There are no good or bad solutions – however:

There is the ability to position a Plan Sponsor with the most optimal solutions related to contract terms and pricing to deliver the lowest net cost result along with control of their data

- Data is the most valuable Plan asset
  - Healthcare data
  - Prescription drug data
  - Clinical data
  - Any and all data from all sources
    - Must be assimilated in a manner that is conducive to measurable, statistical validation
    - Observational data is not typically valid nor to be relied upon for accurate assessment of cost and/or risk analysis
    - Subjective standards and measures lead to program components that do not serve (and increase cost to) the Plan Sponsor and its members
It all starts with data and contract language
Data is the most valuable Plan asset

Frequently, insurance carriers, competing brokers and other service providers create barriers for a Plan Sponsor to control and obtain their data.

- Definition of ownership of data has to begin with the Administrative Service Agreement (ASA)/Service Provider Contract
  - HIPAA’s privacy and security rules apply to covered entities
  - Covered entities are required to establish a HIPAA privacy and security infrastructure to protect personal health information (PHI)
  - Self-funded Plans are covered entities under HIPAA, and therefore, are required to maintain an infrastructure to protect PHI
  - Brokers, consultants and service providers are Business Associates to their clients who are covered entities under HIPAA and, as a Business Associate, are directly subject to the HIPAA privacy and security provisions

It all starts with data and contract language
Data is the most valuable Plan asset

Frequently, insurance carriers, competing brokers and other service providers create barriers for a Plan Sponsor to control and obtain their data.

- Definition of ownership of data has to begin with the Administrative Service Agreement (ASA)/Service Provider Contract
  - The Employee Retirement Income Security Act (ERISA) imposes fiduciary responsibilities on Plan Sponsors to operate and maintain the Plan in the best interest of the participants
  - Plan Sponsors, including Sponsors of self-funded Plans, are subject to those fiduciary obligations
It all starts with data and contract language
Data is the most valuable Plan asset

Frequently, insurance carriers, competing brokers and other service providers create barriers for a Plan Sponsor to control and obtain their data.

- Definition of ownership of data has to begin with the Administrative Service Agreement (ASA)/Service Provider Contract
  - The primary responsibility of fiduciaries is to run the Plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying Plan expenses
  - Fiduciaries may not engage in transactions on behalf of the Plan that benefit parties related to the Plan, such as other fiduciaries, services providers or the Plan Sponsor

- Fiduciaries that do not follow these principles of conduct may be personally liable to restore any losses to the Plan, or to restore any profits made through improper use of Plan assets
- The Plan’s ownership of, and entitlement to, its own data is supported and underscored by the fact that service providers specifically state in their agreements that they are not Plan fiduciaries, but rather provide services that are generally considered “ministerial” and not a “fiduciary” activity
It all starts with data and contract language

Data is the most valuable Plan asset

Frequently, insurance carriers, competing brokers and other service providers create barriers for a Plan Sponsor to control and obtain their data.

- Definition of ownership of data has to begin with the Administrative Service Agreement (ASA)/Service Provider Contract
  - Since service providers are serving at the direction of and not making discretionary decisions for the Plan Sponsor, ministerial functions are excluded from the definition of fiduciary
  - The definition of “ministerial” very clearly establishes a service provider is subservient to the Plan
    - In no way does it support the claim that certain data elements, created through the adjudication of services performed by the service provider on behalf of the Plan, entitle them to withhold information from the Plan or preclude them from disclosure of “proprietary information” unique to their organization

This relationship requires absolute obedience and loyalty from service providers to Plan Sponsors for whom they provide service in a Ministerial capacity
Spread Pricing - Mechanics and Fiscal Impact

### PBM Contract With No Spread Pricing

- Plan Sponsor Billed Same As Pharmacy Paid

### PBM Contract Allowing Spread Pricing

- Plan Sponsor Billed Pharmacy Paid + PBM Spread Margin

Fiscal Components of Prescription Claims Typical Program (Q2 2012)

**Contract Negotiation Options**
- Eliminating Admin. Fee saves 1%
- Cutting Disp. Fee in half saves 0.5%
- Improving Brand pricing by 2% saves 0.94%
- Improving Rebates by 25% saves 1%
- Improving Generic pricing by 40% saves 12.5%

**Solution:** Price Generics at a fixed $/unit schedule

All components, except for possibly rebates, are established by fixed, measurable methods...except for generic pricing.

