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State Financing of the Medicare Drug Benefit: New Data on the "Clawback"

The implementation of the new Medicare outpatient prescription drug benefit on January 1, 2006, will mark a significant change in the federal-state fiscal relationship. For the first time in its 40-year history, the federal Medicare program will finance a significant portion of a new benefit using state dollars. The mechanism through which the states will help pay for the new Medicare drug benefit is commonly referred to as the "clawback" (the statutory term is "phased-down State contribution"). These "clawback" payments will constitute the largest single source of state funds flowing to the federal government from FY 2006 onward.

When the Medicare Part D program is implemented, Medicare, not Medicaid, will pay for outpatient drug coverage for elderly and disabled individuals who are eligible for both Medicare and Medicaid – state Medicaid programs currently provide that benefit. As of January 1, 2006, state Medicaid programs will no longer receive federal matching funds for the provision of Medicare-covered outpatient prescription drugs for the dual eligible population. Instead, each state will owe a "clawback" payment to the Medicare program that is intended to reflect a percentage of the expenditures that the state would have made had it continued to pay for outpatient prescription drugs for dual eligibles through Medicaid. By statute, this percentage "phases down" from 90% of the estimated state cost in FY 2006 to 75% in FY 2015 and thereafter.

The "clawback" will be operationalized as a monthly payment made by each state to the federal Medicare program to offset the cost of the drug benefit provided to Medicaid and Medicare dual eligibles in the preceding month. The first monthly payment is due in February 2006.[1] On October 14, 2005, the Centers for Medicare and Medicaid Services (CMS) notified each State of the per capita monthly payment amount it will be assessed for each Medicare beneficiary enrolled with full benefits in the State Medicaid program during 2006. This Brief provides an overview of the data released and each State's resulting per capita "clawback" obligations.

The "Clawback" Formula

The amount of each State's clawback payment is determined under a formula established by the Medicare Modernization Act (MMA) and detailed by CMS in regulation.[2] As shown in Figure 1, each State's payment is the product of a per capita expenditure, the number of dual eligibles in the month, and a phase-down percentage. The per capita expenditure for each State for 2006, reduced by the phase-down percentage for 2006 (90%), is the amount that CMS announced on October 14. These amounts were calculated by CMS using each state's 2003 Medicaid administrative data as submitted through the Medicaid Statistical Information System (MSIS), supplemented

[1] For more background and detail on this new financing arrangement, see Schneider, Andy, "The 'Clawback:' State Financing of Medicare Drug Coverage," The Kaiser Commission on Medicaid and the Uninsured, June 2004, available at: www.kff.org/medicaid/7118a.cfm.

[2] 42 CFR 423.910, published in 780 Fed. Reg. 4584 (January 28, 2005).

1330 G Street NW, Washington, DC 20005
Phone: 202-347-5270, Fax: 202-347-5274
Website: www.kff.org

with data provided by each state on their capitated dual eligible enrollment, and information from the Medicaid Drug Rebate Program. CMS has worked with states to verify these data and refine their calculations.

Figure 1 - The "Clawback" Formula

Monthly State "Clawback" Payment	=	Per Capita Expenditures (PCE)	X	Full Dual Eligibles (DE)	X	Phased-Down Percentage (PDP)
		State share of monthly per capita Medicaid expenditures on prescription drugs covered under Part D for dual eligibles during 2003, trended forward to 2006, and adjusted for rebates and managed care		Number of Medicaid dual eligibles enrolled in a Medicare Part D plan in the month for which payment is based		Phase-down percentage for the year specified in the statute (e.g., 90% in 2006)

As required by the MMA, the 2006 per capita monthly payment amount was calculated by first establishing a fee-for service per-capita drug cost for dual eligibles in each State during calendar year 2003, adjusted by a Medicaid drug rebate percentage, and weighted for full dual eligible managed care drug costs, if any. The State share of this amount was then trended forward to 2006 using the National Health Expenditures drug cost growth, and reduced by 10 percent for the 2006 phase-down factor of 90%. According to CMS, the final payment amount is based on all 2003 dual eligible drug claims with the following exclusions: claims associated with individuals who were not a full dual eligibles in the prescription fill month; claims for Part D excluded drugs; claims for individuals in pharmacy-plus or other Section 1115 drug-only demonstration programs; claims for Indian Health Service or Family Planning services; claims with an invalid National Drug Code (NDC); and claims with an invalid prescription fill date.

