PharmacyFirst™
Partners in Excellence

Meeting the Challenges of Effective Rate Contracts

Better visibility to the mechanics of effective rates help independent pharmacies leverage data for improved performance.

For independent pharmacies, the challenges to their bottom line continue to grow each year, making the industry more and more difficult to navigate. In 2020, however, COVID-19 created unprecedented issues that called for fresh answers – especially regarding reimbursement.

Besides the basic annual erosion of reimbursement terms, current industry drivers like Effective Rate Contracts have emerged to jeopardize pharmacy profitability and cash flow. With the additional effects of a global pandemic where many thousands of patients have lost healthcare or cannot pay for their prescriptions, the threat to independent pharmacies becomes an even greater concern.

When contracts have elements that are potentially difficult to administer, the goal is to ensure that adjustments are made fairly for pharmacies across the board, so they can correctly anticipate the ups and downs of cash flow and maintain a profitable bottom line. Processes in workflow development, technology and analytics have been put in place to help model out and predict the extent to which the pharmacy may be reimbursed.

Pharmacies are playing a more critical role than ever in their communities. In the world of COVID-19, their pressures are further magnified, and the need to address their reimbursement issues has grown critical – especially as Effective Rate Contracts have become more common. Looking to 2021 and beyond, the support of pharmacies as they work through the special challenges of Effective Rate Contracts will be key for their long-term survival.

WORKING WITH EFFECTIVE RATE CONTRACTS

Effective Rate Contracts have been in use only since 2018, yet they have become a fast-growing trend. They represent a reimbursement model that some Pharmacy Benefit Managers (PBMs) have put into their commercial and Medicaid contracts.

Effective rate language allows the PBM to adjust reimbursements over time so the overall reimbursement averages out to a guaranteed amount. The result is that some claims are paid below the effective rate at the point of sale, resulting in a reimbursement overpayment; while others are adjudicated above the effective rate and lead to an underpayment.

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The argument can be made that an effective rate offers stability and predictability through a guaranteed reimbursement, but other aspects of these contracts can become an obstacle for independent pharmacies. For one, the adjudication and payment of claims close to the effective rate are being managed inconsistently. Individual results vary widely, and in some cases, the overpayment from just one pharmacy can reach millions of dollars.

This can lead to another issue: At the end of the contract year, when a "true-up" takes place to achieve the correct balance, the PBM may choose to offset overpayments with underpayments and collect or pay the net difference, whatever the case may be. For underpaid pharmacies that end up with a loss, this could be a financial disaster.

MANAGEMENT OF EFFECTIVE RATES

Pharmacy Services Administrative Organizations (PSAOs) differ across the board in how they deal with Effective Rate Contracts. Pharmacy First created a selective escrow process to capture overpayments so when a true-up occurs, the opportunity is there to assist underpaid pharmacies in recouping those monies more fairly.

To understand the context, imagine there are just two pharmacies, where Pharmacy A is overpaid by a million dollars and Pharmacy B is underpaid by half a million dollars. The PBM will be satisfied with collecting the net difference of a half-million dollars from Pharmacy A. Although this may work out fine for Pharmacy A, Pharmacy B is left with a half-million loss for the year.

The way to prevent this situation is to collect overpayments first. The selective escrow process is a direct action to protect pharmacies that are consistently underpaid.

Other key efforts at Pharmacy First to assist with Effective Rate Contracts:

- Establishing narrow variance thresholds in contracts
- Implementing new data tools for better visibility to problem drugs and to provide more information to pharmacies
- Expanding and updating member portal features and functions

EXPLAINING EFFECTIVE RATE CONTRACTS?

Effective Rate Contracts set pharmacies' reimbursement rates to a specific target – namely, the full cost (reimbursement plus copay) of drugs over a certain time frame should equal a certain percentage of Average Wholesale Price (AWP) or, in the case of a Dispensing Fee, a specific amount. These contracts can target discount rates for Generics, Brands and/or Dispensing Fees (i.e. AWP-82% for Generics).

They also typically define the minimum reimbursement at the point of sale, which can be "AWP minus" or a Maximum Allowable Cost (MAC) price for a drug. The actual point-of-sale discount rate for any given drug can vary from the Base Rate up to 100% of the listed AWP.

