Advising the Congress on Medicare issues

Sharing risk in Medicare Part D

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Roadmap

- Recap from October 2014 meeting
- Observed patterns of reinsurance and risk corridor payments
- Feedback from plan actuaries
- Numeric examples
- Next steps

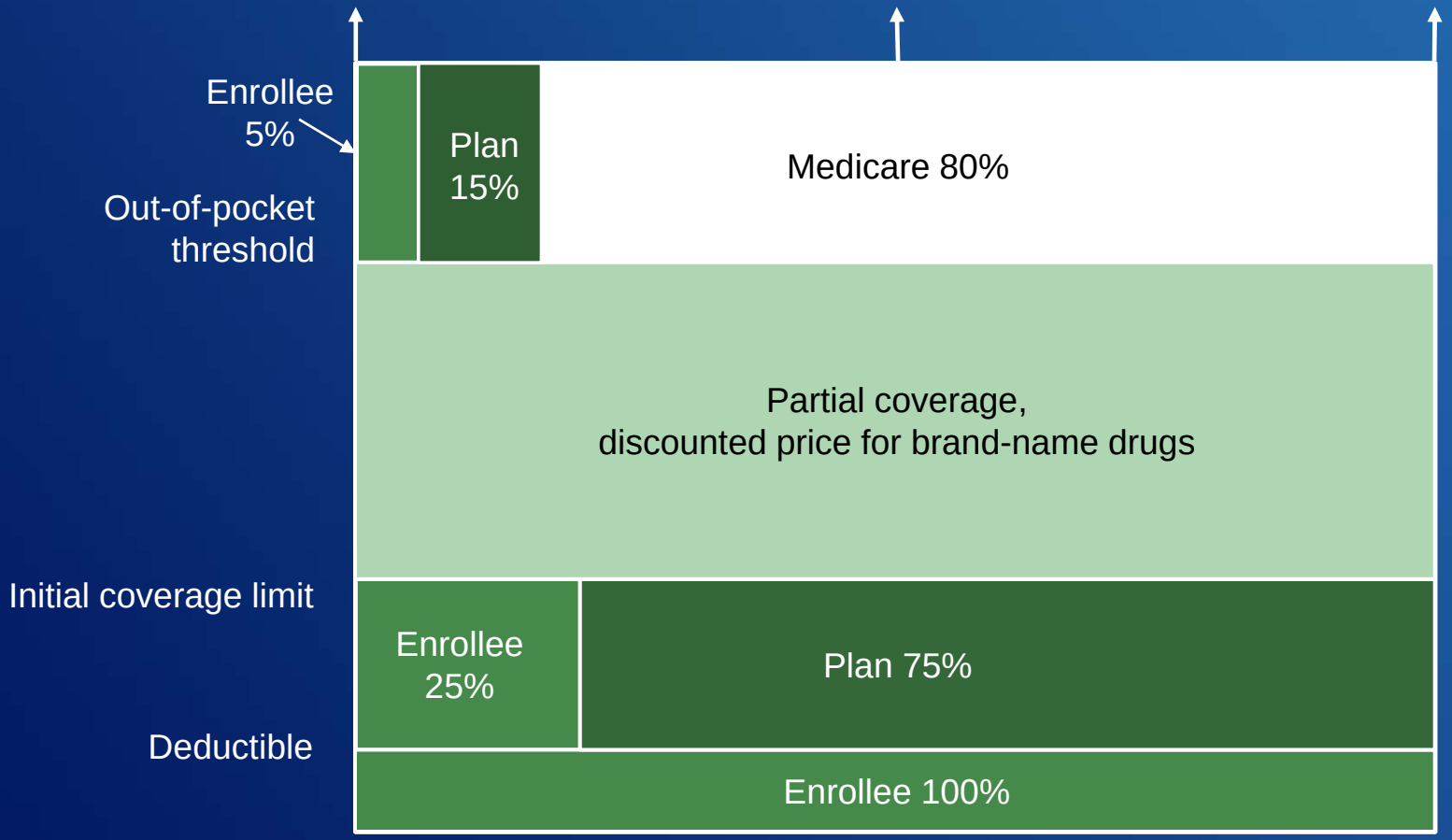
Part D's approach

- Private plans deliver drug benefits
  - Compete for enrollees
  - Drug-only plans or part of Medicare Advantage
- Medicare pays for nearly 75% of basic benefits, enrollees pay almost 25%
  - Monthly capitated payments to plans
  - Plan premiums vary depending on their bids
  - Medicare has other subsidies that offset risk
- Low-income subsidy provides extra help with premiums and cost sharing to 30% of enrollees

Mechanisms for and objectives of risk sharing in Part D

Mechanism	Objective
Direct subsidy: 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.
Risk adjustment	Counters the incentive for sponsors to avoid high-cost enrollees
Individual reinsurance	Counters the incentive for sponsors to avoid high-cost enrollees
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)

