Comments for the Record

The Cost of Compensation and Fee Disclosure for Pharmacy Benefit Managers

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Thank you for the opportunity to submit a statement for the record before the Employee Benefits Security Administration's ERISA Advisory Council regarding the consideration of Pharmacy Benefit Manager (PBM) compensation and fee disclosures to welfare benefit plans through regulatory action.

Introduction

As the Department of Labor (DOL) deliberates over this proposed regulation requiring PBMs to disclose proprietary compensation information, the impact on the prescription drug benefit costs as a whole must be taken into consideration. The PBM industry is highly competitive and uses market incentives to provide lower costs to employer health plan sponsors and health plan administrators. Through these comments, I plan to discuss the savings generated by the current structure of the PBM industry, the existing transparency in PBM-client contract negotiations, and the estimated costs of required pricing transparency regulations that DOL is considering during this ERISA advisory council hearing. Overall, the changes suggested could cost employer health plans and beneficiaries $110 billion over ten years.

PBM Structure and Savings

Established in the 1990's, PBMs create large savings in the costs of providing prescription drug benefits by negotiating with pharmacies and drug manufacturers. As an industry, PBMs serve an estimated 220 million[1] Americans and are projected to save plans and beneficiaries almost $1.3 trillion[ii] from 2012 to 2021.

PBMs create these savings by reducing costs and streamlining benefits. PBMs negotiate with pharmacies and pharmaceutical manufacturers using volume to drive deep discounts. PBMs create networks of pharmacies where health plan beneficiaries can purchase their prescriptions with lower copays. Pharmacies compete to become part of these networks, offering discounted prices in exchange for higher beneficiary volume and a negotiated payment from the PBM.

Along with pharmacy negotiations, PBMs also contract with drug manufacturers. Because PBMs conduct the prescription drug portion of health plans, they have access to a wide patient base which the PBM uses to negotiate significant rebates and discounts from drug manufacturers. Manufacturers compete to place their drug(s) in a preferred (meaning lower copay) position in a plan formulary. PBMs negotiate rebates and discounts from the manufacturer in order to include their drug on the PBMs formulary (list of covered drugs) at a lower price with higher volume.

PBMs offer additional savings through a number of services offered to health plan sponsors including: mail

order pharmacy services, encouraging the use of generic drugs, and incorporating disease management programs. Mail order pharmacies provide medications directly to the beneficiary, allowing for even deeper discounts by removing overhead costs associated with brick and mortar pharmacies, as well as dispensing 90 day prescriptions – increasing medication adherence.[iii] Promoting the use of generic drugs through a variety of financial incentives decreases costs for the plan sponsor and the beneficiary.[iv] Finally, patient chronic care management programs employed by PBMs further drug adherence and reduce harmful drug errors and reactions.

Current PBM Contract Negotiations

The PBM clients – employer health plan sponsors – have created intense competition among PBMs, incorporating a request for proposal (RFP) process where PBMs offer bids for managing the prescription drug benefit in a health plan. This contracting process has developed a market where transparency is already a requirement without federal interference and regulation.

As the first piece of the process, it is important to note that plan sponsors are skilled, knowledgeable purchasers of PBM products. If a client is not familiar with PBM negotiations, they will hire a pharmacy benefit consultant throughout the process. In either circumstance, the PBMs in the bidding process are working with entities that are educated on the particulars of a pharmacy benefit.

As mentioned above, PBMs place a bid making an offer for a contract with the employer health plan. As a part of the competitive process, PBMs are incentivized to offer the lowest bid bringing down prices in order to win the employer's business. Along with the cost to the plan, plan sponsors will also ask for information regarding the PBM's pricing structure. In order to participate in the bidding process, plan sponsors often require PBMs to disclose their compensation levels, for direct and indirect payments, informing the employer of the potential profits earned by the PBM. This disclosure is conducted under heavily protected confidentiality agreements.

Employers also have the opportunity to include auditing agreements as a part of their contract with a PBM. During the contract with the PBM (usually lasting 1-3 years), the employer has the ability to audit the PBM to ensure it is receiving the savings it negotiated and that the PBM is not violating the terms of the contract.

Because of the competitive nature of the process, employers are able to negotiate contracts with PBMs that meet their needs. Surveys of industry participants show that 88 percent of employers participating in PBM contracting are satisfied with the process and outcomes.[v] The ability of employers to view the pricing structure of PBMs and to audit the PBMs as outlined in a contract allows for the employer to assess the agreement made and money saved. However, at the end of the contract, the employer always has the ability to hire a new PBM if it is unsatisfied with the current PBM's services. The competitive nature of the bidding process does not lend itself to required disclosure. Plan sponsors have the ability to assess the value of PBM services – including the pricing structure – without regulatory interference.

