

Understanding Pharmacy Benefit Managers

Prescription drug benefits are a major part of employer healthcare spending. The US Government Accountability Office estimated that retail prescription drug spending in 2021 accounted for more than 10% of total US personal health care services spending, which was up from about 7% in the 1990s¹. If current trends continue, prescription costs will take up an even larger portion of the pie in years to come. In 2022, pharmaceuticals made up 24% of employer healthcare costs, and that was up from 21% in 2021³.

Unsurprisingly, employers are concerned by this trend, with 92% of employers in a 2023 study⁴ saying they are concerned about high-cost drugs in the pipeline. In a related finding in that same study, 91% of employers reported concern about the overall pharmacy cost trend.

It is against this backdrop of rising costs and concerns that we now evaluate and explore the role of Pharmacy Benefits Managers in modern employee health benefits. What are PBMs? How do they deliver value for clients? What is their business model? How can employers be sure they have a good PBM? How do they provide value to clients? We will discuss those issues and more in this paper.

¹ "Prescription Drug Spending," US General Accountability Office. URL: <https://www.gao.gov/prescription-drug-spending>

² "Public Opinion on Prescription Drugs and Their Prices," Kaiser Family Foundation, Aug. 21, 2024. URL: <https://www.kff.org/health-costs/poll-finding/public-opinion-on-prescription-drugs-and-their-prices/>

³ "Prescription Drugs Driving Employer Health-Care Cost Increases," Sara Hansard, Bloomberg Law, Aug. 22, 2023. URL: <https://news.bloomberglaw.com/health-law-and-business/prescription-drugs-driving-employer-health-care-cost-increases>

⁴ "77% of Employers Report Increase in Workforce Mental Health Needs, Says Business Group on Health's 2024 Health Care Strategy Survey," Business Health Group, Aug. 22, 2023. <https://www.businessgrouphealth.org/en/newsroom/news-and-press-releases/press-releases/2024-lehc>

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What is a Pharmacy Benefits Manager?

A Pharmacy Benefit Manager, commonly abbreviated as PBM, serves as a third-party administrator for prescription drug programs within health insurance plans, self-insured employers, and various organizations. PBMs take on many roles within healthcare, which we will discuss in detail below.

Presently, the landscape of PBMs comprises a total of 66 entities, and we can trace the history of PBMs back to the year 1970. Among the prominent players within the industry are the "Big 3": Express Scripts, CVS, and OptumRx. These three major PBMs accounted for about 80% of the market⁵ as of 2021. As mentioned above, in the year 2022, the percentage of healthcare expenditure allocated to pharmacy services saw an increase, reaching 24% of healthcare costs, meaning that PBMs have a significant role to play in the overall healthcare ecosystem.

The specific duties of PBMs include the following:

Negotiating Drug Prices

PBMs engage in negotiations with pharmaceutical manufacturers to secure discounts and rebates on prescription medications.

Formulary Management

PBMs are responsible for developing and overseeing formularies, which outline the medications covered by specific health insurance plans or employer-sponsored benefit programs. These formularies often classify drugs into tiers based on their cost and clinical effectiveness.

Processing Prescription Claims

PBMs handle the processing of prescription drug claims submitted by pharmacies on behalf of patients. This involves verifying patient eligibility, adjudicating claims according to plan terms, and determining patient copayments or coinsurance amounts.

Pharmacy Network Management

PBMs establish and manage networks of pharmacies that contract with them to provide prescription medications to plan members. They negotiate reimbursement rates with pharmacies and monitor their performance to ensure quality and cost-effectiveness.

Clinical Programs

Many PBMs offer clinical programs and services designed to enhance medication adherence, manage chronic conditions, and promote cost-effective prescribing practices. These programs may include medication therapy management, drug utilization review, and disease management initiatives.

Data Analytics

PBMs utilize data analytics and pharmacy claims data to identify trends, patterns, and opportunities for cost savings and quality improvement. This information informs pricing strategies, formulary decisions, and clinical interventions.

⁵ "Beyond the Big Three PBMs," Denise Myshko, Managed Healthcare Executive, Dec. 14, 2022.

URL: <https://www.managedhealthcareexecutive.com/view/beyond-the-big-three-pbms>

What are the PBM models?