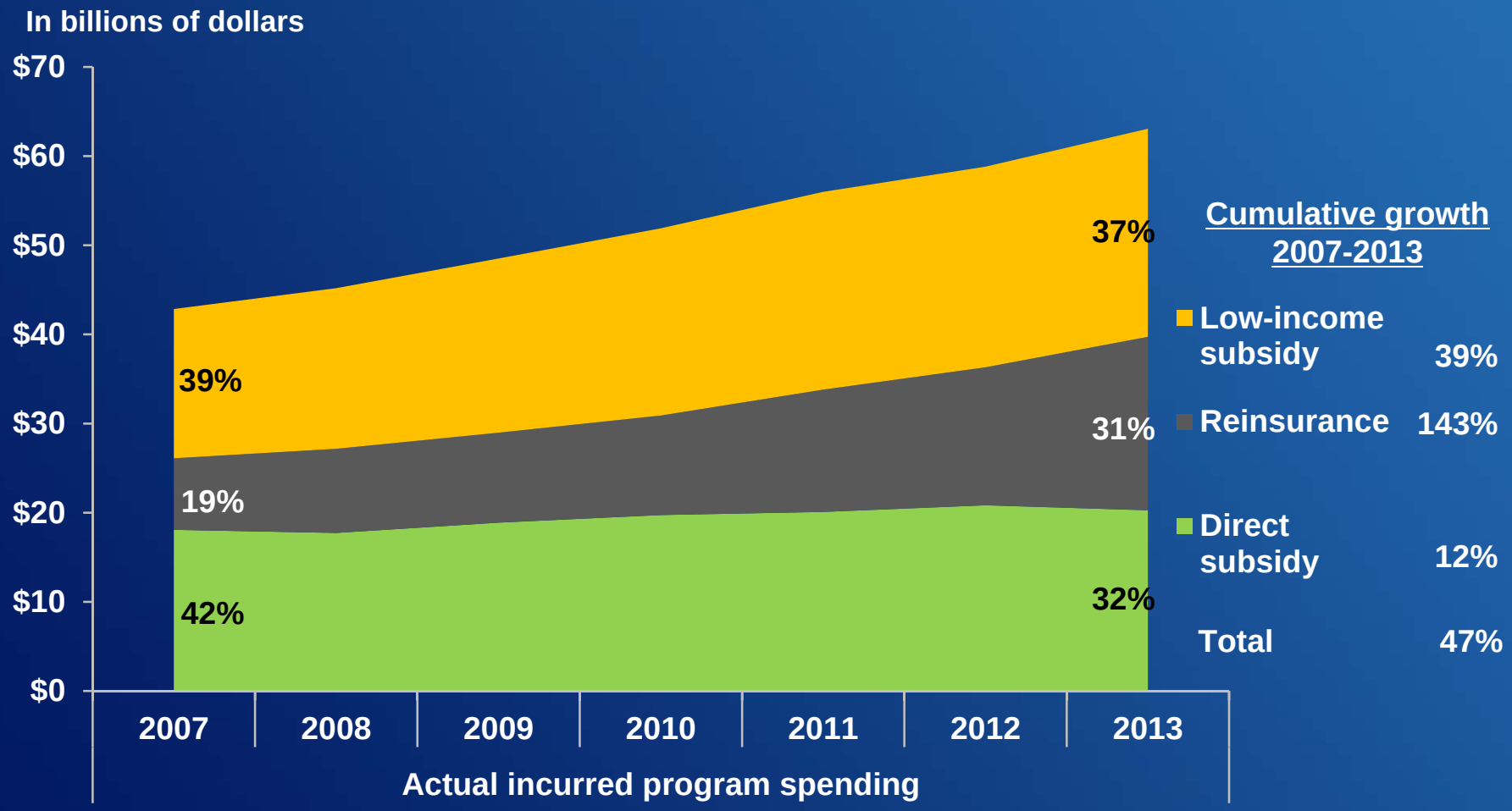
Individual reinsurance: Medicare pays for 80% of benefits above the OOP threshold



Note: OOP (out of pocket).

