# Realigning incentives in Medicare Part D

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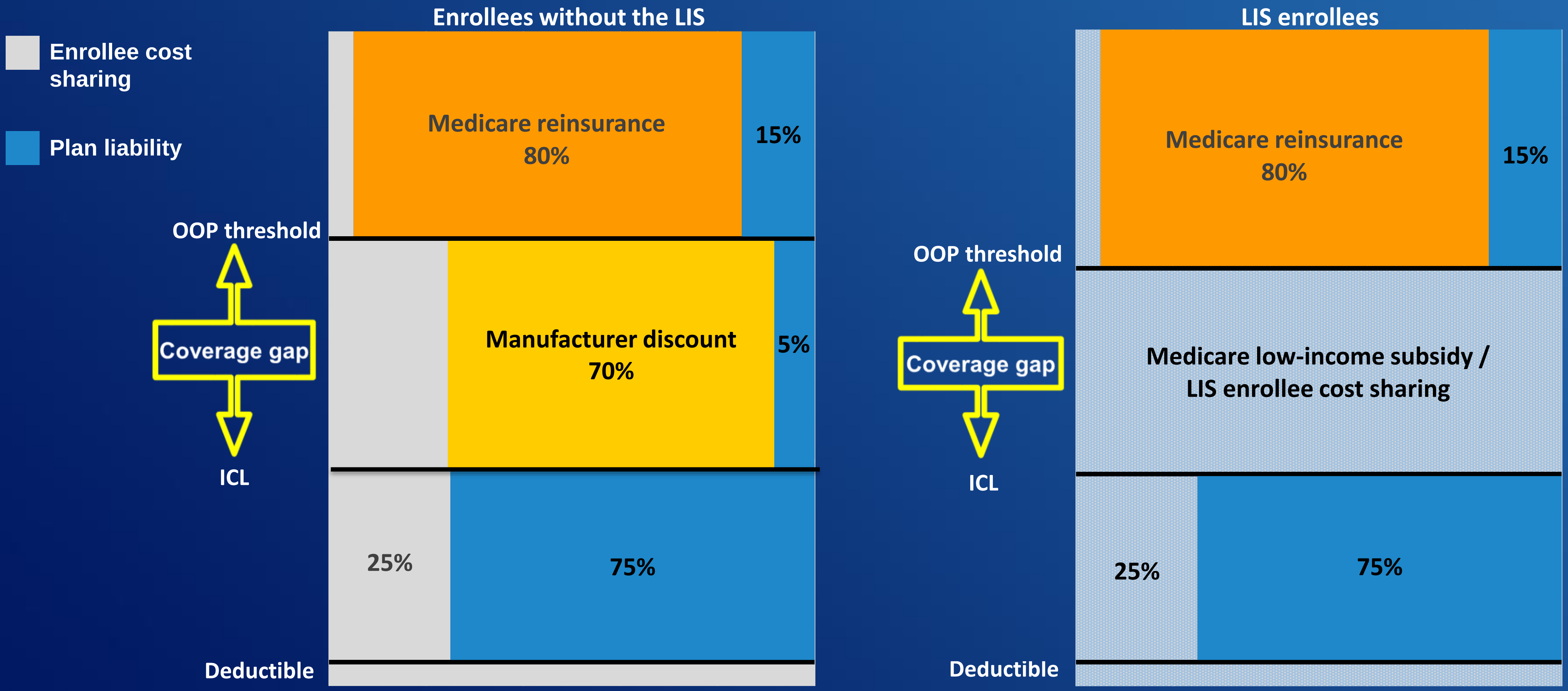
# Why Part D needs to be restructured

- Rapid growth in Medicare's cost-based payments
  - Medicare's reinsurance pays for 80% of catastrophic spending
  - Low-income subsidy (LIS) pays for nearly all cost sharing of LIS enrollees
- Part D's benefit design dampens incentives to manage spending
  - Coverage-gap discount distorts relative prices of brands to generics
  - Low plan liability in coverage gap and catastrophic phase
  - Manufacturer rebates can be larger than plan liability
- Program design may influence manufacturers' pricing and lead to higher:
  - Beneficiary coinsurance
  - Medicare program spending

# Misaligned incentives in Part D




Notes: LIS (low-income subsidy), OOP (out-of-pocket), ICL (initial coverage limit). The coverage gap for non-LIS beneficiaries is depicted as it would apply to brand-name drugs and biologics.

