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PBM Best Practices Series: Effective contracting

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Plan sponsors' prescription drug costs continue to increase year over year and remain as one of the fastest-growing components of the healthcare dollar. One of the most important ways plan sponsors can lower healthcare costs without significantly changing their benefits is to look for opportunities to improve their pharmacy benefit manager (PBM) contracts. This paper explores a few important PBM contract strategies that can be used to reduce costs and quickly evaluate whether a current or new PBM contract is effectively managed.

Important contracting provisions and strategies

The success of the plan's pharmacy benefit depends on effective contracting. PBM negotiations typically involve the following contractual provisions, which are critical to delivering competitive pharmacy benefits on a cost-effective basis:

Aggressive guaranteed discounts and dispensing fee 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 for year-end pricing reconciliation versus how the same drugs are defined at the point of sale. For example, a generic drug might be considered a generic for the purpose of member copays but reconciled as a brand-name drug for the purpose of discount guarantees. The difference between these two pricing reconciliation strategies is typically relevant when calculating plan cost performance. Furthermore, plan sponsors should watch how their guarantees are structured so that over-performance in one area (e.g., brand-name discounts) cannot be used to offset underperformance in another area (e.g., generic discounts).

Adoption of limited retail and specialty pharmacy networks is an effective way PBMs have been able to significantly improve discounts for plan sponsors. Adopting a tiered or select pharmacy network can immediately improve the discount guarantees offered by a PBM. In addition, PBM-owned mail order and specialty pharmacies would typically give large discounts to limit fulfillment exclusively at the PBM-owned operations.

Exclusionary language in minimum pricing and rebate guarantees may exclude certain drugs or claims from discount and rebate guarantees. These exclusionary terms are presented in many different forms, and the lack of consistency and transparency is almost never to the health plan's benefit. At a minimum, plan sponsors should ensure the exclusions 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.

Definitions and key terms such as transparency, pass-through, generic and brand-name drugs, and rebates can have different meanings among PBMs, which can affect pricing and discounts if not clearly defined. Consider our earlier example where a PBM might classify single-source generic (SSG) drugs as brand-name or generic, depending on how the terms are defined in the PBM contract. The way definitions are written versus how they are later interpreted can have a significant effect on plan cost performance. We often see that a PBM does not interpret a definition the same way that a plan sponsor might, which leads to confusion and often frustration.

Performance guarantees should be measurable and auditable to allow the PBM account teams to track, measure, and clearly explain the guarantees to all stakeholders. Best-in-class language regarding missed performance guarantee payout allocation should state that the health plan has the right to allocate the full at-risk payout amount across its choice of performance guarantees. Not doing so allows the PBM to dilute the payout at risk, as some or most performance guarantees are easily achieved. Any customized performance guarantees should also be auditable and measurable.

A termination clause should include a specific provision for the right for the plan sponsor to cancel without penalty. If penalties are assigned, then early termination should be weighed against any potential savings from switching PBMs mid-contract. Negotiating a best-in-class termination without cause clause will assist the health plan in receiving the maximum performance from its PBM partner over the long term versus only in renewal years.

Auditing provisions should include language that allows the health plan the right to choose and hire an independent auditor to periodically validate the PBM's contractual performance. PBM contracts often limit the ability of plan sponsors to audit the PBM's performance, so it is essential the contract allows for flexibility in auditing, permitting the health plan to perform this important oversight function.

Rebate terms should be clearly defined as unclear definitions can take on alternate meanings and put rebate dollars at risk. For example, a poorly defined term "rebate" might include what is not in the definition, whereas a clearly defined term would include what is in the definition. The former allows for loopholes and assumptions, whereas the latter closes loopholes, which makes adding alternative meanings to terms more difficult for a PBM. Bonus tip: In the current environment of high trends in the Average Wholesale Price (AWP) for brand-name drugs, price protection may protect against inflation more than discount guarantees. It is best practice for plans to vnegotiate price protection terms as they prepare for their next contract iterations.

Every contract should have annual market checks

Market checks are a critical tool to ensure competitive PBM terms over the life of the contract. A market check often results in an improvement of plan pricing arrangements compared to currently contracted rates. There are strong financial incentives for plan sponsors to perform formal market checks every year throughout the PBM contract period and ensure pricing is consistent with market improvements and changes. When including a consultant's review of a mid-contract market check, the health plan can leverage the financial contract terms with those recently seen or negotiated with other vendors. The process includes a comparison of the aggregate program pricing terms with the market across product types and distribution channels, administrative fees, allowances, other financial guarantees, and rebates to determine whether the plan sponsor is receiving competitive market rates. The verification of competitive market rates may assist in renegotiating contractual rates with the existing PBM or may contribute to the decision to procure a new PBM service contract.

Conclusion

As the pharmacy industry continues to evolve and drug costs continue to rise, plan sponsors should always evaluate whether their PBM contract terms and provision strategies are in line with the changing marketplace. The PBM should be considered a partner in managing costs and not just a vendor to process claims. The evolution of the contract will give plan sponsors more control, allow them to mitigate risk, and provide comfort that the best possible deal is being actively maintained. A PBM industry expert can provide plan sponsors with the necessary tools that will provide critical insight into the newest and most effective examples of PBM contracting.

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