There are two different models PBMs operate under, each with advantages and disadvantages. As with so much of the health benefits industry, there is no one-size-fits-all answer as to which model is the best option. However, a clear understanding of the models, and the client's needs, will make the decision easier.

Traditional Model

- Relies on traditional discount guarantees (e.g., spread pricing, see below).
- Often retains high rebate percentages or rebate credits.
- Manages multiple maximum allowed Cost (MAC) lists and offers limited visibility to National Drug Code (NDC) level or rebates obtained from manufacturers.
- May involve hidden or complex financial caveats around discounts and guarantees, as well as ancillary fees for services like mail order dispensary or integration.
- Typically involves additional fees for external integration or carve-out solutions and limited access to claims data for reporting/auditing purposes.
- May include fees for clinical management or utilization management programs, and may have multiple undisclosed revenue sources.

Pros:

- **Cost-Savings Opportunities:** Traditional PBMs can leverage their scale and negotiating power to secure discounts and rebates from drug manufacturers, potentially leading to cost savings for clients.
- **Expertise:** Traditional PBMs typically have extensive experience and expertise in managing pharmacy benefits, which can be valuable for clients who lack the resources or knowledge to manage benefits on their own.
- **Convenience:** Traditional PBMs handle many administrative tasks related to pharmacy benefits, which can save clients time and resources.

Cons:

- **Lack of Transparency:** Traditional PBMs often bundle their fees into the overall cost of medications, making it difficult for clients to determine the true cost of PBM services.
- **Potential for Conflicts of Interest:** Traditional PBMs may prioritize their own profits or relationships with drug manufacturers over the best interests of their clients.
- **Limited Control:** Clients may have less control over their pharmacy benefits, as traditional PBMs make many decisions on behalf of their clients without full transparency or input.

Pass-Through Model

- Provides 100% pass-through pricing and rebates.
- Features an all-inclusive administration fee (e.g., Per Script, PEPM, PMPM).
- Grants full access and visibility to all non-proprietary data and contracts down to the NDC level.
- Adheres to a lowest-net cost approach with no additional fees for integration with TPAs for contracted PBMs, Specialty Carveout Solution, or other vendors.

Pros:

- **Transparency:** Pass-through PBMs often offer greater transparency in pricing, as they charge a transparent fee for their services, separate from the cost of medications.
- **Cost Control:** Clients have more control over the costs associated with their pharmacy benefits, as they can see exactly what they're paying for PBM services.
- **Flexibility:** Clients can potentially negotiate better deals with pharmacies and drug manufacturers because they have more insight into the actual costs.

Deciding which model makes sense for a client means weighing factors such as the organization's size, resources, control over costs, and future organizational goals.

Cons:

- **Higher Upfront Costs:** Pass-through models may require higher initial costs as clients directly pay for the PBM services.
- **Limited Resources:** While still possible, smaller organizations might find it challenging to manage their pharmacy benefits effectively without the resources and expertise provided by traditional PBMs.
- **Complexity:** Managing pharmacy benefits directly can be complex and require specialized knowledge and personnel which may be harder to come by in a pass through pricing model.

What makes a PBM great?

Evaluating the relative value of a particular PBM means assessing it against several key factors:

Transparency

A good PBM is transparent in its pricing practices, rebate arrangements, and overall operations. They should provide clear and detailed reports on drug pricing, discounts, rebates, and fees, allowing you to understand how your pharmacy benefit dollars are being spent.

Cost Savings

Does the PBM effectively negotiate drug prices, discounts, and rebates to help control pharmacy benefit costs? Look for evidence of cost savings initiatives and strategies implemented by the PBM and compare their performance against industry benchmarks as well as client business goals.

Formulary Management

It is a tricky area of the industry, but an effective PBM will have a well-managed formulary strategy that balances cost-effectiveness with clinical efficacy. They should provide access to a broad range of medications while promoting the use of generic and lower-cost alternatives when appropriate.

Pharmacy Network

This is incredibly vital to a PBM's value. A great PBM will have a robust network of pharmacies, including both retail and mail-order options, that offer convenient access to prescription medications for members. The network should provide valuable coverage, accessibility, and customer service quality.

Clinical Programs

A good PBM should offer comprehensive clinical programs and services aimed at improving medication adherence, managing chronic conditions, and promoting cost-effective prescribing practices. These programs should be evidence-based and tailored to the specific needs of the client population.

