

Next Generation PBM Strategies

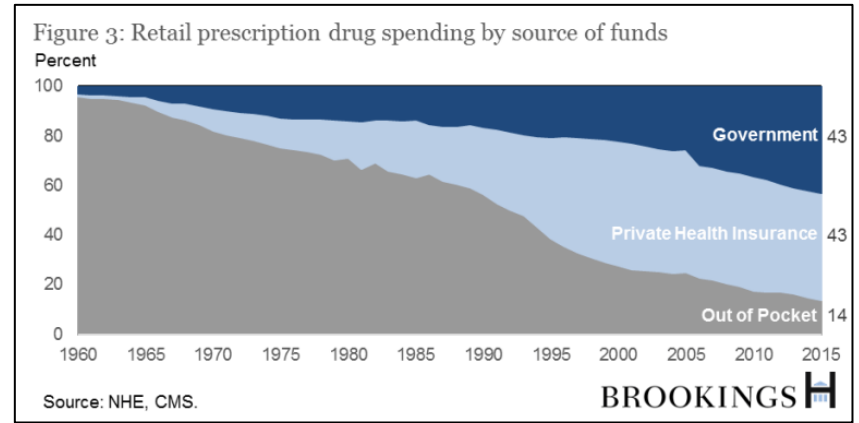
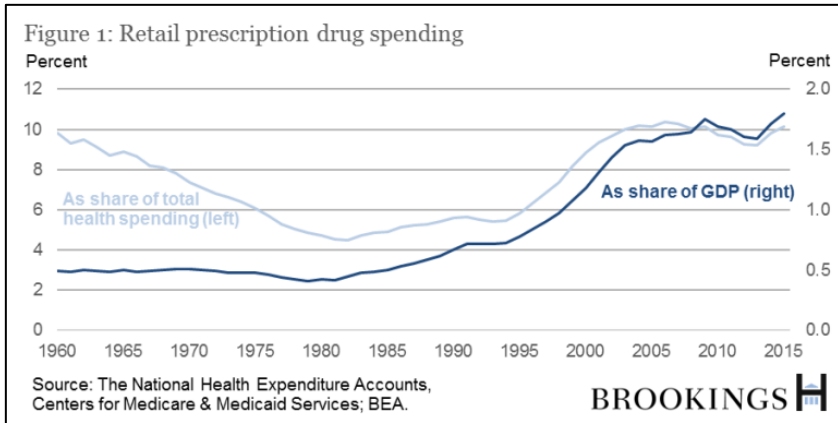
From Opaque to Transparent in
60 Minutes

October 4, 2017

DONN & COMPANY

I. PBM Overview

- ❖ Financial impact of pharmaceuticals = 10-20% of total medical.



I. PBM Overview

- ❖ PBM pricing competitiveness is highly variable.
- ❖ PBM service components (expanded over 25yrs):
 - Drug discounts
 - Formulary
 - Program reporting/data analytics
 - Clinical management
 - Ancillary channels (mail order, specialty drugs)
- ❖ Superior performance = optimized services AND optimized pricing.

I. PBM Overview

❖ Terms

- AWP = drug “sticker price”
- Passthrough Pricing = your cost is the same as PBM’s cost with pharmacy (plus a fixed per-Rx fee). Transparent, piggybacks increased PBM buying power.
- MAC list = PBM proprietary pricing arrangements
- Rebates = also includes manufacturer-derived revenue or “MDR”
- Integration = PBM and health plan/TPA, group health and WC

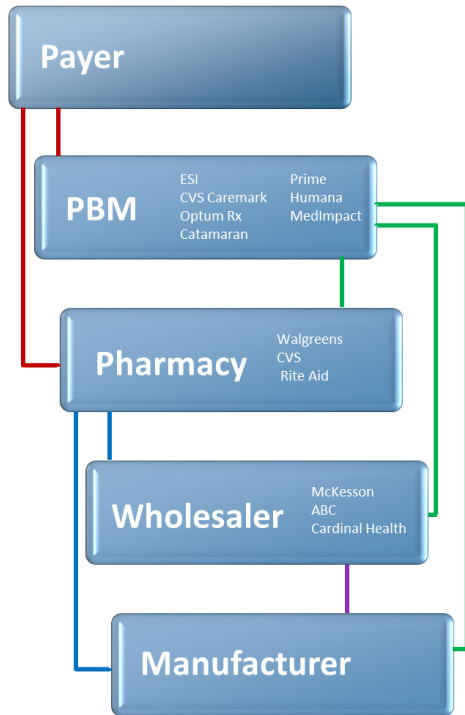
I. PBM Overview

❖ Differences between Group Health and WC

- Program size (GH typically 7-8x larger spend)
- Pricing
- Drug classes (full spectrum of disease/conditions vs. pain)
- Controls and formulary (financial incentives vs. compensability)
- Adherence vs. Dependence
- Specialty drugs (35-40% of spend for group health, nominal for WC)

