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EGWP + Wrap Drug Plans Present Savings Opportunities for Employers

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Recent guidance issued by the Center for Medicare and Medicaid Services (CMS) coupled with certain provisions of healthcare reform have created a potentially significant savings opportunity for employers that provide prescription drug benefits to their Medicare-eligible retirees. By restructuring their prescription drug benefits program to a certain configuration, called an "EGWP + Wrap" (Employer Group Waiver Plan with wrap-around secondary plan), employers can potentially reduce their pre-tax cash cost by 20% or more below current levels under the Retiree Drug Subsidy (RDS) program. Furthermore, the EGWP + Wrap structure will not require a substantial change from the current drug benefit design from the standpoint of the retirees.

For many employers, it may be too late to restructure their benefit program in time for a calendar year 2011 implementation. However, if the proper arrangements and management decisions are made before the end of fiscal year 2010 for implementation at a later time, it may be possible to reflect the substantial reductions in ASC 715-60 liability by fiscal year-end 2010.

Why Now? What Has Changed?

Since the passage of healthcare reform (i.e., the Patient Protection and Affordable Care Act or "PPACA"), EGWP plans have posed a potentially attractive alternative to the RDS program. This was largely due to the loss of some of the tax advantages associated with the RDS starting in 2013. However, a series of guidance released by CMS subsequent to the passage of healthcare reform has made this option increasingly more attractive to employers.

How an EGWP + Wrap Can Reduce Costs

In their guidance, CMS provided that the 50% Discount Program under PPACA applies to EGWPs as well as traditional Part D plans. Under PPACA, 50% of the cost of brand name drugs incurred in the Part D donut hole will be paid for by participating drug manufacturers, starting in 2011. This alone was not enough to drive significant savings for EGWP plans, since PPACA provides that the Discount is applied after any supplemental coverage provided in the donut hole by a Part D plan. This provision effectively restricted the cost reductions under the Discount Program to benefit the retiree and not the plan sponsor.

However, in subsequent guidance, CMS clarified that the discount would be applied *before* any additional coverage provided under a non-Part D plan. This gives rise to significant savings potential for a certain benefit configuration under which any brand name prescription drug coverage in the Part D donut hole is provided by a secondary, non-Part D plan. Such plans are known as "EGWP + Wrap" plans, and are described in more detail below. A large portion of the savings stems from the fact that the full discount reduces costs of the secondary plan sponsor, and not the retiree.

A lesser source of additional savings comes from CMS guidance that provides that amounts paid under the Discount Program count as if paid by the participant, for purposes of meeting the Out-of-Pocket Threshold for catastrophic coverage under Part D. This will result in more members qualifying for catastrophic coverage under Part D, which is primarily funded by reinsurance dollars from CMS.

Description of EGWP + Wrap

The structure consists of two separate but integrated plans. The first is a certain type of Medicare Part D plan offered exclusively to the employer's retirees called an Employer Group Waiver Plan, or "EGWP" (pronounced *egg-whip*). The benefits provided under the EGWP plan in this configuration typically mirror those provided under the defined standard Medicare Part D plan - including the Part D "donut hole" which in 2010 requires 100% retiree cost sharing once $2,830 in drug claims have been accumulated. The second plan

is a non-Part D plan the benefits of which are integrated or "wrapped" around the EGWP plan's benefits so that the combined benefits reflect the employer's original benefit design prior to the EGWP + Wrap conversion. Both plans are typically self-insured.

While some design customization is possible for the EGWP plan, in order to realize the full savings potential of the EGWP + Wrap it is essential that the EGWP does not provide coverage for brand drugs in the Part D donut hole. Any brand drug coverage in the donut hole must be provided by the Wrap plan. Otherwise, amounts paid by the manufacturers via the 50% Discount Program will serve to reduce the retirees' out of pocket costs rather than the employer's costs.

Another plan feature that is necessary to maximize the savings is that the EGWP + Wrap plan must be on a calendar year basis. This is because plans that are not on a calendar year basis are not eligible to receive catastrophic reinsurance funding from the government, per CMS guidance. This may require some employers to change their plan year for prescription drug benefits in order to achieve the maximum savings under this plan design.

