
Drug Rebates & Direct Contracting Strategies for Payers

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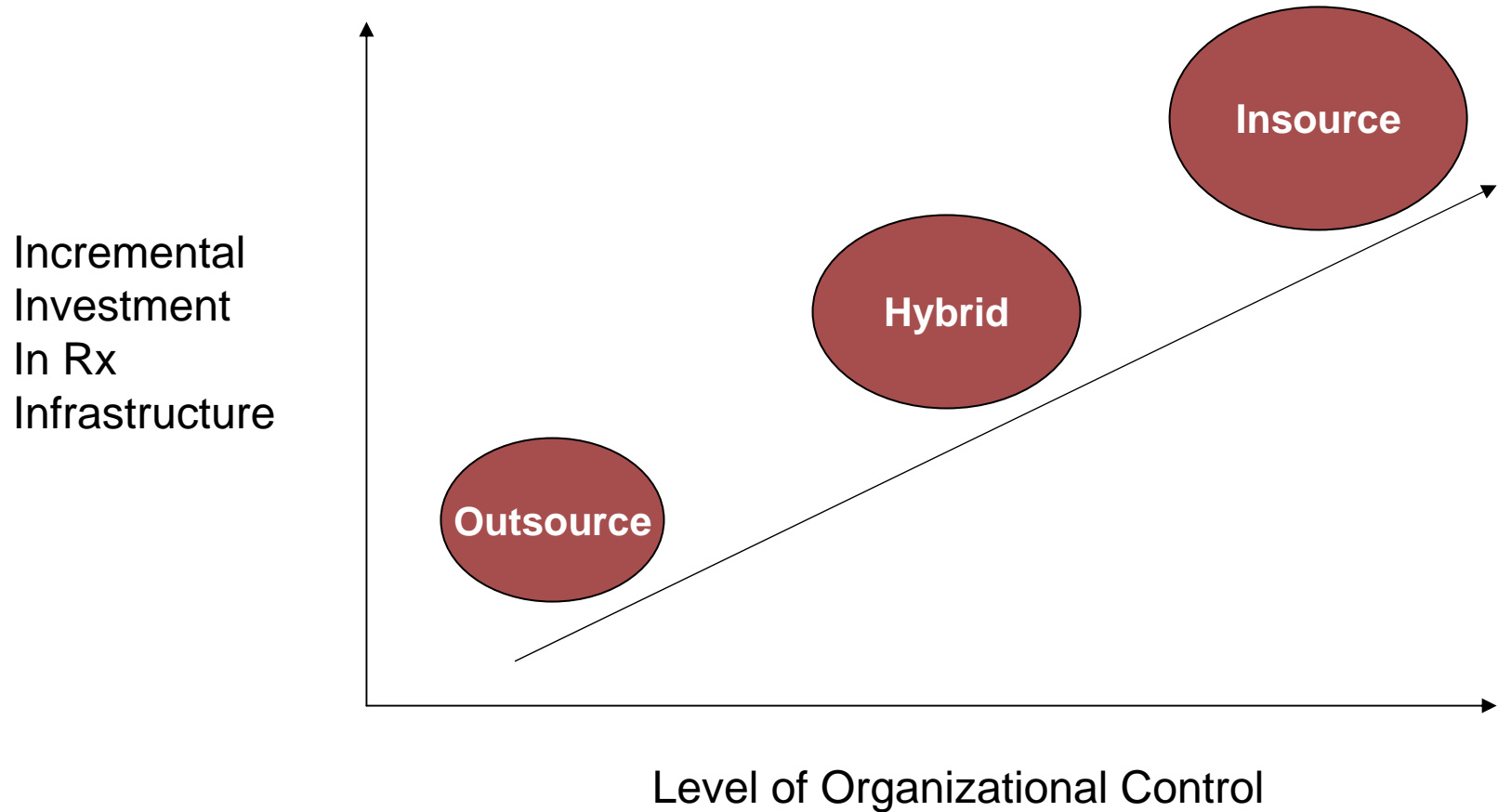
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Maximizing Value in Pharmaceuticals

