Dennis Tumminia, LUTCF, PHIAS
Principal, Employee Benefits
135 Main Street, 21st Floor
San Francisco, CA 94105
415.356.3914
dtumminia@edgewoodins.com

EPIC
www.edgewoodins.com

How Your Pharmacy Benefit Manager Makes Money

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When you sit down to negotiate with a Pharmacy Benefit Management company (PBM), do you know how they make money?

If not, you're not alone.

Since 1991, the year rebates came into the revenue equation, understanding where PBM revenue comes from has become an increasingly difficult task. Knowing how a PBM makes money will make you a more effective negotiator.

Typically, PBM's employ a "balloon strategy" in their price negotiations; if you squeeze one element of the pricing matrix, another element "pops" out. Ask for a lower dispensing fee and the Specialty Rx pricing becomes non-negotiable. Ask for a lower brand discount and rebates begin to disappear.

PBM's use a "per script" net revenue model that combines all revenue elements and if you are going to be successful in your negotiations, you need to understand what the elements are and the revenue associated with each. Only then can you can get your hands around the entire balloon.

Some PBM revenue elements, like Clinical Prior Authorization fees, are highly visible. Others, like rebates, are shrouded in confidentiality agreements. And still others, like generics, are a total mystery.

Where DOES a PBM make money?

Retail Pricing Elements

Administrative Fees- this is the fee charged by the PBM for the electronic processing of each claim. In an attempt to gain a competitive advantage and competitive "spread sheeting", these fees have disappeared in traditional pricing models.

In "pass through" pricing models, these fees can range anywhere from $1.25 to $3.50 per script. This represents the entire "profit" for the PBM- or does it?

Even in a "pass through" model, there is hidden revenue in the form of transaction fees the PBM is charging retail pharmacies for each claim they submit. These fees are typically between $0.10-0.15 per claim. This doesn't seem like much, but is another example of how you can be "nickel & dimed" outside of the visible charges in a PBM contract.

Brand Ingredient Costs- the list price for all drugs is called the Average Wholesale Price or AWP. Typical discounts for brands range from AWP-13% to AWP-17%. In a traditional model a PBM might contract with a retail pharmacy chain such as CVS at AWP-18% and then offer you a contract discount of AWP-17%, keeping the difference for them self. This is called a "pharmacy withhold" or "differential pricing". Each percentage point of withhold is worth approximately $1.00 per script. The withhold or "spread" between what the PBM pays the pharmacy and what they charge you used to be much greater, but competitive forces have driven brand discounts deeper in recent years, reducing the PBM profit margin on these drugs.

Generic Ingredient Costs- generic discounts are priced in one of two ways; (1) as an AWP discount, or (2) at a Maximum Allowable Cost (MAC). There is usually a large gap between these pricing elements, as generics are, along with pharmaceutical manufacturer revenue (which we will talk about later in this article), are the main sources of PBM revenue. PBM's typically make in excess of $6.00 per prescription. If you are not going to conduct a full file re-pricing of your historical claims, consider asking your PBM to price out the top 50 generics used in the previous year, giving you both the list price and the discounted price for these drugs and indicate whether each drug has a MAC or AWP discount price. This will help you understand how extensive the PBM MAC pricing list is.

This is important to know, as MAC pricing is much deeper than AWP discount pricing or generics:

- MAC pricing should average AWP-80%.
- AWP discount pricing typically averages AWP-26%
  *Note that a strong pricing offer would be MAC over 95% of all generic drugs

Dispensing Fees- contractually, these fees can range from $ 0.80 to $1.50 per prescription. A PBM contracts with pharmacies for $0.35 to $1.00 below these rates. Interestingly, all Usual & Customary (U&C) pharmacy claims are processed with no dispensing fee. Before you agree to a final contract dispensing fee, ask your current PBM how many U&C claims you had in the previous plan year. This will help you understand the impact these claims had in reducing your average historical dispensing fee cost to the PBM. If your U&C claims were greater than 10%, ask for a dispensing fee of a $1.00 or less.

