QUARTERLY INSIGHT

STRATEGIES FOR MANAGING PHARMACY COSTS

Stephens Insurance, LLC

BACKGROUND

Prescription medications benefit both consumer health and health plan sponsors' bottom lines by helping to treat patients before medical conditions become more complex and damaging. Rising drug costs, however, are making treatment increasingly challenging for sponsors and consumers alike. In the 1980s, prescription medications accounted for 5% ($12 billion) of overall healthcare expenses. Today, that figure has grown to 10% ($330 billion)—and is slated to double within the next decade[1]. Little can be done to mitigate the primary cost drivers of this increase, which include the need for pharmaceutical companies to recoup reported R&D costs and the FDA's protracted approval process. But more can certainly be done to improve the efficiency and cost-effectiveness of the traditional system for providing prescriptions, which relies heavily on Pharmacy Benefit Managers (PBMs).

Curbing the risk of rising pharmacy expenditures requires taking measures to hold PBMs accountable. Plan sponsors can begin by implementing two strategies to build transparency around PBM pricing and formulary management:

KEY INSIGHTS

1. Shifting from a traditional PBM contract to a pass-through agreement.
2. Inserting a risk management specialist between the PBM and plan sponsor to monitor the drugs coming on and off a controlled formulary.

INSIGHT #1: PHARMACY BENEFIT CONTRACTING

Within a traditional pharmacy contract, the PBM manages the plan sponsor's pharmacy benefit in return for being able to charge more to that plan sponsor than is paid to the pharmacy. In theory, this flexibility allows PBMs to use their collective buying power to obtain discounts from pharmacies and rebates from drug makers, and then pass those savings along to plan sponsors. While it may appear that PBMs are serving the aims of plan sponsors, their contractual dealings with pharmacy networks, pharmacy wholesalers, and drug manufacturers are opaque at best. In fact, only the PBM knows the actual value accrued to plan sponsors.

What are Pharmacy Benefit Managers?

PBMs are third-party administrators of prescription drug programs. They provide services to commercial health plans, self-insured employer plans, Medicare Part D plans, and both federal and state government employee health plans. Over time, their role has evolved from paying claims and managing pharmacy networks to becoming more actively involved in plan management.

What is spread pricing?

Spread refers to the difference between what the PBM pays the pharmacy for an individual drug claim and what they charge the plan sponsor for that claim. There are no limits to what PBMs can charge in terms of spread.

What are the different types of PBM contracts?

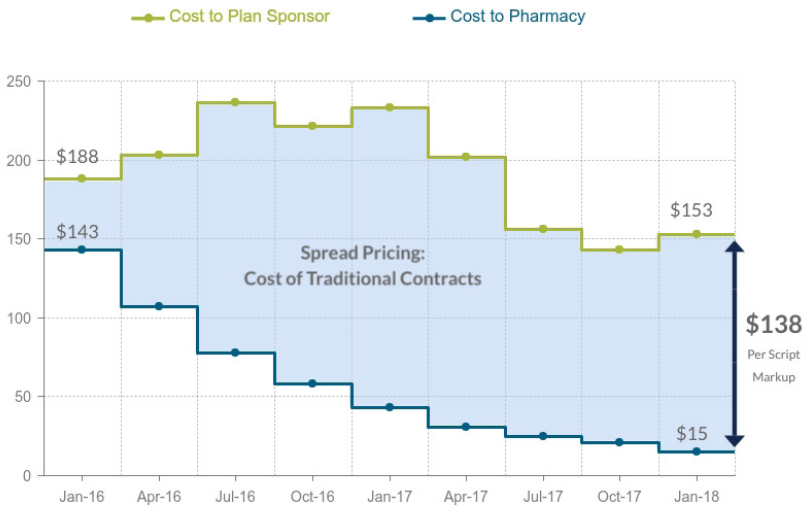
PBMs utilize two kinds of contracts—traditional and pass-through. With a traditional contract, the PBM offers to manage the plan sponsor's pharmacy benefit in return for a percentage of a drug's cost. With a pass-through contract, the PBM charges a monthly administration fee based on per-claim, per-employee, or per-plan member costs.

> **Unless contracts are open and transparent, plan sponsors have no surety over what they are in fact paying.**

Geri Beth Bemberg, PharmD
Stephens Pharmacy Benefits Analyst

To demonstrate the cost implications of a traditional contract, Figure 1 illustrates the concept of spread pricing for one generic drug, esomeprazole (generic Nexium). Assuming that the market price (as reported in the National Average Drug Acquisition Cost [NADAC] dataset—blue line) is likely close to what PBMs pay pharmacies, the average price for a 30-day prescription of esomeprazole as of January 2016 was $143.

