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SPREAD PRICING AND REBATES IN MEDICAL LOSS RATIOS

Responsibilities for States, MCOs and Subcontractors

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The Center for Medicare and Medicaid Services (CMS) established a clear stance on how Medicaid managed care organizations (MCOs) should treat vendor costs in medical loss ratio (MLR) reporting, including pharmacy benefit manager (PBM) spread pricing. The Affordable Care Act required MLR reporting for the private market and Medicaid Advantage plans, and CMS extended similar requirements to Medicaid MCOs via the 2016 Medicaid Managed Care Final Rule effective for rating periods starting on or after July 1, 2017. In their first MLR guidance since 2016, CMS clarified expectations for reporting administrative expenses for managed care subcontracted services, including pharmacy.

When the MCO's PBM contracted rate for prescriptions is higher than the rate the PBM pays network pharmacies, the difference is known as spread pricing, which the PBM retains as a form of payment for services performed. Also, PBMs often collect drug manufacturer rebates on behalf of the MCO and may retain all or a portion of the rebates as additional compensation. CMS' recent press release and informational bulletin clarified that rebates accrued and received, either by the MCO or a PBM, are a deduction to incurred claims. They also explained how some third-party vendor costs and PBM spread are to be treated as administrative expenses for MLR reporting. The stated goal of the CMS guidance is to bring greater transparency to MCOs' real medical claims expense and payments to providers.

By categorizing retained rebates and spread pricing as administrative costs, CMS removed them from the numerator of the MLR calculation, where they were often included as medical expenses. This new guidance is expected to lower the reported MLR for affected MCOs because the costs associated with spread are now excluded from the numerator, which could trigger remittances to states and the federal government depending on the MLR requirements in the managed care contract.

Beyond PBMs, CMS stated MCOs must require any third-party vendor providing claims adjudication activities to show all underlying data associated with MLR reporting, such as the amount actually paid to providers, all rebates received, and any costs incurred for health care quality improvement (HCQI) activities that may be included in the numerator of the MLR calculation. If a subcontractor processes claims, there must be a portion of the amount paid to that subcontractor classified as an administrative expense and excluded from the MLR calculation.

WHAT THIS MEANS FOR STATES

States using a managed care delivery system must add an oversight step to MLR reporting to ensure their contracted MCOs are not reporting third-party administrative costs as medical expenses. Also, states may want to review their contracts with MCOs to ensure their MLR reporting meets definitions required by CMS, especially when there may be an MLR remittance.

WHAT THIS MEANS FOR MCOS

MCOs must review their third-party contracts for medical services such as pharmacy, dental, vision, transportation, or laboratory services, where the third party is processing claims. The contracts must include provisions to report the data necessary to report MLRs accurately as required by CMS. Mainly, MCOs must collect the amounts actually paid to providers, amounts paid for HCQI activities, all rebates, and any spread pricing. Then the MCOs must report their MLRs as defined by 42 CFR § 438.8:

- 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.

WHAT THIS MEANS FOR SUBCONTRACTORS

If not already doing so, subcontractors must report sufficient detail to the MCO for MLR reporting. Concerning 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. For all subcontractors processing claims, expenses related to administrative functions such as eligibility and coverage verification, claims processing, utilization review, or network development must be reported as administrative expenses.

Subcontractors must report and classify all amounts paid to providers, rebates received, and any other expenditures incurred under subcontract with the MCO, such as HCQI, administrative services, and taxes and fees associated with the prescription drug benefit or associated with any other Medicaid covered services so the MCOs can accurately report their MLRs to the state.

HOW MERCER CAN HELP

Mercer Pharmacy, Policy and Operations Services, and Reporting and Monitoring subject matter experts can review contracts and MLR reporting instructions for sufficiency under the new guidance. Mercer also performs desk reviews and audits of MLR reporting on behalf of states.

For more information on this topic or other services, please email us at mercer.government@mercer.com.