Rebates- you may be offered rebates in a dizzying variety of ways: as a percentage, a fixed amount, on a per formulary brand basis, or on a per script basis. Here are some simple negotiating devices that will help you insure a "fair" rebate amount:

- Always negotiate fixed dollar rebate guarantees. If the PBM insists on a percentage, ask for the greater of a fixed dollar amount or a percentage.
- Always negotiate rebates paid on a "per script" basis. If this is not acceptable to the PBM, then fall back to a per brand script rebate guarantee.
- Always ask if rebates are subject to any Days Supply or Formulary Percentage criteria. Together these criteria can reduce the guarantee by up to 10%, so a $30 rebate guarantee will only be $27.

In summary, ask for "fixed dollar rebate guarantees on a per script basis across all scripts at both retail and mail". Rebate values vary by plan design and size. Three tiered co-payment plans with at least a $15 co-pay difference between the 2nd & 3rd tiers drive greater rebates, typically $1.50 to $3.00 more per script.

Mail Order Pricing Elements

Administrative Fees- There should be no administrative fee for mail order prescriptions.

Brand Ingredient Costs- In essence, a PBM becomes a drug store when filling a mail order prescription. Therefore, how they make money at mail order doesn't vary significantly with how a drug store makes money at retail. Typical discounts range from AWP-20% to AWP-24%. Typically, PBM's purchase brand drugs for between AWP-24% and AWP-27%. Additional revenue is derived from:

- **Prompt Payment Discounts**- PBM's can receive significant discounts (1-3%) for prompt payment. Typically, prompt payment terms mean payment within 10 days of invoicing by the GPO.
- **Education & Research Grants**- PBM's receive money from Pharmaceutical Manufacturers for education and research.
- **Manufacturer Administrative Fees**- these fees are paid to PBM's by drug manufacturers for placing their drug as a preferred drug in the PBM's formulary. Under the Department of Justice Safe Harbor guidelines, these fees should be no more than 3% of the total AWP value of the drug. So, for a drug with a $100 AWP, the PBM will receive $3.00 of admin fees. This admin fee should be disclosed in the contract. You can also negotiate the admin fee being included as part of the rebates, but this typically only happens for larger plans.
- **Group Purchasing Organizations**- PBM's buy drugs through Group Purchasing Organizations (GPO's) that deepen the discount levels normally offered by manufacturers. GPO's function in much the same way as healthcare alliances- larger membership means deeper discounts.

When negotiating with your PBM, you can assume they are receiving a net effective discount of AWP-30% for mail order brand prescriptions, with each percentage point worth approximately $3.00.

Generic Ingredient Costs- the real issue on mail order generic pricing is the lack of Maximum Allowable Cost (MAC) pricing. Without MAC pricing, the PBM can choose the generic with the highest AWP in a therapeutic category and apply your mail order contract discount, creating a higher net cost than you would pay for the same generic medication if purchased at retail. To protect yourself from this, you should ask for identical MAC pricing programs at retail and mail.

PBMs typically offer mail order generic discounts of between AWP- 65% and AWP-75% for generic drugs. An effective MAC program drives discounts of at least AWP-70%. If your plan is a percentage co-payment (co-insurance) plan, the lack of an identical MAC program for mail order generics is problematic, as the cost for 90 days at mail order can exceed the cost for 90 days at retail. This will generate phone calls from your plan members questioning why mail order is more expensive than retail. In addition, a co-insurance plan design will expose members to the pricing differences between PBM's MAC pricing when you switch PBM's. This leads to additional member phone calls as they question why they are paying more for the same drug under the new vendor. This impact can be mitigated by proactive member communication that lets members know they may pay more in certain instances.

Dispensing Fees- typical retail dispensing fees are from $1.00 to 1.25 per prescription. There are no dispensing fees at mail order under a traditional pricing program. In contrast, dispensing fees in a pass through pricing program average between $11.00-13.00 per script, as the PBM is not making any profit margin on the actual ingredient cost of the drug itself.

