ESTIMATES OF MEDICARE BENEFICIARIES' OUT-OF-POCKET DRUG SPENDING IN 2006

Modeling the Impact of the MMA

EXECUTIVE SUMMARY

Prepared by

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Introduction

The Medicare Modernization Act of 2003 (MMA) was enacted to extend coverage for prescription drugs to the Medicare population and to ease the financial burden of prescription drug spending for beneficiaries, especially those with low incomes or extraordinarily high out-of-pocket drug expenses. With the new Medicare Part D prescription drug benefit scheduled to begin on January 1, 2006, and enrollment starting in November 2005, there is considerable interest in understanding how the new benefit could affect beneficiaries' out-of-pocket drug spending. In 2006, the first year of implementation, the Congressional Budget Office (CBO) estimates that Part D participants will spend, on average, $792 out of pocket for prescription drugs (excluding premiums), which is 37% less than the $1,257 they would have spent in the absence of the law.[1]

This report delves beneath these average estimates to show how out-of-pocket spending on prescription drugs is likely to vary among Medicare beneficiaries who are expected to enroll in Part D plans in 2006. It examines how the MMA is expected to affect spending by Part D participants at different income and subsidy levels, and projects the effects for beneficiaries with very high out-of-pocket drug expenditures. The report also provides new estimates for the number and characteristics of Part D participants who are expected to have drug spending in excess of the initial coverage limit (in the "doughnut hole") and spending above the catastrophic threshold.

Background on the Medicare Drug Benefit

Under the new Medicare drug benefit (Part D), Medicare will begin to pay for outpatient prescription drug coverage through private drug plans, giving beneficiaries access to a standard prescription drug benefit, or its actuarial equivalent. Under the standard benefit in 2006, after the first $250 in total drug costs (the deductible), Medicare will pay 75% of costs between $250 and an initial coverage limit of $2,250; 0% of costs between $2,250 and $5,100 (with beneficiaries paying 100% of costs in the "doughnut hole"); and 95% after total costs exceed $5,100 ($3,600 out-of-pocket).

The MMA devotes substantial resources to provide premium and cost-sharing assistance to beneficiaries with incomes below 150% of the federal poverty level ($13,965 for an individual in 2004) and modest assets.[2] For example, Part D participants with incomes below 135% of poverty ($12,569 for an individual in 2004) and assets no greater than $6,000 individual/$9,000 couple will receive a premium subsidy for basic coverage in their region, and will be required to pay $2 and $5 copayments for generic and brand-name drugs (respectively) up to the catastrophic limit. The law also replaces state Medicaid programs with new Part D private drug

[1] Congressional Budget Office, *A Detailed Description of CBO's Cost Estimate for the Medicare Prescription Drug Benefit*, July 21, 2004.
[2] See Exhibit 2 in the main text of this report for a detailed overview of Part D benefits for low-income beneficiaries.

plans as the source of prescription drug coverage for beneficiaries who are dually eligible for Medicare and Medicaid.

Methodology

The analysis presented in this report is based on a model developed by Actuarial Research Corporation (ARC). The model was designed to forecast the effects of a major change in public policy, and like any analysis of this type, the reliability of the projections depends on the accuracy of the underlying assumptions. The ARC model generally conforms to CBO assumptions and projections about average per capita drug spending by Medicare beneficiaries, drug utilization[3], Part D participation, and low-income subsidy recipients. The model controls to CBO projections, rather than those prepared by the Office of the Actuary (OACT) at the Department of Health and Human Services (HHS), to be consistent with spending estimates that were used by the Congress when enacting the MMA.[4] In addition, the model developed by ARC incorporates information about beneficiary characteristics, including demographics and insurance coverage, which allows for analysis of projected variations in average per capita spending and distributions of total and out-of-pocket spending by characteristic. A detailed description of the methodology is included in the appendix of this report.

This analysis focuses on beneficiaries who are expected to enroll in Part D plans in 2006 – 29 million of 42.6 million Medicare beneficiaries, according to CBO, including the 8.7 million Part D participants who are projected to receive low-income subsidies that year. CBO assumes that 13.6 million Medicare beneficiaries will not participate in Part D, including 8.2 million beneficiaries who are expected to receive drug coverage through qualified employer-sponsored plans, 5.4 million who receive drug coverage from the Federal Employees Health Benefits Program or TRICARE, or are assumed to go without any drug coverage in that year, and others with Medicare Part A only and not Medicare Part B.[5]

The model takes into account out-of-pocket spending associated with the Part D standard benefit, or its actuarial equivalent, but does not take into account any form of supplemental coverage that beneficiaries might obtain. This feature of the model has the potential to overstate our projections of out-of-pocket spending if beneficiaries receive coverage under Part D plans that is more generous than the standard benefit, or if they receive additional coverage from other sources. The model also excludes out-of-pocket spending for drugs not covered by Part D plans, such as non-formulary drugs or prescriptions filled at out-of-network pharmacies. Excluding these potential costs could have the effect of understating our out-of-pocket spending projections under the new drug benefit.

