantage is that you receive payments directly from the federal government to cover the benefits to retirees, you retain control over the design of your benefit package, and you have a partner in the federal government to share the risk of rising costs.

The downsides—The filing process is complicated, you are exposed to costly federal audits, and you still have to track retirees to exclude any who independently sign up for Medicare Part D. All of this is on top of the fact that you will need to create the entire infrastructure needed to operate as a PDP.

Contract with a PDP—Lastly, you can outsource headaches and lower your costs by contracting with a PDP. Because the benefits are multiple and the disadvantages are few, let's start with the shorter list. If you contract with a PDP, you will not receive the federal subsidy. You will also have to educate retirees about their best options under your approach to Medicare Part D

and deal with any resulting confusion. But in return, you:

- Shift risk to the PDP and the federal government, as the insurer and primary payer.
- Retain the ability to design a benefit package that will disrupt retirees as little as possible.
- Avoid GASB implications by converting an unfunded liability to a current, quantifiable cost – thus protecting your credit rating and ability to sell bonds.
- Take advantage of labor agreements that allow alignment with Medicare to reshape your benefits package, including promoting more retiree cost sharing.
- Steer clear of annual attestations and increased actuarial expense.
- Eliminate the most costly and volatile segment of your retiree health care program.
- Improve customer service by accessing a seasoned workforce that knows how to address retirees' often-complex demands and needs.

Making the Right Choice

As a public risk manager, you play a pivotal role in guiding your organization to make good decisions. Unfortunately, federal programs are often complex, with unintended consequences and hidden costs creating potential traps for the unwary. Adding to your burden is the fact that once you understand all the implications, you still need to convince the policy makers above you about the right course. The basic outline above should help you educate others as you work to implement the plan that works best for your organization.

This much is certain: GASB 45 will create a stark accounting of the high cost of future benefits. Rising pharmaceutical costs will only add to the bleak picture. Even when carefully considered and rigorously approached, Medicare Part D holds the potential for making the situation worse, requiring a new bureaucracy to administer your strategy, confusing retirees and bringing unexpected costs.

Played correctly, however, your decisions about how to handle Medicare Part D can put your organization in an envious spot: continuing to protect your retirees while reducing your long-term liability and shifting costs to the federal government. •