Optum

Leader Perspective

Traditional vs. transparent pricing: Understanding your options

A conversation with Michelle Nack, Senior Vice President, Strategy and Commercial Finance

Historically, pharmacy benefit managers (PBMs) — whether in the group health, workers' compensation, or auto market — have calculated program pricing using discounts to the average wholesale price (AWP) for generic and brand name medications. This traditional form of PBM pricing is often referred to as "spread" pricing.

Over the last decade, consumer interest in "transparent" or "cost-plus" pricing has continually grown. This model calculates prices based on pharmacy acquisition cost, plus a percentage margin or flat administrative fee.

In response to client demand, Optum offers both traditional (AWP) and transparent pricing. Clients can select either pricing model based on what they believe will work best for their organization and stakeholders.

Michelle Nack, SVP, Strategy and Commercial Finance, is enthusiastic about educating clients on pricing options by explaining their advantages and disadvantages for various organization and industry types. As she describes, "There are a number of levers we can pull to offer clients the most advantageous pricing for their business. Our goal is to work with our clients and help determine what structure works best for their business needs."

Recently, we sat down with Michelle to discuss what she is seeing as she works with Optum Workers' Compensation and Auto No-Fault clients, and what she is hearing from her counterparts working with group health clients.

What types of pricing options does Optum provide to clients?

The most common pricing options we offer to Optum Workers' Compensation and Auto No-Fault clients are traditional (spread pricing model) and transparent (a cost-plus pricing model).

Currently, most of our clients choose the traditional pricing model. With this model, we establish prescription drug prices using discounts off a daily AWP feed provided by Medi-Span® or RED BOOK® and apply them to all retail and home delivery transactions plus a dispense fee. We don't apply any additional fees or costs to pharmacy transactions.

With our cost-plus pricing model, we base drug prices on the buy-side price, as negotiated directly with each pharmacy within our proprietary network. We also apply an administrative fee to cover the internal processing costs of formulary administration, state regulatory requirements, clinical oversight, technology integration, system maintenance, large operational costs associated with network requirements and claims processing, and analytics.

Why has Optum Workers' Compensation and Auto No-Fault not offered transparent pricing as long as group health PBMs?

Group health PBMs offered transparent pricing models before workers' compensation PBMs, but this timing is normal in the industry. Workers' compensation, which involves a smaller payer market with different objectives, often follows group health initiatives by several years.

What do payers feel transparent pricing offers that traditional pricing does not?

Well, historically, drug pricing and payment systems have been difficult to understand. The concept of transparent pricing offers psychological benefits to consumers. It's easy to understand the application of a standard administrative fee, and the concept of "transparency" implies to consumers that they're getting a better deal than before.

However, the cost-plus pricing model is just another mechanism to come up with a final price for a prescription drug. And at the end of the day, the price of the drug is what matters.

In a transactional environment, pricing based on a cost-plus approach with a standard administrative fee is relatively straightforward. However, effective workers' compensation pharmacy benefit management involves clinical oversight, network management, and systems that work together to contain overall claim costs and help the injured worker recover as quickly as possible. Our program components work together to make sure the patient is receiving the right drugs for the lowest possible cost. Without effective PBM oversight, the patient might receive expensive drugs that should never have been dispensed.

What about rebates? Are rebates a big reason clients want more transparency?

That's a great question. There's been a lot of discussion in the industry and the media about the huge rebates that pharmaceutical companies pay to PBMs. I do think it's one of the reasons the transparency conversation started.

Rebate amounts can be considerable, so it's not surprising that people wonder where the rebate dollars are going. But rebates impact the financials of group health PBMs much more than workers' compensation.

In group health, all rebate dollars can be applied back to the program to reduce premiums. So, if a PBM negotiates a rebate with a pharmaceutical company for one brand medication, and then pushes that medication over lower priced equivalents or generics, the PBM receives significant rebate dollars through that exclusive arrangement.

> **In group health, rebates on brand name drugs can be applied to the program to reduce premiums. But in workers' compensation, we promote generic drugs, and rebate dollars on brand name drugs are often applied to individual claims.**

On the workers' compensation side, we promote generic, not brand name drugs, and we certainly don't push one brand drug. Our generic utilization rate is very high, so the rebate amounts are vastly lower than in group health. They're also much harder to administer because they need to be applied at the claim level, and claims are often closed by the time the rebates are returned (up to 6 months later), which creates extra work for our clients and their adjusters. We use any funds generated in the form of rebates to lower the costs of prescription medications at the point of sale.

With the media coverage of transparent pricing programs, does this increase pressure within the Optum client base to move to transparent pricing?

It seems like news of companies like Mark Cuban's Cost Plus Drug Company would encourage that pressure, but we are not seeing that. We have several types of transparent pricing programs we offer on the Optum side. But our workers' compensation clients are just not moving in that direction.

So, how are clients reacting to the pricing choices available to them?

When the options are explained to them, they're still selecting traditional AWP pricing.

I do find that clients want to ask questions, and they want detailed answers that make sense to them. But after learning about their options, they're not selecting or moving to transparent pricing. I believe it's because of the way workers' comp is managed and measured, which is predominantly at the claim level. With the cost-plus pricing models, it's hard to keep the same level of competitiveness for drug costs for all claims, because of differences in drug mix. If you care about the drug costs for an individual claimant, traditional pricing offers more consistency in helping make sure you're getting good rates that are not fluctuating.

With the cost-plus model, costs vary from pharmacy to pharmacy, and from drug to drug. When you're trying to manage reserves and manage to a claim, you need to have more consistency.

> **When the benefits and drawbacks of each pricing option are explained to them, our clients are still selecting AWP pricing.**

How can clients be sure they are selecting the right pricing method? What do you do to help?

All of the features of our Pharmacy Care Services program are identical regardless of the pricing model used. So, the most important thing we can do to help a client select the best pricing model is to understand their business and overall goals. How is their book of business structured; how do they look at total cost? How do they sell their services, and how do they define success for their business and their customers? Once we know this, we can show them how a particular pricing model would lend itself better to helping them achieving those goals and benefitting their book of business.

With transparent pricing, the whole concept is looking at aggregate success and savings. This works well for group health payers, where brand utilization is higher, and costs can be normalized across the entire book of business to reduce premiums. But in workers' compensation, we're focused on reducing claim costs through generic utilization, and each claim has to be managed separately. You can't offset the cost of one claim against another, or one group of claims against another group. This is one of the biggest challenges of using cost-plus pricing for workers' compensation clients.

Here's an example: Let's say you have a TPA that has small employer groups, and one of these groups is managing 10 claims. With cost-plus pricing, it's hard to make sure the pricing is really competitive on all of 10 of the claims because of the differences in drug mix. If one claim has a set of low-cost generic drugs, when you add on the administrative fee, suddenly that claim could be much more expensive than it would be with traditional pricing — while another claim that has high-cost brand medications may show as significantly cheaper. While the total program costs would be the same, the individual drug prices at a claim level will vary more dramatically with transparent pricing. But AWP pricing rates will stay consistent, whether you have 1 or 100 claims.

So, we're happy to work with each client to determine what will be most cost-effective for them at both the business level and the claim level. We're in the business of helping clients meet and exceed their goals, and I love being a part of that process.

> **Transparent (cost-plus) pricing is challenging for workers' comp payers. Unlike group health, claim costs are isolated at the claim level. This is one reason we're finding that clients stay with AWP pricing.**