OLIVER WYMAN

# PART D CATASTROPHIC COVERAGE - FINANCIAL IMPLICATIONS OF RESTRUCTURING LIABILITY

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# 1. Executive Summary

As early as 2016, the Medicare Payment Advisory Commission ("MedPAC") has advocated a restructuring of the Centers for Medicare & Medicaid Services ("CMS") Federal Reinsurance payments for Medicare Part D. Under the current program parameters, the CMS covers 80% of prescription drug costs (less an adjustment for rebates and other forms of Direct and Indirect Renumeration ("DIR")) above a certain threshold, known as the True Out of Pocket cost ("TrOOP"). Claims above the TrOOP are commonly referred to as catastrophic claims. In the catastrophic phase of the Part D benefit, the member is liable for 5% of costs and the health plan covers the remaining 15% (plus an adjustment for DIR).

MedPAC has proposed the following:

- Eliminate member cost sharing above the TrOOP,
- Reduce CMS coverage above the TrOOP (after adjustments for DIR) from 80% to 20%, and
- Increase health plan liability to absorb the difference.

Oliver Wyman Actuarial Consulting, Inc. ("Oliver Wyman") evaluated the effect over a 10-year period (2021 through 2030) of restructuring the liabilities in the catastrophic phase of the Part D program as proposed above. First, we examined the impact of establishing an OOP cap for members in the catastrophic phase of the benefit, shifting that liability to health plans, and leaving Federal Reinsurance at 80% (after adjustments for DIR).

- Total CMS payments to plans would see a net increase of $84.7 billion as risk-adjusted capitation payments to health plans (the Direct Subsidy) and Low-Income Premium Subsidy (LIPS) payments would rise by more than Federal Reinsurance and Low-Income Cost Sharing (LICS) payments would fall.
- Members' cost sharing would decrease by $59.3 billion as a result of eliminating their catastrophic liability, but member premiums would increase by $20.0 billion, offsetting some of that savings.
    - We note that the premium increase would be spread across all Part D members, while the cost sharing decrease would only impact those high-cost members who have claims high enough to enter the catastrophic phase. According to the March 2019 MedPAC report, there were 3.6 million Part D members reaching catastrophic (or ~8%) in 2016.

Next, we evaluated the changes above in conjunction with shifting the CMS liability from 80% to 20%. Under this scenario, total CMS payments to plans would see an additional increase of $6.9 billion. Members' cost sharing would remain unchanged at $59.3 billion, as under the first scenario, but premiums would increase by an additional $5.9 billion.

The table below summarizes the impact attributed to the two separate proposed changes as described above:

### Exhibit 1 – Estimated (2021 through 2030) Total Cost of Restructuring the Part D Catastrophic Liabilities

| | Change (In Billions) | | |
|---|---|---|---|
| Scenario | Government Liability | Member Premium | Member Cost Sharing |
| Establish a True MOOP | $84.7 | $20.0 | ($59.3) |
| + Reduce Federal Reinsurance | $6.9 | $5.9 | $0.0 |

We have separated the net increase to government liability of $91.6 billion over a 10-year period (2021 to 2030) into each of the separate Part D subsidies. As noted above, Federal Reinsurance payments decrease significantly as liability is decreased from 80% to 20%, but that is more than offset by a large increase to Direct Subsidy payments as a plan's overall cost of coverage increases. Additionally, since member cost sharing is eliminated in the catastrophic phase, this results in a decrease in government LICS payments, but there is an increase in LIPS payments resulting from the increased plan liability that is being passed on to members that the government is subsidizing.

### Exhibit 2 – Estimated (2021 through 2030) Government Cost of Restructuring the Part D Catastrophic Liabilities

| Change (In Billions) | | | | | |
|---|---|---|---|---|---|
| Scenario | Direct Subsidy | Federal Reinsurance | LICS | LIPS | Total |
| Establish a True MOOP | $63.8 | $34.3 | ($22.7) | $9.3 | $84.7 |
| + Reduce Federal Reinsurance | $733.7 | ($724.2) | $0.0 | ($2.6) | $6.9 |

It is important to note that, in the absence of any changes in member or plan behavior, the net impact of restructuring the Federal Reinsurance Program payments per MedPAC's proposal would solely be a shifting of dollars between stakeholders, with no net increase to the program. We have included the impact of two behavior changes in this analysis:

1) Increasing utilization due to the removal of member cost sharing in the catastrophic phase.