Current structure of risk corridors: actual costs relative to bids

Rapid growth in reinsurance payments, high cost of Low-Income Subsidy

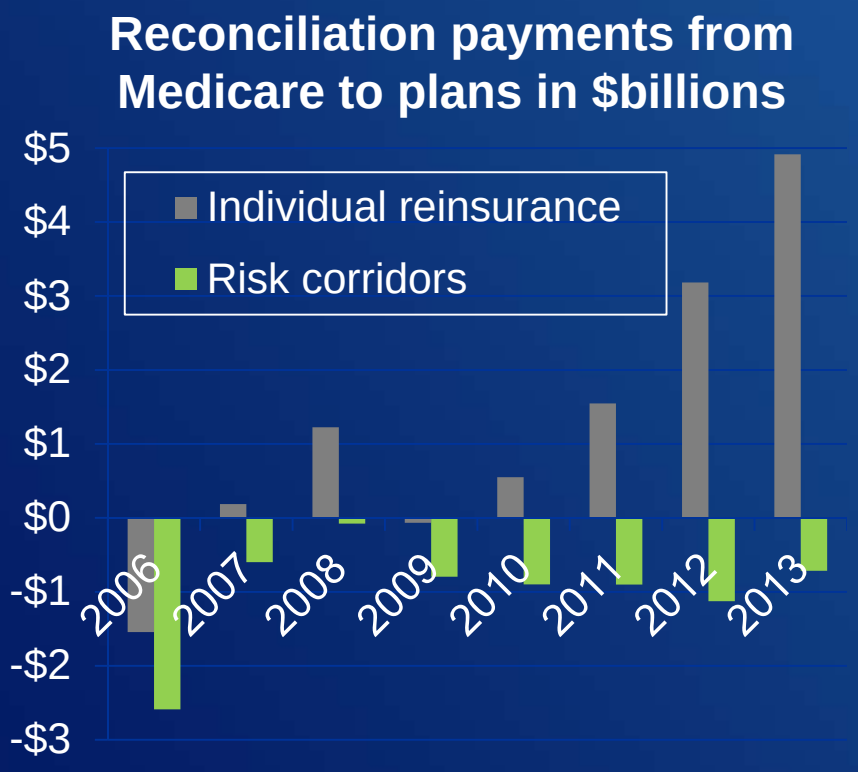


MEDPAC Source: MedPAC based on Table IV.B.10 of the Medicare Board of Trustees' report for 2014.

Timing of bids and reconciliation

- Benefit year starts January 1
- Previous June, sponsors submit bids with estimates of:
  - Benefit spending for an enrollee of average health (net of rebates and discounts)
  - Low-income cost sharing
  - Expected individual reinsurance
- CMS uses bids to set prospective payments
- 6 months after end of benefit year, CMS reconciles prospective with actual payments

Patterns of reconciliation payments



Source: MedPAC based on data from CMS.

Data are preliminary and subject to change.

- 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

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Feedback from plan actuaries

- Some sponsors use smooth assumptions to project benefit spending
  - But growth rates differ by therapeutic class
  - Average trend understates catastrophic spending and individual reinsurance
- When bids are prepared, uncertainty about:
  - Market entrance and prices of drugs
  - Rebate and discount agreements
  - Numbers of LIS enrollees

An advantageous way to bid?

- Uncertainty in key factors that affect plan bids
- But we see a pattern in program's reconciliation payments instead of randomness
- Reasonable to ask if there is a financial advantage in plans' bidding approach

Potential plan approaches to bidding

- Approach #1: focus on premiums
  - Underestimate catastrophic spending
  - Overestimate rest of benefit spending (but not high enough to trigger a risk corridor payment)
    - ✓ 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

Potential plan approaches to bidding – cont.

- Approach #2: aim for higher profits
  - Underestimate catastrophic spending
  - Overestimate rest of benefit spending, high enough to trigger a risk corridor payment
    - ✓ Recoup most of the cost "over-runs" above catastrophic threshold at reconciliation
    - ✓ Retain larger "excess" profits, even after paying a portion back to Medicare
    - ✘ Less competitive (higher) premium
    - ✘ Lower cash flow due to lower prospective reinsurance payments

Numeric example

	Plan bid	Actual cost		Notes
Plan at risk	**$60.00**	**$54.00**		
Reinsurance	**$40.00**	**$48.00**		**Higher covered benefit because coverage is more generous above catastrophic threshold**
Total covered benefit	**$100.00**	**$102.00**	←	
Enrollee premium (25.5%)	**$25.50**	**$25.50**	←	**Should have been $26**
Reconciliation		**+$8**	←	**Additional payments from Medicare for higher reinsurance costs**
Plan extra profit		**+$6**	←	**Difference between $60 (direct subsidy/premium) and $54 (actual cost)**

Potential policy approaches

- Combine changes to risk sharing with other policies to balance competing goals
- Risk sharing options
  - Risk for costs above catastrophic threshold (reinsurance)
    - Plans bear more risk (> 15%)
    - Private provision of reinsurance
  - Changes to risk corridors
- LIS policies

Next steps

- For the April meeting:
  - Conversations with private reinsurers
  - Additional analysis of reinsurance and risk corridors
- For the next cycle (Fall 2015 – Spring 2016):
  - Discussion of risk-sharing policy options
  - Revisit 2012 recommendation on LIS cost sharing?