

# **PBMs: The Basics and an Industry Overview**

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# Agenda

1. Basics of PBMs
2. Snapshot of PBM Industry Today
3. How PBMs Work: PBM Toolbox and Key Relationships
4. Industry Challenges
5. In Summary

# Basics of PBMs

# What are PBMs?

Pharmacy benefit managers (PBMs) are companies that administer drug benefit programs for employers and health insurance carriers.

PBMs contract with managed care organizations, self-insured employers, insurance companies, unions, Medicaid and Medicare managed care plans, the Federal Employees Health Benefits Program and other federal, state, and local government entities (e.g. CalPERS) to provide managed prescription drug benefits.

# Basic PBM Statistics

- Roughly 95% of all patients with drug coverage receive benefits through a PBM
- PBMs manage about 70 percent of the more than 3 billion prescriptions dispensed in the United States each year
- Pharmacy networks typically include over 90% of pharmacies in a given area
- 13-16% of prescription sales are through mail order pharmacy

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Sources: AIS, *A Guide to Drug Cost Management Strategies*, 2002; PCMA, 2001.

# Basic PBM Statistics (cont'd)

- PBMs paid approximately \$121 billion for prescription drugs in 2001-02, or about 80% of total spending on prescription drugs for 2001-02
- PBMs manage pharmacy benefits for nearly 200 million Americans, including 65% of the country's seniors

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Sources: AIS, *A Guide to Drug Cost Management Strategies*, 2002; PCMA, 2001.

# Snapshot of PBM Industry Today

# PBM Industry: Yesterday vs. Today

## Yesterday

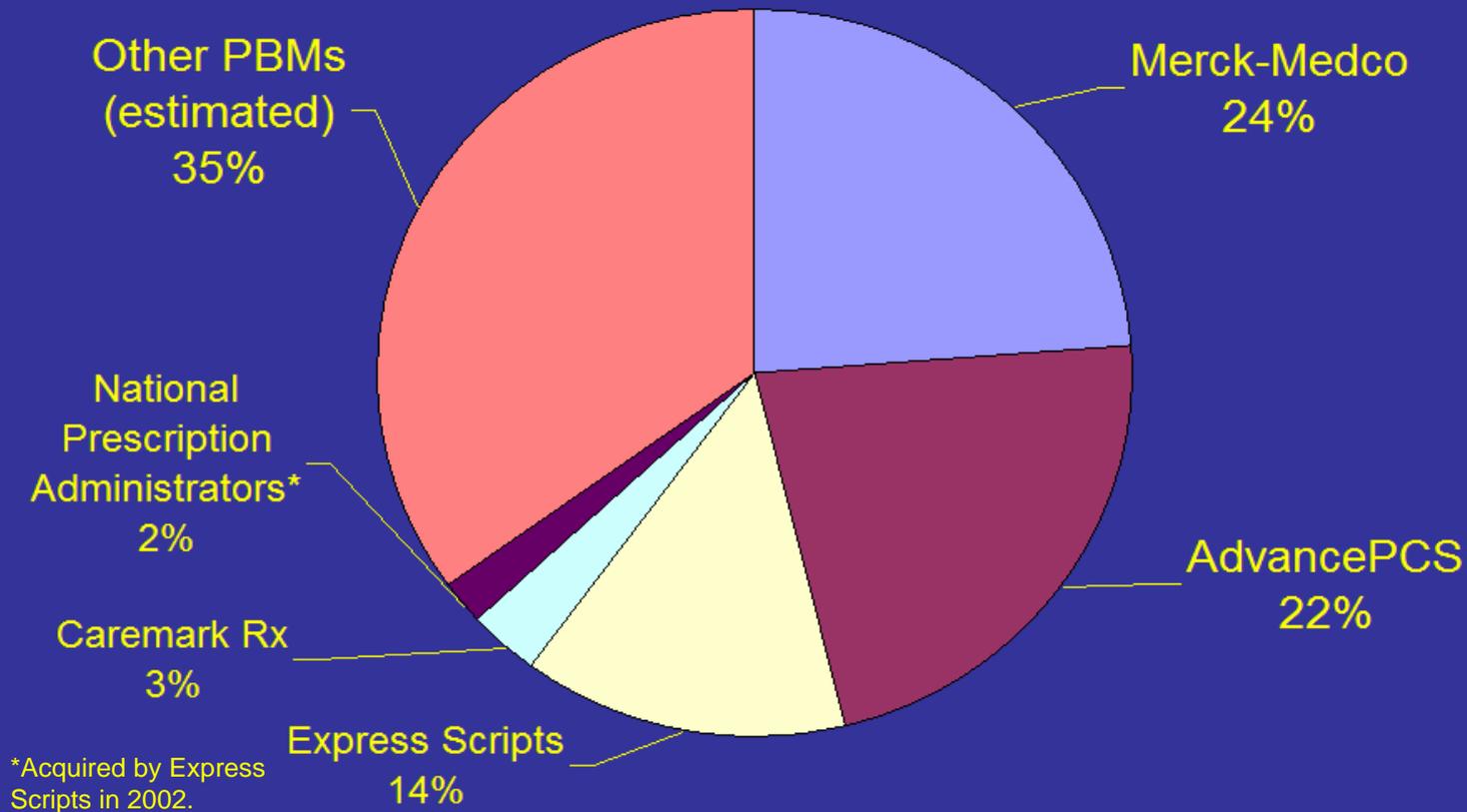
- Primary business is Rx drug claims processing
- About 150 firms; most are small and serve local or regional markets
- Pharmaceutical company has interest or ownership in largest, national firms