2) Health plans requiring additional risk margins to cover a larger portion of the unlimited catastrophic liability, as well as smaller or less mature health plans potentially purchasing private reinsurance.

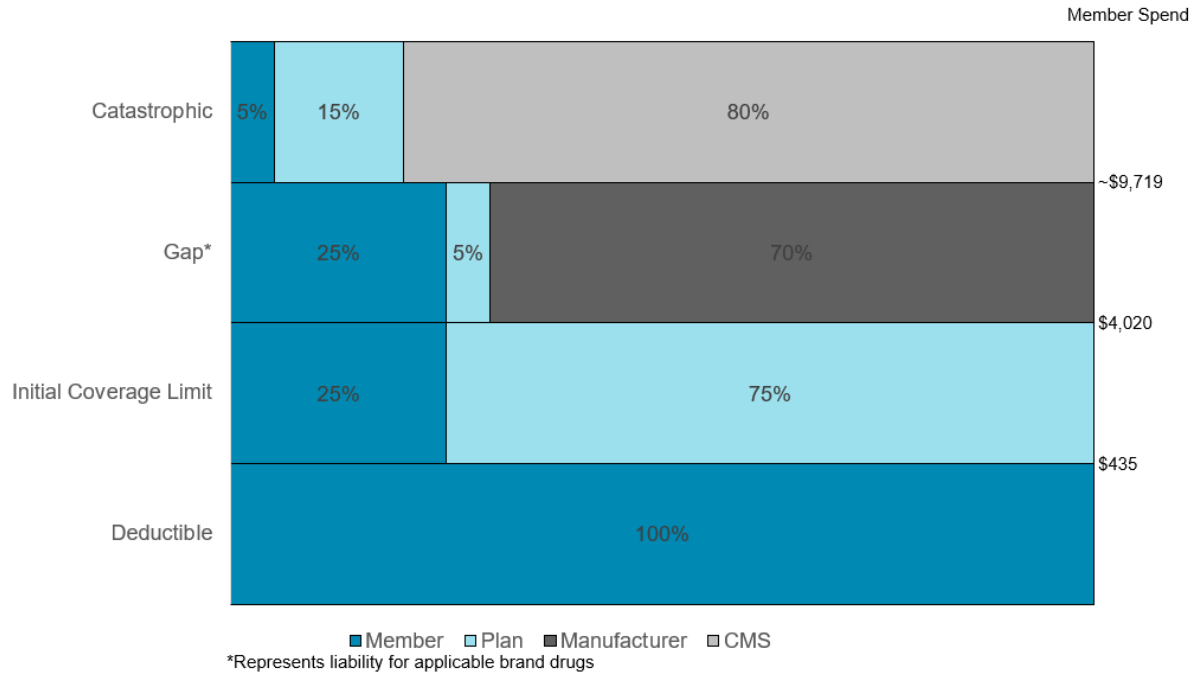
In the analysis, we have assumed that plans make no significant formulary changes in response to the increased risk and liability under the proposal. As such, these results could be viewed as an upper limit.

The remainder of this report provides background information on the proposed restructuring of the Federal Reinsurance Program, outlines the analysis undertaken by Oliver Wyman, and presents the details of our analysis.