The amount that each State must pay the Medicare program each month is computed by multiplying the final per-capita payment amount by each State's monthly full dual eligible enrollment, as reported to CMS in a monthly MMA dual enrollment file and matched to Medicare Part D enrollment data. The November 2005 dual eligible enrollment file will be used to establish the January 2006 payment. According to CMS, this first payment will be due February 1, 2006, with a grace period to February 25, 2006.

2006 "Clawback" Amounts

Table 1 presents each state's final monthly per capita "clawback" payment amount for each month of FY 2006 and FY 2007 during calendar year 2006, as well as some of the key factors used to compute these amounts in each state. This table was prepared by staff of the Kaiser Commission on Medicaid and the Uninsured using information contained in the 51 letters sent to State Medicaid Directors from the CMS Center for Medicaid and State Operations on October 14, 2005.

Analysis of these data indicate that there were a total of 5.9 million full year equivalent dual eligible enrollees in calendar year 2003, for whom outpatient fee-for-service Medicaid prescription drug payments totaled $16.6 billion. 2003 monthly per capita drug spending on full dual eligibles averaged $202 across the 50 states and the District of Columbia, ranging from a low of $122.72 in Arizona to a high of $261.69 in New Jersey. After calculating 90% of the state share of these amounts, 2006 monthly per capita clawback payments will range from a low of $47.08 for the first eight 2006 monthly payments in Mississippi to a high of $159.61 in New Jersey (Tables 1 and 2). Variation in state matching rates (from a statutory minimum of 50% in 12 states to a high of 76% in Mississippi) accounts for roughly 75% of the variation in per capita clawback obligations. States are grouped by FMAP to help separate the effect of the match rate in Table 2.

Although data on November 2005 full dual eligible enrollment are not yet available, the 2003 enrollment presented in Table 1 can function as a lower-bound estimate of what 2006 enrollment might be across the nation. Dual eligible enrollment has grown slowly, yet consistently, over the last few years in nearly all states. Assuming each state has the same dual eligible enrollment as they had during 2003 for each of the first 11 payments due during calendar year 2006, states will pay an estimated $6.6 billion to the federal government over the first year of the "clawback." This amount will be greater if enrollment levels are higher.

In a survey of Medicaid directors conducted during July and August 2005, prior to receiving final notice from CMS of their official 2006 clawback obligations, a number of directors reported that they expect no significant cost savings in future years through the clawback, despite the scheduled partial phase-down of their contribution from 90% to 75%.[3] States commented that the base year (2003) used for the clawback formula did not account for pharmacy cost containment measures taken in their states after 2003, resulting in an inflated 2006 clawback obligation. Other states expected increased costs associated with an anticipated "woodwork effect" whereby implementation of the new Medicare drug benefit would have the effect of increasing the number of dual eligibles, increasing both Medicaid spending and clawback obligations. Others were concerned about increased administrative costs related to the Medicare drug benefit, including the need for computer system upgrades, coordination of benefits issues, data and data exchange issues, state staffing impacts, and administering Part D Low-Income Subsidy eligibility determinations.

