

PERSPECTIVES

PROVIDING INSIGHT INTO TODAY'S EMPLOYEE BENEFITS ISSUES

SPECIAL REPORT: Prescription Drug Costs and Your Employee Health Plan

Fourth Edition

Prescription Drug Spending Trends

Rising prescription drug costs are a primary cause of escalating overall spending on healthcare, and also represent an increasingly large portion of healthcare expenditures. Pharmaceutical research is continually providing treatment breakthroughs that should not be impeded, but the costs associated with this progress are beginning to and will continue to have a major impact on healthcare financing and delivery systems.

According to the Centers for Medicare & Medicaid Services (CMS) (formerly the Health Care Financing Administration/HCFA), overall national spending on healthcare has been rising steadily for over a decade, and will continue to rise sharply well into the new millennium. Overall healthcare expenditures were 8.8 percent of Gross Domestic Product (GDP) in 1980, and are projected to reach 18.4 percent of GDP by 2013.

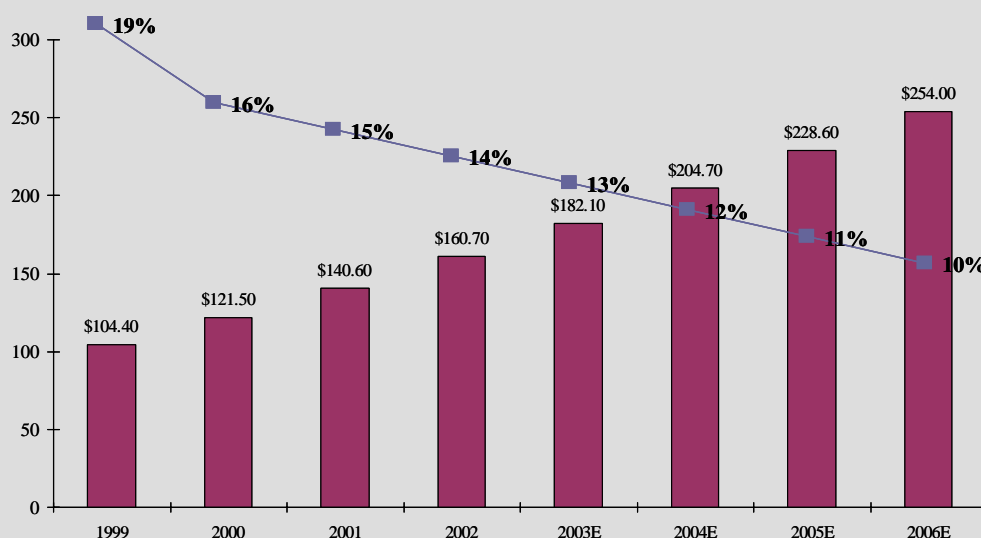
Prescription drugs are making up an increasingly large portion of those expenditures. Overall healthcare spending rose

7.3 percent from 2002 to 2003, while spending on prescription drugs rose 13.4 percent — more than any other personal health category.

Not all the news is bad, however. CMS does predict that while prescription drug spending has hit an all-time high, the upward trend may be slowing. Despite remaining the fastest-growing health expenditure category, drug spending has slowed over the last several years, from 19.7 percent in 1999 down to 13.4 percent in 2002. The deceleration is expected to continue throughout the 2003 – 2013 projection period due to slower growth in drug prices, the expiration in patent protection for several top-selling drugs, and increased use of multi-tiered copays that have slowed demand.

Exhibit 1, below, depicts overall drug spending from 1999 to 2006 (projected), as well as the percent change from year to year.

Drug Spending Continues to Increase, But Trend May Be Slowing



Note: 2003 – 2006 data are projections. Total Drug Spend includes uninsured expenditures.
Source: Centers for Medicare and Medicaid Services (CMS), 2003.