# 2. Background

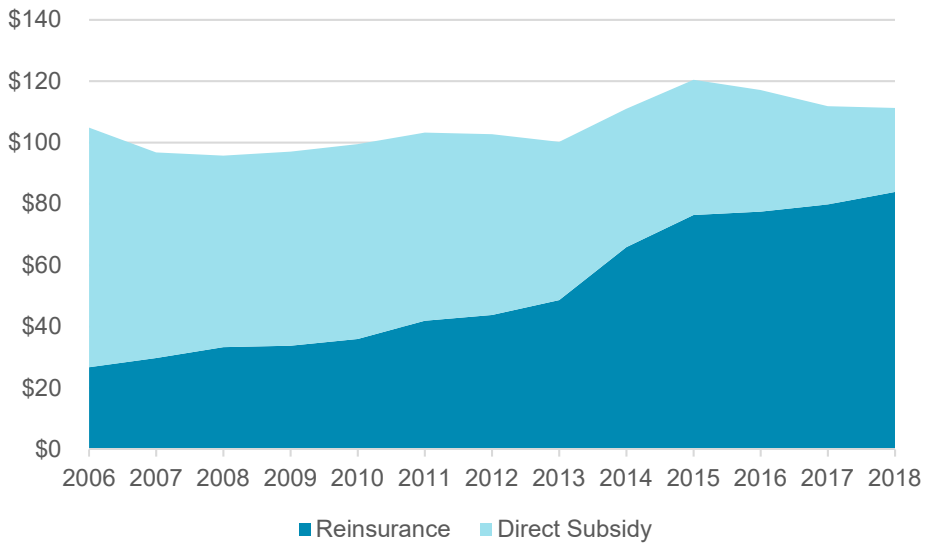
With the passage of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("MMA"), Congress authorized Medicare coverage of outpatient prescription drugs beginning in 2006. The MMA established the minimum standard benefit Part D plans must offer. The benefit structure adjusts each member's liability as their cumulative drug expenditures grow. After moving through the deductible, Initial Coverage Limit, and Coverage Gap phases, a member's OOP costs would eventually reach the annual true out-of-pocket threshold, or TrOOP ($6,350 in 2020). Once a member reaches the TrOOP, their cost-sharing would be reduced to 5% and CMS would pay 80% of the drug cost after adjustments for rebates. Exhibit 3 highlights the Part D benefit structure and stakeholder liability in 2020.

### Exhibit 3 – 2020 Part D Benefit Design




In the years since inception of the Part D program, the thresholds for exiting and entering the different benefit phases, as well as the structure of the Coverage Gap have changed, but the catastrophic phase still features the same liability percentages as they were originally outlined in the MMA. Reinsurance payments from the government have increased significantly over time, primarily due to expensive specialty medications, but there has been some leveling off of reinsurance payments in the most recent years. Exhibit 4 shows the change in the CMS Direct Subsidy and Part D Reinsurance since 2006 based on the 2019 Medicare Trustees Report.

## Exhibit 4 – 2006 through 2018 CMS Average Actual Reinsurance and Direct Subsidy Payments Per-Member Per-Month (PMPM)




This exhibit illustrates that CMS reinsurance payments have increased significantly, which is driven heavily by the introduction of Hepatitis C medications starting in 2014. Concurrent with the reinsurance increase, there have been offsetting reductions in risk-adjusted capitation payments PMPM. In tandem, the increasing reinsurance payments and decreasing capitation payments result in the overall combined cost of the two items increasing only slightly over time. The MedPAC proposal to restructure the liability in the catastrophic phase would significantly alter this trajectory of increasing Federal Reinsurance payments, but it would also increase Direct Subsidy payments, resulting in an increased total cost to the federal government.

# 3. Analysis

Using data sources made public by CMS, the 2019 Medicare Trustees Report, and data proprietary to Oliver Wyman, we projected 2021 drug costs, rebates, and member cost sharing, as well as government and plan liabilities associated with the Medicare Part D program. This calculation includes both the impact of removing member cost sharing in the catastrophic phase as well as reducing government liability from 80% to 20%.

As defined by statute, the CMS Direct Subsidy payment is equal to the difference between the National Average Bid Amount ("NABA") and the National Average Member Premium Amount ("NAMPA"). The NAMPA is calculated as 25.5% of the "total cost", or the sum of the NABA and the National Average Federal Reinsurance Amount. The program changes modeled in this report would significantly increase the NABA, while only moderately increasing the sum of NABA and Federal Reinsurance, resulting in a large increase in the Direct Subsidy. CMS will realize a reduction in LICS payments as it is no longer liable for the difference between the actual LICS amounts and the standard 5% those members would have otherwise paid. Lastly, the LIPS payments will increase as a result of increased plan liability.