- Admin Fee: $/Rx
- Disp. Fee: $/Rx
- Brand Pricing: AWP-X%
- Rebates: $/Brand Rx

Generics are often at AWP-X%, but AWP is a variable (non-fixed) term.
Consider this: Consumers do not purchase prescriptions from pharmacies

- How do intermediaries that make substantial profits help lower costs for Plan Sponsors and Consumers?
- Because it follows tradition, most Plan Sponsors and consumers believe they purchase their medications from a pharmacy
  - However, due to the contracting environment of PBMs, this is not an accurate reality
- PBMs often engage contracts which prohibit the pharmacy from telling employers how much the PBM pays them for medications

The contract between a PBM and a Plan Sponsor establishes a price that is charged to the Plan Sponsor and Consumer

- Often, this price is not related to the cost of the claim that is paid to the dispensing pharmacy
- Thus, spread pricing is the difference between what is charged to the Plan Sponsor and consumers versus what is actually paid to pharmacies
- Because contractual restrictions that prohibit pharmacies and employers from talking to each other, the PBMs have room to engage in spread price strategies without disclosure
- Even under increasing pressure for transparency, many PBM contracts with pharmacies have become more restrictive, not less.
  - Creates an atmosphere which allows the PBMs to increase the cost of medications and raise member fees for employers
Consider this: Transparency and its relative, Pass-through pricing do not matter

- Transparency and Pass-through pricing are commonly utilized terms by PBMs to placate the aspiration of a client to assure they are getting a good deal
- However, the applicability of these terms is very subjective
  - There can be many interpretations of Pass-through and Transparency and the actual cost paid to the pharmacy may be defined in the same manner as “traditional” PBM contracts
- Dependence on these terms that imply the best interest of the Plan Sponsor (or its members) is better served should be avoided
  - Use of these terms does not take the place of assessing the competitiveness of PBM services on a cost accounting basis

Consider this: Average Wholesale Price discount for generic drugs doesn’t matter

- Generic drugs are typically paid to the pharmacy on a set Maximum Allowable Charge (MAC) pricing schedule, not AWP
  - However, generic drugs are charged to the Plan Sponsor based on an alleged AWP discount and are so reflected within the PBM contract with the Plan Sponsor
- With the existence of multiple generic manufacturers the validity of AWP to generic pricing is low
- Allowing generic drugs to be priced to a Plan Sponsor on an AWP-discount basis provides arbitrary pricing which facilitates spread pricing
  - Why allow one definition of cost basis to the Plan Sponsor and another to a pharmacy?
  - Most PBM's have multiple MAC pricing schedules – which one is applicable?
Generic Pricing
What Does AWP-70% Mean?

Lisinopril 10mg Tab
6 manufacturers, package size = 90 or 100 units

Wholesale Price

$/Unit:

High Volume Generics

RETAIL: q4 2011 vs. q1 2012

$/Rx

Medication
Generic Pricing

What Does AWP-70% Mean?

**Prescription Benefit Cost Creep**

$/Unit: High Volume Generics
MAIL ORDER: q4 2011 vs. q1 2012

![Bar chart showing cost comparison between Q4 2011 and Q1 2012 for different medications.]

