

DISINTERMEDIATION

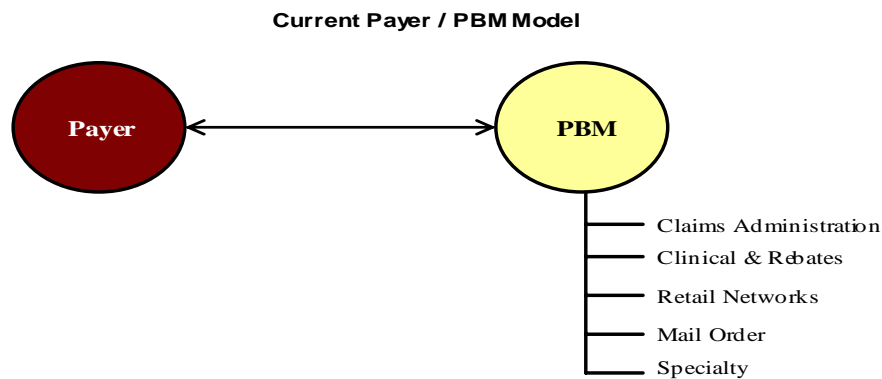
How To Improve the Performance of Your Pharmacy Program
By Insourcing PBM Functions

Pharmaceutical Strategies Group
Maximizing Value in Pharmaceuticals

Today's Pharmacy Benefit Management Model

During the past 10 years, pharmacy benefit managers (PBMs) have evolved from small, niche focused companies that provided very basic administrative services to today's model of highly evolved health care institutions. Along with the evolution in service delivery, the dynamics of the PBM financial model have changed. No longer do PBMs earn the majority of their revenues from claims processing services. Instead, mail order pharmacies, pharmaceutical rebates, and other "specialized" services make up an ever important source of revenues and profits for many of today's leading PBMs.

The service delivery evolution has caused some to believe that the industry has lost its way. Rather than finding new and innovative ways to save their clients money, some criticize PBMs as mere Wall Street darlings focused on meeting quarterly earnings estimates, and generating "free cash flow". In addition, as PBMs have morphed into organizations in many different businesses, their ability to provide outstanding service in all areas has diminished. Figure 1 below depicts a typical payer-PBM model