Customer Service

How is the PBM's customer service? A good PBM should provide excellent customer service and support to clients and their members. The PBM should be responsive to inquiries, resolve issues promptly, and offer assistance with benefit design, member education, and claims processing.

Data Analytics and Reporting

PBMs harness the power of data analytics and pharmacy claims data to pinpoint trends, patterns, and opportunities for cost savings and quality enhancement. They furnish clients with comprehensive reporting and actionable insights, empowering informed decision-making and fostering continuous improvement in pharmacy benefit management.

Regulatory Compliance

It should go without saying that a good PBM will adhere to all regulatory requirements and standards governing pharmacy benefit management. They should stay abreast of changes in regulations and demonstrate a commitment to compliance and ethical business practices.

Feedback and Reviews

Seek feedback from members, employees, and other clients who have experience with the PBM. Look for reviews and testimonials online and consider joining industry networks or forums to discuss PBM performance with peers.

Overall, a good PBM should demonstrate transparency, cost-effectiveness, clinical excellence, and excellent customer service. Regular evaluations of the PBM's performance against these criteria will help ensure that the client and members are getting the most value from their pharmacy benefit program.

Why should you care about PBMs?

Here are five key reasons to take a keen interest in PBMs.

Cost Management

As stated above, PBMs are often responsible for a significant portion of overall healthcare costs for employers. Brokers need to understand PBM practices to help their clients effectively manage pharmacy benefit costs and to make certain the PBM they are working with is the right one for the client.

Client Satisfaction

Pharmacy benefits are essential for employee satisfaction and retention. Brokers who can effectively advise their clients on selecting the right PBM can help ensure that employees have access to affordable medications and quality pharmacy services. This, in turn, can enhance client satisfaction and loyalty.

Compliance and Regulations

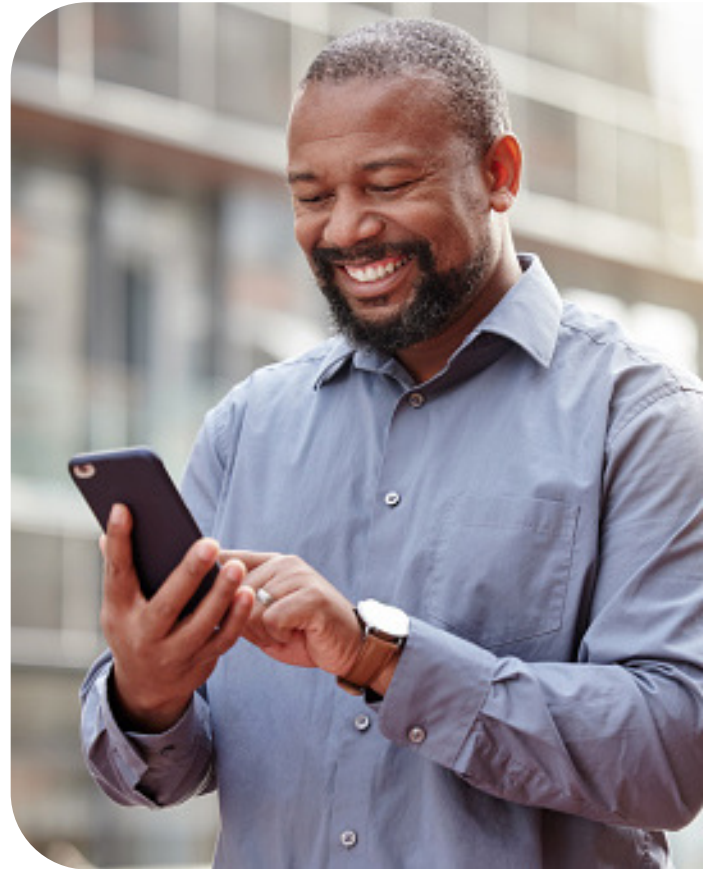
PBMs are subject to various regulations and compliance requirements. Brokers need to stay informed about these regulations to ensure that their clients' pharmacy benefit programs comply with legal requirements. Failure to do so could expose clients to legal and financial risks.

Market Knowledge and Competition

The PBM landscape is constantly evolving, with new players entering the market and existing PBMs introducing innovative solutions. Brokers who stay abreast of these developments can provide valuable insights to their clients, helping them make informed decisions and stay competitive in the market.