# Key elements of the restructured Part D benefit

| | Current benefit | Restructured benefit |
|---|---|---|
| Phase-in period | n/a | 4 years |
| **Below OOP threshold** | | |
| Enrollee cost sharing between deductible and ICL | 25% | 25% |
| Plan liability between deductible and ICL | 75% | 75% |
| Coverage gap? | Yes | No |
| Brand manufacturer discount | 70% in coverage gap | None |
| **Projected OOP threshold in 2022** | $3,100 ($7,100)* | $3,100 |
| Total spending at OOP threshold | About $11,000 | About $11,000 |
| **Above OOP threshold (catastrophic phase)** | | |
| Enrollee cost sharing | 5% | 0% |
| Medicare reinsurance | 80% | 20% |
| Plan liability | 15% | 50% for brands and high-priced generics<br>80% for lower-price generics |
| Manufacturer discount** | 0% | 30% for brands and high-priced generics |

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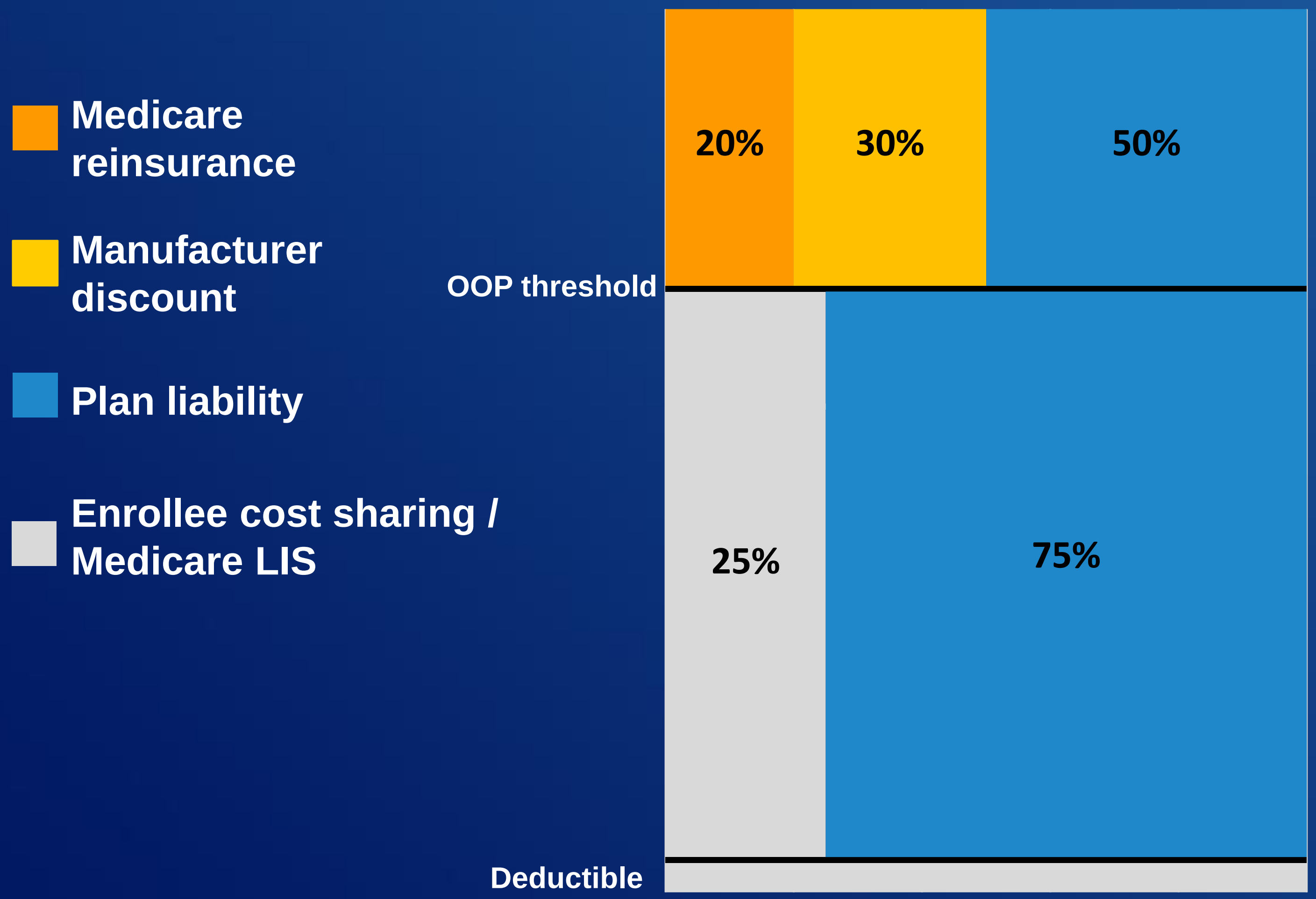
Notes: n/a (not applicable), LIS (low-income subsidy), OOP (out-of-pocket), ICL (initial coverage limit). *In 2022, a non-LIS beneficiary would pay about $3,100 of the $7,100 threshold and brand manufacturers would discount the remaining $4,000 in the coverage gap. **Applies to brand-name drugs, biologics, biosimilars, and certain high-priced generics.