The out-of-pocket spending estimates presented in this report also exclude premiums paid by beneficiaries for existing prescription drug coverage such as Medigap or retiree health plans in the absence of the MMA, as well as annual premiums for Part D coverage (estimated by CBO to

[3] Similar to CBO and OACT, we assume that drug utilization would change as a result of insurance coverage.
[4] For a comparison of CBO and OACT assumptions and projections, see Appendix Table 1.
[5] CBO assumes that only Part B enrollees, a majority of all Medicare beneficiaries, will join Part D.

average $420 for 2006[6]). Premiums are excluded from baseline spending estimates because existing data sources do not provide sufficient information to measure the drug-related portion of premiums that beneficiaries pay out of pocket for different sources of supplemental coverage nor how premiums vary by beneficiary characteristics. Therefore, the only beneficiaries for whom we consider the effects of estimated Part D premiums are those beneficiaries who are assumed to lack drug coverage in the absence of the MMA, and therefore face no existing premiums, but who are expected to enroll in Part D plans in 2006.

Key Findings

Part D Participants Receiving Low-Income Subsidies Projected to Spend 83% Less, on Average, on Prescription Drugs Under the MMA; 28% Less for All Others

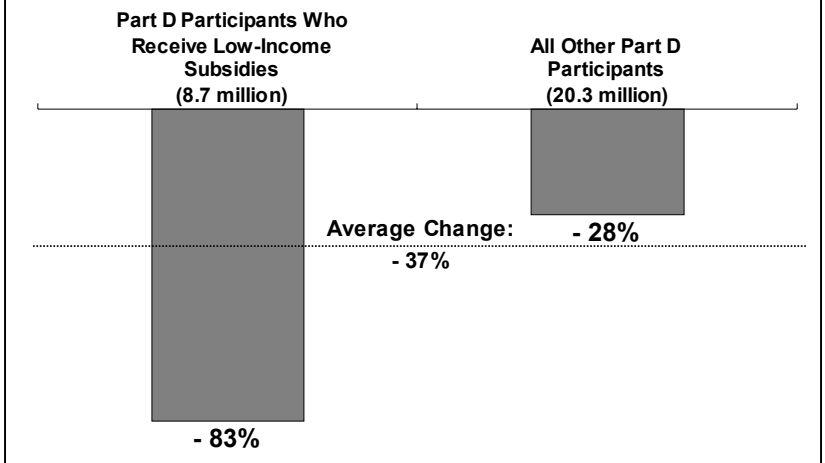
The 29 million beneficiaries who CBO assumes will participate in Part D in 2006 are projected to spend, on average, 37% less out-of-pocket for drugs under the MMA than they would have spent in the absence of the law. The MMA is projected to have a large impact on out-of-pocket drug spending by Part D participants who *do* receive low-income subsidies, but a noticeably smaller effect on out-of-pocket spending by beneficiaries *not* receiving these subsidies, who comprise the majority of those expected to enroll in Part D plans in 2006.

- The 8.7 million Part D participants who receive low-income subsidies are projected to spend, on average, 83% ($584) less under the MMA than they would have spent in the absence of the law in 2006 **(Exhibit ES1)**.

  – In dollar terms, the most significant reductions are projected to occur for an estimated 2.3 million low-income beneficiaries who did *not* have Medicaid drug coverage prior to 2006. These low-income subsidy recipients are projected to spending approximately $1,400 less out of pocket under the MMA than they would have spent in the absence of the law.

Exhibit ES1

Percent Change in Projected Out-of-Pocket Prescription Drug Spending by Part D Participants, Baseline vs. Under the MMA, by Subsidy Level, 2006



SOURCE: Actuarial Research Corporation analysis for the Kaiser Family Foundation, November 2004.

[6] $420 is CBO's estimate of the average annual premium for Part D plans, however some Part D participants will pay more and others will pay less depending on geography, demographics, and the particular plan they join.

  - The estimated 6.4 million Medicare beneficiaries with Medicaid prior to 2006 (dual eligibles) are projected to see a substantially smaller reduction in average out-of-pocket spending, in dollar terms, under the MMA, because of their relatively low out-of-pocket spending for drugs under Medicaid. On average, dual eligibles are projected to spend $263 less under the MMA than their baseline spending in 2006.