## Today

- Comprehensive clinical Rx mgmt. service offerings and diversification into new lines of business (e.g., disease management & specialty pharmacy)
- About 60 firms: 4 large, publicly-traded; dozens of smaller firms
- Most firms independent or MCO has interest/ownership

# PBM Market Share in 2002 by:

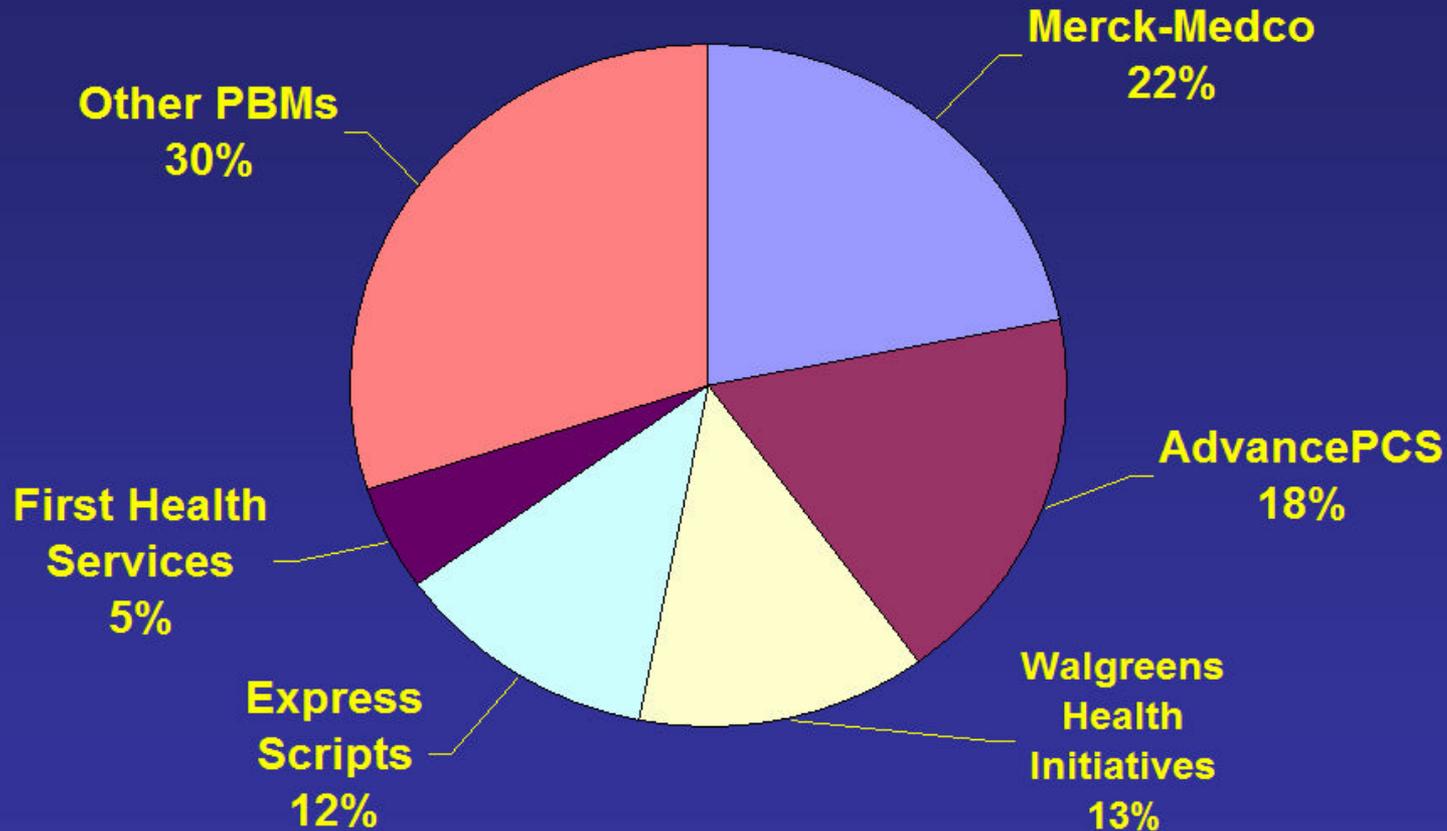
## Total Annual Expenditures



Source: AIS, *A Guide to Drug Cost Management Strategies*, 2002.