Specialty Pharmacy Rebates- PBM's receive rebates on high cost injectable/biotech mail order prescriptions. If you do not ask for rebates on Specialty Pharmacy prescriptions, they are not normally included in the rebate calculations. At the current time, these rebates are relatively insignificant. But, as more and more Specialty Rx drugs are introduced into the market, Specialty Rx rebates will become more prevalent, so it is worth asking for them to be included in the overall rebate guarantees.

Brand Rebates- Typically, the brand drug rebate offered on mail order is going to be between 2.5 and 3.0 times the value of the rebate offered at retail. There are numerous ways to ask for rebates or for ways that the PBM will offer them:

- Per brand script- guarantees at both mail & retail
- Per formulary brand script- guarantees at both mail & retail
- Per script across all scripts- guarantees at both mail & retail

You can also ask for a guaranteed minimum dollar amount or a percentage, the greater of the two, but this type of guarantee is not popular with the PBM community and also requires a rebate audit to verify that you are receiving the percentage, so it can be expensive and administratively cumbersome.

The preferred guarantee is per brand script, which also eliminates the necessity to track which brands are formulary and which are non-formulary.

PBM's receive two types of rebates- Access and Performance. The only rebates that a PBM typically shares with you are the Performance Rebates. So when a PBM tells you that they are sharing 90% of the rebates, they could be referring to Performance Rebates only. Access Rebates are paid from drug manufacturers to PBM's for listing and keeping their brand drug on the preferred formulary. Be sure to include both types of rebates, along with the other Manufacturer revenue previously discussed, in your contract pricing negotiations.

Claims Data- each prescription filled by your plan members is sold to either a manufacturer or data repository. This data is aggregated and de-identified, so there are no HIPAA concerns. The revenue generated by the sale of data varies significantly, but can be anywhere from $0.05 to $0.15 per script, depending on the purchaser and the type of data requested.

Prior Authorizations- there are two types of Prior Authorizations (PA), administrative and clinical. You should not be charged for Administrative PA's. Clinical Prior Authorizations typically cost between $30 and $40 per PA.

Other Revenue Sources- PBM's now offer a myriad of "value added" programs from which you can choose: disease state management, retrospective DUR, dosage management, physician intervention- the list goes on and on. These programs are usually priced at a base fee plus a percentage of savings, with a "guaranteed" savings amount. Whether these programs offer you a sufficient return on investment really depends on the specific utilization of your plan members. Don't buy a program to manage something that is already managed or that your plan members don't need. In addition, ask your PBM how they determine "savings". Unless you have the ability to quantify and verify "savings"- beware!

Understanding how PBM's make money is critical to success in negotiating contract prices for pharmacy benefit management. As your business partner, PBM's provide a valuable service.

Pricing is just one of the considerations that come into play when deciding which PBM to use. But, pricing is the baseline against which service and risk management is measured. As such, pricing evaluation receives the greatest amount of scrutiny by decision makers.

By understanding the PBM revenue inside each of these elements, you can negotiate the lowest net cost for your plan without sacrificing member benefits or agonizing over which plan design changes will get you within budget.

Dennis Tumminia, with more than 35 years experience in the insurance industry, has gained an in-depth knowledge of client specific needs and industry trends focused on field underwriting, risk management and alternative funding models. As former Founder and President of Comprehensive Insurance Marketing, Inc. a large interstate consulting/brokerage agency, Mr. Tumminia assisted employers of various sizes both on a local and multi-state basis. Mr. Tumminia has gained experience in his ability to evaluate an organizations employee benefit portfolio and its unique risk characteristics. Mr. Tumminia has been an industry pioneer in the design of cutting edge solutions and implementation strategies for a variety of employee benefit programs. To learn more about EPIC, please visit www.edgewoodins.com.