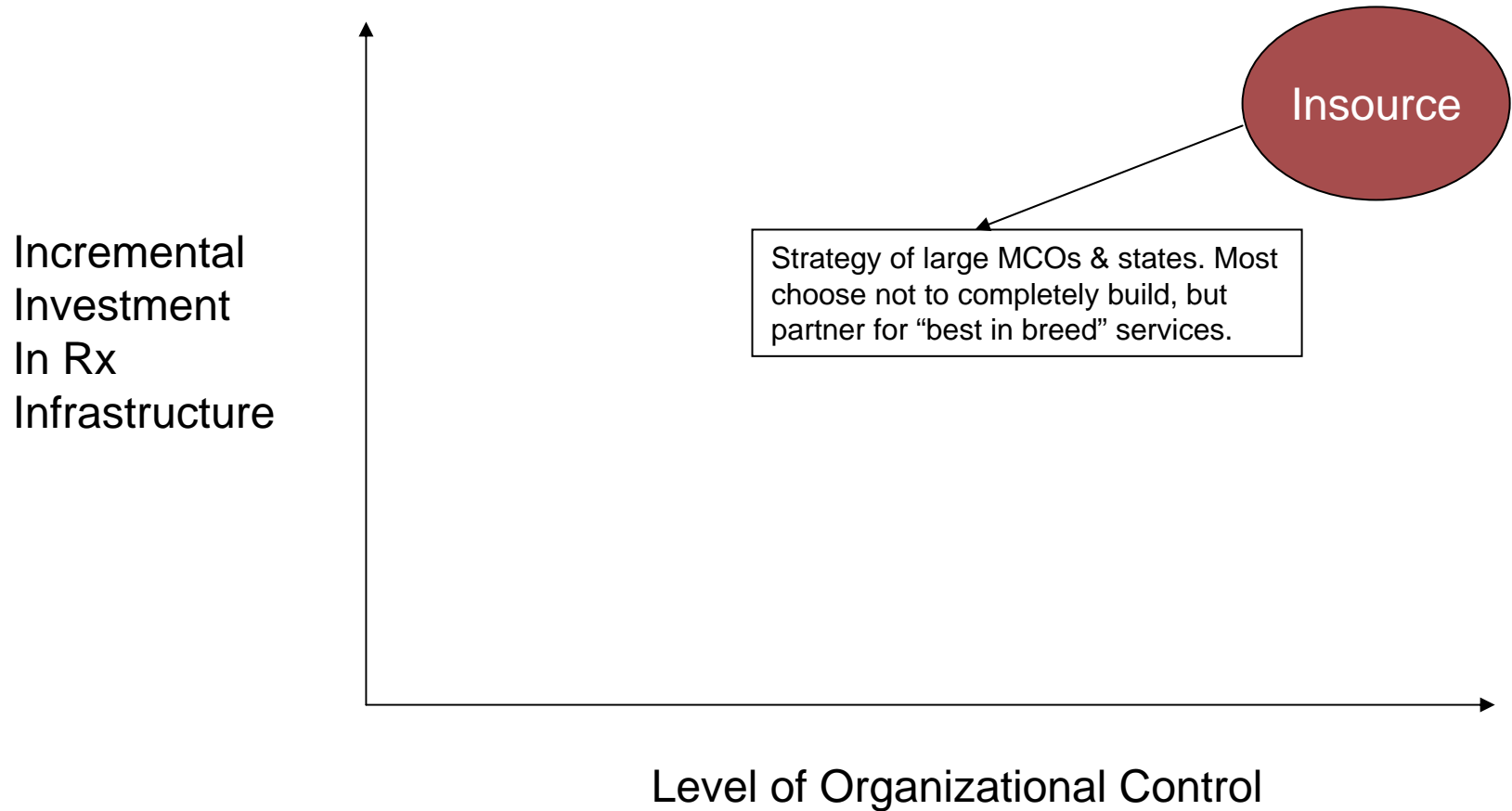
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Approaches To Managing The Rx Benefit