Value-added Services

Some PBMs offer value-added services such as data analytics, clinical programs, and specialty pharmacy services. Brokers who understand these offerings can help their clients leverage these services to enhance employee health outcomes and reduce healthcare costs.



Overall, by understanding the role of PBMs and staying informed about the latest trends and developments in the pharmacy benefits space, employee benefits brokers can better serve their clients, drive cost savings, and enhance employee satisfaction.

How do PBMs make money?

Overall, PBMs derive revenue from a blend of spread pricing, administrative fees, rebates and discounts, specialty pharmacy operations, clinical programs, and consulting services. The precise revenue mix may vary depending on the business model and the array of services offered by each PBM.

Moreover, PBMs have numerous revenue streams, including but not limited to reverse claim fees, admin fees, mail order fees, audit recovery fees, vaccine admin fees, formulary management fees, and drug (NDC) reclassification fees (e.g., Brand vs. Generic or Traditional vs. Specialty). These diverse revenue streams contribute to the overall financial viability of PBMs within the healthcare ecosystem.

PBMs employ various revenue-generating mechanisms, which include:

Spread Pricing

PBMs negotiate discounts and rebates with both drug manufacturers and pharmacies. They then charge their clients—such as health insurance plans and employers—a higher price for medications compared to what they reimburse pharmacies, thus earning a spread or margin on each transaction.

Administrative Fees

PBMs may levy administrative fees on their clients for overseeing prescription drug benefits. These fees encompass services like formulary management, claims processing, network management, and clinical programs.

Rebates and Discounts

PBMs negotiate rebates and discounts from pharmaceutical manufacturers in return for including their drugs on formularies and promoting their utilization. A portion of these rebates is typically retained by PBMs as revenue.

Mail Order and Specialty Pharmacy

PBMs frequently operate their own mail-order and specialty pharmacies, which generate revenue through dispensing fees and markups on medications.

Clinical Programs and Services

Some PBMs provide supplementary clinical programs and services, such as medication therapy management and disease management initiatives, for which they may impose additional fees.

Consulting Services

PBMs might extend consulting services to their clients on various topics like pharmacy benefit design, cost containment strategies, and regulatory compliance, charging consulting fees for these services.

What should PBMs provide to clients?

When evaluating agreements with PBMs, clients and advisors should consider the following areas:

Discount Guarantees

Discounts denote the percentage variance between the Average Wholesale Price (AWP) and the actual point-of-sale ingredient cost for a specific drug. These discounts can fluctuate based on factors like the type of drug, pharmacy channel, and the duration of supply.

Dispensing Fees

Dispensing fees refer to charges applied at the point of sale, in addition to the ingredient cost of the drug. Similar to discounts, these fees may vary depending on factors such as the type of drug, pharmacy channel, and duration of supply.

Rebate Guarantees

Rebate guarantees are commitments made by drug manufacturers, typically paid to the PBM, either partially or entirely passed through to the client.

Admin Fees

Admin fees are often assessed to clients on a per-script, per-employee-per-month (PEPM), or per-member-per-month (PMPM) basis for services provided by the PBM. These fees can be found within both traditional and pass-through models.

PBM Ancillary Fees

Ancillary fees represent additional revenue streams derived from services or programs furnished by the PBM, such as Prior Authorizations (PAs), Integration, formulary management, audits, etc.

Reconciliation

Reconciliation entails the assessment, monitoring, and adjustment of overall contract performance concerning discounts, dispensing fees, and rebates. Offset is a term often mentioned in contracts concerning the reconciliation process. Clients should be cognizant of these factors when evaluating PBM contracts to ensure transparency and alignment with their objectives.

What issues are facing PBMs today?

The landscape for PBMs today is continually shaped by ongoing developments in healthcare policy, regulation, and market dynamics may further influence their operations and strategies. Additionally, factors such as regulations, real-time pricing tools, transparency initiatives, and evolving pharmacy auditing practices contribute to the evolving environment in which PBMs operate. Several current issues impact PBMs and the broader pharmaceutical supply chain.

Drug Pricing and Transparency

PBMs have come under scrutiny due to concerns about their role in drug pricing and the lack of transparency in their pricing practices. Critics argue that the negotiations PBMs conduct with pharmaceutical manufacturers for rebates contribute to opaque pricing and ultimately result in higher costs for consumers.