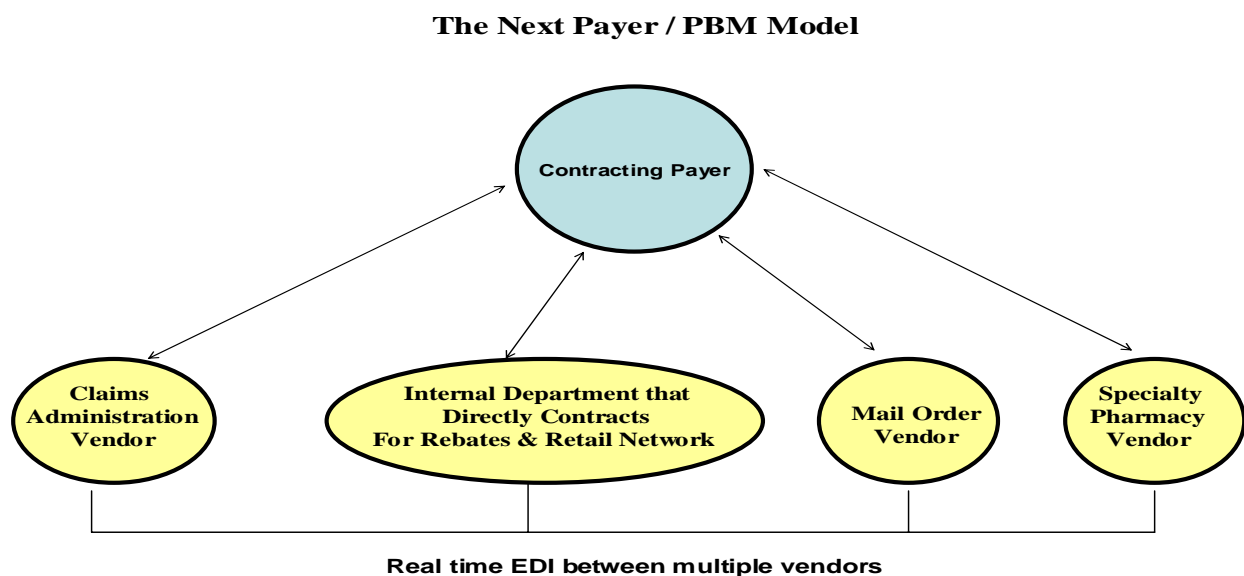


In today's Payer / PBM model, most services required to administer a pharmacy benefit are provided by a single PBM. This is true even though a particular PBM may excel in some areas, while being deficient in others

A New Approach

In an effort to gain more control over how service delivery is provided to their members, many payers are beginning to question the wisdom of relying on their PBM for a growing list of comprehensive pharmacy services. Instead, some large payers are beginning to adopt a model of purchasing “best in class” services for key elements of their pharmacy programs. The new purchasing model can be termed “disintermediation” as it brings together buyers and sellers of services in a more direct fashion, as depicted in Figure 2 below:

FIGURE 2



In a future pharmacy benefit model, payers may seek to direct contract for certain strategic services (rebates & retail networks) while continuing to partner with vendors who offer best-in-breed service in other aspects of their pharmacy program

Rationale for Managing Pharmacy Service Components Internally

Plans that are considering developing an internal approach to pharmacy benefit management should consider the complexity of performing each element of pharmacy services, along with the expected benefit of developing those services. Table 1 below describes how some plans are evaluating several important elements of pharmacy benefit services.

Managed Pharmacy Service Component	Rationale for Considering Managing This Program Element Internally	Complexity and / or Cost to Insource (Modest, Moderate or Significant)	Resources Required
Clinical programs (Formulary development, UM / DM, etc.)	Though PBMs have substantial experience in developing and maintaining formularies, drug product selection decisions made by a PBM may not be in alignment with those that an individual plan would make for its members. Therefore, many plans consider clinical program decisions a part of their core competency. Many plans consider insourcing these functions to maintain control over this important component of drug benefit design (product selection, utilization management, therapeutic intervention platforms, etc.).	Modest	Ability to hire or contract for clinical pharmacy expertise, including drug information specialists with well developed analytical skills.
Network Contracting	To offset expenses associated with developing and maintaining pharmacy networks, PBMs may keep a “spread” on retail pharmacy ingredient costs. Some PBMs retain a significant percent of ingredient costs, which can range from 0-3% for branded products and 0-30% on many generic products. By contracting directly with pharmacy network suppliers, the plan can eliminate any ingredient cost spread, and retain the full value of supplier contracts for its membership.	Modest	Ability to hire or contract for expertise in negotiating agreements with pharmacy chains and independents. Ideally, the plan should also have a strong local market presence, as well as a willingness to partner with its pharmacy network to develop & implement customized clinical programs.