Exhibit 1

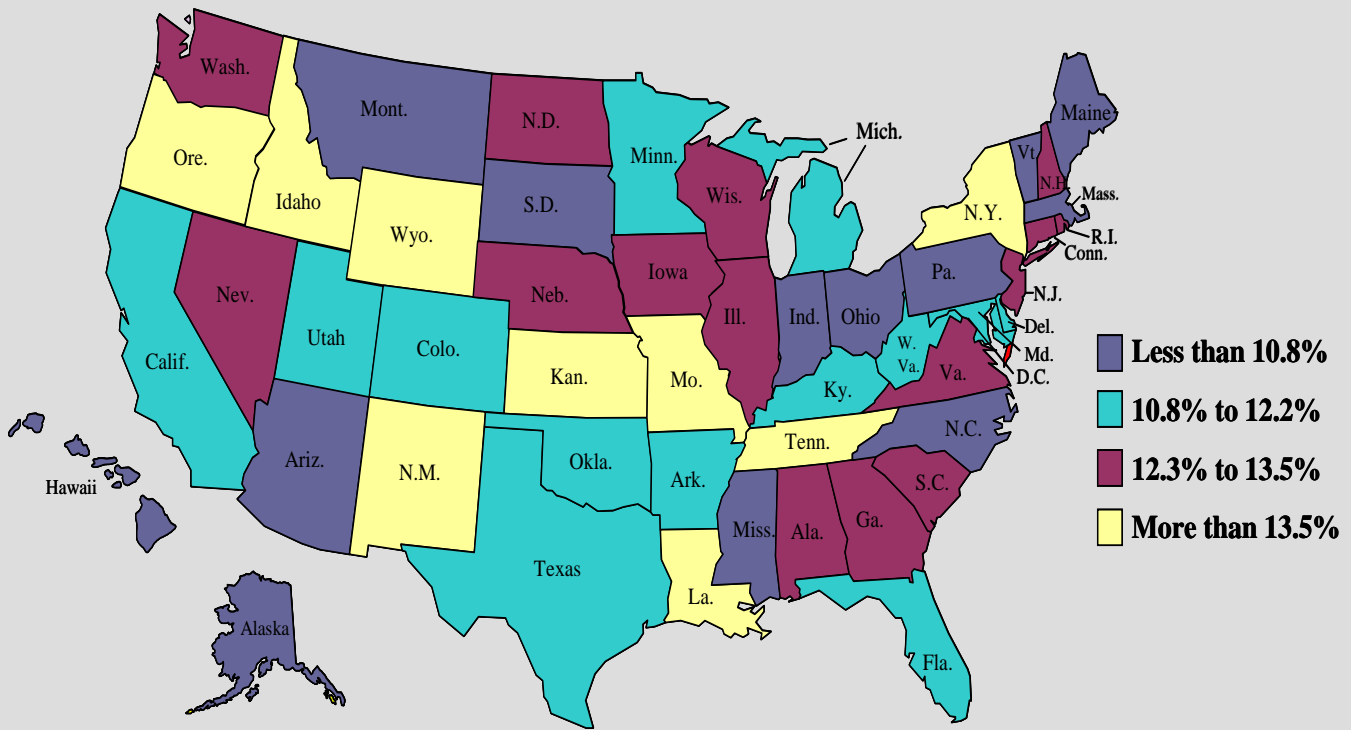
While overall U.S. sales in retail prescriptions were up 12.2 percent in 2002, research has shown there is wide variation in spending hikes on a state-by-state level. Alaska saw the lowest increase at just 6.7 percent, while New Mexico had the highest rate of growth at 21.3 percent. For most states, the increase in

total spending was caused more by growth in the average price per prescription, rather than by rising utilization.

Exhibit 2, below, depicts how the growth in prescription drug spending varied among states from 2001 to 2002.

Growth in Prescription Spending Varies Significantly Among States

Percent Change in Total Sales of Retail Prescriptions, 2001 – 2002



NOTES: This data comes from Verispan Scott Levin's Source™ Prescription Audit, which collects over 140 million prescriptions on a monthly basis from nearly 37,000 retail stores including chains, independents, mass merchandisers, and food stores. The sample covers 71% of all retail dispensing activity nationwide and 1,300 regional zones to ensure the measures are not biased by regional differences in the prescription marketplace (e.g., managed care penetration, PBMs, state-level controls).

DEFINITIONS: Prescriptions: All products dispensed in retail pharmacies, including new prescriptions and refills. These products do not include medicines purchased without a prescription (i.e., over-the-counter items).

SOURCE: The Kaiser Family Foundation, State Health Facts Online. Data Source: Verispan Scott-Levin, Source™ Prescription Audit: Special Data Request, 2003.

Impact on Health Plans and Employers

The fast and steep ascent of the cost of prescription drugs is undoubtedly having an impact on insurance carriers and managed care organizations, and consequently on employers who sponsor employee health plans. Prescription drug costs have become a major component of health plan costs, with managed care plans hit especially hard because of the generous drug benefits they tend to provide.

CMS reports that prescription drug expenditures make up 11% of overall national health expenditures, and project that figure to reach 14.5% by 2012. Recognizing this trend, payers and plan sponsors have moved toward more aggressive plan designs — like higher copayments or three-tier copayment plans — that shift more of the cost burden to members.

AdvancePCS's latest analysis, *Health Improvement Report Summer 2003*, finds that plan sponsors who have adopted cost sharing and utilization management techniques are experiencing lower rates of drug spending.

Driving Forces

Pharmaceutical costs are rising due to a variety of factors that can be linked to two major driving forces: the increased flow of new drugs to market, and increased utilization.

