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MLR *FLASH*

Spread Pricing and Rebates in Medical
Loss Ratio Reporting

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SPREAD PRICING AND REBATES IN MEDICAL LOSS RATIO REPORTING: RESPONSIBILITIES FOR STATES, MANAGED CARE ORGANIZATIONS AND SUBCONTRACTORS

As State Medicaid programs continue to wrestle with the high cost of prescription drug coverage, the Centers for Medicare & Medicaid Services (CMS) has released guidance intended to bring more transparency to pharmacy costs incurred by managed care organizations (MCOs) and their subcontracted Pharmacy Benefit Managers (PBMs).

CMS released an informational bulletin entitled “Medical Loss Ratio (MLR) Requirements Related to Third-Party Vendors” on May 15, 2019. CMS clarified how Medicaid programs should treat payments to subcontractors such as PBMs when calculating an MCO MLR.

Specifically, the CMS guidance addressed ambiguity regarding spread pricing and rebates retained by PBMs for MLR categorization. Spread pricing is the difference

between what PBMs pay pharmacies for a drug and the higher amount the state reimburses them for that same drug.

CMS took an explicit stance on the reporting of PBM spread pricing, which will impact MCOs that have been including both the spread and pharmacy provider payment as medical expense in reporting MLR. This new guidance is expected to lower the reported MLR for affected MCOs because the costs associated with spread are now excluded from medical.

Beyond PBMs, CMS stated MCOs must require any third-party vendor providing claims adjudication activities to provide all underlying data associated with MLR reporting to the MCO to calculate and validate the accuracy of MLR reporting. Therefore, a vendor's refusal to provide data identifying amounts paid to providers would violate 42 CFR 438.8(k)(3).

STATE RESPONSIBILITIES

Ensuring MCOs are providing all necessary data for the MLR calculation.

Routinely auditing reported data and MLR calculations to ensure appropriate classification of reported revenues and expenditures.

MCO RESPONSIBILITIES

Accurately calculate, validate, and report the MLR calculation:

- The numerator is the sum of incurred claims, expenditures for activities that improve health care quality and fraud reduction activities.
 - The denominator, adjusted premium revenue, is calculated as premium revenue minus federal, state, and local taxes and licensing and regulatory fees.
 - Require any third-party vendor or subcontractor providing claims adjudication activities to provide all underlying data associated with MLRs.
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SUBCONTRACTOR RESPONSIBILITIES

If not already doing so, subcontractors must report sufficient detail to the MCO for MLR reporting. For PBMs, the amount paid to pharmacy providers must be separately identified from the amount retained by the PBM as the spread.

Prescription drug rebates received by the PBM must be deducted from the cost of the incurred claims, regardless of whether the entire amount of the rebate is passed on to the MCO either directly or indirectly.

Also, PBMs must report and classify all other expenditures incurred under subcontract with the managed care plan, such as activities that improve health quality, administrative services, and taxes and fees associated with the prescription drug benefit or associated with any other Medicaid Covered services administered by the plan.

NEXT STEPS

States should review MLR instructions and reported MLR calculations from MCOs with rating periods beginning on or after July 1, 2017, to ensure compliance with this CMS guidance.

In instances where MCOs have subcontracted services such as dental, vision or pharmacy benefits, the MCOs should ensure contract requirements, with the subcontractors, include provisions to report incurred claims and non-benefit costs per federal regulations and guidance.

Links to the relevant CMS communications and Mercer's article on PBM Spread Pricing are provided for additional detail.

CMS Press Release for “CMS Issues New Guidance Addressing Spread Pricing in Medicaid, Ensures Pharmacy Benefit Managers are not Up-Charging Taxpayers”

<https://www.cms.gov/newsroom/press-releases/cms-issues-new-guidance-addressing-spread-pricing-medicaid-ensures-pharmacy-benefit-managers-are-not>

“Medical Loss Ratio (MLR) Requirements Related to Third-Party Vendors”

<https://www.medicaid.gov/federal-policy-guidance/downloads/cib051519.pdf>

Mercer GHSC Newsletter article on PBM Spread:

<https://www.mercer-government.mercer.com/content/dam/mercero-subdomains/us-government/attachments/newsletter-articles/Mercer%20Article%20-%20PBM%20Spread%20January%202019.pdf>

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