- The 20.3 million Part D participants who do *not* receive low-income subsidies are projected to spend, on average, 28% ($414) less under the MMA than they would have spent without the new drug benefit in 2006. Their out-of-pocket spending is projected to fall from $1,495 to $1,081 under the MMA.

- For the 8.5 million beneficiaries currently lacking drug coverage who are expected to enroll in Part D plans in 2006 but not receive low-income subsidies, average out-of-pocket drug spending is projected to be 50% lower under the MMA than it would be in the absence of the new law, but only 23% lower when Part D premiums are taken into account.

- The 5.7 million Part D participants with incomes less than 150% of poverty who are *not* projected to get low-income subsidies in 2006 – either because their assets are too high or because they do not apply for subsidy assistance – are projected to pay substantially more out-of-pocket on prescriptions than beneficiaries at the same income level who *do* receive Part D low-income subsidies.[7]

  - For example, the 2 million beneficiaries with incomes below 100% of poverty ($9,310 for an individual in 2004) who are *not* expected to receive low-income subsidies in 2006 are projected to spend, on average, 10 times more than the 5.2 million beneficiaries at the same income level who *do* receive subsidies ($943 vs. $90, respectively)

6.9 Million Beneficiaries Projected to Have Spending in the "Doughnut Hole"

Under the MMA, Part D participants could face significant out-of-pocket costs if they have spending that falls in the gap in the standard Part D benefit – known as the "doughnut hole." By definition, beneficiaries with spending in the doughnut hole will have out-of-pocket spending that exceeds $750 (equivalent to the initial coverage limit of $2,250 in total drug costs), and will be required to pay 100% of their total costs between $2,250 and $5,100 ($3,600 out-of-pocket) before receiving catastrophic benefits.

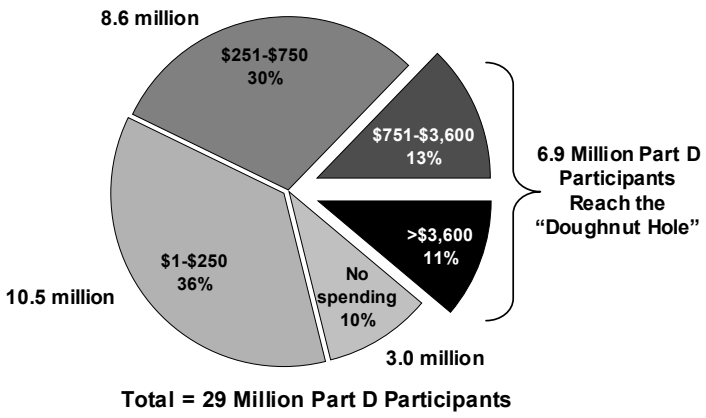
- One in four Part D participants, or 6.9 million beneficiaries, are projected to have spending in the "doughnut hole" in 2006 **(Exhibit ES2)**.

[7] CBO estimates that 1.8 million Medicare beneficiaries with incomes below 150% of poverty will not receive low-income subsidies in 2006 because they have assets above the threshold defined in the law. There are various reasons why eligible beneficiaries might not enroll in the low-income subsidy programs, including lack of knowledge about the subsidies or their eligibility, administrative burden, or stigma associated with receiving the extra help.

In general, low-income subsidy recipients with high total drug costs are not likely to have spending that exceeds the initial coverage limit, because they pay only nominal copayments under Part D (up to $5 per prescription in 2006). However, those with low-incomes who do *not* receive the additional subsidies would pay the standard Part D benefit cost-sharing obligations, and thus could face significant out-of-pocket drug costs.

Exhibit ES2

Distribution of Part D Participants, by Projected Out-of-Pocket Prescription Drug Spending Under the MMA, 2006



Total = 29 Million Part D Participants

Note: Estimates exclude premiums and assume no supplementation of Part D coverage.
SOURCE: Actuarial Research Corporation analysis for the Kaiser Family Foundation, November 2004.

- Of the 6.9 million beneficiaries who are projected to have out-of-pocket spending in the doughnut hole in 2006:
  - 1.9 million people (28%) have incomes less than 150% of poverty;
  - 2.9 million (42%) are in fair or poor health;
  - 3.8 million (55%) are women.

More than half (55% or 3.8 million) of the 6.9 million Part D participants projected to have spending in the doughnut hole are *not* expected to receive catastrophic benefits in 2006 because their out-of-pocket drug spending is projected to be less than $3,600.