We are modeling two factors that are likely to bring additional costs into the program: Induced utilization due to removal of member cost sharing above the TrOOP and increased risk margins as plans take on additional risk in the catastrophic phase and/or purchase private reinsurance.

We have assumed that Low-Income members exhibit no behavioral changes as a result of removing any nominal cost sharing in the catastrophic phase. For Non-Low-Income members, we have assumed that the current cost sharing level of 5% causes some implicit reduction in their utilization. Many members in the catastrophic phase of the Part D benefit are utilizers of very expensive brand and specialty medications. The current 5% cost sharing forces some members to opt for the least expensive version of the drug, or to forego non-essential drugs all together. If that cost sharing is removed, there would be additional utilization as member financial incentives change.

In the 2019 Medicare Trustees Report, the Board estimates that Part D enrollment will increase from 45.8 million enrollees in 2019 to 59.1 million enrollees in 2028. Using this membership data, we projected that Part D enrollment will reach 61.7 million enrollees in 2030. We estimate that these changes would have a **net cost impact to the Government of $91.6 billion over the 10-year period**. Using the same membership growth assumptions, we estimate that these changes would cause an **increase of $25.9 billion to member premiums over the same time period**. Eliminating member cost sharing in the catastrophic phase would reduce total member cost sharing by $59.3 billion. Further, reducing Federal Reinsurance would not change total member cost sharing.

In Exhibits 5 and 6 below, we have summarized the cost impact by stakeholder and year, first showing the result of eliminating member cost sharing in the catastrophic phase, and then showing the additional impact of reducing Federal Reinsurance payments.

### Exhibit 5 – Estimated Cost of Eliminating Member Cost Sharing in Catastrophic Only

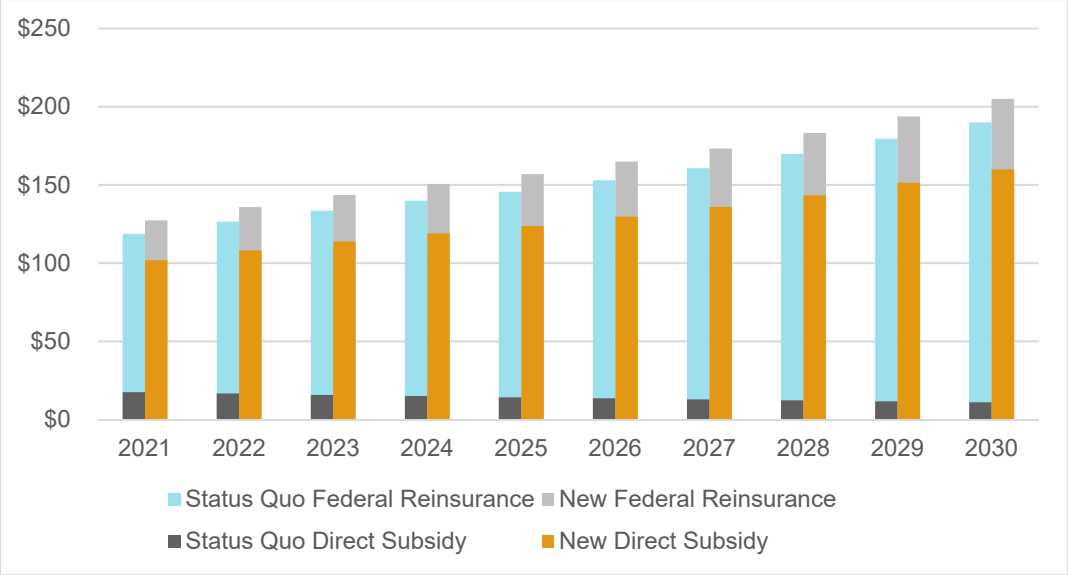
| | | Change (In Billions) | | |
|---|---|---|---|---|
| Year | Members (In Millions) | Government Liability | Member Premium | Member Cost Sharing |
| 2021 | 49.1 | $5.4 | $1.3 | ($3.7) |
| 2022 | 50.8 | $6.0 | $1.4 | ($4.2) |
| 2023 | 52.3 | $6.7 | $1.6 | ($4.7) |
| 2024 | 53.8 | $7.3 | $1.7 | ($5.1) |
| 2025 | 55.2 | $7.9 | $1.9 | ($5.5) |
| 2026 | 56.5 | $8.6 | $2.0 | ($6.0) |
| 2027 | 57.8 | $9.4 | $2.2 | ($6.5) |
| 2028 | 59.1 | $10.2 | $2.4 | ($7.1) |
| 2029 | 60.4 | $11.1 | $2.6 | ($7.8) |
| 2030 | 61.7 | $12.1 | $2.9 | ($8.5) |