Effects of DOL Regulation

Despite all of the disclosures occurring during the contracting process, some at DOL appear to believe that plan administrators are not receiving enough information to determine if their PBM is receiving fair compensation.[vi] In order to remedy this assumed gap in information, the DOL is considering requirements for PBMs to disclose the costs within a pharmacy benefit. These disclosures would include both direct payments to PBMs and indirect forms of compensation such as rebates, as well as negotiated prices in PBM contracts.[vii] Requiring PBMs to disclose proprietary cost structure information through regulatory authority will harm plan sponsors and beneficiaries, costing an estimated $110 billion over ten years.

Pharmacies compete to become part of a PBM network by offering discounted prices on drugs in return for a set payment rate from the PBM for each specific drug. However, if pharmacies become aware of each other's discounted prices, they will be less likely to offer some of the steep discounts currently available behind the veil of PBM pricing. The same argument is true for drug manufacturers. Dr. Joanna Shepherd put it well in her recent testimony to the ERISA Advisory Council on this topic. Dr. Shepherd states that manufacturers have the incentive to bid more aggressively, offering higher rebates when they are competing against unknown rates from their competitors and competition lessens when manufactures are no longer working to outbid an unknown price.[viii]

The risk of leaked information increases with the regulatory requirements because ERISA has a limited ability to protect this information. Unlike the aggregated disclosures required by the ACA, the information PBMs would be required to offer is at the individual PBM, drug, and pharmacy level.[ix] Regulations under the EBSA would not be able to enforce confidentiality requirements – placing PBMs in a situation where they are disclosing highly sensitive competitive pricing information without a guarantee of its confidentiality.

If this information is leaked to competitors, PBMs will be less able to negotiate large discounts for plan sponsors. The negotiating process relies in significant part on the confidentiality of the agreements between PBMs and prescription drug providers—both manufacturers and pharmacies. In addition to reducing the incentive for providers to make aggressive bids, public disclosure of rebates and discounts will discourage manufacturers and pharmacies from offering large discounts to individual PBMs. A provider will likely resort to offering the lowest discount that is affordable to offer every PBM with which it negotiates. Overall, these restrictions on PBM negotiations are estimated to result in lost employer savings of $110 billion over 10 years.

Recommendations and Conclusion

The regulations being considered by DOL will not work to drive down costs of prescription benefits. Instead, they will limit the ability of a cost saving arm – pharmacy benefit managers – to negotiate lower prices from drug manufacturers and pharmacies and lower co-pays for plan beneficiaries. A contracting system is already in place to ensure that plan sponsors are appropriately compensating PBMs for their services. This is a system where employers have the freedom to change PBMs if they see fit, or to not use one at all. Further regulation of a competitive industry that now works effectively to decrease the cost of health benefit plans is both harmful and unnecessary for plan sponsors and PBMs.

Quantifying the Impact: Cost Estimate Methodology

When the Congressional Budget Office estimates the cost of similar disclosure requirements, they identify two primary ways in which the proposals might influence spending: a tightening of the distribution of drug discounts and tacit collusion in concentrated portions of the pharmaceutical market. In both cases, the effect of the regulation can be quantified by approximating the change in the mean discount off the average wholesale price (AWP) as a result of requiring public disclosure.

Though economic theory supports that the AWP discounts for PBMs will fall, it is non-trivial to estimate the magnitude. In an effort to offer insight into possible outcomes, we identify a plausible scenario: the AWP discount for all employers will decline to the smallest common AWP discount.[x]

We calculate the average discount by blending generic and brand discount averages offered by pharmacies for 30-day retail prescriptions, 90-day retail prescriptions, and mail-order prescriptions reported by the Prescription Drug Benefit Cost and Plan Design Report. First, we calculate an average retail discount for both generics and branded drugs as a straight average of 30-day and 90-day discounts. We then calculate a weighted generic and brand average by weighting retail and mail-order discounts according to retail and mail-order drug expenditures in 2013–$169 billion and $64 billion respectively.[xi] And the overall average is weighted according to the ratio of generic to branded drug expenditures—roughly 1 to 3.[xii] In order to estimate the total dollar cost of the proposal, we apply the AWP discount decline to the $1.3 trillion of savings to plan sponsors over ten years estimated by Visante.[xiii]

The current overall average AWP discount achieved by PBMs is 30 percent. If PBMs are required to disclose their rebates, the average discount may fall to 27 percent, resulting in a loss of up to $110 billion in savings for employers over ten years. However, there is a significant amount of uncertainty in this analysis. Based on variation in the estimated savings generated by PBMs, the cost to plan sponsors could range from $80 billion to $140 billion over ten years.

[1] http://www.dol.gov/ebsa/pdf/ACKilberg061914.pdf