Advantages of EGWP + Wrap

The main advantage of the EGWP + Wrap configuration is the cost savings to employers. Some employers are expecting pre-tax cash savings of over 20% below current costs under the RDS program. It should be noted that until 2013, the RDS program may be less costly on a post-tax cash basis than the EGWP + Wrap for some plans. Beginning in 2013, the tax advantages associated with the RDS will expire, in that the amount an employer can deduct for healthcare expenses will be reduced by the RDS subsidy the employer receives.

Furthermore, from a financial reporting perspective, the EGWP + Wrap will often result in lower postretirement benefit costs and obligations[1] than the RDS program. For many employers, this more than offsets the temporary advantage of the RDS program on a near-term post-tax cash cost basis. Note the cost savings of the EGWP + Wrap will vary according to each employer's specific benefit arrangement. For example, the savings to the employer will generally be less if the employer's costs are capped for some retiree groups. For such capped retiree groups, the savings from the EGWP + Wrap structure will generally be realized by the retirees through lower required contributions.

Another advantage of the EGWP + Wrap configuration is that, like the RDS program, the EGWP + Wrap does not require a substantial change to the benefits in order to realize the savings. Because of this, many employers will be able to convert to an EGWP + Wrap configuration for their collectively bargained arrangements (although agreement by the union will likely be required). In fact, for some plans the benefits may be somewhat improved due to the requirement that the EGWP provide benefits that are at least as rich as the defined standard Part D plan. For example, Part D provides 75% coverage for drugs incurred after the $310 deductible and before the $2,830 Initial Coverage Limit (ICL). If the cost of a generic drug is $20, Part D will require $5 in cost-sharing from the retiree, whereas an employer plan may require a $10 copayment. In this case, the EGWP + Wrap would require the $5 copayment rather than the $10.

Unlike the RDS program, there are no restrictions under the EGWP + Wrap on the amount of premiums the employer charges its retirees for participation in the program. This can be especially advantageous for employers who are expecting to lose RDS eligibility in the near future due to the Net Test on actuarial equivalence, which requires that the value of the employer's drug benefits net of allocated retiree contributions is greater than or equal to that under Part D. For such employers, the EGWP + Wrap may offer a substantial reduction in their postretirement benefits obligation and expense.

Other Considerations

There are some additional considerations associated with EGWP + Wrap plans relative to their RDS counterparts. For instance, EGWP + Wrap plans are more complex to administer. While much of the burden is handled by the drug benefit vendor, the vendor will charge additional fees for administering these plans. However, the cost savings from converting to an EGWP + Wrap will likely more than offset these additional costs.

Another consideration is the increased level of retiree communications required on the EGWP plan, which when combined with additional communications explaining the secondary plan and overall impact on benefits may confuse some retirees.

Other considerations stem from the fact that the EGWP is a Part D plan and thus is subject to various restrictions and benefit mandates set forth by CMS.

[1] Accounting guidance related to postretirement benefits is in Accounting Standards Codification No. 715-60, *Compensation - Retirement Benefits - Defined Benefit Plans - Other Postretirement* (ASC 715-60).

For example, mandatory generic drug provisions are generally not allowed on Part D plans. Furthermore, EGWP + Wrap plans are still relatively new, so there may be some unforeseen implementation issues in the early years of adoption.

How PwC Can Help

Employers who are interested in pursuing an EGWP + Wrap conversion should contact a prescription drug vendor to discuss their capabilities in administering these plans. PwC can assist employers in these discussions by helping them assess the short and long-term savings potential of EGWP + Wraps over their current programs, as well as consider the broader administrative, contracting, and communications issues. Our professionals have a deep understanding of the complex pricing considerations necessary in estimating the short and long-term cash costs, and can help employers understand these considerations. We can also apply our knowledge of longer-term health reform implications, coupled with broad actuarial, tax, accounting, and administrative expertise to help employers take the full advantage of the savings potential to their ASC 715-60 financial reporting.

For more information on the topic discussed in this *HRS Insight* or to change your address, contact your local PricewaterhouseCoopers professional.

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