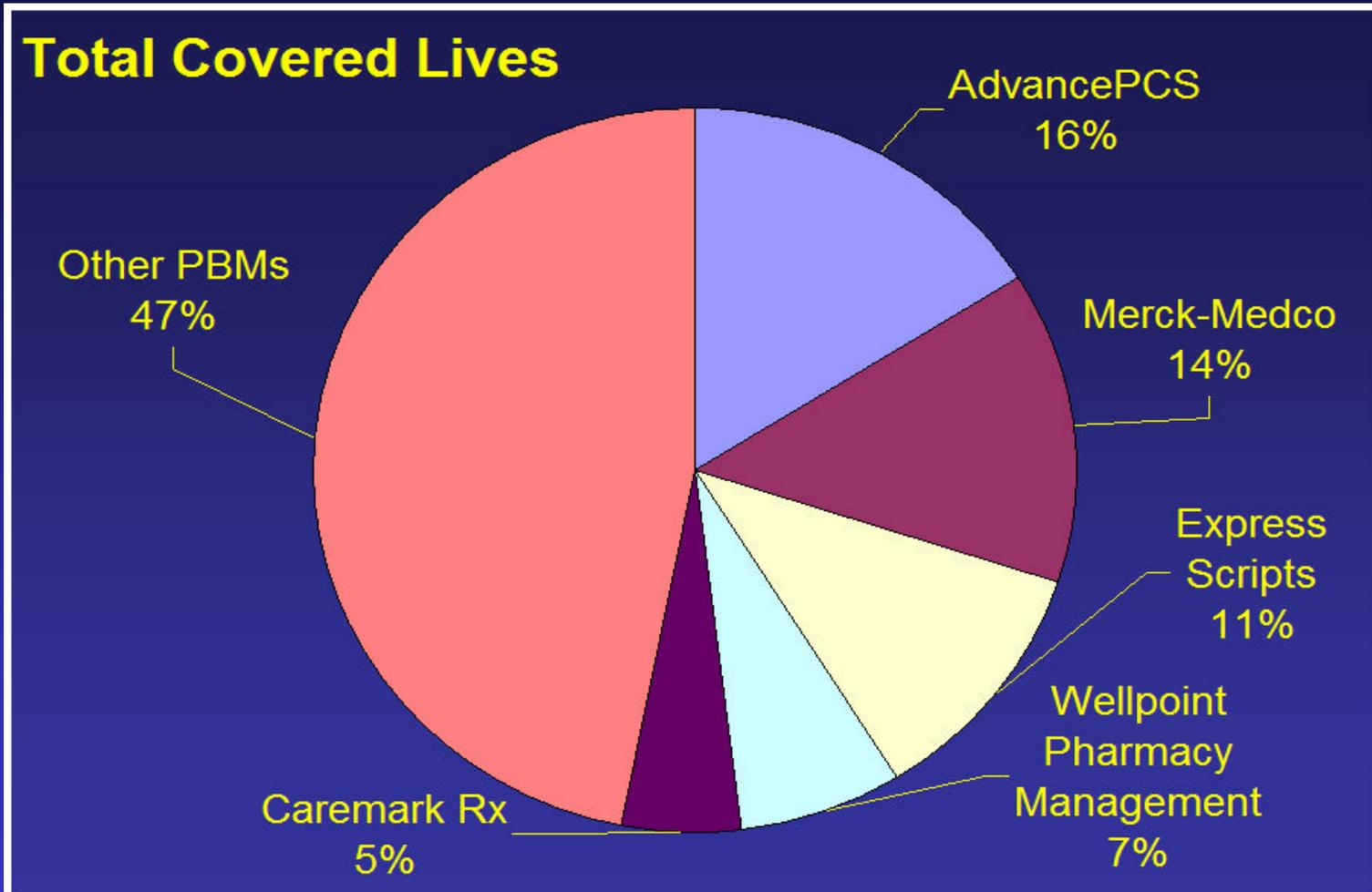
# PBM Market Share in 2002 by:

## Prescriptions per Year



Source: AIS, *A Guide to Drug Cost Management Strategies*, 2002.

# PBM Market Share in 2002 by:



Source: AIS, *A Guide to Drug Cost Management Strategies*, 2002.

# PBM Industry Participants by Covered Lives

<u>Over 20 million</u>	<u>10-20 million</u>	<u>Less than 10 million</u>
<ul style="list-style-type: none"><li>• AdvancePCS</li><li>• Caremark Rx</li><li>• Express Scripts</li><li>• Merck-Medco</li><li>• WellPoint Pharmacy Management</li><li>• MedImpact Healthcare Systems</li></ul>	<ul style="list-style-type: none"><li>• Eckerd Health Services</li><li>• Aetna US Healthcare</li><li>• First Health</li><li>• Pharmacy Services Group</li><li>• PharmaCare</li></ul>	<ul style="list-style-type: none"><li>• Anthem Prescription Management</li><li>• Inteq Group</li><li>• MIM Corp.</li><li>• National Medical Health Card Systems</li><li>• Prescription Solutions</li><li>• RESTAT</li><li>• RxAmerica</li></ul>

Source: Morgan Keegan & Company, *PBM Industry Overview*, June 25, 2002.

