PBM-Plan Sponsor Relationships May Not Look All That Different In A Post-Rebate World

WHITE PAPER

In today's complex and costly health care system, plan sponsors are seeking greater transparency, accountability and affordability. Many do not believe they are getting it from their pharmacy benefit manager (PBM). In fact, 63 percent of employers stated in a recent survey that PBMs aren't transparent, especially when it comes to revenue streams.[1] However, plan sponsors aren't alone, patients are looking for greater transparency and affordability, too, which is understandable when one in four people can't afford their medications.[2] With an outcry from plan sponsors and patients, government legislatures from across the nation have gotten involved. States have proposed bills in an attempt to demand transparency and better control cost at the PBM level.

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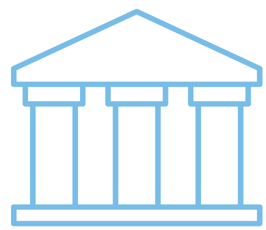
State Legislative Activity

- **Over 20 states have proposed legislation about PBMs**
- **States are auditing PBMs. As a result, Ohio's Medicaid program issued a state mandate that managed health care plans must re-negotiate PBM contracts to a non-spread or pass-through model**
- **Other states such as Wisconsin and Minnesota are requiring PBMs to register and provide reports in an attempt to gain greater control and transparency**



Most recently, CMS proposed a rule change to the current Anti-Kickback Statute Safe Harbor for manufacturer rebates. The proposed rule change essentially removes rebates from PBMs and redistributes those funds directly to patients at the point of sale. It seems likely this proposed rule change will take effect in the next one to two years for Medicare and Medicaid. Commercial will likely follow soon thereafter.

So what will the world be like for plan sponsors and patients going forward? For plan sponsors it could be a world without rebates. Will costs go down? Will this mean PBMs take a more accountable posture and transparent approach? No one knows for sure. However, a look at the PBM pricing models in place today and how each may be impacted, may provide a glimpse into the future and help plan sponsors know what to expect.

Understanding the Models

Traditional

Traditional models earn "spread" or revenue through various pharmacy dispensing channels such as retail, mail, and specialty. Spread occurs when the pharmacy is paid one price and the plan sponsor is charged a different—most often higher price. The difference is spread.

Traditional pricing models also generate spread by retaining a portion of the negotiated rebates from pharmaceutical manufacturers. This incentivizes the PBM to create more spread revenue by driving up costs through formulary product selection. In turn, this leads PBMs to promote products that have higher rebates, creating an incentive for manufacturers to price products higher and deeply rebate the products back to the PBMs. As a result, plan sponsors and members end up paying more than they need to. This might be why, 69 percent of employers in a recent survey stated that they would welcome an alternative to rebate-driven approaches to managing pharmacy costs.[3]

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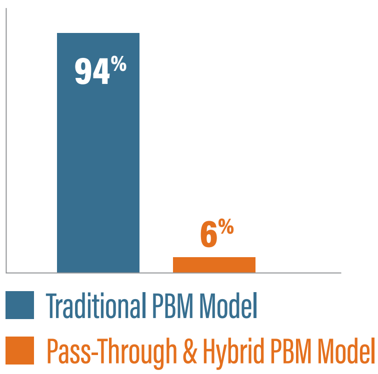


Because PBMs operating under this model produce significant margin on spread pricing of drugs, they typically charge a significantly reduced administrative fee for services rendered as the majority of their revenue comes from the non-disclosed fees. Visibility into actual market prices and the actual true-net cost (net of rebates) are significantly obscured, if not invisible to plan sponsors.

The traditional model is the most popular of the PBM approaches and accounts for about 94 percent of overall PBM business and transactions across the industry.[4] Although the other models may seem less popular, fewer plan sponsors choose these because they are unaware other options exist. However, these alternative models are gaining traction.