Flow of New Drugs to Market

A primary force behind the growth of overall prescription drug spending is the introduction of new branded drugs to the marketplace. New drugs are classified as those approved by the Food & Drug Administration (FDA) since 1992. Expedited by a rise in the number of FDA new drug approvals, federally funded research, and growth in private research and development spending, the number of new drugs being introduced to the marketplace is greatly accelerating. These new drugs are often more effective than old therapies that they replace, yet this innovation bears a hefty price tag.

- ✓ According to the *Medical Cost Reference Guide* developed by the BlueCross BlueShield Association in June 2003, new and pipeline drugs account for a majority of prescription drug spending growth. In 2002, existing drugs accounted for only 3.6% of drug spending growth, while new and pipeline drugs accounted for 10.6% of the growth in drug spending.
- ✓ AdvancePCS reports that the number of new drugs entering the market appears to be increasing, especially high-cost biotech drugs. In 2002, the U.S. Food and Drug Administration (FDA) approved 78 new drugs, nearly 20 percent more than in 2001. The year 2002 also saw the greatest number of approvals for biotech drugs and vaccines in a single year; the FDA approved 35 new biotech drugs and vaccines or new indications for biotech therapies — up from 24 in 2001.

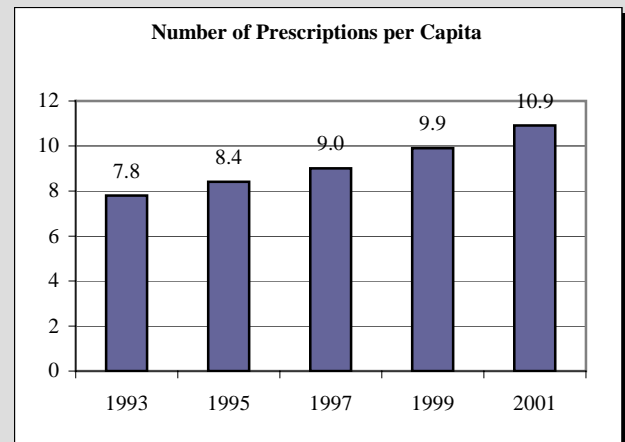
Increased Utilization

It is a fairly simple concept: more people are using more prescription drugs, thereby driving overall spending upward. The number of prescriptions dispensed has been growing dramatically

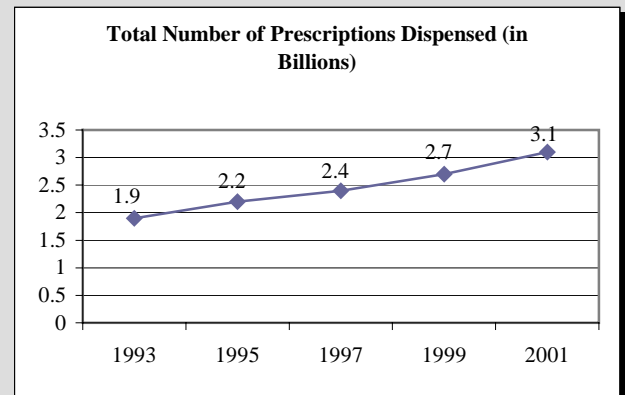
from 1992 to the present, and is projected to continue at a similar pace for years to come.

Exhibits 3A and **3B**, below, illustrate the growth in the number of prescriptions per capita and total prescriptions dispensed from 1993 to 2001.

A



B



Source: Adapted from National Institute for Health Care Management, 2002; U.S. Census Bureau, 2002, as reported in BlueCross BlueShield Association *Medical Cost Reference Guide*, Revised June 2003.

There are a number of reasons for the growth in utilization of prescription drugs. They include the following.

INSURANCE COVERAGE FOR PRESCRIPTION DRUGS

Individuals with insurance are more likely to use prescription drugs than those without, and the growing prevalence of managed care plans — which often offer generous drug benefits — has fueled greater drug utilization. Only 10% of drug costs were funded by third party coverage in 1970; in 2003, private health insurance paid for 50% of drug costs. Likewise, consumers paid for 80% of drug costs out-of-pocket in 1970; currently out-of-pocket funding accounts for only 40% of drug costs.

THE AGING OF AMERICA

As discussed earlier in this article, Americans are growing older and are expected to live longer than ever before. With this general aging of the population there is a higher incidence of

chronic disease, and a resultant increase in the use of pharmaceuticals to treat those conditions. This demographic trend is the leading cause of increased utilization of prescription drugs.