Figure 1: Drug Prices for a 30-Day Prescription of Esomesprazole (Generic Nexium)[2]



At that time, PBMs charged plan sponsors (green line) $188 per script, on average. The difference between the two prices reflects a spread of $45, a noticeable but fairly innocuous markup. Two years later, the price paid to pharmacies had declined to $15 per script. Yet PBMs charged plan sponsors (in traditional contracts) $153 per script, resulting in an average markup of $138 per script. If you add in the fact that this common generic drug is available over the counter, you really start to wonder about the value of traditional contracts—and about the cost of having no line of sight into PBM pricing practices.

SOLUTION

Shifting from traditional to pass-through contracts will increase transparency and oversight. In a pass-through arrangement, the PBM charges a set monthly administrative fee per claim, member, or employee, thereby obviating the cost implications of spread pricing. This type of contract helps to ensure crystal-clear contractual terms, giving plan sponsors a firmer grasp of what they are paying for—and what they are getting in return.

INSIGHT #2: CONTROLLED FORMULARY MANAGEMENT

In recent years, PBMs have taken a more active role in pharmacy benefit plan management. While PBMs do use clinical data to build their formularies, the presence of rebates and other financial incentives influence which drugs make it onto the formulary. Drug manufacturers, for example, offer PBMs rebates in exchange for preferred placement on formularies.

Prescription drug manufacturer rebates are promoted by drug manufacturers as a way to lower drug spending for a health plan. In response to complaints about higher list prices for drugs, manufacturers frequently point to rebates as a way to lower overall drug cost. Because rebates are offered in exchange for preferred placement on drug formularies, it's important to ensure that drug formularies aren't designed to generate rebate revenue, but rather to give patients and employers access to the most cost-effective drugs. Oversight is also needed to ensure that PBMs pass the savings from rebate payments on to the health plan.

What is a drug formulary?

A drug formulary is an official list of preferred and approved prescription medicines that are covered by a drug plan.

What are the different types of formularies?

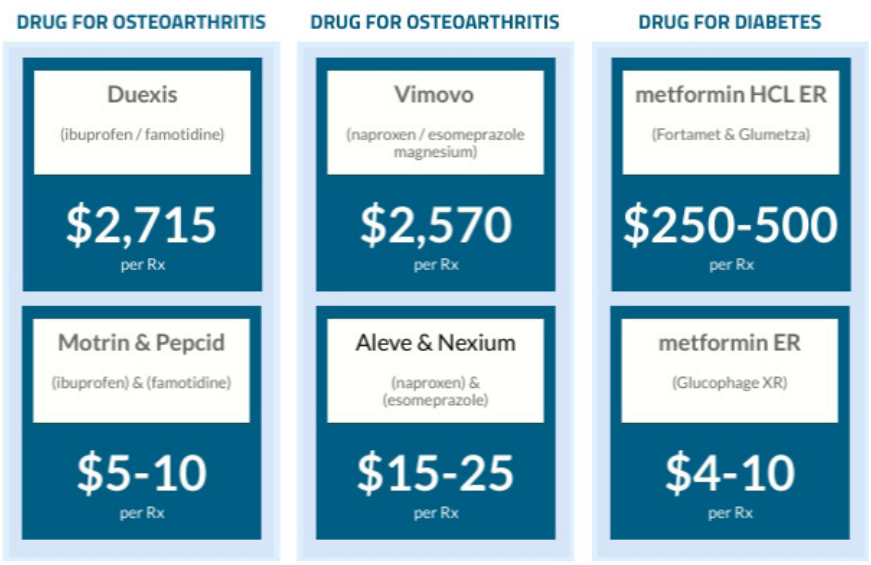
Formularies are generally divided into two types. An open formulary is a more all-inclusive option, with new drugs hitting the formulary almost instantly. In a controlled formulary, all new drugs are reviewed for clinical and cost effectiveness before being placed on the formulary.

How do rebates influence PBM-controlled formularies?

PBMs mostly manage their formularies based on rebates from drug manufacturers. While clinical evidence is taken into account, rebates may drive choices regarding which drugs are deemed "preferred."

It is difficult to quantify the full financial repercussions of PBM formulary management, given the current lack of transparency. We can, however, illustrate the issue by looking at the cost implications of three drugs that are often found on PBM-controlled formularies. These drugs are commonly chosen by PBMs, even though there is no clinical evidence of improved performance when compared to equally effective generic alternatives.

For example, Duexis and Vimovo are merely combinations of over-the-counter drugs that have been bundled together for convenience. Neither offers any additional medical benefit to the patient and, in each case, the plan sponsor absorbs a significant cost.