**Comparison of Generic Costs**

AWP discount price vs. negotiated price (schedule)

<table>
<thead>
<tr>
<th>Medication</th>
<th>AWP-based</th>
<th>Schedule-based</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citalopram 20</td>
<td>$1.01</td>
<td>$0.11</td>
</tr>
<tr>
<td>Simvastatin 20</td>
<td>$1.24</td>
<td>$0.10</td>
</tr>
<tr>
<td>Zolpidem 10</td>
<td>$0.97</td>
<td>$0.08</td>
</tr>
</tbody>
</table>

*These are actual results (q1 2012), initially found in an employer’s data, negotiated to a fixed-pricing strategy...so...what’s the impact on cost?*
Differing Client Pricing From Different PBM Still The Same Target (Optimal) Price

Consider this: Mail Order pharmacy programs frequently cost more

- The premise of mail order pharmacy is mail order provides better pricing for the drugs they dispense
  - Unfortunately, this is often not the case
  - The irony of this situation is that often a Plan Sponsor requires less copay for a mail order claim that is HIGHER in price (when evaluated on a per unit basis)
- Almost always there is manipulation of brand AWP values
  - This is because mail order pharmacy contracts at a higher discount (say -17% instead of -13% retail)
  - However, the actual AWPs used for the calculation is either similar or identical (when evaluated on a per unit basis)
Consider this: Mail Order pharmacy programs frequently cost more

- The challenge comes in generic pricing (often over 80% of claims)
  - Generic pricing is established using AWP discount even though it is inapplicable
- The generic pricing (MAC) list for a retail pharmacy is based on a per unit basis
  - A separate list(s) is maintained for the mail service pharmacy
- Often, when evaluated on a $/unit basis, the cost of a generic is higher for mail than retail
  - This occurs in spite of contracted discounts being 5 to 10 points better for mail than generic

Consider this: A $0.00 PBM administration fee may not be a good deal

- While a low cost (or $0) administrative fee often sounds good to a Plan Sponsor, this arrangement is an indicator of an inequitable contractual and fiscal arrangement
  - Administrative fees, even if they are in the $1-$2 per claim range, are dwarfed by the cost reduction achieved through optimal pricing
- Often, $10 to $15 per claim is left on the table due to poor pricing (often due to spread pricing) while the client is convinced the $0 administrative fee is of value
  - Focusing on the administration fee (or any other minor fees) as a measure of a favorable contract (to the Plan Sponsor) negates focus on the actual driver of costs in a PBM relationship, ingredient cost (and how it is calculated)
Consider this: Formulary rebates may not be a key fiscal factor

- Much like administrative fees, rebate yield is frequently the focus of contract negotiation
  - Often a Plan Sponsor believes that they are getting a “good deal” if the formulary rebate is represented as a high value, such as $10 per brand claim
- In reality, the variation between a high yield rebate program and a low yield program is often less than $1 (at most $2) per total Rx claim count
  - This value continues to diminish as the overall utilization of generics increases and brand drugs move to generic status
  - Similar to administrative fees, focusing on rebate yield and not on ingredient cost leads a Plan Sponsor to allow ingredient pricing that costs them much more than the difference between formulary rebate programs

Besides The Fact That Reducing Other Factors Has Little Effect On Net Costs, Focusing On Generics Is Valuable Because...

- Generic Use Is Rising, Likely Over 80% Of Claims For Most Plans, Soon
- Generic Drug Drop In Price Precipitously, After The First Six Months Of Generic Availability
- Generic Drug Pricing, Based On AWP Discount, Can Be Greatly Improved By Establishing A Unit Price Schedule
- It Eliminates The Only Significant Variable In The Pharmacy Cost Equation (Utilization x Pricing), Except For Specialty Drug Experience
- Reducing Generic Drug Costs Assists Meeting The Challenge Of Future Specialty Drug Costs
Cost Reduction From Specialty Pharmacy Management
Projection From Unmanaged Utilization