As states seek new cost-containment measures to limit Medicaid spending growth in an era of ongoing medical cost growth, erosion of employer sponsored insurance, and potential reductions in federal Medicaid payments, their only lever to affect the amount of their monthly clawback payment is to change the number of full-benefit dual eligible Medicaid enrollees. Thus, the clawback formula may create an incentive for fiscally-strapped states to reduce coverage for optional groups of costly dual eligibles, which yield savings not only in reduced Medicaid spending on benefits and Medicare cost-sharing and premiums, but also reduce state obligations to the federal government under the clawback. Indeed, several states have already begun to adopt policies that have the effect of reducing dual eligible enrollment.[4] To the extent states respond to the formula's incentive in this way, some Medicare beneficiaries who now qualify for Medicaid through optional eligibility pathways may find that enrollment and reenrollment in Medicaid becomes more difficult after January 1, 2006, when the "clawback" begins.

[3] See Smith et al., "Medicaid Budgets, Spending and Policy Initiatives in State Fiscal Years 2005 and 2006 – Results from a 50-State Survey," The Kaiser Commission on Medicaid and the Uninsured, October 2005, available at: http://www.kff.org/medicaid/7392.cfm. It should be noted that these projections were made before states were informed of their final clawback payment amounts, although preliminary data had been received.
[4] Florida, Mississippi, and Missouri each plan to eliminate eligibility for significant numbers of "optional" aged and disabled enrollees in FY 2006 – see Smith et all, 2005.

Table 1

State Financing of the New Medicare Drug Benefit: The "Clawback" Component Table, 2006

