

## **Employers Must Act Now to Prepare for Medicare Drug Benefits**

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*Note: Penny Wofford will discuss this topic in detail at special SDA-hosted luncheon briefing September 20. In addition, attorney Wade Ballard will provide an update of a number of employment-related issues. For details, visit: <http://www.thesda.org/memberf.htm>*

For the first time, persons eligible for Medicare will be able to elect optional prescription drug coverage beginning in 2006. Employers who offer prescription drug benefits to persons eligible for Medicare (generally, retirees or older or disabled employees) must take steps to prepare for the new Medicare prescription drug benefit ("Part D"). First, employers must notify their Medicare-eligible employees and retirees, no later than November 15, 2005, whether the prescription drug program offered by the employer is as good as the Medicare Part D benefit. Second, employers who want to receive a federal subsidy for their plan's drug costs must file an application for the subsidy by September 30, 2005.

### **Description of Medicare Drug Benefits**

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("MMA") added the new voluntary prescription drug benefit (called "Medicare Part D"). Enrollment for Part D coverage will begin on November 15, 2005, and benefits will be available beginning January 1, 2006. Part D benefits are generally available to anyone who is otherwise eligible for Medicare Part A or Part B benefits (that is, has reached age 65 or is eligible for Medicare because of disability).

Eligible individuals who elect to be covered by Part D will pay a monthly premium (expected to be approximately \$35 per month in 2006), and will be required to pay the first \$250 of their annual drug costs. After that, the amount paid by Part D varies throughout three tiers, depending on the total amount of drug costs incurred during the year. In the first tier, for total annual drug costs from \$250 to \$2,250, Part D will pay for 75% of the costs (that is, the participant will have a 25% co-pay). In the next tier, for total annual drug costs from \$2,250 to \$5,100, the participant will have to pay all drug costs. (Because there is no Part D coverage for this tier, it is often referred to as the "doughnut hole.")

After total annual drug costs exceed \$5,100, the participant will have paid the maximum annual out-of-pocket ("OOP") amount of \$3,600, and will be eligible for catastrophic coverage under Part D. After the OOP limit has been reached, the participant will be required to pay the greater of a co-pay (\$2 for a generic prescription or \$5 for a brand name prescription), or 5% of the cost of the prescription.

## **Late Enrollment Penalty**

As noted above, the monthly premium for Part D benefits in 2006 is expected to be \$35. But this basic premium applies only if an individual elects Part D coverage when first eligible. If an eligible individual chooses not to enroll immediately, his or her monthly premium will be subject to a late enrollment penalty. The amount of the penalty is 1% for each month that the individual delays enrollment after first becoming eligible. For example, an individual who enrolls in Part D 20 months after initially becoming eligible will have premiums 20% higher than participants who enrolled timely. If the monthly Part D premium in the year the individual enrolls is \$40, then this individual would be required to pay 20% more, or \$48 per month. This 20% penalty surcharge is permanent, and will apply to all future Part D premiums.

### **Waiver of Late Enrollment Penalty Where "Creditable Coverage" Exists**

Even if an individual does not enroll in Part D when first eligible, there will be no late enrollment penalty if the individual had "creditable coverage" for prescription drugs under a private health plan ("creditable coverage" is discussed below), and enrolled in Part D less than 63 days after losing the private health plan coverage. This means that an individual who has creditable coverage under a private health plan may choose not to enroll in Part D when first eligible, and still pay the same basic monthly premium for Part D benefits at the time he or she actually enrolls.

### **Employer's Obligation to Provide Notice of Creditable Coverage**

It is crucial for a Part D eligible individual who has prescription drug benefits through a private health plan to know whether the private plan drug benefits are "creditable coverage." Only if the private plan benefits are considered creditable coverage will the individual be able to delay enrolling in Part D without incurring the late enrollment penalty.

So that health plan participants will have the necessary information about drug benefits offered through the plan, employers must provide a Notice of Creditable Coverage to each plan participant who is eligible for Part D. This notice will disclose whether or not the plan's drug benefits are considered creditable coverage, and will provide other information about the participant's rights to benefits under Part D. The initial notice must be provided to all covered Part D eligible participants no later than November 15, 2005. Additional notices must be provided annually, to new enrollees, and upon any change in the plan that would impact whether the plan's drug benefits were considered creditable coverage. In addition to the notices that must be sent to Part D eligible plan participants, the employer must also notify CMS whether the coverage is creditable.

To be able to meet the November 15, 2005 notice deadline, an employer whose plan offers drug coverage must begin now to (i) prepare the form of the notice, (ii) identify all persons covered under its plan (including spouses and dependents) who are eligible for Part D, and (iii) determine whether its plan's drug coverage is "creditable coverage." The Centers for Medicare & Medicaid Services ("CMS") has prepared two alternative model Notices of Creditable Coverage (depending on whether a plan's drug coverage is creditable or not) that can be used by employers to develop their notices that must be

sent out by November 15, 2005. Thus, the development of the form of the notice should not be overly difficult. However, the other two steps will take more effort on the part of the employer.

Employers may review their own records to determine which plan participants are eligible for Part D. However, employers may not always have this information easily available, particularly with respect to spouses and dependents covered under the plan. CMS has set up procedures by which an employer can request assistance in determining which individuals who are covered for drug benefits under its health plan are also eligible for Part D.