# How Part D would be restructured




- 75% plan liability between the deductible and OOP threshold
- No cost sharing above the OOP threshold
- Shift catastrophic insurance risk from Medicare to plans and manufacturers

MEDPAC

Notes: OOP (out-of-pocket), LIS (low-income subsidy). The catastrophic phase (above the OOP threshold) is depicted as it would apply to brand-name drugs, biologics, biosimilars, and high-cost generics. For lower-priced generics, there would be no manufacturer discount and plans would have 80% liability in the catastrophic phase.

# Related policy changes would help ensure a successful transition to a restructured benefit

- Implementation of new benefit structure
  - Phase in higher plan liability in catastrophic phase
  - Recalibrate Part D’s risk-adjusters to ensure adequate payments and discourage plans from engaging in risk selection
  - Temporarily make risk corridors more generous
- Give plans new tools to manage drug spending
  - Differentiate LIS cost sharing for preferred & nonpreferred drugs
  - Allow plans to use a nonpreferred tier for specialty drugs
  - Give plans greater flexibility in the protected drug classes

# Draft recommendation #1

The Congress should make the following changes to the Part D prescription drug benefit:

- Below the out-of-pocket threshold:
  - Eliminate the initial coverage limit.
  - Eliminate the coverage-gap discount program.
- Above the out-of-pocket threshold:
  - Eliminate enrollee cost sharing.
  - Transition Medicare's reinsurance subsidy from 80 percent to 20 percent.
  - Require pharmaceutical manufacturers to provide a discount equal to no less than 30 percent of the negotiated price for brand drugs, biologics, biosimilars, and high-cost generic drugs.

# Draft recommendation #2

Concurrent with our recommended changes to the benefit design, the Congress should:

- Establish a higher copayment amount under the low-income subsidy for nonpreferred and nonformulary drugs.
- Give plan sponsors greater flexibility to manage the use of drugs in the protected classes.
- Modify the program's risk corridors to reduce plans' aggregate risk during the transition to the new benefit structure.

# Draft recommendation #3

Concurrent with our recommended changes to the benefit design, the Secretary should:

- Allow plans to establish preferred and nonpreferred tiers for specialty-tier drugs.
- Recalibrate Part D's risk adjusters to reflect the higher benefit liability that plans bear under the new benefit structure.

# Spending implications of draft recommendations

The Congressional Budget Office estimates that the combination of the Commission's three recommendations would lead to:

- 1-year program savings greater than $2 billion
- 5-year program savings greater than $10 billion

# Implications of draft recommendations for beneficiaries

- More complete financial protection for all non-LIS beneficiaries
- Improved access to drug therapies in catastrophic phase
- No change in out-of-pocket (OOP) spending for LIS beneficiaries using preferred drugs
- No change or reduced OOP spending for beneficiaries using preferred specialty-tier drugs
- Some beneficiaries would need to switch medications, pay higher nonpreferred cost sharing, or seek exceptions
- Effects on beneficiary premiums would depend on the catastrophic discount rate and other factors

# Implications of draft recommendations for plan sponsors

- Stronger incentives to manage spending
- Reduces financial benefit of high-price, high-rebate drugs
- No catastrophic cost sharing may make it more difficult to manage spending in that phase
- Greater leverage to negotiate manufacturer rebates for some products
- Plans with high LIS enrollment will see larger increases in plan liability but also higher capitated payments after CMS recalibrates risk adjusters
- Modified risk corridors would provide financial protection during the transition to a new benefit structure and would be especially valuable to smaller plans
- Employer group waiver plans will receive less in manufacturer discounts

# Implications of draft recommendations for pharmaceutical manufacturers

- Discount liability would shift from manufacturers of brand-name drugs and biologics with relatively low prices to manufacturers of drugs and biologics with higher prices
- Effects on manufacturer pricing decisions for existing products would vary
- Some manufacturers may experience lower Part D revenues or diminished ability to raise prices
- May lead to higher launch prices
- May change distribution of R&D spending

# Summary of draft recommendations

- Major components
  - Plans become responsible for 75% of spending between the deductible and OOP threshold
  - Provide complete financial protection to non-LIS enrollees
  - Restructure the catastrophic benefit to shift insurance risk from Medicare to plan sponsors and pharmaceutical manufacturers
  - Provide plans with more tools and flexibility to manage spending
- ▶ Restore risk-based capitated approach
- ▶ Eliminate program features that distort market incentives