

PBM contracts: Understand then optimize

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As a plan sponsor, you likely have a contract in place with your pharmacy benefit manager (PBM) that defines the pricing and operational aspects of your pharmacy benefit program. Being able to pinpoint changes and areas for improvement within your contract can significantly reduce pharmacy program costs without having to change members' benefits. Effective control starts with understanding these complex documents, effectively auditing and monitoring adherence to the contract, and results in optimizing this important and critical relationship.

Effective contracting

Understanding the contract between a plan sponsor and its PBM is the first step toward optimizing your organization's pharmacy benefit. Typical contracts with PBMs are structured under a three-year master agreement negotiated at the time of implementing the PBM but the agreement can be updated via addendums and amendments throughout the contract term. The most advantageous times to negotiate contract changes are during a contract renewal period when the current contract is expiring, or during a midterm market check that compares the contract terms to the terms offered to your peers.

PBM contracts often include a considerable number of definitions and terms that explain how drug claims are adjudicated and priced. Small wording nuances in these definitions can favor the PBM's ability to meet their pricing or performance guarantees during year-end reconciliation.

Two critical contracting terms are generic drug definitions and the types of exclusions from the pricing guarantees. These terms play a critical role in the financial reconciliation process involved in PBM pricing and are highly impactful on the financial value of the agreement.

PBM PRICING AND RECONCILIATION

Contracts with PBMs typically involve guarantees in a number of pricing areas. The PBM may guarantee individual pricing by dispensing channel (retail, mail order, and specialty) as well as by drug type (brand or generic). The PBM might commit to these pricing metrics such that overall, at the end of the year, the aggregate pricing within each channel and drug type will be at least as good as the guarantees outlined in the contract. In the case that a PBM has not met a guarantee, the PBM would issue a true-up payment to the plan sponsor to make up for any deficiencies. However, some contracting language may allow the PBM to cover its underperformance by using any overperformance from other channels.

The reconciliation process is performed by the PBM and, typically, a formal report is generally not required to be delivered to the plan sponsor. Auditing the PBM's reconciliation calculations can reveal significant discrepancies between the PBM's calculations and the plan sponsor's expectations. These audits can also provide insights, such as how the PBM is classifying certain drugs. The definitions, clauses, and exclusionary language within the contract stipulate what categories of drugs are subject to the reconciliation.

DEFINITION OF A GENERIC DRUG

Although a simple concept, the actual ways that PBMs define a generic drug have become exceedingly complex. Complex definitions can lead to disputes and disagreements about what constitutes a generic drug, which is very important when there is a guarantee tied to the distribution between generic and brand drugs. PBMs may be able to change the brand or generic statuses of drugs, to help them better achieve the aggregated discount guarantees that they quoted in the pricing contract.

Which method of defining a generic drug is the best to use for a plan sponsor? The easiest answer is to negotiate a contract with a simple and auditable definition, such as using an independent industry standard as the sole distinguisher of a brand or generic drug. The more complicated the definition, the more difficult it becomes to audit and the more likely there are to be disputes between the PBM and the plan sponsor about what constitutes a generic drug. This can cause the plan sponsor to not receive the full benefit of the contracted rates.

While this paper discusses generic drug definitions, this type of concept is relevant to many drug category types of definitions. It is best practice to rely on simple definitions throughout a PBM contract to avoid disputes and disagreements and ensure transparency in contract reconciliations.

EXCLUSIONS

There are many categories of drugs encompassing a pharmacy benefit program's utilization. Traditional prescription medications, limited distribution drugs (LDDs), over-the-counter (OTC) products, vaccines, physician-administered medications, specialty drugs, etc. The list is seemingly endless.

PBMs are expected to manage these categories of drugs in terms of their utilization, negotiated pricing, and manufacturer rebates. However, some categories of drugs have more complex pricing structures and therefore some PBMs will exclude them from the overall reconciliation process. These drugs may still be paid for by the plan sponsor as a covered drug, but they will not be subject to the contractual pricing guarantees.