Approaches To Managing The Rx Benefit



Benefits of Direct Contracting

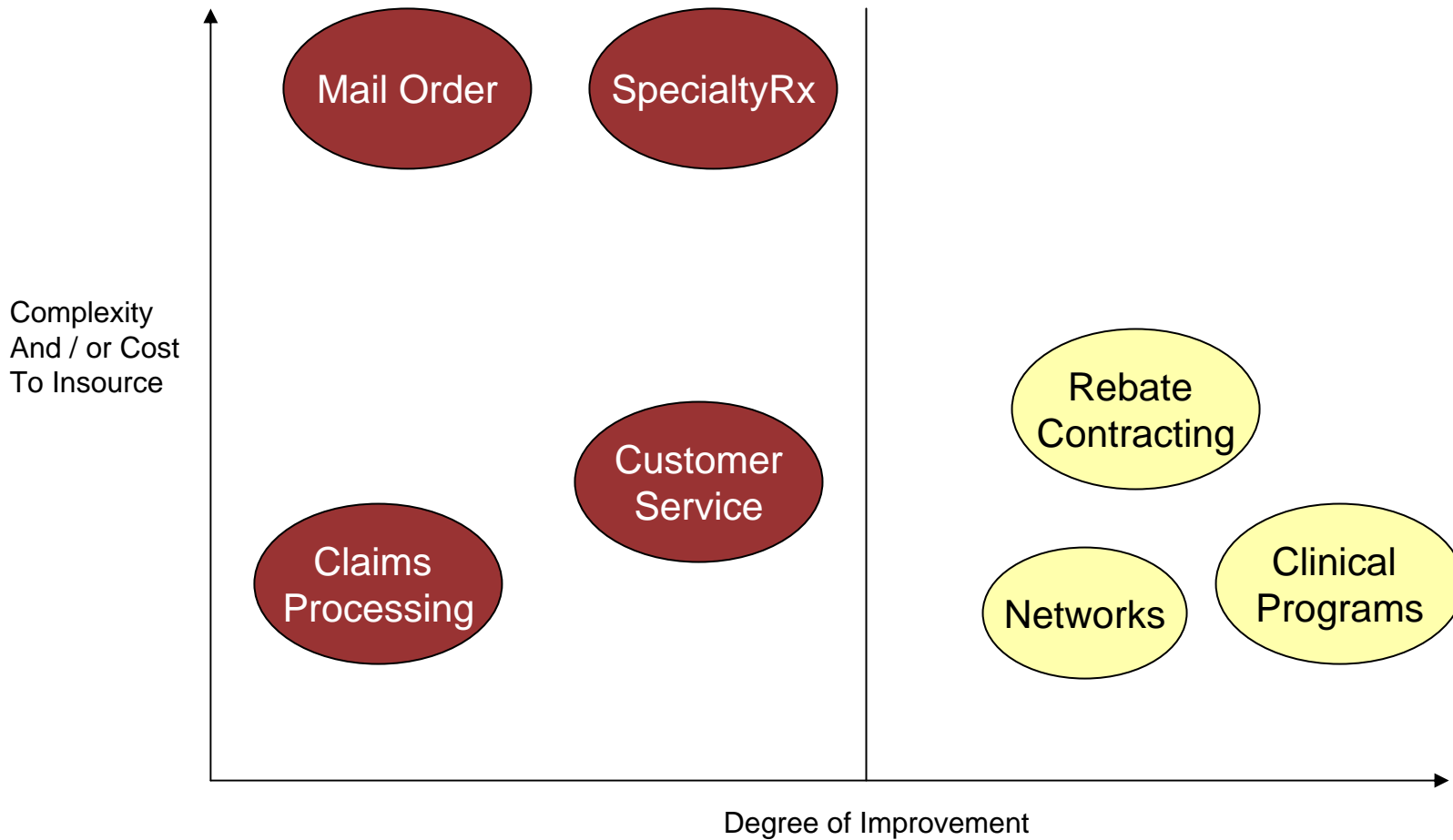
Seven Reasons to “Insource” all or part of pharmacy programs

1. Concern over PBM revenue sources (alignment of business objectives).
2. Increased local control (enhanced power to influence pricing and service delivery in local markets).
3. Marketing strength (Minimize direct competition for employer Rx services by providing them directly).
4. Reduction in pharmacy cost trends (better control of utilization mgt, formulary mgt, etc. leads to better financial performance).
5. Increased rebate collections (“Volume purchasing is important, but not as important as the ability to control market share”).
6. Shared savings with customers (Better Rx control will translate into lower overall pmpms for employer customers).
7. Strengthened vendor relationships (Better ability to partner with pharmaceutical firms on local / regional initiatives when contracting is done locally).

