



Arthur J. Gallagher & Co.
BUSINESS WITHOUT BARRIERS™

PBM Revenue Generation Secrets

HEALTHCARE ANALYTICS



TODAY'S AGENDA

- Brief background on the Prescription Benefits Manager (PBM) marketplace
- Basic Components of a PBM Contract
- How PBMs are exploiting contract language
- How to protect your company

THE PBM INDUSTRY HAS BEEN CONSOLIDATING

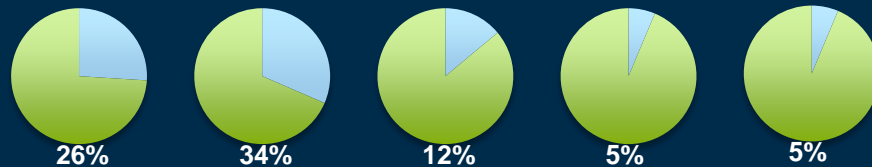
- As of 2013, the Top 3 PBMs controlled 72% of the market
- Leading industry PBM's are experiencing record profits, with many stocks are trading at all time highs
- There is marketplace choice and many PBMs are attempting to capture a piece of this \$284 billion dollar market
- Employer Rx spend remains excessive as the field of "truly independent" Rx advisors continues to shrink

PAST

- | | | | | |
|---|--|--|--|---|
| <ul style="list-style-type: none"> • PharamaCare (CVS) • Caremark • PCS • Advance Paradigm • RXAmerica | <ul style="list-style-type: none"> • Express Scripts • ValueRx • NextRx (Wellpoint) • DPS • NPA • Medico | <ul style="list-style-type: none"> • Prescription Solution/Optum • Medico Carve-in | <ul style="list-style-type: none"> • WHI • Catalyst • Future Scripts • RegenceRx • SxC • NMHC • HealthTrans | <ul style="list-style-type: none"> • Prime |
|---|--|--|--|---|



2013





POSSIBLE PLATFORM SOLUTIONS FOR AN EMPLOYER

Varying Delivery Models	Examples	Advantages	Concerns
Traditional PBM (carve - in)	Aetna & CVS/Caremark; CIGNA & Catamaran; UHC & Optum Rx; Some BCBS Plans & Prime Therapeutics	Integration of data	Higher base cost; contract issues; loss of control and misaligned incentives
Traditional PBM (carve - out)	CVSCaremark; Catamaran; Express Scripts; MedImpact; Optum Rx, etc.	Greater control and lower costs	Contract issues and misaligned incentives
Carve - out Pass-through PBM Model	Envision; Navitus, ProCare Rx, etc.	Greatest level of control, lower costs and aligned incentives	Lower rebate dollars
Purchasing Groups	Mercer Collation; Towers Watson Collaborative; industry groups etc.	Weight of group purchasing	Contract Issues; loss of control and misaligned incentives

THE PBM MARKET IS BEING MANIPULATED DUE TO A LACK OF OBJECTIVE OVERSIGHT

COMMON CONTRACT COMPONENT DIFFERENCES	EXAMPLE
Multiple definitions of AWP	Pricing Based on “actual” vs. “smallest” package size
Generic Drug Mix	Pricing Based on “actual” vs. “smallest” package size
Definitions of Brand and Generic for guarantee purposes	Can limit what is included as a generic for guarantee purposes
Delayed MAC Price	When a drug goes generic, the pass through savings can be delayed
Treatment of Zero Balance Claims	Claims that are less than the co pay can be treated as claims paid at 100% discount
Scope of the Rebate Program	May only apply to specified class of manufacturer rebate dollars; may include administrative and service fees.