I. PBM Overview

The Rx Value Chain



CONSOLIDATION (to increase price leverage)

- PBM acquisitions (ESI/Medco, SXC/Catalyst Rx)
- Wholesaler acquisitions (McKesson/Celesio)
- Pharmacies acquisitions (many by Walgreens, CVS)
- Pharmacy/Wholesaler alliances (Walgreens/Alliance Boots, CVS/Cardinal Health)

VERTICAL INTEGRATION (to add revenue streams and ways to expand margins)

- PBMs as pharmacies (Mail order, specialty)
- Wholesalers as pharmacies (franchises, PSAO group selling orgs)
- Pharmacies as networks (Direct to consumer programs)
- Pharmacies as clinics

I. PBM Overview

The Largest PBMs

Group Health	WC
Express Scripts (ESI) CVS Caremark Optum Rx Prime Humana Medimpact	Express Scripts (ESI) Optum Rx Healthsystems Mitchell Coventry FirstScript CorVel

I. PBM Overview



DONN & COMPANY

II. Optimizing PBM Deals

❖ Where do PBMs make money?

1. Price Spread (i.e. PBM pays pharmacy \$50 for Rx and bills payer \$100. But how much is your markup?)
2. MDR
3. Services (numerous components can be charged *a la carte*)
4. Verticalization (more revenue streams *and* more margin control)
5. *Watch out for abusive practices and contract pitfalls (see next slide)*

II. Optimizing PBM Deals

❖ Key Negotiation Point #1 – Price

- Optimal price levels vary by system (Group Health vs. WC).
- Passthrough pricing is rare in WC, more common in Group.
- Both AWP and Passthrough rates can work. Both also have loopholes that need to be closed (audit rights, price change contingencies).
- Target optimal pricing levels:

System	Brand drugs	Generic drugs
WC	AWP – 15%	AWP – 60% and up
Group Health	AWP – 22% or passthrough	AWP – 78% or passthrough

II. Optimizing PBM Deals

❖ Key Negotiation Point #2 – Contract Definitions

- **Brand vs. Generic.** Prevent PBM shifting generic drugs into more expensive Brand pricing (usually defined via the *Multi Source Code* in the MediSpan AWP database).
- **AWP source.** Prevent PBM cherry-picking the most expensive AWP source for any given drug (MediSpan vs. Redbook) and using pre-lawsuit AWP prices (inflated via collusion between AWP vendor and manufacturers).
- **MAC lists.** Prevent PBM from using one MAC list to pay pharmacies and another (more expensive) MAC to bill you.
- **MDR.** Prevent PBMs from hiding rebates under different MDR names (admin fees, data analysis fees).

II. Optimizing PBM Deals

❖ Key Negotiation Point #3 – SLAs

- SLA every key performance area (e.g. generic and network penetration, card issuance, call center, adherence, opioid use, etc.).
- SLAs must have financial teeth (penalties). Upside incentives are ok to include as well.
- Penalties should be material (at least 5% of PBM billings).
- Make the SLA cost predictable (i.e. fixed costs are the safest, but percent-of-fees formats are ok if PBM fees can be predicted reliably).

II. Optimizing PBM Deals

❖ Key Negotiation Point #4 – Audit Rights

- Twofold purpose: baselining an existing program, and validating contract adherence in a newly negotiated program.
- Allow no significant audit limitations (i.e. the number of transactions you may audit, the data points the PBM will provide, timeframes allowed for your audits, and the maximum number of audits you can perform during the contract term).
- For passthrough pricing, you must have the ability to verify the PBM's costs via their contracts with pharmacies.

III. Optimization Strategies

- ❖ #1 – Leverage your Health Plan/TPA/excess carrier's buying power
 - These large “institutional” buyers represent roughly 75% of PBM revenue in their respective systems.
 - Health plans and carriers in particular have superior pricing.
 - But will they share it with their customers? On occasion, if you have a unique relationship or leverage.

III. Optimization Strategies

❖ #2 – Pool buying power

1. Combining the buying power of multiple programs will significantly increased participants' negotiating leverage.
2. Buying blocks can be established in various ways:
 - Your own Group Health + WC programs
 - Sister agencies within the state
 - Larger multi-agency groups open to growing membership
3. Buying blocks can also offer flexibility:
 - Negotiate tiered pricing with PBM, so your pricing continues to improve as additional members join.
 - Deals can be established with 2-3 PBMs, giving participants a range of program and vendor choices.

III. Optimization Strategies

❖ #3 – Market or renegotiate your own program

- Most programs can extract material improvements when armed with strong market intel and a good negotiating strategy.
- Take inventory of your specific negotiating leverage (there is always some).
- Putting your program out to RFP will always motivate further improved offerings.
- Carving out your program is operationally manageable, and usually feasible under your health plan/TPA contract (you'll want to review your contract terms).