PRICEWATERHOUSECOOPERS

Impact of "Prompt Payment" Legislation On Medicare Costs

March 2008

A Report Prepared for the Pharmaceutical Care Management Association

1301 K Street NW

Washington, DC 20005

PRICEWATERHOUSECOOPERS

Impact of "Prompt Payment" Legislation on Medicare Costs

PricewaterhouseCoopers (PwC) was retained by the Pharmaceutical Care Management Association (PCMA) to estimate the fiscal impact of so-called "prompt payment" legislation mandating that Medicare prescription drug plans (PDPs) reimburse pharmacy claims within 14 days.

We find that this legislation could increase costs to the Medicare program and its beneficiaries by $3.3 to $7.8 billion over the next decade. The impact depends on how various costs are shifted between Part D plan sponsors and pharmacies (as shown in the table below). We estimate that the ten-year costs to the Medicare program would be about $2 billion after accounting for PDPs renegotiating retail pharmacy contracts to offset pharmacy gains caused by the legislation. Medicare beneficiaries would also pay $1.3 billion in additional premiums and cost sharing. In the absence of contract renegotiations offsetting pharmacy gains, government costs would increase by $4.7 billion and beneficiary costs would increase by $3.1 billion.

Implications of 14-Day Prompt Pay Requirement under Medicare
(Millions of Dollars)

	2009	2010	2011	2012	2013	2009-13	2009-18
*Low Alternative (With Renegotiation)**							
Total	**$402**	**$394**	**$380**	**$358**	**$297**	**$1,831**	**$3,307**
Costs to Medicare Program	$241	$236	$228	$215	$178	$1,098	$1,984
Costs to Medicare Beneficiaries	$161	$157	$152	$143	$119	$732	$1,323
*High Alternative (No Renegotiation)**							
Total	**$452**	**$505**	**$568**	**$643**	**$717**	**$2,885**	**$7,772**
Costs to Medicare Program	$271	$303	$341	$386	$430	$1,731	$4,663
Costs to Medicare Beneficiaries	$181	$202	$227	$257	$287	$1,154	$3,109

* Our "high alternative" assumes PDPs are not able to renegotiate their pharmacy contracts in response to prompt payment legislation. Our "low alternative" assumes PDPs are able to negotiate contractual discounts from pharmacies that, in time, partially offset the costs of mandated prompt payment terms.

Source: PricewaterhouseCoopers calculations.

Discussion

Currently, PDPs reimburse pharmacies according to mutually agreed contractual terms, typically 30-days from when a clean claim is filed. A 30-day payment standard is consistent with reimbursement for medical claims in Medicare Parts A and B and for pharmacy claims throughout the private sector. This standard allows plans to batch claims for administrative efficiency and conduct audits to detect fraud and abuse.

Accelerating payment cycles raises costs by reducing administrative efficiency, making audits more difficult, and causing a reallocation of working capital available to PDPs. We estimate that legislation mandating a 14-day standard would reduce the number of days that pharmacy claims are outstanding from over 23 days to less than 12 days—an acceleration of more than 11 days on average. This acceleration would increase Medicare costs by billions of dollars.

Methodology

PwC conducted structured interviews and gathered data from five major companies that sponsor and administer Medicare PDPs and process approximately 40 percent of prescription claims in the United States. We found that accelerating payment cycles twice as fast as those applicable to other Medicare providers could raise costs by reducing administrative efficiency, reducing working capital available to PDPs, and making it more difficult to detect claims fraud and abuse.

Based on information from Part D sponsors, PwC estimates that the legislation would reduce the number of days that claims are outstanding from over 23 days to less than 12 days, an acceleration of over 11 days on average. In terms of administrative costs, we found that PDPs would have to invest in a number of up-front costs, such as computer hardware and software, and then face higher annual operating costs to process the claims faster. Acceleration will also cause a permanent change to the allocation of capital by PDPs. We valued working capital at a pre-tax rate consistent with industry pretax returns as reported in their 10-K filings with the SEC. Our lower bound estimate assumes that competitive negotiations would allow PDPs to exact compensating discounts from pharmacies over time. Any higher costs that are not offset by changes in terms with retail pharmacies are assumed to be passed along to the Medicare program through higher bids under Part D.

Finally, in some cases, compressed payment cycles would result in PDPs not having time to conduct their current level of auditing to catch fraud and abuse before pharmacies are reimbursed. In many cases, the loss would not be recoverable after reimbursements have been disbursed.