Hybrid

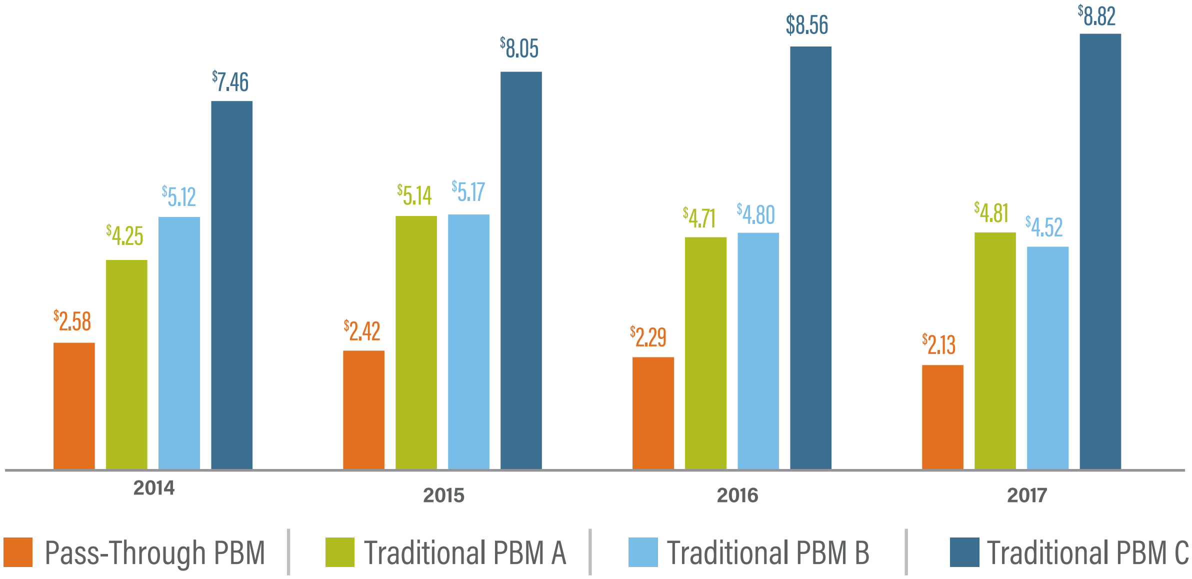
Hybrid pricing models offer some combination of the traditional and pass-through models for a slightly more transparent option, allowing visibility into some pricing and revenue practices. A hybrid model may disclose the portion of rebates it retains and take spread in only one or two channels such mail and specialty. However, transparency is limited, leaving little visibility into how much the PBM retains. Hybrid PBMs may charge a minimal administrative fee or none at all..

Pass-Through

On the other hand, pass-through pricing models offer the most transparency. As the result of a pass-through PBM's transparent financial and operational processes, 100 percent of rebates and discounts are passed back to the plan sponsor. Because spread is not involved from any distribution channel, the plan sponsor is billed the same amount the pharmacy is paid. This takes the unnecessary costs out of pharmacy benefits, making prescriptions more affordable for plan sponsors and their members. A pass-through PBM's only revenue source is an administrative fee for services agreed to by the plan and PBM up front. This model offers visibility down to the claim and invoice level for complete transparency and full disclosure. Ultimately, the plan sponsor has complete visibility into the true claims cost and knows what it's paying for PBM services.

> "A true pass through doesn't retain any dollars from pharmacies or pharmaceutical manufacturers."

Comparing Traditional vs. Pass Through Gross Profit Per Claim



Information based on published SEC filings.

It's important to note that some traditional PBM's are claiming to offer a "pass-through" model. However, plan sponsors should be aware that this might be their version of a pass through. A true pass-through does not retain any dollars from pharmacies or pharmaceutical manufacturers.

Exploring the Potential Changes in Each Model

With a better understanding of PBM pricing models, it's a good time to explore what a plan sponsor may experience within each model in a post rebate world.

Most of the traditional model PBMs are publicly traded companies and must answer to shareholders. Historically, they have performed well and delivered a high gross profit per claim. See above. Without revenue from rebates, these organizations will likely have to find other revenue streams, from both new and existing sources. This may occur as higher administrative fees or increased pharmacy network spread, negatively impacting plan sponsors.

Hybrid PBMs may follow suit as well, although some of these organizations may not be publicly traded, they will still need to replace lost revenue.

Pass-through PBMs tend to be smaller, privately held organizations so they likely will not be negatively impacted by the removal of rebates. They operate with full financial disclosure and transparency and charge an administrative fee to earn revenue. Since revenue streams are not impacted under the pass-through model, this may provide plan sponsors with an option that is more predictable from a cost standpoint and can continue to deliver the desired savings for greater affordability.

As a plan sponsor now is a good time – just ahead of the proposed Safe Harbor rebate change – to evaluate your PBM's pricing model to determine if your PBM is the best option moving forward. Will you possibly be exposed to increasing costs? Or, will you be with a pass through PBM where your pharmacy benefit costs will remain lower and more predictable? Will your PBM possibly expose you to additional hidden spread costs? Or, will your PBM continue to deliver predictable costs and opportunities for increased savings? The model you choose will determine the outcome in a post rebate world.

Sources:

1. Toward Better Value: Employer perspectives on what's wrong with the management of prescription drug benefits and how to fix it, National Pharmaceutical Council, 2017, page 8.
2. Kaiser Family Foundation Health Tracking Poll, 2016.
3. Toward Better Value: Employer perspectives on what's wrong with the management of prescription drug benefits and how to fix it, National Pharmaceutical Council, 2017, page 8.
4. The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Manager, Drug Channels Institute, 2018.
5. Navitus analysis, 2014-2017 and SEC filing from traditional PBMs, 2014-2017.