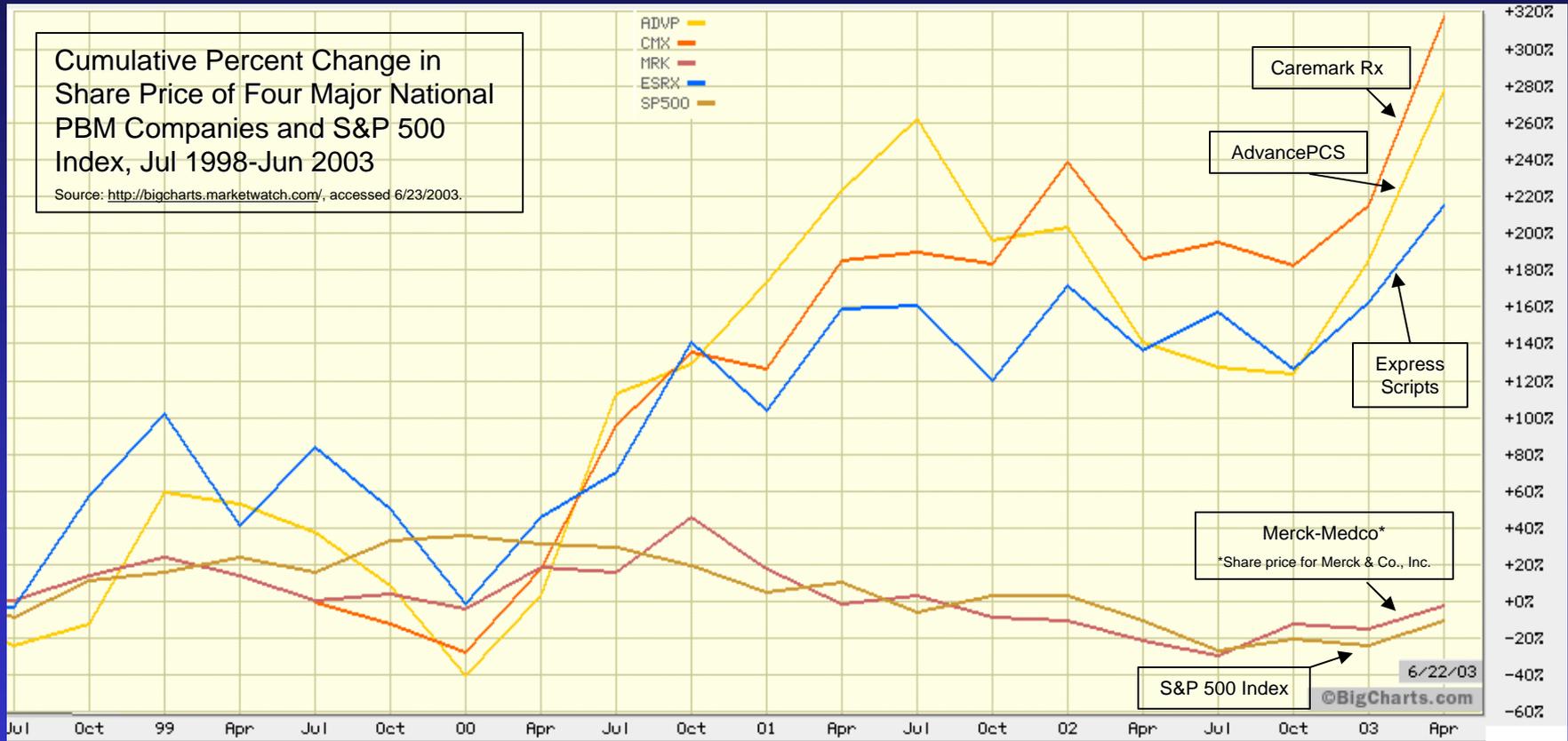
# View of Industry from Wall Street

- **Appears to be real 20%-plus top-line growth**
- **Not capital-intensive businesses, once past initial systems implementation and basic footprint**
- **Industry is boosting efforts to communicate value statement**
- **Untapped market opportunities: Medicare Rx drug benefit & States grappling with Medicaid Rx drug cost pressures**
- **Expanded growth in: mail order, specialty pharmacy, integrated use of data sets**

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Source: Lehman Brothers, *PBM Roadmap*, March 11, 2003.