<table>
<thead>
<tr>
<th>Pricing and Distribution</th>
<th>Benefit Design</th>
<th>Clinical Management</th>
<th>Formulary Rebates</th>
<th>Waste Minimization</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-6%</td>
<td>2-5%</td>
<td>5-25%</td>
<td>2-5% or more</td>
<td>2-5%</td>
</tr>
</tbody>
</table>

with dosage control

virtually open ended

**Cost reduction is observed and achieved immediately, upon commencement of the new contract with schedule-based generic pricing**

Schedule-Based Pricing
Impact on Plan Costs (timeframe)
Schedule-Based Pricing
Impact on Plan Costs (timeframe)

Added benefits: Generic ingredient cost trend is eliminated. Only trend variance is demographic utilization case mix

Case Study: Ramifications

- Client (3000 lives) had just renewed a contract for PBM services negotiated by their broker
- 3 year term, with no termination unless cause
  - A situation where the client has no leverage unless there is a breach
- AWP-64% generic rate at retail
  - Generic drugs were found to be priced well over 100% higher than market competitive pricing, on aggregate
- AWP-70% generic rate for mail service pharmacy
  - Mail service generic pricing was actually higher (per unit) than retail
- Allowed to aggressively promote mail order conversion
  - Even with slightly better brand pricing, this strategy costs the Plan Sponsor more money
- Rebate guarantee: 90% of all rebates
  - Rebate yield was actually very low, not competitive. A large portion of manufacturer payments were not classified as rebates
Added Value of an Optimally Negotiated PBM Arrangement

- Lower Overall Plan Inflation
- Cost Reduction From Future Generic Availability
- Lower Member Costs, Particularly in % Coinsurance Plans
- Direct Accountability of PBM and Consultant
- Plan Management Fiduciary Responsibilities Met
- Direct Accounting of Formulary Rebates
- Avoidance of Physician/Member Education Programs Increasing Plan Costs

Contract Terms To Avoid

- Rebates defined as anything but all funds collected from manufacturers
- AWP discount guarantee for generics...utilize the actual pricing (MAC) list for generics
- Mutually agreed upon auditor...this allows one party to have ultimate veto power, in essence allows one party to select the auditor
- Mandatory mail utilization
- Long term, no out clause
Optimal PBM Relations - What It Means For The CFO and Human Resources

- Immediate, significant lowering of operating costs
- Establish low cost basis for prescription benefit, for the long term
- Take full advantage of future improvements in market pricing
- Establish vendor relationship unlikely to require future modifications
- Low cost, high quality service from a vendor that is open and trustworthy
- No network disruption to members

It all starts with data and contract language
Data is the most valuable Plan asset

Frequently, insurance carriers, competing brokers and other service providers create barriers for a Plan Sponsor to control and obtain their data.

- Blue Cross Liable for Self-Dealing After Charging 'Hidden' Fees on Self-Funded Health Plan, Court Rules
  - Case: Borroughs Corp. v. Blue Cross Blue Shield of Michigan, E.D. Mich., No. 2:11-cv-12557-VAR-PJK, 9/7/12
  - Blue Cross Blue Shield of Michigan engaged in self-dealing when it unilaterally calculated and collected additional administrative fees from employers that contracted with Blue Cross for claims administration and network access to its self-funded employee health benefit plans, the U.S. District Court for the Eastern District of Michigan ruled Sept. 7, 2012 in the above Borroughs case

Is undisclosed PBM Spread Pricing any different?
Summary

- Using objective standards and concise method, Plan Sponsors can reduce their prescription benefit costs by negotiating and executing a contract solely in their interest.

- A significant cost reduction can be achieved by focusing on the factors driving costs, particularly ingredient unit pricing.

- Introduction of subjective standards and measures leads to the establishment of program components that do not serve (and increase cost to) the Plan Sponsor and its members.

- An objective, unambiguous contract, oriented in the interests of the Plan Sponsor, creates a partnership with ongoing verification and a low cost basis with low inflation.