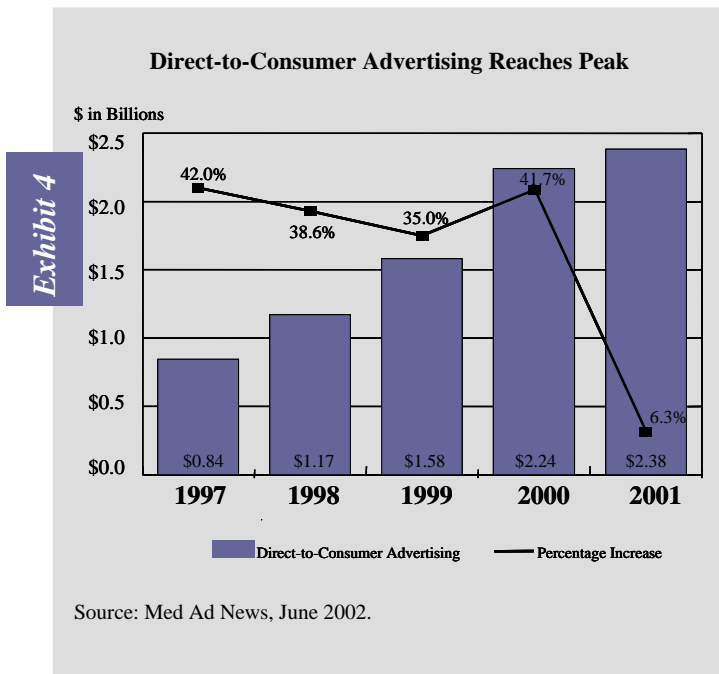
AGGRESSIVE DIAGNOSIS AND TREATMENT METHODS

New technology and clinical protocols have brought increasingly aggressive diagnosis and treatment methods, and a greater emphasis on preventive measures. Pharmaceuticals often play a primary role in these more aggressive ways of diagnosing and treating diseases.

PHARMACEUTICAL MARKETING

In 1985, the FDA lifted its moratorium on direct-to-consumer (DTC) advertising of prescription drugs. Prior to this change, pharmaceuticals were marketed solely to physicians and other medical professionals. Now, prescription drugs have become one of the most highly marketed product categories, with spending on DTC advertising of prescription drugs growing from \$55 million in 1991 to \$1.58 billion in 1999. Many feel this promotional push is creating inappropriate consumer demand that is contributing to unnecessary utilization. In addition, critics of the drug companies charge that pharmaceutical prices could be lower if exorbitant amounts of money were not being spent on advertising.

Exhibit 4, below, shows how DTC ad spending for prescription drugs has more than doubled since 1997. It should be noted, however, that from 2001 to 2002, DTC advertising of pharmaceuticals decreased for the first time in decades, from \$2.77 billion in 2001 to \$2.71 billion in 2002.



Ad spending for prescription drugs has more than doubled since 1997.

What Can Employers Do?

Several opportunities exist to help you keep your employee health plan's prescription drug costs in control. Through careful analysis and consideration, and with the advice of your benefits consultant, you may decide that one or several of the following cost saving tools is right for your particular needs.

- ✓ **Offer a plan with an open formulary.** The open formulary encourages the use of appropriate, cost-effective prescription drugs through physician education, voluntary therapeutic substitution, member communication, and by higher copayment requirements for non-formulary drugs.
- ✓ **Offer a plan with a closed formulary.** The closed formulary excludes coverage for certain drugs.
- ✓ **Increase coinsurance or copayments.** Sharing costs with employees encourages more responsible drug utilization by increasing patient sensitivity to drug costs.
- ✓ **Require generic substitution.** Requiring employees to substitute appropriate generic medications for more expensive brand-name drugs will have a substantial impact on your plan's prescription drug spending.
- ✓ **Offer a plan that utilizes therapeutic/pharmacy interventions.** This means that utilization of preferred drugs is encouraged over non-preferred drugs when clinically appropriate.
- ✓ **Make utilization management a part of your prescription drug plan.** This includes measures such as prior authorization, step therapy, and managed drug limitations such as restricting refills for certain medications depending upon clinical guidelines.
- ✓ **Use a narrower pharmacy network.** Greater discounts can often be achieved by using a narrower network.
- ✓ **Offer a mail order drug benefit.** Mail service pharmacies can generally negotiate deeper discounts from drug wholesalers and manufacturers than retail pharmacies can. These savings can be passed on to the payer.

Clearly there are many options to explore if you are trying to better manage your health plan's prescription drug costs. And again, educating your employees about the reasons for rising drug costs and their impact on your health plan will be the key to successfully introducing changes to your plan or the out-of-pocket amounts required of your employees.

Perspectives is provided to IPG Employee Benefits clients for informational purposes. Please seek qualified and appropriate counsel for advice on how to apply the topics discussed herein to your employee benefits plan.