Source: Managed Care Week, 3/17/03; Comments made during NMHCC meeting in 2003 from VP Pharmacy for a large BCBS Plan



Insourcing Opportunity Matrix



Direct Rebate Contracting Advantages & Disadvantages

Advantages

- Full disclosure of arrangements
- Full knowledge of components of pharmacy cost allows for true analysis of:
 - Pharmacy trends and costs
 - Formulary changes
 - Programs
- Greater rebate return
- Faster rebate payment
- Minimizes clinical message / formulary confusion between plan & PBM

Disadvantages

- Incremental investment in people & tools required to implement & manage new process
- Resistance from PBM if rebates and other pharma funding represents a significant source of revenue
- Potential scrutiny if the plan retains incremental value of rebates



Financial Benefits of Direct Rebate Contracting

- Eliminates 1-3% administrative fee pharmaceutical firms pay to the PBM
- Eliminates PBM share of rebates collected
 - 10-40% improvement is common, depending on plan size, current contract with PBM
- Rewards plan for the ability to directly impact pharmaceutical utilization
 - Rather than diluting efforts across the PBM's entire book of business
- Improves cash flow
 - Many PBMs pay rebates 6-12 months after they are earned



Benefits of Direct Rebate Contracting

Lessons From the Field

Quotes from Payers in a Recent Study:

- “In our first year, the rebates we received from one therapeutic class equaled 80% of the total rebates we were receiving from the PBM for all drug classes during the previous year”
- “In our first year, we increased our rebate retention by 40%, while improving our generic dispensing rate to almost 50% of all claims”
- “Most of the money from pharmaceutical firms is concentrated in the top 15-20 suppliers. Though we have > 40 contracts, we really focus on managing the top 20”



Benefits of Direct Rebate Contracting

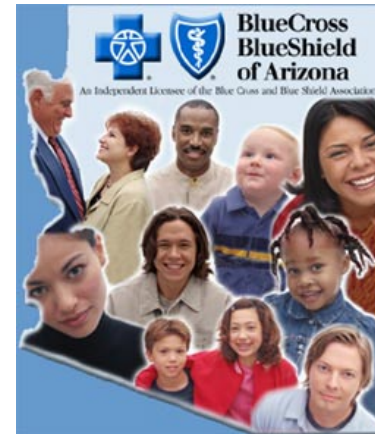
Lessons From the Field

Quotes from Payers in a Recent Study:

- “Based on benchmarking we did in 2001 via an RFP, our rebate collections have been 20% better than the best offer we received from a PBM’s rebate contracting initiatives”.
- “We have used the additional monies received from our rebate contracting to fund clinical development projects in our retail network”.
- “PBMs will tell you there is no way your plan could achieve the same rebates, because of the PBM’s large size. **What we found at our plan, however, is that though size matters, the ability to influence utilization is a greater determinant of how successful contracting with pharmaceutical manufacturers can be.** In many cases, the value of a particular plan’s utilization can be diluted by the PBM’s large national population that may have little or no control over which products are utilized in their population”.