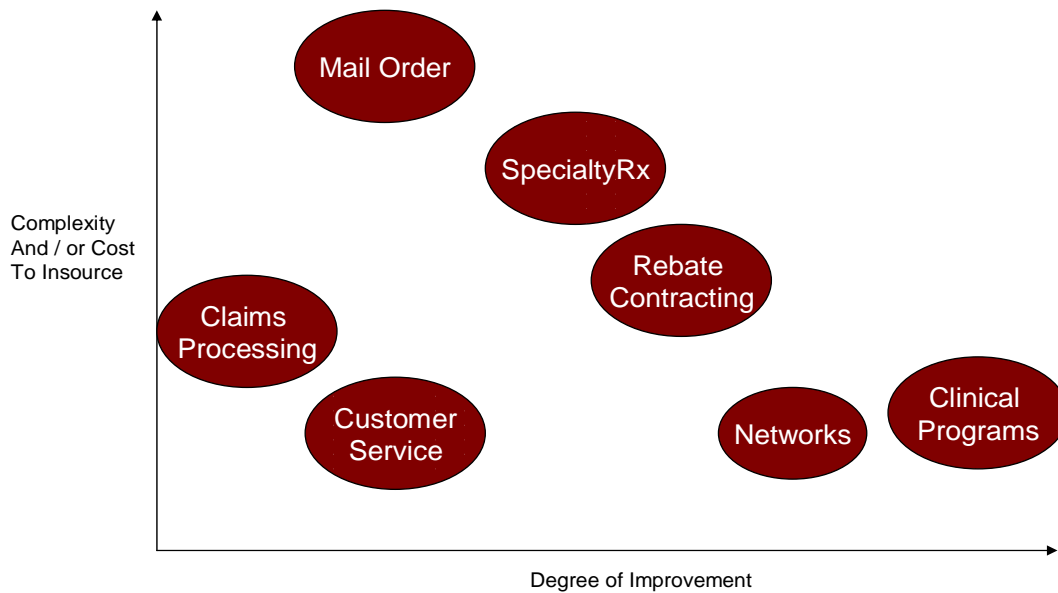
Managed Pharmacy Service Component	Rationale for Considering Managing This Program Element Internally	Complexity and / or Cost to Insource (Modest, Moderate or Significant)	Resources Required
Rebate Contracting	<p>PBMs perform a legitimate service for their customers by leveraging the PBM's size to obtain volume purchasing discounts from pharmaceutical manufacturers. However, in exchange for this service, PBMs may retain a sizeable portion of the rebates collected. The range of rebate retention varies widely by PBM, and by individual client agreements. However, a typical PBM retention rate is in the range of 0-25%.</p> <p>In addition to retaining the full value of the rebate dollars collected, direct contracting also provides more robust data points for plans to utilize in making drug product selection decisions. Whereas some PBMs are hesitant to provide net cost information for individual drugs, by contracting directly, the plan will have access to all of the clinical and economic data it needs to make decisions around the best medications to promote within its population.</p>	Moderate	<p>Ability to hire or contract for expertise in the pharmaceutical contracting processes.</p> <p>Ideally, the plan will have significant data analysis capabilities, and a demonstrated ability to influence drug utilization towards preferred formulary agents.</p>
Member services	<p>Plans are accustomed to providing member services to their health plan enrollees. In many cases, however, plans elect to have their PBM answer member calls regarding the pharmacy benefit. Most industry observers and plan representatives have expressed satisfaction with the PBM's ability to accurately and efficiently manage pharmacy benefit call centers. Plans should consider providing these services themselves if a PBM is unable or unwilling to provide the level of service expected by the plan's management team and members.</p>	Moderate	<p>Call center technology and additional staffing to support enhanced call volumes. May need system integration with the PBM to accurately resolve some member questions (i.e. status of a mail order prescription)</p>

Managed Pharmacy Service Component	Rationale for Considering Managing This Program Element Internally	Complexity and / or Cost to Insource (Modest, Moderate or Significant)	Resources Required
Specialty	<p>Specialty pharmacy is a growing component of health plan drug expenditures. Most plans today rely on contracted specialty pharmacy providers and / or PBMs to provide clinical and distributive services associated with specialty pharmaceuticals. Plans that want to strip the profit margins out of the specialty pharmacy supply chain may elect to perform this service internally. Plans may also elect to provide their own specialty pharmacy programs as a means of establishing more robust and integrated utilization and disease management programs for members being treated with specialty pharmaceuticals.</p>	Significant	<p>Ability to acquire significant knowledge of pharmaceutical purchasing, distribution, legal requirements, reimbursement processes, etc.</p> <p>Entering the specialty pharmacy market can require a large initial capital investment, and a financial commitment to significant annual operating expenses.</p>
Mail order	<p>Most plans today rely on a PBM to provide mail order prescription drug services.</p> <p>Plans who want to strip the profit margins out of the mail order pharmacy supply chain may elect to perform this service internally. Plans may also elect to provide their own mail order pharmacy programs as a means retaining control over formulary interventions that are deployed in the mail order environment.</p>	Significant	<p>Ability to acquire significant knowledge of pharmaceutical purchasing, distribution, legal requirements, etc.</p> <p>Entering the mail order pharmacy market will require a large initial capital investment, and a financial commitment to significant annual operating expenses.</p>
Claims processing	<p>Most plans today rely on a PBM to provide standard claims processing services.</p> <p>Plans should consider providing these services themselves if a PBM is unable or unwilling to perform claims processing services in a manner that is consistent with the plans current and future goals.</p>	Modest if technology is leased	Staff to load and manage IT system.

