

Medicare Part D PBM contracting strategy

Michael J. Polakowski, FSA, MAAA

Nicholas Johnson, FSA, MAAA

Todd M. Wanta, FSA, MAAA



Prescription drug costs have increased dramatically in recent years with double-digit average wholesale price (AWP) inflation trends becoming common.

Organizations offering Medicare Advantage prescription drug plans (MAPDs) and standalone prescription drug plans (PDPs) must look closely at all aspects of their pharmacy benefits in an effort to contain costs. One of the most important ways plan sponsors can lower pharmacy costs is to look for ways to improve their pharmacy benefit manager (PBM) contract. With 2018 Medicare bids due to be filed in a few months, now is an ideal time for plan sponsors to reevaluate their PBM contracts. In this article, we summarize the strategies that should be considered in any PBM contract negotiation.

Typical strategies

PBM negotiations usually involve the following contractual provisions:

- **Discounts/dispensing fees.** These provisions have historically been among the key metrics used to evaluate PBM contracts and to compare proposals from different PBMs. Special consideration should be given to how brand-name and generic drugs are defined and to single-source generics, which typically have higher discounts than brand-name drugs but lower discounts than other generics. Some contracts may classify single-source generics as brands, which makes achieving discount guarantees for brands and generics easier than if these drugs were classified as generics. Furthermore, plans should watch how their guarantees are structured so that over-performance in one area (e.g., brand discounts) cannot be used to offset underperformance in another area (e.g., generic discounts).
- **Direct and indirect remuneration (DIR).** Rebates originate from pharmaceutical manufacturers in exchange for inclusion on the formulary and favorable tier placement. DIR can also be generated by retail pharmacies (e.g., in preferred networks or as part of the overall performance agreement). Increasingly, separate rebate arrangements are made with mail order and specialty pharmacies.
- **Formulary selection.** PBMs typically offer plan sponsors a selection of one or more standard formularies. PBMs use the formulary placement of drugs on their standard formularies as part of their contract negotiations with drug manufacturers, so a plan sponsor may be able to achieve better discounts or rebates by selecting one of a PBM's standard formularies. While convenient, the one-size-fits-all formulary approach leaves little room for plan sponsors to integrate specific medical management initiatives into the pharmacy benefit or tailor the formulary design to meet the unique needs of a covered population. Plan sponsors should also consider Medicare meaningful difference and other compliance requirements as well as whether fees apply to customize formularies.
- **Mail order.** PBMs typically offer better discount rates for mail order pharmacies. Some PBMs owning a mail order pharmacy may also offer mail pharmacy rebates outside of those from the pharmaceutical manufacturer.
- **Utilization management (UM).** Step therapy is a UM program that requires members to try a low-cost medication for select drug classes before a higher-cost medication is dispensed. PBMs use step therapy placement in negotiations with manufacturers. We see this as an underutilized approach to control costs, particularly for specialty medications. Prior authorizations and appeals management should also be considered when evaluating a PBM's UM program.
- **Administrative fees.** PBMs charge administrative fees for the services they provide. Both fees and the services provided can vary widely by PBM. Fees can be structured in ways that make it difficult for plan sponsors to compare PBMs. They should be scrutinized closely as terms beneficial to the plan sponsor in one area (e.g., rebates or discounts) can be offset by higher administrative fees.

Advanced strategies

As contracting has become more complex, the following contract provisions are becoming more common as plan sponsors look to reduce their pharmacy expenses.

- **Price protection.** In the current environment of high-cost trends for brand-name drugs, price protection can offer more inflation protection than discount guarantees. Any price increases above a predefined threshold are paid back to the

PBM by the manufacturer and considered rebates by the Centers for Medicare and Medicaid Services (CMS). Plan sponsors should carefully consider how price protection can affect Medicare bids and end-of-year settlements.

- **Membership.** More favorable dispensing fees, discounts, and/or rebates may be achieved for plan sponsors with higher membership counts. Improved contracting levels are specified directly in the PBM contract.
- **Discount/rebate guarantees.** Discount and rebate guarantees may be presented in many different forms, e.g., rebates per brand-name script or on a per member per month (PMPM) basis, or discounts off AWP or the maximum allowable cost (MAC) list. Rebate guarantees may exclude certain drugs. At a minimum, plan sponsors should ensure the targets are clearly understood and auditable. Plan sponsors should be wary of proprietary definitions when industry definitions are available for reference. Plan sponsors should also ensure that reimbursement mechanisms are in place if targets are not achieved.
- **Rebate maximization.** Because of the structure of the Part D benefit, rebates can be a more effective way to reduce Medicare bids than discounts. Over the last few years (and with the increasing cost of specialty drugs), plan sponsors have increasingly negotiated with PBMs to maximize rebates rather than discounts. The financial incentives for this approach are discussed by Milliman consultants Adam Barnhart and Jason Gomberg in a recent article for the AIDS Institute, “Financial Incentives in Medicare Part D.”¹
- **Multi-year agreements.** Some PBMs have been willing to provide discount or rebate improvements over time if plan sponsors commit to multi-year contracts. Plan sponsors should be sure to verify that the improvements are contractually guaranteed and meet or beat market-wide improvements. Even multi-year discounts should have market check provisions to allow plan sponsors the ability to receive better terms when the market changes.
- **Tiered and select pharmacy network.** One way PBMs have been able to significantly improve discounts for plan sponsors is through adoption of a tiered or select pharmacy network. Adopting such a network can immediately improve the discount guarantees offered by a PBM at preferred pharmacies, though fewer pharmacy choices or higher cost sharing at non-preferred pharmacies may be less appealing to members. However, plan sponsors may elect to receive the benefit of a tiered network through combinations of pharmacy rebates.
- **Limiting days supply.** Plan sponsors often limit medications on the specialty and high-cost tiers to 30 days. First fills for specialty medications may be limited further (e.g., a 15-day supply).