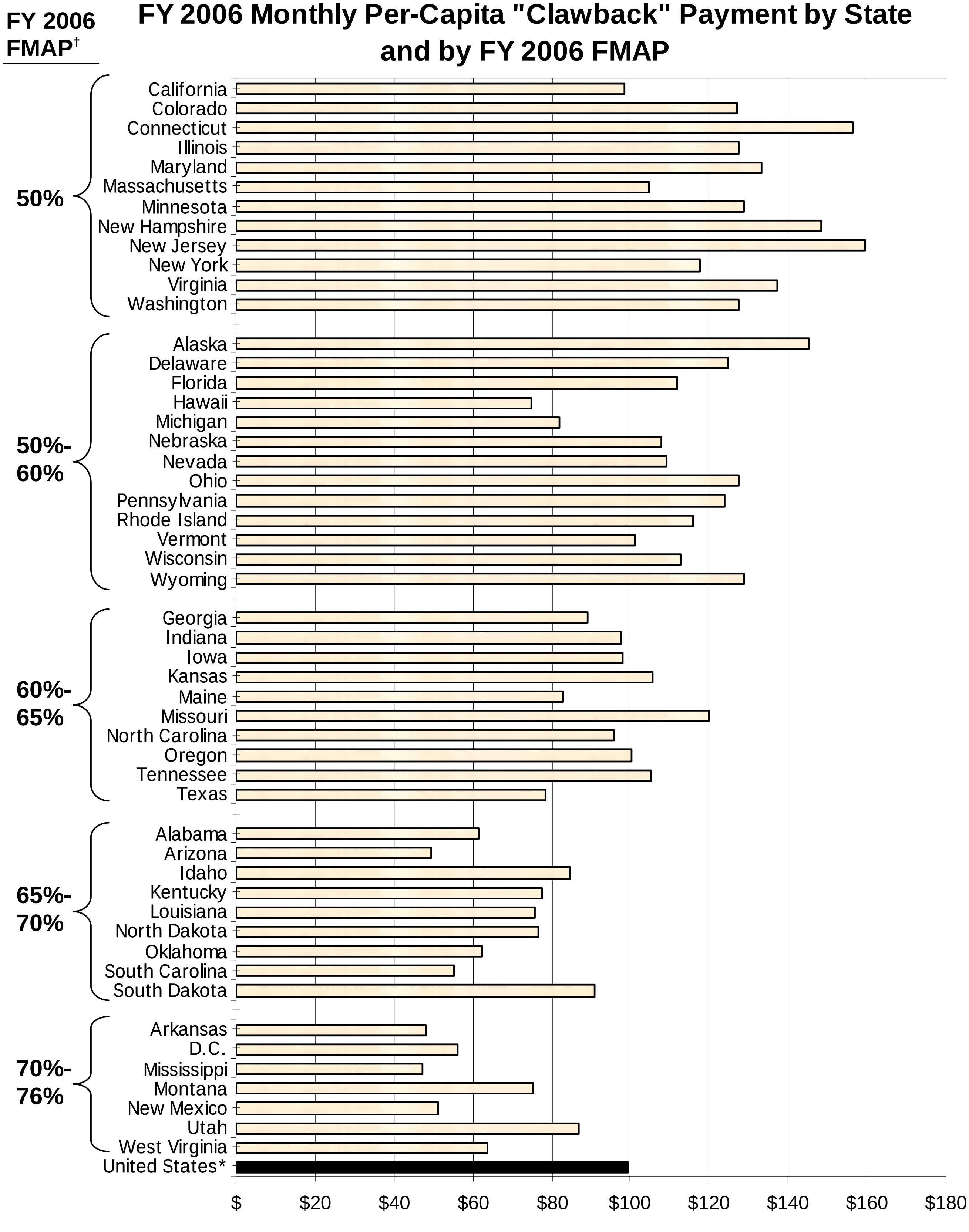
State	2003 Full-Year Equivalent Dual Eligible Enrollment	Total 2003 Fee-For-Service Dual Eligible Drug Payments	Baseline 2003 Per-capita Dual Eligible Drug Payment	2006 Inflated Per-capita Dual Eligible Drug Payment	2006 State Share of Per-capita Drug Payment	Per-capita Monthly 90% "Clawback" Payment FY 2006 Q2-Q4	Per-capita Monthly 90% "Clawback" Payment FY 2007 Q1
United States*	5,916,201	$16,559,416,191	$202.00	$273.79	$110.36	$99.32	$99.97
Alabama	93,165	$231,661,420	$164.85	$223.43	$68.12	$61.31	$62.64
Alaska	9,441	$34,036,456	$239.03	$323.97	$161.47	$145.32	$142.67
Arizona	80,191	$1,261,633	$122.72	$166.33	$54.92	$49.43	$50.19
Arkansas	60,544	$134,297,069	$150.98	$204.64	$53.68	$48.31	$49.05
California	934,582	$2,272,918,487	$161.56	$218.98	$109.49	$98.54	$98.54
Colorado	48,256	$127,380,741	$208.17	$282.15	$141.07	$126.97	$126.97
Connecticut	68,327	$260,456,291	$256.10	$347.12	$173.56	$156.20	$156.20
Delaware	9,557	$31,663,451	$205.27	$278.22	$138.86	$124.97	$125.20
District of Columbia	15,621	$35,329,505	$153.09	$207.49	$62.25	$56.02	$56.02
Florida	331,046	$1,047,844,421	$223.44	$302.84	$124.50	$112.05	$112.40
Georgia	140,839	$384,329,136	$185.18	$250.98	$98.89	$89.00	$85.90
Hawaii	23,462	$53,818,985	$148.94	$201.87	$83.15	$74.83	$77.12
Idaho	16,584	$58,773,067	$230.39	$312.26	$93.96	$84.56	$83.30
Illinois	190,102	$581,991,450	$209.26	$283.62	$141.81	$127.63	$127.63
Indiana	95,546	$324,582,341	$215.79	$292.47	$108.27	$97.45	$98.42
Iowa	52,217	$171,045,855	$220.93	$299.44	$108.97	$98.07	$102.46
Kansas	39,089	$131,620,757	$218.25	$295.82	$117.11	$105.40	$105.83
Kentucky	96,657	$272,848,106	$207.23	$280.87	$86.34	$77.71	$76.90
Louisiana	96,618	$300,033,140	$204.92	$277.75	$83.91	$75.52	$75.77
Maine	43,636	$128,374,559	$182.73	$247.66	$91.88	$82.70	$81.87
Maryland	58,612	$183,164,126	$218.77	$296.51	$148.26	$133.43	$133.43
Massachusetts	183,683	$498,162,857	$171.49	$232.43	$116.21	$104.59	$104.59
Michigan	187,741	$459,785,626	$155.10	$210.22	$91.26	$82.13	$82.53
Minnesota	92,171	$176,664,843	$211.16	$286.19	$143.10	$128.79	$128.79
Mississippi	133,899	$321,215,854	$160.81	$217.95	$52.31	$47.08	$47.29
Missouri	134,358	$511,380,946	$258.33	$350.13	$133.29	$119.96	$121.00
Montana	13,874	$44,610,494	$209.67	$284.18	$83.72	$75.35	$79.00
Nebraska	30,747	$100,849,954	$218.80	$296.56	$119.57	$107.61	$112.28
Nevada	16,311	$47,158,738	$198.15	$268.56	$121.50	$109.35	$111.35