Some common categories of excluded drugs are:

- OTC products
- Vaccines
- 340B-eligible drugs
- Compound drugs
- LDDs

When comparing pricing proposals from PBMs, plan sponsors should be aware of all exclusions to ensure a fair and equitable accounting of PBM performance. This is commonly seen with LDDs in the specialty drug channel. LDDs are typically considered rarer drugs to which PBMs have limited access and are not able to negotiate strong discounts or rebates. The LDD distinction varies by each PBM and in some cases can comprise up to 30% of total specialty drug utilization.

Consider a pricing contract from a PBM where it quotes a specialty drug rebate of \$1,000 per specialty brand drug. If this pricing contract excludes LDDs, and the LDDs are 30% of the total utilization, then the actual rebate this plan should expect to receive is \$700 per specialty brand drug.

The best way to manage exclusions within a PBM contract is to ensure understanding of whether the highest utilized categories are excluded to better project expected rebates. Negotiating little or no exclusions helps ensure that the PBM is passing through 100% of the rebates it receives on every drug, regardless of exclusion status.

Auditing

Enforcing transparency in the plan sponsor's relationship with the PBM starts with the ability to audit the PBM's adherence to the contract. PBM auditing is an in-depth evaluation of claims processing and key financial terms. There are a number of other types of audits a plan sponsor can perform, including implementation (when changing PBMs), pass-through rebate,

operational, and other targeted audits. PBMs normally define all audit rights and limitations in the PBM contract and plan sponsors must initiate the audit.

Plan sponsors should confirm that their pharmacy claims are processed according to their *intended* plan designs. A plan's benefit intent can often get lost in translation when filling out a PBM's implementation and change forms.

Plan sponsors should also audit key financial components in the PBM contract. PBM contracts typically include financial guarantees for discounts off the average wholesale price (AWP), dispensing fees, administration fees, and rebates. All of these pricing components impact the pharmacy costs and trends. The audit should compare the guarantees in the PBM contract to the actual pricing achieved by the PBM by carefully evaluating the following:

- Categorization definitions that are used (e.g., generic and brand definitions)
- Claims excluded from the guarantees
- Reconciliation calculation methodologies (e.g., allowing a surplus in one guarantee to offset a deficiency in another guarantee)

All of the plan sponsor's claims data should be included in this analysis (compared to solely "sampling" a few claims), and any instance where the PBM does not achieve the contract guarantees should be presented to the PBM for remediation. An audit may also result in an opportunity to renegotiate terms to clarify definitions, exclusions, and other ambiguous or unfavorable terms. Auditing a PBM often results in a positive return on investment (ROI) for plan sponsors as well as granting much-needed peace of mind knowing that the many facets of a pharmacy program are being administered correctly.

ONGOING MONITORING

Plan sponsors should be vigilant in monitoring pharmacy claims experience. Unlike an audit, plan sponsors should perform monitoring more regularly (e.g., on a monthly or quarterly basis). During this process, plans should evaluate cost and utilization trends and identify any irregularities such as unexpected increases and/or decreases.

Ongoing, frequent monitoring allows for rapid identification of experience materializing differently from expected. Monitoring is especially important when plan sponsors implement changes to their pharmacy benefit plans.

Ongoing monitoring helps plan sponsors be proactive in identifying emerging trends and evaluating whether changes to plan benefits are achieving the desired outcomes. This ultimately results in optimal member satisfaction, pharmacy program outcomes, and delivery of care.

Conclusion

The pharmacy landscape is dynamic and complex. Stakeholder strategies in the pharmacy supply chain (e.g., PBMs and manufacturers) are constantly evolving. Plan sponsors must regularly examine and review their pharmacy programs under a microscope. Auditing and ongoing monitoring are key processes plan sponsors should use regularly to help understand and manage drug trend. Negotiating an up-to-date and clear contract is the most effective way to ensure the plan sponsor is not overpaying for pharmacy benefits.

Avoid ambiguities in the plan sponsor's relationship with the PBM and closely monitor it to effectively evolve over time. The contract between the plan sponsor and PBM is the heart and soul of that relationship. An effective contract, which requires understanding contractual terms as well as critical monitoring, can prevent significant overpayments by the plan sponsor and result in an optimized relationship.



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