PBM Contracting: Are You Playing With a Full Deck?

Seth Friedman
Area Senior Vice President
Solid Benefit Guidance
(Arthur J. Gallagher & Co.)
Montvale, New Jersey

Josh Golden
Area Senior Vice President
Solid Benefit Guidance
(Arthur J. Gallagher & Co.)
Montvale, New Jersey
WAL*MART  GE  ExxonMobil  CVS Health  GM
UnitedHealth Group  COSTCO  at&t  McKesson
verizon  chevron  amazon  CardinalHealth  apple  Kroger
walgreens  Berkshire Hathaway inc.  ford  Fannie Mae
hp  EXPRESS SCRIPTS  AmerisourceBergen
WHOLESALER

RETAILER

PATIENT

MANUFACTURER

Flow of Product

Flow of Product

Flow of Product

Flow of Product

$ Wholesaler Payment

$ Retailer Payment

$ Member Cost Share

Claims Costs & Fees

Rebates

(Partial Pass-Thru)

Claims Reimbursements

Pharma Revenue

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

PLAN SPONSOR

(EMPLOYER)
PBM: A Diversified Revenue Model

- BASE ADMIN FEES
- ANCILLARY ADMIN FEES
- CLINICAL PROGRAM FEES
- FORMULARY & MARKET SHARE REBATES
- REBATE ADMIN FEES
- CLINICAL PROGRAM SUPPORT REVENUE
- INFLATION PROTECTION PAYMENTS
- DATA SALE AND RESEARCH REVENUE
- MARGIN ON RETAIL CLAIMS
- NETWORK PARTICIPATION FEES
- MARGIN ON MAIL ORDER CLAIMS
- MARGIN ON SPECIALTY CLAIMS

CLIENT FEES

PHARMA REVENUE

RETAIL NETWORK

DISPENSING ASSETS

$
PBM Underwriting and Contracting

- The PBM pricing process is **extremely complex**.
- Money is made in the “**fine print**”.
- Most pricing “**gimmicks**” play games with weighted averages by manipulating definitions.
- PBM们 capitalize on **constant movement** within the industry and the use of optics to improve margins.
- All deals are **situationally** priced.
- **Specialty** pricing is increasingly important.
- The notion of “**Business Transparency**” is used (and misused) widely in the industry.
Common Contracting Pitfalls

- Rebate Loopholes
- Guarantee Offsets
- Bad B/G Definitions
- Price Modification
- Faux Transparency
- Lack of Term Rights
- Audit Limitations
- 340B Exclusions
- Hidden Fees
- Inflation Protection
- Weak Service PGs
Contractual Definitions: *Every Word Matters!*

Q: Isn’t the difference between a Brand Drug and Generic Drug obvious?

- **Multi-Source Generics**
  - Achieved Discount of AWP – 75%

- **Single-Source Generics**
  - Achieved Discount of AWP – 40%

- **Single-Source Brands**
  - Achieved Discount of AWP – 16.5%

If defined as “Generics”, the network offer is:
- Brands: AWP – 16.5%
- Generics: AWP – 71.1%

If you’re a PBM, which offer would you put in a proposal?

If defined as “Brands”, the network offer is:
- Brands: AWP – 18.1%
- Generics: AWP – 75.0%
### Pricing Optics: 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>Discount Performance</th>
<th>Contracted Discount</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>$336,000</td>
</tr>
<tr>
<td>Retail</td>
<td>Generic</td>
<td>$30,000,000</td>
<td>77.00%</td>
<td>78.00%</td>
<td>($300,000)</td>
</tr>
</tbody>
</table>

If Offsetting is NOT PERMITTED, client is paid $300,000.
If Offsetting IS PERMITTED, client receives nothing.
Rebate Guarantee Loopholes

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

- Specialty Drug Rebates
- Rebate Administrative Fees
- 340B-Eligible Claims
- Generic Drug Claims
- Onsite Pharmacy Claims
- Low Day Supply Claims
The Nuances of Transparency

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

<table>
<thead>
<tr>
<th>Date of Service</th>
<th>Pharmacy Name</th>
<th>NDC11</th>
<th>Name</th>
<th>Qty</th>
<th>AWP</th>
<th>Ing. Cost</th>
<th>Discount</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>
</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>
</tr>
</tbody>
</table>

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!
Limited Termination Rights

A multi-year contractual commitment with fewer early termination provisions gives the PBM greater underwriting favorability.

Why might you want to terminate?

- Repeated service deficiencies
- Change in ownership of PBM
- Change in ownership of client
- Significant member disruption
- Inappropriate changes to pricing
- Discretionary termination
Lack of Market Check Provisions

The Market Check process ensures that your contract remains market-competitive in a rapidly evolving pharmacy landscape.

COMPONENTS OF A GOOD MARKET CHECK

✓ Client controls the evaluation
✓ Independent third-party involved
✓ Data-driven, based on real deals
✓ No savings threshold requirements
✓ Includes client termination rights
Audit Right Considerations

Standard PBM contract language may place significant limits on the client’s ability to effectively audit their plan.

- Limit to frequency of audits
- No re-audit of same time span
- Audit blackout periods
- Charges or fees for audits
- Only “approved” auditors allowed
- Slow response time commitments
A Closer Look At Inflation Protection

Pharma guarantees inflation caps on a drug-by-drug basis

- Pharma Company 1
- Pharma Company 2
- Pharma Company 3
- Pharma Company 4

The PBM guarantees inflation caps in the aggregate

- CLIENT A
- CLIENT B
- CLIENT C
- CLIENT D
- CLIENT E
There were 75 drugs that had copay cards on 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.
How PBM Are Addressing Copay Cards

- PBMs have **little or no control** over the use of coupons in the retail pharmacy setting.
- Most major PBMs can **adjust accumulators** to “back-out” the value of DTC funding for specialty drugs.
- Some PBMs offer **variable copay arrangements** that optimize the use of DTC funding for specialty drugs.

*Despite media and government scrutiny, most experts anticipate that copay card funding will continue to increase over the next three years.*
Beware of Optical Illusions
Carefully review your current PBM agreement, to identify gaps or issues.

Conduct regular Market Checks, to optimize pricing.

Issue an RFP (with multiple bidders) after every 3-year contract cycle.

Audit PBM financial performance metrics annually.
Thank You!

Questions?