Plan Specific Evaluations

For many plans, a logical place to begin gaining more control over their pharmacy programs is by taking control of clinical decision making. Rather than relying upon an external business partner for key clinical program decisions such as formulary product placement, prior authorization programs, disease management initiatives, etc. many plans are developing their own infrastructure to support these efforts. Once clinical program decisions are internalized, plans often evaluate insourcing pharmaceutical rebate and retail network contracting. The benefits derived from these direct contracting initiatives can be very significant, and the infrastructure required to support these efforts is modest. As individual plans develop their own analyses, they may find it useful to develop an “insourcing opportunity matrix” based on the unique needs present in the plan. An example of such a matrix appears below:

Insourcing Opportunity Matrix



A comparison of PBM strategy by some leading Managed Care organizations.

Many payers have already made the decision to begin providing some or all PBM services internally. Others, however, are just now developing the business case around insourcing. The table below provides a partial list of how some of the nation’s prominent MCOS approach their pharmacy programs:

Internal Pharmacy Management

Plans with External PBM Partners

Plan Name	Internally Sourced Program Elements	Plan Name	PBM
Aetna	Rebates, Network Contracting, Clinical, Mail	BCBS Massachusetts	AdvancePCS
BCBS Arizona	Rebates, Network Contracting, Clinical	HCSC	AdvancePCS
Blue Shield California	Rebates, Network Contracting, Clinical	Highmark BCBS*	Medco Health Solutions
Cigna	Rebates, Network Contracting, Clinical	Oxford Health Plan	Medco Health Solutions
Harvard Pilgrim Health Plan	Rebates, Clinical	Tufts	AdvancePCS
Regence	Rebates, Network Contracting, Clinical	Premera Blue Cross	Medco Health Solutions
Touchpoint Health Plan	Rebates, Network Contracting, Clinical	United Health Care	Medco Health Solutions

* Highmark recently announced its decision to acquire a specialty pharmacy provider. It is unknown whether it will consider insourcing other elements of its pharmacy program

Overall Appeal of the New Model

There are many appealing aspects to a disintermediation model, including:

- Ability to contract with true best-in-class providers whose cost and service profiles could be far superior vs. a bundled product
- Ability to achieve pricing transparency in all elements of traditional PBM pricing elements, including the elusive rebate administration system
- Ability to isolate and manage component costs

Potential Disadvantages of Disintermediation

For all of the potential benefits of the disintermediation model, there are some potential drawbacks. Examples could include:

- Contracting with multiple parties could impose an added layer of administrative complexity on payers
- Electronic data interchange required among various niche vendors must be developed and maintained
- Presence of multiple providers may confuse employees / plan members

Though each of these potential disadvantages is real, their impact can be mitigated with appropriate planning.

The Road Ahead

The current approach of “one-stop-shopping” for pharmacy services from one PBM must be reevaluated. The lack of pricing transparency, coupled with declining service levels for key elements of current pharmacy services, begs consideration of a new approach. Disintermediation is one example of how payers can strip a layer of cost from the current PBM system, while gaining control over the quality and consistency of services provided to their plan enrollees.

About The Pharmaceutical Strategies Group

The Pharmaceutical Strategies Group was founded to assist payers in designing and implementing programs that will maximize the value of pharmaceuticals in their population.

The strategies employed by PSG consultants allow payers to gain immediate control over their pharmacy benefit budgets, while positioning their company for the pharmacy benefits platform of the future.

We have served some of the leading payers in the country, including leading national Managed Care Organizations, large public sector programs, and several Fortune 100 employers.

Contact us today to learn how PSG Consultants can assist you in maximizing the value of pharmaceuticals in your population.

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