



**“Fourth Tier”
Benefit Designs:
How Do We Get
Out of This Box?**

THE MORAN COMPANY

Fourth Tier Benefit Designs: How Do We Get Out of This Box?

Given the evolution of pharmacy benefits management designs:

- Fourth tier designs were probably inevitable.
- Tier One motivated generic substitution, but did nothing on branded pricing.
- Tiers Two & Three enforced favorable rebate agreements on the branded side.
- Tiering has become universally loved in the benefits management industry as a politically palatable alternative alternative to command-and-control regulation.

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Hence when very high cost drugs began appearing in this decade:

- A fourth tier coinsurance scheme seemed a natural extension of prior policy.
- Why take the heat for denying drugs for patients when you can just let them talk themselves out of it?
- Given prospects for heavy off-label use, the need for some defense mechanism was understandable.
- Hence the “fourth tier” model quickly became ubiquitous in drug benefit designs.

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What's the problem?:

- The policy question concerns the optimal way to finance very low frequency, very high cost events.
- They taught me in grad school that this sort of risk should optimally be pooled through insurance mechanisms.
- The problem with fourth tier benefit designs is that they “de-pool” a very large share of this risk, and pass it back to beneficiaries as a structured game of Russian Roulette.
- Those who lose this lottery lose everything.

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The challenge is that:

- Even if you agree with what I just said, the insurance market is not going to naturally evolve away from fourth tier benefit designs.
- The first insured plan to offer a plan without a fourth tier would attract profound unfavorable selection.
- Hence game theory predicts that no one will move.
- If you want to get rid of this problem, something else is going to have to happen.

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Now, there is some cause for optimism:

- Large employer plan sponsors have, over the last few years, gotten hip to the fact that this benefit design feature has the practical effect of producing random bankruptcies in their workforce.
- Such plans can act unilaterally without profound selection concerns – and are starting to do so.
- Public sector employer plans could also chart this course.
- In the insured market, however, the Prisoner's Dilemma continues.
- Small group and individual policies cannot escape this new equilibrium – unless they drop drug benefits altogether.

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In this sort of situation:

- Those not totally averse to government intervention in markets may be motivated to intervene.
- Strictly speaking, there are two basic flavors of non-market interventions that might be efficacious:
 - ❖ Regulatory prohibitions on fourth tier benefit designs;
 - ❖ Subsidy schemes that buy down the risk now held by beneficiaries.
- Each approach has some issues with which to wrestle.

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On the regulatory side:

- A Federal solution for this interstate problem is complicated by the fact that insurance regulation (particularly in the individual and small group markets) is State-centered.
- While the HIPAA statute provides a theoretical handle, there is no practical way for the Feds to tidily insert themselves as a policymaker in narrow corners of a State-designed regulatory regime.
- Coming up with an operationally-workable definition of what is being regulated could be difficult, and it would be impossible to regulate surrogate benefit design elements that accomplished the same objective – limit coverage for high cost drugs – outside the boundaries of whatever line was drawn.

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In terms of subsidy schemes:

- The general idea would be a federally-supported program that reinsured this risk for carriers willing to eliminate the fourth benefit tier.
- The delivery model could be a free-standing federal program – or subsidies (direct or through tax policy) for private reinsurers to play this role.
- Operationally defining what constituted “this risk” would not be simple.
- Large employers might want to climb on board this train as well, substantially increasing the cost.

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Net assessment:

- The fourth tier problem is real, and won't cure itself.
- While large employers are reversing trend, some residual problem will remain.
- Technical tools are available to address the remaining problem – but would have to be complex to avoid gaming (which may not actually be avoidable).
- At the end of the day, the choice of Federal policy in this area – including the choice of whether to do anything at all -- is a matter of personal taste...
- As a small, insured employer, I personally would be willing to pay the incremental premium for a drug benefit without a fourth tier.