Pharmacy Program Management: Pitfalls, Challenges, and Best Practices
October 2, 2017

About Solid Benefit Guidance

- SBG is a unique benefits consulting firm with a specialty practice in pharmacy benefits.
- We engage with clients that collectively manage over 60,000,000 covered member lives.
- Our experts have a combined 450+ years of INSIDER Rx/PBM experience.
- We have complementary skill sets in all aspects of pharmacy and healthcare management.
- SBG was acquired by Gallagher Benefit Services in June 2015.

The Current Landscape: Prevailing Themes

- Specialty drug costs continue to escalate, with no easy solutions in sight.
- The PBM business model is convoluted, and incentives are misaligned.
- A highly consolidated PBM sector leaves fewer retail options and diminished competition.
- Questionable pricing and promotion tactics have deteriorated trust in the supply chain.
- A shifting political and regulatory climate creates uncertainty about the future.
Drug Prices Are Outpacing CPI

INCREASES IN THE CONSUMER PRICE INDEX, 2008-2016

Many Factors Contribute to Drug Price Inflation

BRAND DRUG PRICE INFLATION FACTORS
- Increased demand for rebates and other incentives
- Funding for coupons and patient assistance
- Subsidization of global pharmaceutical economics
- Escalating R&D costs and increased investment risk

GENERIC DRUG PRICE INFLATION FACTORS
- Manufacturer M&A and reduced competition
- Opportunistic price manipulation
- Sluggish ANDA approval by the FDA
- Volatility of costs for drug ingredients

The Pharmacy Supply Chain: Follow The Dollars (Cash Price)

- WAC = Wholesale Acquisition Cost (determined by Manufacturer).
- AWP = Average Wholesale Price (contains WAC).
- May incorporate fee charged to pharmacy to cover administrative costs of the process, e.g., dispensing fee for applause drug.
- Flow of money may vary considerably based on type of drug (i.e., generic, specialty) and unique prescription characteristics (i.e., mail order, 340B).
The Pharmacy Supply Chain: Follow The Dollars (PBM Deal)

- WHOLESALER
- MANUFACTURER
- PLAN SPONSOR
- (EMPLOYER)

- Member
- Cost Share

- Retailer Payment
- (WAC-based)

- Wholesaler Payment
- (WAC-based)

- Claims Costs
- (AWP-based)

- Rebates
- (Partial Pass-Through)

- Monthly Contribution

- Multiple Revenue Streams:
  - Formulary & Market Share Rebates
  - Rebate Administrative Fees
  - Clinical Program Funding
  - Inflation Protection Payments
  - Data Sale & Research Payments

- Claims Reimbursements
- (AWP-based)

- Flow of Product

- WAC = Wholesale Acquisition Cost (determined by Manufacturer).

- AWP = Average Wholesale Price (multiplier of WAC).

- Infographic is reflective of typical monetary flow for an oral, single-source branded product under a traditional PBM deal with partial pass-through of rebate revenue.

- Flow of money may vary considerably based on type of drug (i.e. generic, specialty) and unique prescription characteristics (i.e. mail order, 340B).

PBMs: A Diversified Revenue Model

- BASE FEES
- CLIENT FEES
- CLIENT REBATE
- PHARMA REVENUE

- RETAIL NETWORK
- DISPENSING ASSETS

A Heavily Consolidated Industry

- Estimated PBM Market Share, 2016

- Express Scripts 30%
- CVS Health 20%
- CIGNA 12%
- Humana 7%
- Aetna 6%
- OptumRx 5%
- Prime Therapeutics 5%
- MedImpact 4%
- Envision 1%
- All Other < 1%
Searching for A Better Way to Price Drugs

- Outcomes Based: Higher rebate paid on Repatha if patient’s LDL outcome is not in line with clinical trial results.
- Event Based: Higher rebate paid on Entresto if the incidence of heart attacks is not reduced in the population.
- Indication Based: Price of several oncology drugs varies based on effectiveness for specific indications.

Copay Cards: By The Numbers

- There were 75 drugs that had copay cards in 2009. By 2015, there were 700 drugs.
- An estimated 80% of specialty drug products currently have copay card programs available for them.
- Copay cards were used in 10% of all prescriptions in 2015, and this figure is increasing.
- One study suggests there will be $32B in additional healthcare costs generated by copay cards over the next decade.

Levers of Rx Program Management

- PRICE NEGOTIATION: Request for Proposal, Renegotiate, Market Check
- UTILIZATION MANAGEMENT: Clinical Programs, Prior Authorization, Formulary Review
### Three Options for Price Negotiation

<table>
<thead>
<tr>
<th>Option</th>
<th>What is it?</th>
<th>When does it typically occur?</th>
<th>What value does it generate?</th>
</tr>
</thead>
<tbody>
<tr>
<td>REQUEST FOR PROPOSAL</td>
<td>Competitive procurement with multiple bidders.</td>
<td>End of any contract term</td>
<td>5% to 12% savings*</td>
</tr>
<tr>
<td>RENEWAL</td>
<td>Price concessions for extension of contract term.</td>
<td>End of initial contract term</td>
<td>3% to 6% savings*</td>
</tr>
<tr>
<td>MARKET CHECK</td>
<td>Benchmark-driven mid-term renegotiation.</td>
<td>Every year</td>
<td>2% to 4% savings*</td>
</tr>
</tbody>
</table>

* Savings measured as a % of gross program cost

### What Drives the Selection of a PBM?

**Top Factors for Selecting a PBM**

<table>
<thead>
<tr>
<th>Factor</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>5.4</td>
</tr>
<tr>
<td>Customer Service</td>
<td>4.8</td>
</tr>
<tr>
<td>Transparency</td>
<td>4.7</td>
</tr>
<tr>
<td>Pharmacy Networks</td>
<td>4.1</td>
</tr>
<tr>
<td>Formulary</td>
<td>3.7</td>
</tr>
<tr>
<td>Value-Added Services</td>
<td>3.3</td>
</tr>
<tr>
<td>Performance Guarantees</td>
<td>2.8</td>
</tr>
</tbody>
</table>

*Factors ranked from 1 to 7, with 1 being the most important. Data from J.P. Morgan Pharmacy Benefits Survey, December 2015.