Representative Plans that Insource Select PBM Functions



The **Regence** Group

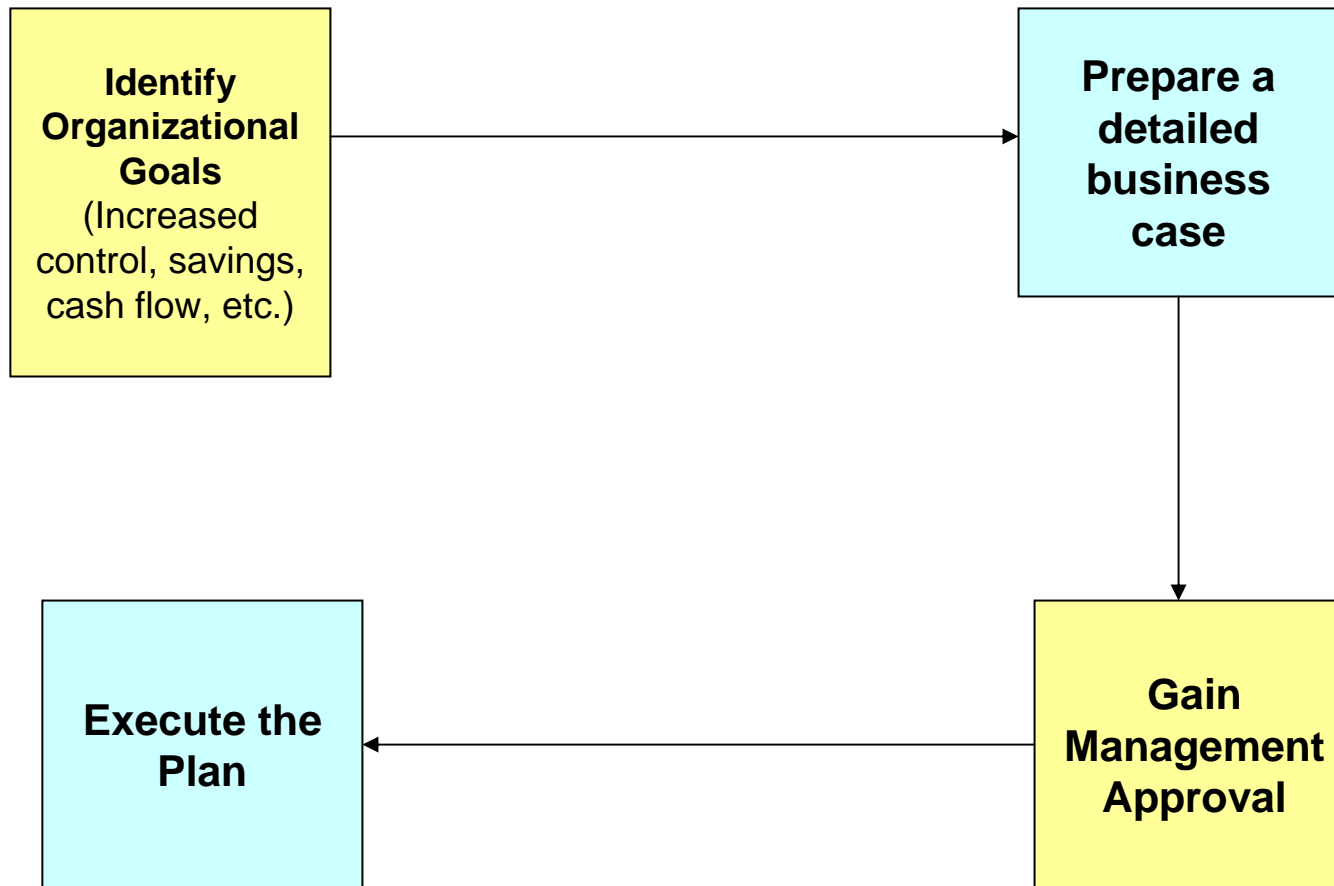


Building The Business Case for Direct Contracting



Building the Business Case for Direct Contracting

Preparing for Migration to Direct Contracting



Building the Business Case for Direct Contracting

Key Elements of Preparing the Business Case

- Financial Value Proposition
- Resource GAP Analysis
- Detailed Risk Analysis
- Assimilation of Best Practices From Other Plans
- Implementation Workplan
- Resource Allocation to Support Build-Out



Building the Business Case for Direct Contracting

- Perform “Top Drug” Analysis
 - Identify Top 200 branded drugs by spend
 - Evaluate rebates received on those products under the current arrangement with your PBM
 - Model the “range-of-rebates” based on published reports, expert opinion research, and industry contacts
 - Compare the range of rebates to what your plan is currently receiving today
 - Utilize the results of the analysis to calculate savings & prioritize contracting targets



Building the Business Case for Direct Contracting

- Perform “Top Drug” Analysis
 - Example: Product X
 - Required Data Elements
 - Assume that you have access to benchmark data that will provide a range of potential rebate values
 - Assume that you can identify the gross costs associated with your drug use (both WAC & AWP)
 - Assume that you can identify the total rebates received for this product

Gross AWP	Gross WAC	Total Rebates	Rebate % of AWP	Rebate % of WAC
\$10,000,000	\$8,000,000	\$500,000	5%	6.25%