### **Determining Whether Drug Benefits are "Creditable Coverage"**

The final information an employer will need to provide the required notices is to determine whether its health plan provides drug benefits that are "creditable coverage." To be creditable, the health plan's prescription drug coverage for Part D eligible individuals must be at least equal in value on an actuarial basis to the value of coverage that would be provided to these same individuals under Part D.

To determine if the health plan coverage is creditable, the plan must pass a two-prong test. The first part of the test (the "gross value" test) requires that the expected amount of prescription drug claims paid from the health plan for Part D eligible individuals must be at least equal to the expected amount of paid claims from Part D (including the catastrophic coverage discussed above when the OOP limit has been exceeded in a particular year).

The second part of the test (the "net value" test) is similar to the first part of the test, but compares the net value of expected prescription drug claims in the health plan (that is, the expected gross value of the expected claims reduced by the contributions that the Part D eligible individuals have to pay for the health plan drug coverage) to the net value of expected claims from Part D (that is, the expected claims less the Part D premiums).

It is obvious that the determination of whether a health plan provides creditable prescription drug coverage to its Part D eligible participants is difficult. In most cases, this determination will need to be made by an actuary. The CMS has provided simplified rules that will deem certain health plans to be creditable, provided they meet specified design standards (including types of prescription drugs covered, access to retail providers, and limits on deductibles and benefit maximums). However, to meet the simplified standards, a health plan will also have to be designed to pay on average at least 60% of participants' prescription drug expenses, which will likely require the involvement of an actuary.

### **Government Subsidy for Private Health Plan Drug Costs**

If a private health plan provides creditable coverage for prescription drugs, the sponsoring employer can apply to the CMS for a government subsidy for the health plan's drug benefits paid for Part D eligible participants. To obtain the subsidy for 2006, the application must be filed no later than September 30, 2005. The applications are filed online using a form provided by CMS. The primary requirement of the application is that

there must be an attestation by an actuary that the health plan's drug coverage is creditable.

The federal subsidy for qualifying plans is equal to 28% of each Part D eligible individual's allowable prescription drug costs paid by the health plan in excess of the Part D deductible (\$250 in 2006) up to the maximum cost limit (\$5,000 in 2006). This means that a qualifying health plan that pays out at least \$5,000 in prescription drug benefits for a Part D eligible individual in 2006 will receive a federal subsidy of \$1,260. This subsidy can significantly reduce the cost of providing drug coverage to Part D eligible individuals (generally, retirees and their spouses) through a private health plan.

### **Plan Design Options for Employers**

Aside from preparing to give the required Notices of Creditable Coverage, employers have a number of options for coordinating drug coverage in their health plans with the new Part D benefit. Some of those options include:

- Continuing the drug benefit currently contained in their health plans. This is the simplest approach, but will not avoid the requirement of providing Notices of Creditable Coverage. If the plan's drug coverage is creditable, the employer can apply for the federal subsidy described above. If the plan's drug coverage is not creditable, participants who wish to delay enrollment in Part D until they no longer are covered under the employer's health plan will be subject to the Part D late enrollment penalty.
- Eliminating drug coverage in their health plans, or eliminating the coverage only for retirees. This approach avoids having to worry about whether the drug coverage is creditable, and eliminates the need for Notices of Creditable Coverage. However, this would be a cutback in benefits (which the employer may not wish to do), and under recent case law may run afoul of federal statutes that limit the coordination of private plan benefits with Medicare.
- Eliminating drug coverage for retirees, and subsidizing or paying the premiums for coverage of eligible individuals under Part D. This approach eliminates the creditable coverage and notice issues, but requires that the employer give careful consideration to ensuring that all requirements under the laws applicable to such a subsidy program are satisfied.
- Providing health plan drug coverage for Part D eligible individuals that "wraps around" the Part D benefit. This approach offers enhanced benefits over the benefits provided through Part D, and may be attractive if an employer provides generous prescription drug benefits, but wishes to cut back to a "supplement" with respect to retiree drug coverage.
- If the health plan's drug coverage is not currently creditable, amending the plan to make the coverage creditable, and then applying for the federal subsidy as described above.

There are other options and combinations of the above that might be considered in particular situations.

## Important Dates

There are a number of important dates that employers must keep in mind in connection with the new Part D prescription drug benefit:

- September 30, 2005 - Deadline for employers to file with CMS for government subsidy for health plan drug benefits paid to Part D eligible participants.
- November 15, 2005 - Notice of Creditable Coverage must be sent to individuals covered for health plan drug coverage who are also eligible for Part D.
- November 15, 2005 to May 15, 2006 - Initial enrollment period for Part D coverage.
- January 1, 2006 - Part D coverage begins.

## Getting Answers to Your Questions

If you have any questions about the impact of the new Medicare Part D drug benefit, your obligations under the new law, or plan design options you may wish to explore, please contact Penny C. Wofford at Ford & Harrison LLP, (864) 542-8612, [pwofford@fordharrison.com](mailto:pwofford@fordharrison.com).

## About the Author



Penny Wofford concentrates her practice in the area of employee benefits. She advises and defends employers, employer-sponsored plans, and plan fiduciaries against all types of claims under ERISA and employment discrimination laws. She regularly assists employers with the design, drafting, and administration of welfare benefit and retirement plans. Penny is a frequent speaker on employee benefits and employee leave topics such as the FMLA, HIPAA and COBRA compliance and employer responsibilities for employee benefit plans.

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**Published by the Spartanburg Development Association  
September, 2005**