Rebate Reform

Calls for reforming the rebate system within the pharmaceutical supply chain have intensified, potentially affecting PBMs significantly. Proposed reforms aim to increase transparency and ensure that rebates are passed on to consumers at the point of sale, potentially altering PBMs' revenue models.

Vertical Integration

The trend of vertical integration within the healthcare industry, where PBMs merge with or are acquired by health insurers or pharmacy chains, has raised concerns regarding conflicts of interest and market consolidation. Critics fear that such consolidation may reduce competition and lead to increased prices for consumers.

Regulatory Scrutiny

PBMs are subject to regulatory oversight at both federal and state levels. Regulatory scrutiny has centered on transparency, pricing practices, and potential anticompetitive behavior. Changes in regulations could significantly impact PBMs' operations and business models.

Pharmacy Reimbursement

PBMs negotiate reimbursement rates with pharmacies for dispensing medications to plan members. Disputes over reimbursement rates, direct and indirect remuneration (DIR) fees, and other reimbursement practices have strained relationships between PBMs and pharmacies, particularly independent ones.

Impact of COVID-19

The COVID-19 pandemic has disrupted healthcare systems and posed challenges for PBMs in managing prescription drug benefits. Issues such as drug shortages, changes in utilization patterns, and increased demand for specialty medications have required PBMs to adapt and demonstrate flexibility.

Drug Access and Affordability

Ensuring access to affordable medications for patients remains a significant concern. PBMs are pivotal in managing formularies, implementing cost-saving strategies, and facilitating patient assistance programs to address concerns about drug affordability and access.

Biosimilars and Specialty Medications

The increasing use of specialty medications, including biosimilars, presents challenges for PBMs in managing costs and ensuring appropriate access to these high-cost therapies. PBMs are exploring strategies to promote biosimilar use and effectively manage spending on specialty medications.

What does the future hold for PBMs?

Overall, the future of PBMs is likely to be characterized by innovation, collaboration, and a continued focus on driving value for patients, payers, and other stakeholders in the healthcare system. The future of PBMs is likely to be shaped by several key trends and factors:

Increased Focus on Cost Containment

With rising healthcare costs globally, there will be continued pressure on PBMs to contain costs while ensuring access to affordable medications. This may involve leveraging technology, negotiating better drug prices, and implementing cost-saving strategies.

Expansion of Services

PBMs may expand their services beyond traditional pharmacy benefit management, including offering more comprehensive healthcare solutions such as specialty pharmacy services, medication therapy management, and population health management programs.

Integration with Healthcare Ecosystem

PBMs may increasingly integrate with other stakeholders in the healthcare ecosystem, such as healthcare providers, insurers, and pharmaceutical manufacturers, to optimize patient care and outcomes while controlling costs.

Technological Innovation

Advancements in technology, such as artificial intelligence, data analytics, and telemedicine, are likely to reshape how PBMs operate. These technologies can improve efficiency, personalize patient care, and enable better decision-making.

Regulatory Environment

Changes in healthcare policy and regulation can significantly impact PBMs. Regulatory scrutiny over drug pricing practices, rebate structures, and transparency may influence how PBMs operate and structure their business models.

Focus on Value-Based Care

With a shift towards value-based care, PBMs may increasingly focus on outcomes-based contracting, where reimbursement is tied to patient outcomes rather than the volume of services provided. This could drive greater collaboration between PBMs and other stakeholders to improve patient outcomes while reducing costs.

Patient-Centric Care

There may be a greater emphasis on patient-centric care, with PBMs playing a role in enhancing medication adherence, providing education and support to patients, and promoting wellness and prevention initiatives.

Conclusion

Understanding the nature of PBMs will help advisors to properly guide employers as they decide how best to handle pharmaceutical benefits for their people. As prescription drugs become an even bigger piece of the healthcare spending pie, PBMs will continue to grow in importance. Knowing what makes them tick, and what makes one a better fit for a client and population, will likely be a major advantage to employee benefits professionals today and in the years to come. We hope this paper has been useful to you, and we are happy to answer any new or lingering questions you may have. Please connect with us online at <https://www.luminarehealth.com/contact-us> or scan the QR code below.