### Carve-In vs. Carve-Out

- Larger plan sponsors are more likely to carve-out the PBM relationship.
- States with dominant health plans (e.g., BCBS) have higher carve-in rates.
- We have seen a recent uptick in large employer interest around carve-in options.
- Pricing of carve-in deals continues to lag vs. carve-outs, with occasional exceptions.
- Uncertainty in the landscape (Anthem, Aetna, Cigna, etc.) may create a headwind for carve-in sales.

**Type of Relationship with PBM**

- Overall: 55%
- Larger: 61%
- Small: 38%
- With PBM entity: 61%
- Through administrator: 38%
PBM Underwriting & Contracting

- The PBM bidding and pricing process is extremely complex.
- Like any high volume, low margin business, the "fine print" is where the money is made.
- PBM’s capitalize on constant movement within the industry and the use of optics to improve margins.
- All deals are situationally priced.
- Specialty pricing is playing an increasingly important role in total cost outcomes.
- "Business Transparency" is used (and misused) widely in the industry, with mixed success.
- Most pricing "gimmicks" play games with weighted averages by manipulating definitions.

Pricing Optics Example: Guarantee Offsetting

- Offsetting allows PBMs to avoid paying out on "missed" guarantees during the year-end reconciliation by overachieving on others.

<table>
<thead>
<tr>
<th>Channel</th>
<th>Drug Type</th>
<th>AWP</th>
<th>Performance</th>
<th>Contract %</th>
<th>Surplus/ (Shortfall)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>Brand</td>
<td>$28,000,000</td>
<td>16.20%</td>
<td>15.00%</td>
<td>$360,000</td>
</tr>
<tr>
<td>Retail</td>
<td>Generic</td>
<td>$30,000,000</td>
<td>77.00%</td>
<td>76.00%</td>
<td>($300,000)</td>
</tr>
</tbody>
</table>

At year end, client is owed...

- Offsetting Allowed: $0
- Offsetting Not Allowed: ($300,000)

Rebate Guarantee Loopholes & Exclusions

- A full pass-through of "Rebates" likely does not capture all of the revenue that the PBM receives from pharmaceutical companies.
The Nuances of “Transparency”

...for many PBMs means a pass-through of “A Rate”, not necessarily the “Best Rate”

Example: These prescriptions were filled at the same pharmacy on the same day with two different plans that both had “transparent deals” with the same PBM:

<table>
<thead>
<tr>
<th>Date of Service</th>
<th>Pharmacy Name</th>
<th>NDC</th>
<th>Name</th>
<th>Qty</th>
<th>AWP</th>
<th>Eng. Cost</th>
<th>Discount</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>07/08/2011</td>
<td>Blinded</td>
<td>68180051703</td>
<td>lisinopril 40mg</td>
<td>30</td>
<td>$46.24</td>
<td>$12.90</td>
<td>72%</td>
<td></td>
</tr>
<tr>
<td>07/08/2011</td>
<td>Blinded</td>
<td>68180051703</td>
<td>lisinopril 40mg</td>
<td>30</td>
<td>$46.24</td>
<td>$15.50</td>
<td>66%</td>
<td></td>
</tr>
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</table>

Beware of Optical Illusions

Trends in Pharmacy Plan Design

- Hybrid plan designs (combining copays and coinsurance) are becoming more popular.
- Exclusion-based formularies are now ubiquitous.
- Mandatory generic policies are commonplace.
- Separate tiers for specialty drugs may be used.
- Mandatory mail order is common, particularly for specialty drugs.
- Narrow retail network strategies may be used, but don’t often generate huge value.

Prescription plan includes copays, coinsurance or both

<table>
<thead>
<tr>
<th>Categories</th>
<th>Rate</th>
<th>Copay/Percentage</th>
<th>Coinsurance</th>
<th>Both</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-$250</td>
<td>25%</td>
<td>25%</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>$251-$500</td>
<td>20%</td>
<td>20%</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>$501-$750</td>
<td>15%</td>
<td>15%</td>
<td>85%</td>
<td>15%</td>
</tr>
<tr>
<td>$751-$1000</td>
<td>10%</td>
<td>10%</td>
<td>90%</td>
<td>10%</td>
</tr>
</tbody>
</table>

The “Old” Plan Management Toolbox

- Most plan sponsors have a comprehensive set of basic management protocols in place.
- PBMs tend to sell these as “bundled”, fee-based solutions.

Use of Utilization Management Tools

New Tools for New Challenges

Management programs tend to support the PBM’s underlying business model.

A Checklist for Plan Managers

- Run a competitive bid process (RFP) every 3 years.
- Conduct annual Market Checks, if permitted.
- Periodically update your plan design, to keep pace with drug price inflation.
- Optimize clinical programs, such as those designed to curb potential Fraud, Waste, and Abuse.
- Develop and maintain a specialty drug management strategy across your benefits.
- Periodically audit your plan, especially pricing terms.