- **Prior authorizations.** Prior authorization standards can be an effective way to reduce unnecessary drug utilization. Contracts should outline a PBM’s policies on prior authorization enforcement. Third-party vendors exist to independently enforce or check them to ensure the plan sponsor’s best interests are in mind.
- **Biosimilars.** While biosimilar medications are currently limited, their presence in the market may continue to grow. Formulary placement for these products must consider offsetting effects of lower costs and the general ineligibility of these products for the coverage gap discount.
- **Specialty pharmacy.** Because of the recent growth in specialty pharmacy spend, net cost comparisons have become an important part of judging PBM proposals. Plan sponsors may pursue specialty pharmacy rebates as part of the contract negotiation if the specialty pharmacy is owned by the PBM.

Other considerations

As the PBM contracting process continues to evolve, plan sponsors also need to consider the effects their PBM decisions can have on their plans.

- **Selection.** Formulary design can drive positive or negative selection in Medicare because members can easily enter medications in the Medicare Plan Finder website to identify plans that favorably cover their medications. Revenue received from CMS is adjusted for members’ risk scores, so plan sponsors are at least partially compensated for higher-risk members. Plan sponsors can analyze the experience of members by disease state to assess the coverage options for drugs used to treat specified diseases to help ensure the plan’s goals are achieved in terms of efficiency, quality, and financial results. For example, some plans have placed diabetic drugs on their own tier to ensure low-cost access for these drugs.
- **Rebates.**
 - **Retained rebates.** Rebates that are retained by the PBM (instead of passed through to the plan sponsor) are considered by CMS to be rebates received by the plan sponsor and administrative expenses paid to the PBM. This is significant because plan sponsors must remit a percentage of their earned rebates to CMS.
 - **Rebate determination.** Plans should consider how rebates are determined in the PBM contract as CMS considers predetermined rebates to be a price reduction rather than a rebate. Some PBM contracts include a retrospective component so pharmacy rebates are not determinable at the point of sale.
- **Quality metrics.** While prescription drug costs (Medicare Part D) are rising faster than medical costs (Part C), Part C revenue and expenditures still comprise the overwhelming majority of MAPD revenue and expenditures. Part C revenue is significantly affected by a plan’s star rating, which is

1 Barnhart, A.J. & Gomberg J. (November 3, 2016). The AIDS Institute: Financial Incentives in Medicare Part D. Milliman Client Report. Retrieved February 2, 2017, from <http://theaidsinstitute.org/sites/default/files/attachments/Milliman%20Report%20-%20Final.pdf>.

based on both Part C and Part D quality metrics. Examples of Part D quality metrics include adherence rates, prior authorization timeliness, and step therapy exemptions. Plan sponsors may want to consider including Part D performance metric reporting and/or guarantees into the PBM contract to ensure a satisfactory star rating metric performance. PBMs may also offer programs to increase performance measures.

- **Requests for proposals.** Plan sponsors may be able to more easily compare PBM contracts by inviting multiple PBMs to bid through a request for proposal (RFP) process. This is a time-consuming process for both the plan sponsor and PBMs and may be done every few years. Small organizations may have difficulty attracting PBMs through a burdensome RFP process and instead may need to approach PBMs directly. The PBM RFP process is discussed in more detail by Milliman consultants Brian Anderson and Alex Johnson in their article “Staying Competitive in the Pharmacy Benefits Manager Selection Process.”²
- **Market checks.** Plan sponsors should include the option for market checks, particularly for multi-year contracts, to ensure the current contract is competitive. Penalties for early termination should be weighed against any potential savings from switching PBMs mid-contract.

- **Other contractual items.** While we focused on the components primarily affecting pricing, plan sponsors will also need to consider other contractual items such as contract termination penalties, audit rights, and customer service performance metrics.
- **Analysis.** PBM contracts should be evaluated both on a gross cost and a net cost basis. Because the plan is ultimately responsible for net costs, proposed contracts should focus on net cost more than gross cost. This will take careful modeling of all contract provisions.

As the prescription drug industry continues to evolve, plan sponsors need to continually evaluate and update their PBM contracts to adjust to the changing environment.

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2 Johnson, A. & Anderson, B.N. (September 7, 2016). Staying Competitive in the Pharmacy Benefits Manager Selection Process. Milliman White Paper. Retrieved February 2, 2017, from <http://www.milliman.com/Reduce-costs-PBM-RFP-101/>.



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CONTACT

Michael J. Polakowski
michael.polakowski@milliman.com

Nicholas Johnson
nick.johnson@milliman.com

Todd M. Wanta
todd.wanta@milliman.com