Catastrophic Benefits Projected for 3.1 Million Part D Participants

For Part D participants with extraordinarily high out-of-pocket drug expenditures, the law provides additional assistance, because Medicare will pay 95% of costs above the catastrophic threshold ($3,600 in out-of-pocket spending in 2006). Nevertheless, beneficiaries with catastrophic expenses in 2006 are projected to continue to face high average out-of-pocket spending under the MMA, due to the doughnut hole in the benefit design.

- Nearly half (44% or 3.1 million) of those with spending in the doughnut hole are projected to receive catastrophic benefits because they incur at least $3,600 in out-of-pocket drug costs in 2006.

- The roughly one in 10 Part D participants who are projected to have out-of-pocket drug expenses above the catastrophic threshold are estimated to experience a 37% reduction in average out-of-pocket spending – from $5,980 in the absence of the MMA to $3,784 under the MMA in 2006.

One in Four Part D Participants Projected to Spend More

Although on average, Part D participants are projected to have lower out-of-pocket drug spending in 2006 than they would in the absence of the law, some beneficiaries are projected to spend more.

- In 2006, 18.6 million Part D participants (64% of total) are expected to have lower out-of-pocket spending than they would have had in the absence of the new drug benefit, with an average reduction of $919 (excluding premiums).
  - The greatest reductions are expected to occur for low-income subsidy recipients who did not have Medicaid drug coverage, and for beneficiaries who receive catastrophic benefits under Part D in 2006.
- One in four Part D participants – 7.4 million – are projected to have higher out-of-pocket spending under the MMA than they would have had without the drug benefit in 2006, with an average increase of $492.
  - Two-thirds of these beneficiaries are projected to face modest increases of $250 or less. This group would likely include beneficiaries with low drug spending who currently have prescription drug coverage with a low or no deductible (e.g., Medicare Advantage enrollees), but who would pay a $250 deductible before coverage begins under Part D. It also includes an estimated 2 million low-income Medicare beneficiaries with Medicaid, who generally face low or no cost-sharing for prescription drugs under state Medicaid programs (prior to the MMA).
  - The remaining one-third are projected to pay significantly higher amounts in 2006 under the MMA than their spending in the absence of the law, including people with relatively high drug costs who are projected to lose access to more comprehensive drug coverage such as an employer-sponsored retiree plan, after the new Medicare drug benefit goes into effect.[8]
- Three million Part D participants (10%) are projected to have no prescription drug spending in 2006 and thus no change in out-of-pocket spending for drugs.

Conclusion

The MMA commits substantial resources to achieve the goals of expanding access to drug coverage among Medicare beneficiaries and providing additional help to those with low incomes or catastrophic drug expenses. As a result, the 29 million beneficiaries CBO expects to enroll in a Part D plan in 2006 are projected to spend, on average, 37% ($465) less out of pocket for drugs

[8] Our model incorporates CBO's projection that 2.7 million beneficiaries with employer-sponsored drug coverage will lose it and shift into Part D plans once the new drug benefit takes effect. For purposes of this analysis, we assume this shift will occur in 2006.

under the MMA than they would have spent in the absence of the law. And, as designed, those with low incomes who take advantage of the low-income subsdies under the MMA receive substantial additional projection. Thus, as this analysis shows, the expected change in out-of-pocket spending varies substantially by income (which determines whether or not beneficiaries will be eligible for low-income subsidies) and by total drug costs.

Low-income beneficiaries receiving additional help with premiums and cost-sharing under the new law, particularly those without Medicaid drug coverage prior to the MMA, are projected to see a significant reduction in out-of-pocket drug spending in 2006. Overall, those who receive low-income subsidies are projected to spend 83% less under the MMA than they would have spent in the absence of the law. However, all other Part D participants (20.3 million in 2006), who are *not* expected to receive low-income subsidies, are projected to realize a more modest 28% reduction in their average out-of-pocket drug spending.

Although average out-of-pocket spending in 2006 is projected to be lower under the MMA than it would have been had the MMA not been enacted, many beneficiaries will continue to face high out-of-pocket costs when the new law goes into effect, especially the 6.9 million Part D participants who are projected to have spending in the doughnut hole. Our analysis projects that the majority of Part D participants will spend less under the MMA in 2006 than they would have spent in the absence of the law, but one in four will pay somewhat more. For low-income beneficiaries not receiving subsidy assistance, even modest increases in out-of-pocket spending could represent a financial burden and a barrier to getting needed medications.

Amid uncertainty about the actual response of Medicare beneficiaries to the new drug benefit, the design of Part D plans, and ongoing concern about prescription drug prices, the impact of the MMA on beneficiaries' out-of-pocket drug spending is a measure of the program's success and should be carefully monitored as the law is implemented.

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