HOW REBATES CAN MISALIGN PBM INCENTIVES

	Discounted Ingredient Cost	Rebate Generated	Client Rebate Amount	PBM Rebate Amount	Actual Drug Cost	Net Employer Cost
PBM 1: Brand Drug ABC	\$200	\$100	\$50	\$50	\$100	\$150
PBM 2: Brand Drug XYZ	\$150	\$25	\$25	\$0	\$125	\$125

In designing a formulary, PBM 1's financial incentives differ greatly from that of PBM 2

SAMPLE DEFINITIONS OF AWP

Bad

“Average Wholesale Price” or “AWP” means the average wholesale price of a prescription drug as identified by drug pricing services such as First Data Bank or other source recognized in the retail prescription drug industry selected by your PBM for all clients. The applicable AWP shall be the 11-digit NDC for the product on the date dispensed, and for prescriptions filled in (a) Participating Pharmacies will be the **AWP for the package size** from which the prescription drug was dispensed, and (b) in the Mail Service Pharmacy the AWP for the **smaller of**: (i) the NDC code for the package size from which the prescription drug was dispensed, or (ii) package sizes of **100 units or 16 ounce quantities, or the next larger quantity** if such specified quantities are not available.

Good

"Average Wholesale Price" or "AWP" shall mean the current dollar value assigned to a National Drug Code number as determined by the current edition of Medi-Span National Drug Data File including supplements as updated regularly by **Medi-Span, or another mutually agreeable industry standard reference** on which pricing and drug classification hereunder is based, for the actual package size dispensed. Your PBM will update AWP on a weekly basis.

WHICH DISCOUNT SHALL WE USE?

Example: Lipitor 20mg discounted to 3.79/ Tablet

SIZE	NDC	AWP PER TABLET	90 TABLET EMPLOYER COST	"ACHIEVED" DISCOUNT
100	0071-0156-40	\$5.40	\$341.65	29%
5000	00071-0156-94	\$4.93	\$341.65	23%
90	00071-0156-23	\$5.14	\$341.65	26%

Bad Practice: PBM will use the AWP from the **smaller** of the standard package size at mail of 100 units

Good Practice: Use the AWP from the actual bottle dispensed

VARYING DEFINITIONS OF BRAND AND GENERIC

Bad

“**Generic Drug**” means a prescription drug, whether identified by its chemical, proprietary, or non-proprietary name, that is therapeutically equivalent and interchangeable with drugs having an identical amount of the same active Ingredient(s) and approved by the FDA.

See MAC List. (P 27)



P27. “MAC List” means a list of prescription drug products identified as readily available as Generic Drugs, generally equivalent to a Brand Drug (in which case the Brand Drug may also be on the MAC List) and which are deemed to require pricing management due to the number of manufacturers, utilization and pricing volatility. Whether a Prescription Drug Claim processes at the Generic ingredient cost rates set forth on **Exhibit A-1** is subject to the Covered Drug’s inclusion on the MAC List and the application of “dispensed as written” protocols and Sponsor defined plan design and coverage policies.

Exhibit A-1

Pharmacy Reimbursement Rates

Participating Pharmacy Reimbursement Rates

Minimum 50,000 Participating Pharmacy Network

PBM 1 National Preferred Formulary
Sponsor-Owned Pharmacy
(excludes Specialty Products)

Brand Ingredient Cost

Single Source Generic Drugs are priced as brands

Year 1: Lower of AWP –17.25% or U&C

Year 2: Lower of AWP –17.50% or U&C

Year 3: Lower of AWP –17.75% or U&C
Pass-Through

Generic Ingredient Cost⁽¹⁾

Year 1: Lower of AWP –17.25%, MRA, or U&C

Year 2: Lower of AWP –17.50%, MRA, or U&C

Year 3: Lower of AWP –17.75%, MRA, or U&C
Pass-Through



Good

“**Generic**” shall mean and refer to Prescription Drug(s) designated as “Y” in Medi-Span’s Generic Product Indicator.

THE GENERIC RECLASSIFICATION GAME

- Many PBMs maintain separate tracking files – one strictly capturing how well the PBM performs relative to the guaranteed discounts as stated in the employer’s contract.
- Specific contract definitions (or lack there of) may allow the PBM to reclassify a generic drug as a brand drug.