### Exhibit 6 – Estimated Additional Cost of Reducing Federal Reinsurance from 80% to 20% After Eliminating Member Cost Sharing in Catastrophic

| Year | Members (In Millions) | Government Liability | Member Premium | Member Cost Sharing |
|---|---|---|---|---|
| 2021 | 49.1 | $0.5 | $0.4 | $0.0 |
| 2022 | 50.8 | $0.5 | $0.4 | $0.0 |
| 2023 | 52.3 | $0.6 | $0.5 | $0.0 |
| 2024 | 53.8 | $0.6 | $0.5 | $0.0 |
| 2025 | 55.2 | $0.6 | $0.6 | $0.0 |
| 2026 | 56.5 | $0.7 | $0.6 | $0.0 |
| 2027 | 57.8 | $0.7 | $0.6 | $0.0 |
| 2028 | 59.1 | $0.8 | $0.7 | $0.0 |
| 2029 | 60.4 | $0.9 | $0.7 | $0.0 |
| 2030 | 61.7 | $0.9 | $0.8 | $0.0 |

As discussed previously, under the MedPAC proposal, the Federal Reinsurance and LICS payments would decrease while the risk-adjusted Direct Subsidy and LIPS would increase by a larger amount. Exhibit 7 below outlines the impact by government liability, highlighting the change between what percentage of total payments that the direct subsidy would make up as compared to federal reinsurance.

### Exhibit 7 – Estimated Direct Subsidy and Federal Reinsurance Payments PMPM from CMS under Status Quo vs Proposed Restructuring




## Additional Considerations

These results do not reflect an assumption that plans will respond to these policies with significant changes to formularies to offset the impacts of their increased liability in the catastrophic phase.

We have not included any transitional period from the current 80% Federal Reinsurance to the proposed 20% Federal Reinsurance. It is possible that CMS would implement this change over a number of years, similar to other major historical programmatic changes. In that case, our estimates for the net impact would be overstated.

In January 2019, the Department of Health and Human Services ("HHS") proposed that rebates after the point of sale will no longer be excluded under Federal anti-kickback statutes. This would have a meaningful impact on the CMS direct subsidy, federal reinsurance payments, and member cost sharing amounts estimated in this analysis. We have not included any adjustments for this rule, and the results presented in this paper would need to be revisited should this rule be finalized.

Some versions of the MedPAC proposal have included a recommendation that CMS exclude coverage gap discount payments from accumulating to the TrOOP. This proposal would also have a meaningful impact on the CMS direct subsidy, federal reinsurance payments, and member cost sharing amounts estimated in this analysis. We have not included any adjustments for this proposal, and the results presented in this paper would need to be revisited should this rule be finalized.

Lastly, as the CMS RxHCC model is calibrated based on health plan liability, it would require significant recalibration as a result of this proposal. The impact of this recalibration on revenue has not been considered as part of this analysis.

## REPORT QUALIFICATIONS/ASSUMPTIONS AND LIMITING CONDITIONS

Oliver Wyman was commissioned by America's Health Insurance Plan to analyze the impact of restructuring the CMS Federal Reinsurance program would have on members, health plans, and the federal government.

Oliver Wyman shall not have any liability to any third party in respect of this report or any actions taken or decisions made as a consequence of the results, advice or recommendations set forth herein.

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While this analysis complies with applicable Actuarial Standards of Practice, users of this analysis should recognize that our projections involve estimates of future events and are subject to economic and statistical variations from expected values.

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