Sharing risk in Medicare Part D

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Roadmap

- Recap from March 2015 meeting
- Potential effects of lowering Medicare’s individual reinsurance
- Feedback from private reinsurers
- Potential changes to risk corridors
- Medicare’s medical loss ratio requirements
- Next steps
# Mechanisms for and objectives of risk sharing in Part D

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Objective</th>
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</thead>
<tbody>
<tr>
<td><strong>Direct subsidy</strong></td>
<td>Medicare’s subsidy that lowers premiums for all enrollees. Medicare pays plans a monthly capitated amount. Plan sponsors manage enrollees’ benefit spending because the sponsor loses money when spending is higher than payment + enrollee premium.</td>
</tr>
<tr>
<td>Risk adjustment</td>
<td>Counters the incentive for sponsors to avoid high-cost enrollees</td>
</tr>
<tr>
<td>Individual reinsurance</td>
<td>Counters the incentive for sponsors to avoid high-cost enrollees</td>
</tr>
</tbody>
</table>
| Risk corridors          | • Initially used to establish the market for stand-alone drug plans  
                          | • Protection against unanticipated benefit spending (e.g., introduction and wide use of a high-cost drug)                                    |
Patterns of reconciliation payments

- Individual reinsurance
  - Sponsors underbid on catastrophic spending
  - Medicare paid plans
- Risk corridors
  - Sponsors overbid on rest of covered benefits
  - Actual benefits often 90% of bids or lower
  - Plans paid Medicare

Reconciliation payments from Medicare to plans in $billions

Source: MedPAC based on data from CMS.
Data are preliminary and subject to change.
An advantageous way to bid?

- Underestimate catastrophic spending
- Overestimate rest of benefit spending
  - ✔ Competitive premium
  - ✔ Recoup most of the cost “over-runs” above catastrophic threshold at reconciliation
  - ✔ Retain some “excess” profits above those already in bid
    - ✗ Lower cash flow due to lower prospective reinsurance payments
Current reinsurance: Medicare pays for 80% of benefits above the OOP threshold

- **Out-of-pocket threshold**: Enrollee 5%
- **Initial coverage limit**: Enrollee 25%, Plan 75%
- **Medicare pay limit**: Medicare 80%
- **Partial coverage, discounted price for brand-name drugs**: Plan 75%
- **Deductible**: Enrollee 100%

Note: OOP (out of pocket).
One option: Medicare pays for 20% of benefits above the OOP threshold.

Note: OOP (out of pocket).
Example of effects of lower Medicare individual reinsurance on premiums

- Same 74.5% Medicare subsidy, but more through capitated payments
- Potential behavioral effects:
  - Downward pressure on cost because of greater incentive to manage benefit spending
  - Upward pressure on cost because plans may need to reflect a risk premium or buy private reinsurance

<table>
<thead>
<tr>
<th>Hypothetical example assuming no behavioral changes</th>
<th>Medicare’s reinsurance above catastrophic limit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>80% above the limit</td>
</tr>
<tr>
<td>Medicare reinsurance</td>
<td>$40.00</td>
</tr>
<tr>
<td>Plan’s at-risk benefits:</td>
<td></td>
</tr>
<tr>
<td>Above the limit</td>
<td>$7.50</td>
</tr>
<tr>
<td>Rest of benefit</td>
<td>$52.50</td>
</tr>
<tr>
<td>Total</td>
<td>$60.00</td>
</tr>
<tr>
<td>Total benefit cost</td>
<td>$100.00</td>
</tr>
<tr>
<td>Enrollee premium</td>
<td>$25.50</td>
</tr>
<tr>
<td>Medicare subsidy:</td>
<td>$34.50</td>
</tr>
<tr>
<td>Direct subsidy</td>
<td></td>
</tr>
<tr>
<td>Reinsurance</td>
<td>$40.00</td>
</tr>
<tr>
<td>Total</td>
<td>$74.50</td>
</tr>
</tbody>
</table>
Effects on bidding incentives?

- Lower Medicare reinsurance would not eliminate incentives to underestimate catastrophic spending in bids.
- But dollar amount of Medicare’s reinsurance would be smaller, so financial advantage of underestimating reinsurance would be smaller too.
Could plan sponsors purchase private reinsurance?

- Most Part D sponsors are large insurers that can likely reinsure themselves
- Conversations with private reinsurers:
  - Already have contracts in place with smaller regional Medicare Advantage sponsors
  - Reinsurance for drug spending could be included with coverage of medical spending or stand-alone
  - Individual reinsurance used more commonly than aggregate reinsurance (one-sided risk corridor to protect against losses)
  - Would likely use higher threshold for individual reinsurance or wider corridors than Medicare
Part D risk corridors could be removed or restructured

<table>
<thead>
<tr>
<th>Year</th>
<th>Plan at full risk</th>
<th>Plan gains</th>
<th>Plan losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>20% plan, 80% Medicare</td>
<td>25% plan, 75% Medicare</td>
<td>20% plan, 80% Medicare</td>
</tr>
<tr>
<td>Current</td>
<td>20% plan, 80% Medicare</td>
<td>50/50</td>
<td>50/50</td>
</tr>
<tr>
<td>Wider option</td>
<td>20% plan, 80% Medicare</td>
<td>50/50</td>
<td>20% plan, 80% Medicare</td>
</tr>
</tbody>
</table>
Potential changes to risk corridors

- In isolation, removing risk corridors would mean sponsors bear more risk, have greater incentive to manage benefits.
- In practice, effects of risk corridors and individual reinsurance are interrelated:
  - Corridors have constrained overpayments and profits.
  - Removing corridors would be considered a cost in legislative scoring.
- Might want to keep corridors in the near term, consider widening or removing them in the long term.
Medical loss ratio (MLR) requirements

- As of benefit year 2014, CMS evaluates Part D and Medicare Advantage MLRs
  - Benefit claims and quality-improving activities must be greater than or equal 85% of revenues
  - If MLR < 85%:
    - Sponsor must return the difference to Medicare
    - If not in compliance over consecutive years, contract subject to sanctions or termination
- Similar role as a one-sided risk corridor: constraint on administrative costs and profits
- Definition of MLR affects how binding it will be
LIS enrollees not distributed equally

- About 30% of Part D enrollees get LIS
- Among top 20 PDP plans in 2014:
  - 10 had 25% or fewer enrollees with LIS
  - 6 had 75% or more enrollees with LIS
- Changes to risk sharing could affect incentives to enroll individuals with LIS
- Calibration of risk adjusters is very important
Next steps

- Your comments on this work
- June 2015 chapter
- For the Fall 2015 – Spring 2016 cycle:
  - Continued discussion of policy options for sharing risk
  - Revisit 2012 recommendation on LIS cost sharing