To calculate the Actual Effective Rate, PBMs use the following formula:

AER = 1-(Ingredient Cost paid/AWP)

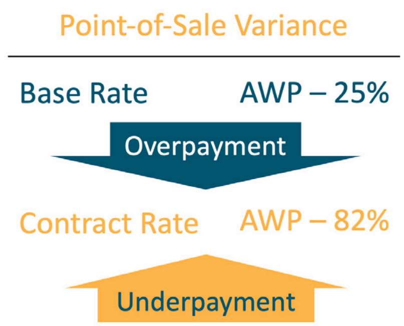
If the Actual Effective Rate is above the Contract Effective Rate (i.e. AWP-95%), there is an underpayment to the pharmacy; if the Actual Effective Rate is below the Contract Effective Rate (i.e. AWP-50%), there is an overpayment. The dollar amount of over/under payment for each claim is calculated:

Variance = (Contract Effective Rate – Actual Effective Rate) x AWP

Under Effective Rate Contracts, individual claims will be over/underpaid as the PBM continues to manage contractual obligations throughout the year. While this can create some uncertainty at the point of sale, each pharmacy needs to understand that the overall contract rate will eventually be achieved through periodic reconciliations and an eventual end-of-year true-up.

POS Rate Based on NDC

Base Rate	AWP – 25%
MAC Rate	AWP – 50 to 80%
Contract Rate	AWP – 82%



RECONCILIATIONS

An Effective Rate Contract will include periodic reconciliations and monthly or quarterly accounting of the PBM's performance during the term of the agreement. The monthly/quarterly snapshots include data elements that are subject to final evaluation at the end of the year. The PBM will also use these results to implement point-of-sale reimbursement changes along the way.

This often leads to sudden pricing changes, especially for those drugs being reimbursed at the contract base rate. The result is that pharmacies might see a drug reimbursed at a higher amount one week and at a lower rate shortly afterward. As the payer is responsible for adjudicating claims and sending the paid response back to the pharmacy, the PSAO or pharmacy is powerless to control these variances. And unlike with DIR fees, a pharmacy's performance measures have no bearing on effective rates.

Compared with the old days of arbitrary MAC pricing and no accountability, the Effective Rate Contract model does offer some positive aspects – the pharmacy will always know the net reimbursement. But if the payer does not manage to point-of-sale claims (Actual Effective Rate) near the target, the overpayments and underpayments can be difficult to anticipate and track, contributing to significant financial stress for the pharmacy. As a service to every pharmacy in the PSAO, periodic reporting at the claim level is provided to help track the overall trend and future obligations under these contracts.

TRUE-UPS AND THE ESCROW PROCESS

At the end of the year, a final reconciliation known as a true-up occurs. Through this process, the PBM resolves the net result of underpayments and overpayments for the term of the contract. The annual report will compare the Actual Effective Rate for every claim during the applicable calendar year to the Contract Effective Rate and aggregate the variance amounts at the pharmacy level.

If the net result is an overpayment, the PBM initiates a recoupment process, or at the PSAO level socialized across all pharmacies. If the net result is an underpayment, the PBM will credit the excess amount back to the entire pharmacy network for distribution.

The PSAO determines the allocation of these funds, which primarily go only to those individual underpaid pharmacies. However, if the PBM cannot collect all the overpayments and the underpaid pharmacies cannot receive the reimbursements they are owed, the result often is wildly fluctuating cash-flow problems.

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Pharmacy First has also created tools that enable member pharmacies to monitor the Effective Rate Balance during the contract term, with the ability to review escrowed funds for net overpayments, periodic reconciliations, and escrow payout at the end of the contract year.

The bottom line: Through uncertain, rapidly changing times, Pharmacy First is committed to transparency of contracts; to fair and equitable reimbursement under the terms of those contracts; and to providing the support that independent pharmacies need for continued operational success.

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With a network of more than 2,300 independent pharmacies across the country, Pharmacy First is committed to providing the right tools, resources and support to keep our customers competitive and sustainable.

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