

The Facts about Health Care Reform and the Medicare Retiree Drug Subsidy

The Medicare Retiree Drug Subsidy

1. The Medicare Modernization Act of 2003 (MMA) created an outpatient prescription drug benefit (known as Medicare Part D). The law included a subsidy for employers who provide retiree drug benefits at least equal in value to the Part D benefits. The subsidy was intended as an incentive for employers to continue to provide benefits.
2. The subsidy reimbursed employers 28 percent of the cost of actual spending on prescription drugs for Medicare eligible retirees.
3. The subsidy was provided tax-free. The cost of providing retiree prescription drug benefits was already tax deductible. So, employers could deduct the total cost of their retiree drug plans, plus get a subsidy, and not have to pay any taxes on the subsidy. For example, an employer who paid out \$100 million in retiree drug benefits would qualify for a \$28 million subsidy. The Company's real expenses were only \$72 million in benefits, but it was able to deduct the full \$100 million from its taxable income.

2010 Health Care Reform

4. The current Congressional thinking is that the arrangement is bad tax policy because employers get a deduction for expenses they did not actually pay.
5. The recently enacted reform package allows employers to deduct the cost they pay for retiree drug benefits. They will continue to receive the subsidy, but it will be subject to income taxes.

Accounting Rules Regarding the Change in Tax Policy

6. According to the New York Times, as a result of the 2003 MMA tax-free subsidies, AT&T saw its obligations for retiree benefits decline by \$1.6 billion.
7. The new provisions will require companies that take the subsidy to recalculate their retiree health care liabilities to reflect the loss of the tax deduction. AT&T has announced that it will take a one-time \$1 billion charge to account for the tax change.
8. Tax accounting requires companies to report the impact of tax law changes in the quarter in which the change is enacted. The change was enacted earlier this month and the quarter ends March 31. Thus, news media are reporting on a number of companies that are taking the charge. AT&T is among them.

Protections for Retirees

1. CWA has negotiated agreements with our major telecommunications companies that protect retiree benefits through the term of the agreement. Employers will not be able to change these benefits outside the collective bargaining process.
2. The health care reform legislation also changed the Medicare Part D prescription drug benefits, closing the so-called doughnut hole. Currently, once drug costs exceed \$2,830 Medicare will pay no more toward coverage until total out-of-pocket spending reaches \$4,550, then they will begin to pay 95 percent of the cost. The health care reform bill will close the gap (doughnut hole) completely by 2020, with incremental improvements beginning immediately.
3. For employers and trust funds that cover pre-Medicare and Medicare-eligible retirees, costs will be eased by a \$5 billion reinsurance program established for retirees between the ages of 55 through 64. That program will reimburse plans for part of the cost of high-cost cases – 80 percent of the cost of claims which are at least \$15,000 and up to \$90,000. This will provide significant cost relief in the short-term.
4. Some elements of health care reform will “bend the cost curve,” helping to moderate the cost of retiree benefits. Even greater savings are estimated if the private sector adopts the same measures. For example, provisions to reduce hospital readmissions are estimated to save 5 percent from prevented readmissions. Accountable Care Organizations have been shown to improve cost efficiency by 10 to 15 percent. These cost savings will flow through to our negotiated retiree benefits.

Future Prospects

A study commissioned by the Business Roundtable estimated that key legislated reforms could reduce the per employee cost of coverage by more than \$3,000 over the next 10 years. Many of the reforms included in the study have been enacted by the new legislation, for example, individual accountability, transparency and dissemination of the cost and quality information, measures to reduce variation in practice patterns, and investments in information technology. Over time, the reduction in the value of the retiree drug subsidy will be offset by these long-term savings measures.

Next Steps

1. CWA will engage with groups to thoughtfully analyze the impact of the changes overall and work with Congress to remedy any unintended consequences.
2. CWA will engage employers about the impact of the health care legislation on our negotiated plans and on our members.
3. AT&T has affirmed that no changes will be implemented for CWA retirees prior to the expiration of our current agreements in 2012.