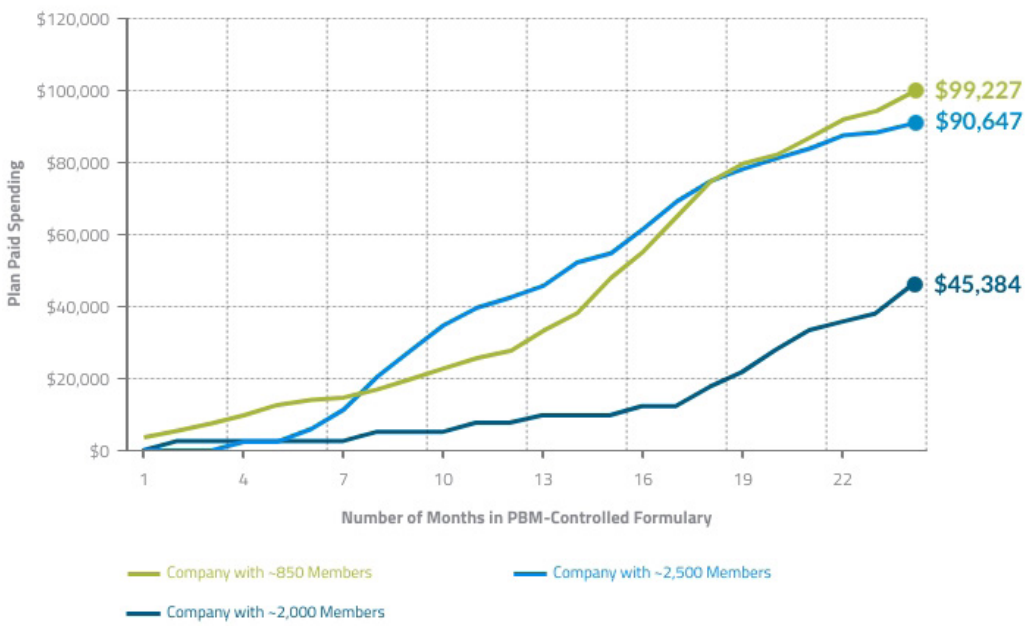
The third example, metformin HCL ER, is simply an expensive generic version of two branded products, Fortamet and Glumetza. Much cheaper alternatives are available in all three instances.

> **Drugs like Duexis and Vimovo are examples of convenience formulations—not medical innovation. The only thing they are adding to our healthcare system is cost.**
>
> **David Keisner, PharmD**
> **Stephens Pharmacy Benefits Analyst**

Duexis, Vimovo, and metformin HCL ER are three drug formulations that do not deliver any medical benefit over recommended alternatives. They do, however, carry significant additional expense. They should thus be excluded from formularies. To illustrate these superfluous costs, we calculated plan-paid spending on all three drugs. As shown in Figure 2, we found that the lack of oversight of PBM-controlled formularies cost plan sponsors tens of thousands of dollars for just these three medications, each of which had cheaper, medically equivalent alternatives. Over a 24-month period under a PBM-controlled formulary, these medications cost plan sponsors $1.93 per member per month (PMPM), on average, which represented 2.2% of overall PMPM.

For just three drugs, Duexis, Vimovo, and metformin HCL ER, our clients paid nearly $2 PMPM, on average, representing over 2% of overall PMPM.

Figure 2: Total Plan Paid Spending on Duexis, Vimovo & metformin HCL ER in a PBM-Controlled Formulary[3]



SOLUTION

To curb pharmacy spending, it is critical that plan sponsors take steps to increase oversight of PBM formulary management and rebate strategies. The first step is to shift to a controlled formulary. The next is to insert a layer of oversight between the PBM and plan sponsor. A third-party risk management specialist can determine the cost effectiveness of a new drug on the market while remaining free of influence from lucrative rebate deals. Furthermore, careful oversight of the formulary and a clear picture of PBM contracts will enable plans to receive the full financial benefits of existing rebates. With a transparent, pass-through contract, financial and other barriers to full disclosure are dissolved. Among other positives, sponsors will be able to see whether members are filling prescriptions based on the PBM formulary. This information enables plans to hold PBMs accountable for returning the maximum quantity of rebate funds to the plan itself, thereby increasing overall pharmacy savings.

Sources
1. Peter Peterson Foundation (Sept 4, 2018),"How will the Rising Cost of Prescription Drugs Affect Medicare?", Available here: https://www.pgpf.org/blog/2018/09/how-will-the-rising-cost-of-prescription-drugs-affect-medicare
2. Figure 1 Sources & Notes: The cost to plan sponsors reflects the average price paid by clients within Stephens's book of business for a 30-day prescription of esomeprazole magnesium. These average prices reflect what our clients paid for esomeprazole prior to shifting from a traditional contract to a pass-through contract. To estimate the price paid to pharmacies, we relied on estimates from the National Average Drug Acquisition Cost [NADAC] dataset. These price estimates are based on a nationwide survey of retail community pharmacies. For the prices presented here, we calculated the cost for a 30-day prescription using the average of 20mg and 40mg esomeprazole magnesium DR capsule prices.
3. Figure 2 Sources & Notes: Drug spending by plan sponsors is from a proprietary claims dataset housed by Stephens Insurance in partnership with our clients. This calculation reflects cumulative plan-paid spending in the period of time before the plan switched to a controlled formulary with oversight by the Stephens pharmacy team. The version of Metformin HCL ER is NDC 68180033707.