Takes Another Victim

by Mike Ehmke, EA, ASA, MAAA
As many have already heard, the Federal Government is undergoing mandatory reductions in spending through a payment reduction process referred to as “sequestration.”

For employers who provide their retirees with health insurance (specifically prescription drug benefits), under certain conditions they can receive a subsidy from the Federal Government for prescription drug costs incurred by their Medicare-eligible retirees. This Retiree Drug Subsidy (RDS) is a payment subject to sequestration, and the Federal Government will apply a mandatory 2% payment reduction for all months from April 2013 and beyond when calculating the RDS for eligible employers.

The RDS began as part of the Medicare Modernization Act of 2003, which (among many other changes) allowed for the creation of prescription drug benefits under Medicare or Medicare Part D beginning in 2006. In order to encourage employers who had provided prescription drug benefits to their Medicare-eligible retirees prior to the law change, the law gave employers a subsidy (the RDS) on the prescription drug costs of qualifying retirees. The RDS is equal to 28% of allowable retiree drug costs and gives employers a significant incentive to continue providing prescription drug benefits to their retirees, rather than eliminating them and forcing retirees to sign up for Medicare Part D plans. The RDS is received when an employer completes an annual application and supplies certain information on covered retirees and prescription drug costs as part of the annual application.

Sequestration Impact on RDS

Only RDS applications with a plan year that includes April 2013 and beyond are affected by sequestration, and the 2% payment reduction is applied on a monthly basis. For example, if an employer completed an application for the plan year of January 1, 2013 through December 31, 2013, only the months of April 2013 through December 2013 would be subject to the mandatory 2% payment reduction.

The amount of the RDS remains equal to 28% of allowable retiree drug costs. The 2% payment reduction applies to the calculated subsidy amount for final allowable retiree drug costs incurred in April 2013 and beyond. The reporting of drug costs (currently required on a monthly basis) will remain unchanged. The following chart illustrates the impact of the 2% payment reduction. The table on the following page shows how an employer would realize a reduction only for the month of April 2013, but would continue to receive the full amount of the RDS for March 2013.

<table>
<thead>
<tr>
<th>PLAN MONTH</th>
<th>ALLOWABLE RETIREE DRUG COSTS</th>
<th>SUBSIDY PERCENTAGE</th>
<th>CALCULATED SUBSIDY</th>
<th>2% PAYMENT REDUCTION</th>
<th>SUBSIDY AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2013</td>
<td>$4,000</td>
<td>28%</td>
<td>$1,120</td>
<td>N/A</td>
<td>$1,120</td>
</tr>
<tr>
<td>April 2013</td>
<td>$5,000</td>
<td>28%</td>
<td>$1,400</td>
<td>$28</td>
<td>$1,372</td>
</tr>
</tbody>
</table>

How the Payment Reduction Occurs

The Federal Government will apply the mandatory 2% payment reduction in the RDS during a process called “reconciliation.” Reconciliation occurs following the end of the year designated on the annual application when the employer finalizes the covered retirees and eligible drug costs upon which the RDS is paid. Reconciliation must be completed within 15 months after the last day of the year designated on the annual application. Therefore, for a plan year beginning January 1, 2013 and ending December 31, 2013, reconciliation must be completed no later than March 31, 2015. All payment reductions will be reflected on the federal website that administers the RDS program at www.rds.cms.hhs.gov.

All Is Not Lost

Although a payment reduction in the RDS for employers is not welcome news, the amount of the payment reduction ultimately is not significant compared to the typical cost of providing medical and prescription drug benefits to Medicare-eligible retirees. If the average cost of prescription drug benefits is 50% of the total medical and prescription drug benefits for Medicare-eligible retirees, and the RDS was equal to 28% of the prescription drug benefits, the mandatory payment reduction due to sequestration would, at most, equate to a 0.3% increase in overall medical and drug costs (and it would likely be less). Of course, the impact on each employer will vary depending on the benefit design of the medical and drug plans and the retiree contribution structure. For more information regarding this important topic, contact the experts in SilverStone Group’s Post-Retirement Benefits division.

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