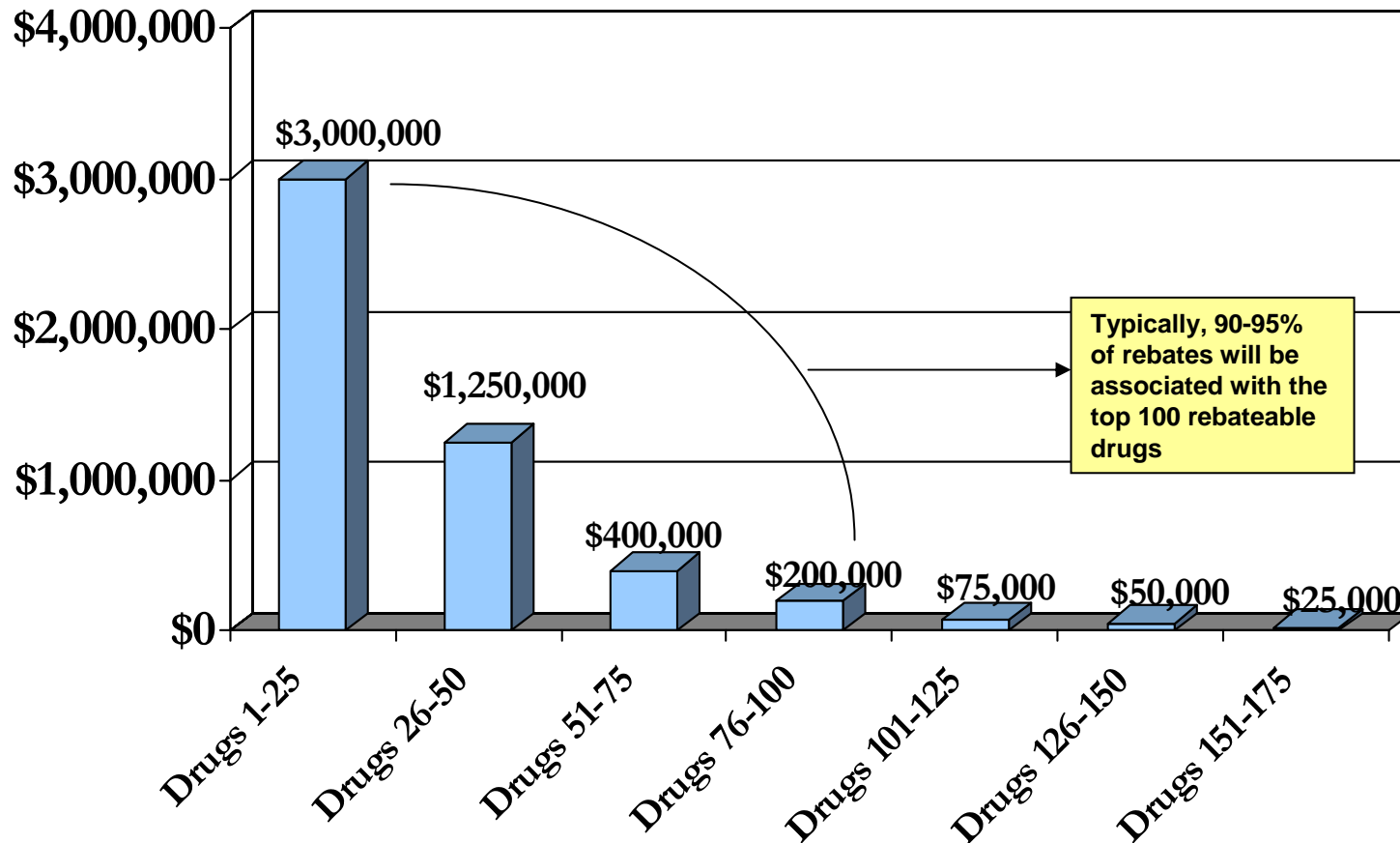
Key Question: Based on your market knowledge, how do the rebates you receive from your PBM fall in the range of potential rebates? Most build the business case based on different assumptions for improvement (e.g. conservative, moderate or aggressive improvement assumptions)