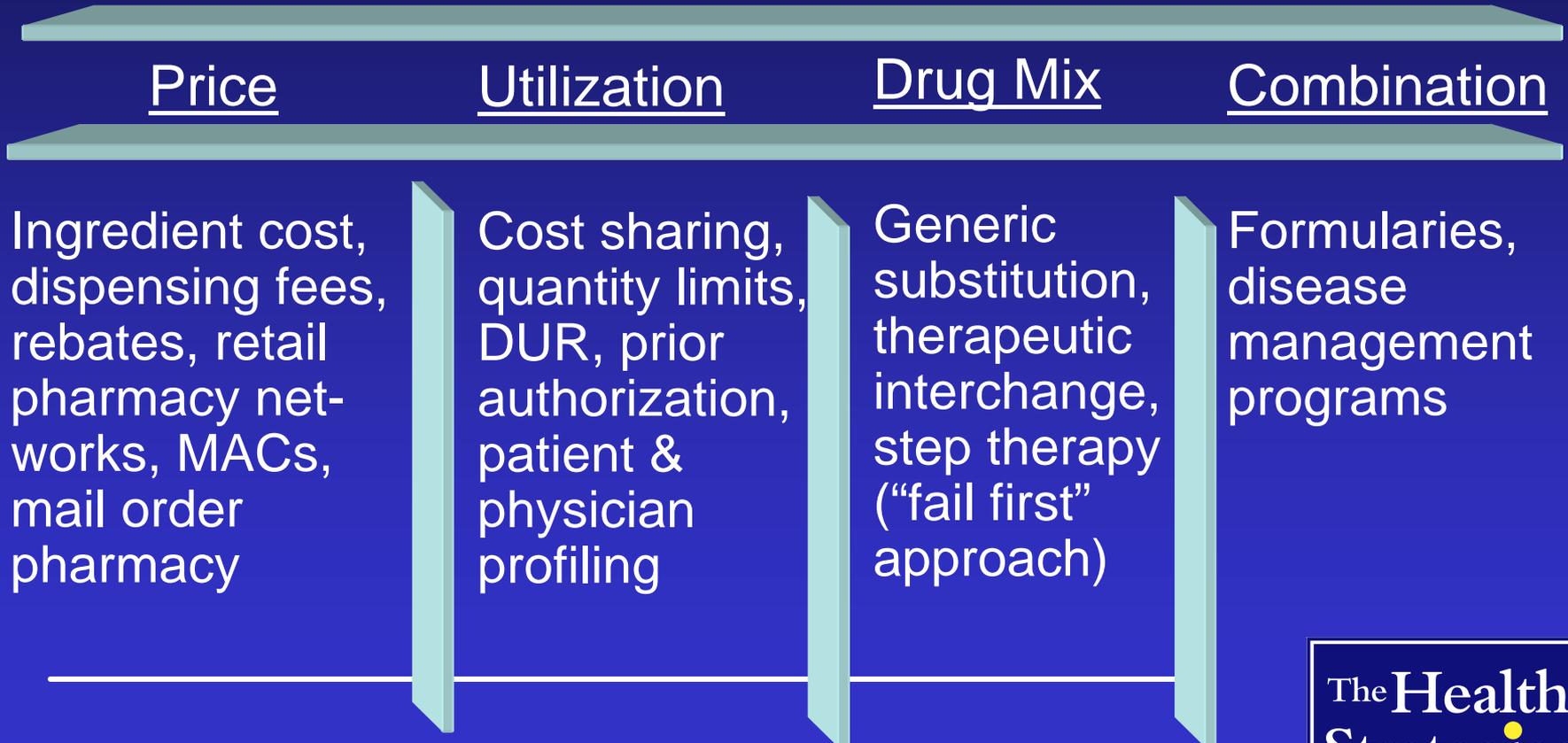
# Major PBM Stocks Outperform S&P 500 Over Last Five Years



