Explaining Types of Pharmacy Benefit Contracts

Employers and other plan sponsors contract with pharmacy benefit managers (PBMs) to administer the pharmacy benefit for their enrollees. Plan sponsors typically issue requests for proposals (RFPs) detailing their pharmacy benefit needs, to which PBMs respond and compete on quality, cost effectiveness, and accountability. Once a plan sponsor has selected a PBM, the plan sponsor and PBM negotiate contract terms and conditions. The plan sponsor typically retains rights to audit their PBM as set forth in the contract negotiated with the PBM.

Types of Pharmacy Benefit Contracting Models

Plan sponsors use two basic approaches to pay for the services that their selected PBM performs: risk mitigation or pass-through pricing.

- Risk Mitigation Pricing Model

A **risk mitigation** (sometimes referred to as "spread") pricing model provides employers and other health plan sponsors cost predictability by giving a price-certain for prescription drug benefit reimbursement to pharmacies. If the pharmacy charges more than the rate agreed to between the plan sponsor and the PBM, the PBM takes a loss, as it must pay the pharmacy more than it will be reimbursed by the plan sponsor. If the pharmacy charges less than the PBM's negotiated rate with the plan sponsor, the PBM earns a margin.

Through this model, the PBM takes on the risks of daily fluctuations in drug prices and differing pharmacy charges for the same drug. It also encourages performance-based contracts with pharmacies that reward higher generic dispensing and more cost-effective drug acquisition.

- Pass-through Pricing Model

In a **pass-through pricing model,** the amount paid by the PBM to the pharmacy is passed through to the plan sponsor, and the PBM is compensated through administrative fees. Under this model, the plan sponsor takes on *greater risk* for each prescription dispensed because of the likelihood of pricing differences between and among pharmacies, as well as pricing fluctuation.

The plan sponsor also has less cost *predictability*, as the PBM is passing through the amount paid to the pharmacy of each prescription. For example, there could be a higher volume of prescriptions from higher-cost pharmacies, which the plan sponsor would only discover after the prescriptions have been dispensed.

Considerations for Plan Sponsors

Plan sponsors have every opportunity to choose the pricing model that best suits their needs and typically require PBMs to submit bids for both approaches. Some employers and other plan sponsors choose risk mitigation pricing to ensure *predictability* in knowing what their prescription drug costs will be. **That choice should be theirs to make.**

Risk Mitigation Models in Health Care and Other Industries

- **Risk mitigation is not unique to PBMs and the pharmacy benefit; other health care sectors and industries employ risk mitigation models to manage financial risks.**
    - Capitated Payment in the Medicaid Program: Increasingly since the mid-1990s, state Medicaid agencies have pursued risk-based contracting with private health plans ("managed care organizations," or MCOs) seeking to increase budget predictability, constrain spending, improve access to care, and promote value. In exchange for a set per member, per month capitated payment, Medicaid MCOs provide comprehensive services to enrollees. MCOs are at financial risk for the Medicaid services specified in their contracts should costs exceed the capitation rate.
    - Fuel Price Risk Management by the Airline Industry: Fuel (petrol) costs are a large part of an airline's overhead, which means price fluctuations can affect their costs and the prices they charge. Airlines commonly practice "fuel hedging," whereby they buy or sell the expected future price of fuel, protecting the airline against rising prices.
    - Price Protection Heating Oil Contracts: Similarly, the oil-heat industry often offers a range of heating oil contracts for commercial facilities, such as provider offices and hospitals, to help limit oil-heat costs when oil prices rise. Such options may include fixed-price plans, pre-payment plans, and price protection or "cap" plans.

- **Like these examples, so-called "spread" in pharmacy benefit contracts is not a mark-up.** Simply, it is the average over time of the difference in the *totality* of pharmacy reimbursements agreed to between the plan sponsor and the PBM, and the *totality* of the *actual reimbursement charged by the pharmacy* to the PBM.
    - Again, if the pharmacy charges less than the agreed-upon plan sponsor-PBM rate, the PBM earns a margin for each prescription dispensed.
    - If the pharmacy charges more, and patients fill their prescriptions from these higher-cost pharmacies, the PBM loses money.
    - Either way, the plan sponsor is held harmless and experiences predictable costs—regardless of what pharmacy its employees or enrollees use.

The plan sponsor, as the purchaser of PBM services and as payer of the prescription drug benefit, should have the final say on the type of pricing model it prefers. Reimbursement is and should be a contract term privately negotiated at the plan sponsor's discretion and without government interference.

PBMs provide value by taking on financial risk and negotiating lower drug costs. Removing options from employers and plan sponsors will not do anything to reduce drug prices, premiums, or enrollee's out-of-pocket costs. It will only *increase* costs and *undermine* cost predictability for employers, plan sponsors, and patients.