EXAMPLE	AWP	PHARMACY DISCOUNT	INGREDIENT COST
Retail Brand	\$718,562.87	16.50%	\$600,000
Retail Generic	\$1,600,000.00	75.00%	\$400,000
Generic Subject to Reclassification	\$83,333.33	40.00%	\$50,000

Bad

GENERIC RECLASSIFIED AS BRAND

PBM 1	AWP	PHARMACY DISCOUNT	INGREDIENT COST
Retail Brand	\$801,896.21	18.94%	\$650,000
Retail Generic	\$1,600,000.00	75.00%	\$400,000

INFLATED DISCOUNTS ◀

GENERIC CLASSIFIED AS GENERIC

PBM 2	AWP	PHARMACY DISCOUNT	INGREDIENT COST
Retail Brand	\$718,562.87	16.50%	\$600,000
Retail Generic	\$1,683,333.33	73.27%	\$450,000

ACTUAL DISCOUNTS ◀

Good

Sample effect on reported discounts when reclassifying less than 5% of drug spend.

DELAYED MAC: OLANZAPINE (ZYPREXA)

(MAY AND JUNE OF 2012)

EFFECTS OF TRANSITION PRICING

	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	TOTAL
Net Rx	170	150	190	150	170	180	1,010
AWP	\$111,990	\$98,330	\$120,560	\$88,080	\$114,140	\$111,790	\$644,890
PBM 1	\$94,330	\$82,830	\$101,260	\$73,670	\$95,030	\$51,380	\$498,630
	16%	16%	16%	16%	17%	54.4%	23%
PBM 2	\$82,800	\$69,990	\$80,330	\$59,700	\$22,530	\$12,930	\$328,300
	26%	29%	33%	32%	80%	88.8%	49%
PBM2 vs PBM1 Savings	\$11,630	\$12,840	\$20,930	\$13,960	\$72,490	\$38,450	\$170,330

End of six month exclusivity

- When a brand becomes generic, the first generic drug often receives 6 months exclusivity.
 - Paragraph 4 of the patent application (Wax- Hatchman)
- Many PBMs consider that first generic to be a “brand” and it distorts discounts.
- When a brand becomes generic, the pharmacy is immediately paid at the generic rate.
- Many PBMs delay passing those deeper discounts to employers for several months

IMPACT OF ZERO DOLLAR CLAIMS

Plan Generic Copay: \$10.00

Claim #	AWP	Ingredient Cost	Dispensing Fee	Copay	Employer Pays	Actual Discount	Include Zero Balance Claim As Zero Pay
Drug 1	\$150.00	\$30.00	\$1.50	\$10.00	\$21.50	80%	80%
Drug 2	\$120.00	\$25.00	\$1.50	\$10.00	\$16.50	79%	79%
Drug 3	\$16.00	\$3.50	\$1.50	\$10.00	\$0.00	70%	100%
Drug 4	\$40.00	\$6.50	\$1.50	\$10.00	\$0.00	80%	100%
Drug 5	\$120.00	\$15.00	\$1.50	\$10.00	\$6.50	88%	88%
Totals	\$446.00	\$80.00	\$7.50	\$50.00	\$44.50	80%	85%

Note: A red circle labeled "Bad" is positioned over the "Employer Pays" column for Drug 1 and Drug 2. Red arrows point from this circle to the "Include Zero Balance Claim As Zero Pay" column for Drug 3 and Drug 4, which are highlighted with red boxes.

- When the copy exceeds the cost of a drug, many PBM's retain the difference.
- Including “zero balance claims” are increases the weighted average discount from 80% to 85%.

PBM CONTRACTING IS FRAUGHT WITH PROBLEMS LEADING TO INCORRECT SELECTIONS

Common PBM Advisor Missteps

- Misaligned incentives
- No accounting for the financial impact of PBM contract language
- Inability to track unit cost over time and independently confirm plan performance
- Lack resources to help clients achieve low net cost



*Rx advisors receiving non-disclosed income often struggle getting the same **FINANCIAL** commitment from each PBM.*



HOW DO YOU PROTECT YOURSELF AGAINST THESE BAD CONTRACTING PRACTICES?

- Review the contract **FIRST**, not last
- Value financial terms against there contract language
- Track unit costs and independently confirm performance
- Secure full audit rights