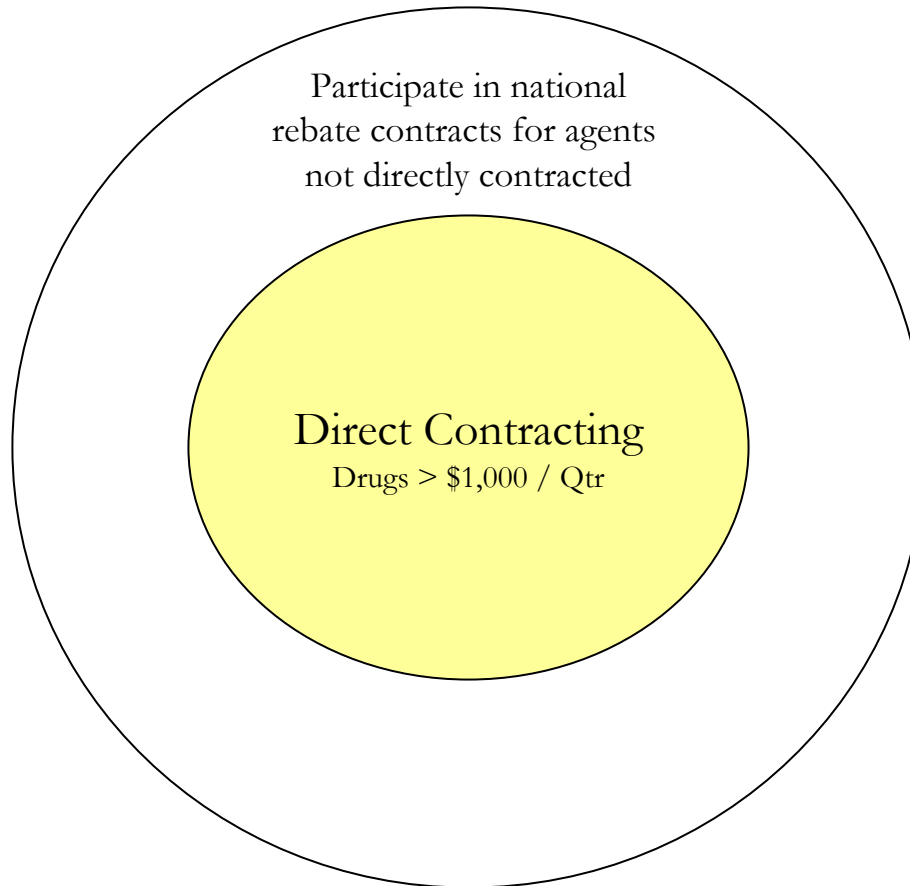
Building the Business Case for Direct Contracting

Sample Distribution of Rebates Received

(Sample plan with \$5 Million in Annual Rebates)