New Hampshire	17,231	$64,344,329	$243.20	$329.63	$164.82	$148.33	$148.33
New Jersey	132,467	$492,161,281	$261.69	$354.69	$177.35	$159.61	$159.61
New Mexico	30,609	$69,433,943	$145.96	$197.84	$57.08	$51.37	$49.98
New York	564,589	$1,656,898,291	$192.93	$261.50	$130.75	$117.67	$117.67
North Carolina	216,707	$684,599,208	$214.69	$290.98	$106.24	$95.61	$92.92
North Dakota	11,259	$31,643,411	$183.48	$248.68	$84.93	$76.43	$78.96
Ohio	180,783	$711,075,547	$260.21	$352.68	$141.49	$127.34	$128.04
Oklahoma	72,332	$168,773,949	$158.82	$215.26	$69.08	$62.17	$61.72
Oregon	51,597	$104,946,354	$213.65	$289.58	$111.29	$100.16	$101.46
Pennsylvania	252,021	$455,519,256	$225.69	$305.89	$137.50	$123.75	$125.56
Rhode Island	29,691	$90,582,892	$208.08	$282.03	$128.46	$115.62	$120.95
South Carolina	108,624	$240,549,538	$147.66	$200.13	$61.40	$55.26	$54.86
South Dakota	11,324	$36,736,362	$213.33	$289.14	$101.00	$90.90	$96.49
Tennessee	246,495	$853,088,769	$239.14	$324.12	$116.72	$105.05	$106.04
Texas	325,273	$798,314,005	$163.46	$221.54	$87.16	$78.44	$78.20
Utah	17,916	$64,376,863	$243.76	$330.39	$96.61	$86.95	$88.79
Vermont	14,219	$43,959,834	$199.79	$270.79	$112.41	$101.17	$100.09
Virginia	94,255	$306,082,506	$224.95	$304.89	$152.44	$137.20	$137.20
Washington	87,590	$276,774,756	$208.58	$282.70	$141.35	$127.21	$126.91
West Virginia	41,812	$122,957,680	$193.92	$262.84	$70.99	$63.89	$64.30
Wisconsin	107,198	$341,391,616	$217.80	$295.20	$125.02	$112.52	$113.00
Wyoming	5,335	$17,945,493	$230.28	$312.11	$142.85	$128.57	$132.28

* Per capita U.S. values are means.

Source: Kaiser Commission on Medicaid and the Uninsured analysis of 10/14/05 Dear State Medicaid Director Letters from the Centers for Medicare and Medicaid Services, 2005.

Note: Due to changes in the state FMAP, 39 states will pay a different per capita amount under the clawback during the last 3 months of calendar year 2006
during the first quarter (Q1) of FY 2007.

Table 2
FY 2006 Monthly Per-Capita "Clawback" Payment by State and by FY 2006 FMAP



† FMAP = Federal Medical Assistance Percentage.
* Per capita U.S. values are means.
Source: Kaiser Commission on Medicaid and the Uninsured analysis of 10/14/05 Dear State Medicaid Director Letters from the Centers for Medicare and Medicaid Services, 2005.

1330 G Street NW, Washington, DC 20005
Phone: (202) 347-5270, Fax: (202) 347-5274
Website: www.kff.org/KCMU

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