

Advisers, clients in the dark about pharmacy benefit management fees

By Molly Bernhart

Pharmacy benefit managers make a great deal of their revenue from layers of contracts and agreements with entities like retail pharmacies, pharmaceutical companies and rebate aggregators. These arrangements result in a variety of revenue streams that are difficult for most advisers and plan sponsors to unearth and analyze.

Because pharmacy benefits are an area where employee health can be directly affected by financial decisions, it is important that fiduciaries attempt to decipher the revenue streams that PBMs use. Fiduciaries often have no idea what the service provider is making in incentives and rebates for putting particular drugs on a formulary list.

The obvious reason fiduciaries should be concerned about fee transparency is that the traditional PBM contract can create an environment where there is biased decision making on what drugs are available for plan members. Drugs with high rebates and incentives from pharmaceutical manufacturers could make it onto a plan sponsor's formulary list, while other drugs may not.

Another reason why advisers may want to open their client's eyes to PBM fees is those employers may be breaching fiduciary responsibility, and -depending on the adviser's role - he may be in breach as well.

Plain and simple

What fiduciaries don't know can hurt them. The main piece of evidence: the Employee Retirement Income Security Act.

Under ERISA, the primary responsibility of fiduciaries is to run benefit plans "solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses."

The Department of Labor has held that a fiduciary must know all compensation related to the plan from outside sources to the service provider.

"It is very typical [for] fiduciaries to not understand the complexities and the financial dynamics of the PBM. That can lend itself to not complete disclosure on the financial transactions of where the money's flowing," says David Kikumoto, president and CEO of Denver Management Advisors. "This is a huge issue and it's not completely understood by the employers who are acting as fiduciaries," he says.

Many pharmacy benefit plans do not freely disclose what other contracts with third parties are contributing to the PBM's revenue. Some employers have a traditional pharmacy benefit plan and think their fiduciary responsibility ended when they chose their vendor.

"It's a fiduciary obligation that you selected the PBM, it's a fiduciary obligation to monitor the prescription drug provider and it's a fiduciary obligation to make sure it's reasonable compensation that they're making off of the contract. It's really those three separate parts of it, and again, you can't just submit an RFP, select a vendor and then forget about it for five years. That's kind of falling asleep at the wheel," says Frank Palmieri an attorney at Princeton, New Jersey-based Palmieri & Eisenberg.

Asleep at the wheel

Fiduciaries could be asleep at the wheel for two reasons: PBM fees are cryptic, and employers and advisers would rather not know because it's much cheaper to blindly take a traditional plan.

"Whether you're paying the right amount or not it's almost impossible for you to figure it out," says Palmieri.

Some advisers are trying to decode the PBM compensation mystery for their clients. Kikumoto says that if advisers want to do everything they can to manage client's health care costs more efficiently, there's a lot they can do when selecting PBMs.

"At our company, the only contracts we make with PBMs are completely transparent contracts - which means there's no script pricing, no contingent fees, all rebates are passed back to the client and we pay them a fair administrative fee for a fair service," says Kikumoto.

But transparent pass-through models can be more expensive than traditional plans because when the PBM loses those fees, rebates and incentives paid by a third party, they must charge a higher administrative fee to the plan sponsor to fill the void. With so many advisers being pressured to lower bottom-line costs, it's no wonder people would rather not know what they're paying for and simply take the cheap and easy solution.

Peter Day, vice president of strategic relations at Express Scripts says they have clients with transparent pass-through contracts. The company saw an increase in requests for the plans in 2005 and 2006, but says the trend is leveling off somewhat.

"It's not that it's lost importance, it's still an important mechanism and an important idea from a client's standpoint," says Day. "But recently we are actually encouraged by the increased focus on net cost by both the adviser community as well as increasingly, employers ... we think that is ultimately the important thing to look at. What is, ultimately, a client going to spend with one PBM versus another."

However, others are willing to pay more to know that clinical decisions are not being swayed by financial decisions — especially in light of the many value-based health initiatives taking off. Some employers want to choose what drugs are on their formularies or want the option to subsidize co-payments on certain drugs that yield better outcomes. As plans pick and choose what's on the formulary this can have an effect on the rebates PBMs might make on the drugs being excluded.

"A pass-through arrangement is going to have a direct and immediate impact on a plan sponsor's cost," says Nick Vasilopoulos, vice president of employer accounts at Medco. "It might not be the right way to structure your financial arrangement, but certainly as a concept it's the right way to understand the economics that are going into the discounts we are negotiating."

Even when PBMs charge a higher admin fee on a transparent pass-through model to compensate for what is lost in rebates, the PBM still might not come close to what they would make from pharmaceutical manufacturers and retail pharmacy, says Tim Thomas, consultant and founder of Pharmacy Benefits Advantage. If the PBM is making more from third parties on the contracts than they are from the client, what is the state of the industry?

"The PBM game is an unbelievable shell game and PBMs should be audited on a regular basis ... The industry needs to be blown up and started over again," says Sam Fleet, president of AmWINS group benefits division - AmWINS' PBM branch is IdealScripts.

Happily turning off the light

While many employers and advisers are in the dark, disclosure is not necessarily a problem PBMs have to deal with. The burden is on the fiduciaries. The PBM only has to show auxiliary revenue streams when the fiduciary asks for transparent provisions. But with such a focus on net cost, fee transparency may not be a huge concern for PBMs.

"I think you have to really focus on whether [considering fiduciary responsibility] is the risk that a broker or adviser faces or if it's more of a business opportunity/risk to be able to give their clients the clearest line of sight as to what's the best deal," says Steve Littlejohn, VP of public affairs for Express

Scripts.

Many PBMs are more concerned with promoting net costs as compared to other PBMs and clinical transparency, like generic fill rates, rather than fee transparency.

"Medco's approach with all of our clients is to try to bring perspective around the transparent arrangement. We don't hesitate to propose or quote both arrangements side-by-side in our financial analysis - we will project bottom line under both," says Vasilopoulos.

Some PBMs are so successful promoting the bottom-line benefits of a traditional fee structure they downplay transparent pass-through models.

"[Some PBMs] don't have the right, natural infrastructure to create true transparency for the fiduciary and the client," says Kikumoto.

Palmieri says there is no Spitzer-esque push for transparency in this area because the world is primarily driven by the retirement side of the house and welfare benefits are the stepchild. However, with health benefits' costs skyrocketing, they may begin receiving a lot more attention.

When the Pharmacy Benefit Management Institute compared performance ratings of pharmacy benefit managers with employer responses to questions about the financial transparency of PBMs they found a link between transparency and employer satisfaction "As employers' satisfaction with transparency increases, their overall satisfaction also increases," says Dana Felthouse, PBMI president.

Fifty-six percent of respondents think their PBM relationships are "somewhat transparent," while 28% say their relationships are "completely transparent," according to the 2006 Pharmacy Benefit Manager Customer Satisfaction Report.

PBM customers who say they are "extremely satisfied" with the degree of financial transparency from their PBM rated their PBMs higher in all 16 categories than those who are less satisfied with their PBM's level of financial transparency - an average "overall service and performance" rating of 8.9 on a 10-point scale.

By comparison, employers who are "somewhat satisfied" with financial transparency gave their PBMs an average performance rating of 7.8. Those who are "somewhat dissatisfied" gave their PBMs a 6.7, and those who are "extremely dissatisfied" with financial transparency gave their PBM's a 6.2.