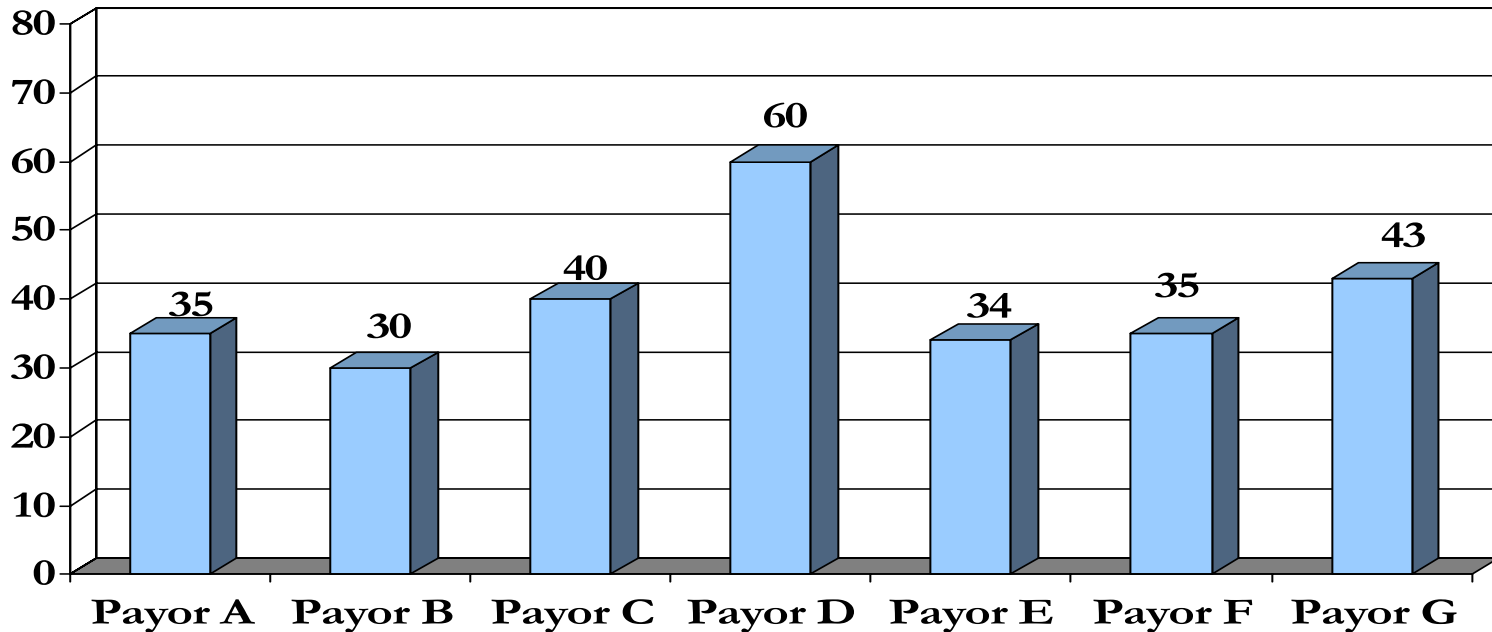


Building the Business Case for Direct Contracting



Building the Business Case for Direct Contracting

Typical Number of Pharmaceutical Rebate Contracts Held By Plans

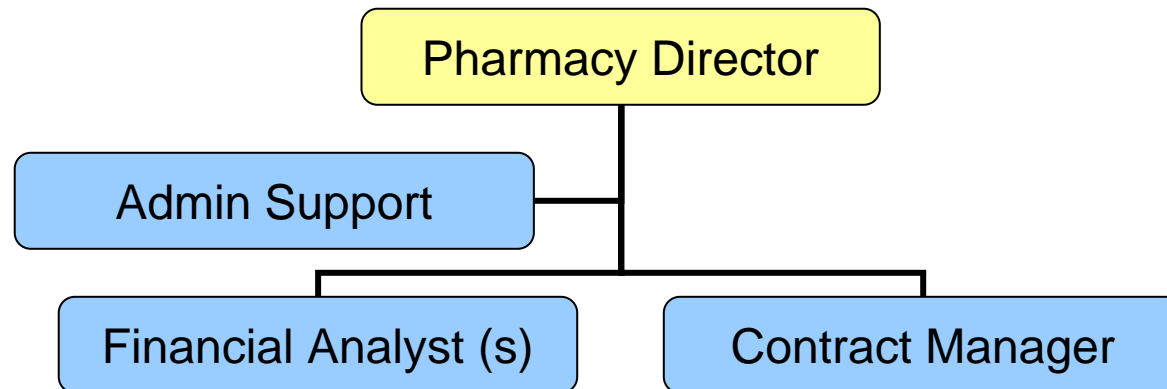


Source: Market research conducted by PSG in 2003



Building the Business Case for Direct Contracting

Resource Requirements



The number of FTE's required to support direct contracting varies by the size of the plan, as well as the number and complexity of contracts. A typical range is 2-6 FTEs.



Building the Business Case for Direct Contracting

- Disruption Analysis
 - Rebate contracting process should follow your formulary policy, not direct it
 - Goal of contracting process is to closely mirror current preferred product portfolio
 - Some manufacturers may reject new contracts
 - PDL realignment could occur, however
 - Access to therapeutically equivalent and cost effective medications will be maintained
 - Members will still have access to non-preferred products, likely at higher copay tiers
 - Modest changes in PDL composition may be tolerated by customers as a trade-off for incremental rebates, and lower net costs



Building the Business Case for Direct Contracting

- Predictors of Success
 - Internal Keys
 - Obtaining executive sponsorship of the initiative
 - Constructing a detailed business case
 - Executing on the plan
 - External Keys
 - Developing strong supplier relationships for outsourced services
 - Gaining / maintaining strong local market presence



Industry Trends that May Alter Rebates

- Proliferation of prescription-only to over-the-counter status of highly utilized drugs
 - Ulcer
 - Cholesterol
 - Allergy
- Migration towards more specialized treatments
 - Limited potential for therapeutic equivalence
 - Specialty pharmacy providers
 - Yet, some classes are primed *Growth hormone, arthritis classes, etc.)
- Legislative changes



To Review

- Rebates remain a strategy to help payers reduce their overall exposure to rising prescription costs
- Rebate contracting should follow your formulary development strategy, rather than lead it
- Constructing a business case for direct rebate contracting will allow you to measure the:
 - Potential for improvement
 - Resources required to achieve that improvement
 - Risks associated with the new strategy
 - Strategies to execute the plan successfully
- The benefits of the approach have been validated in the market



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