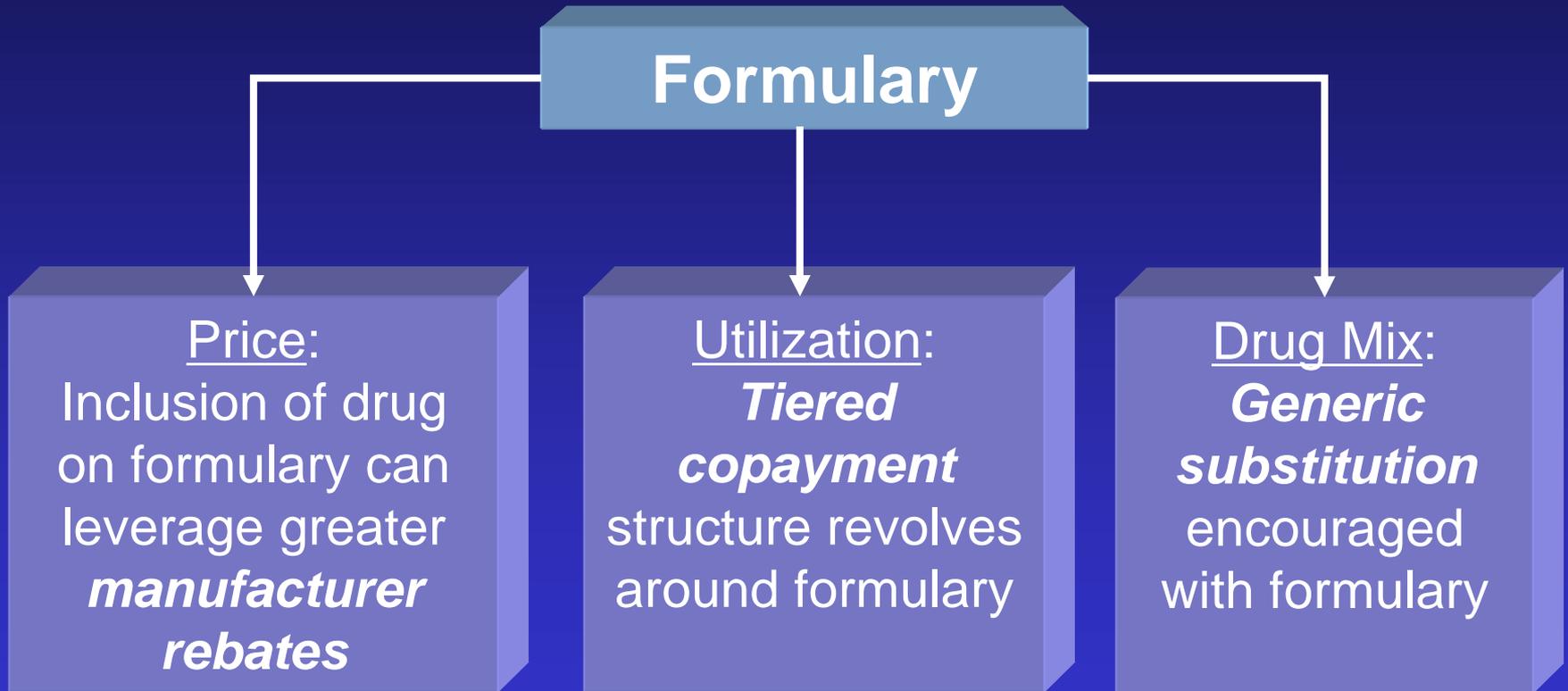
# How PBMs Work: PBM Toolbox and Key Relationships

# PBMs Employ Variety of Tools to Manage Pharmacy Benefits

Price, utilization, and drug mix are key leverage points:



# Formularies Are Central to Management Efforts



# Formulary Structure Dictates Ability to Achieve Savings

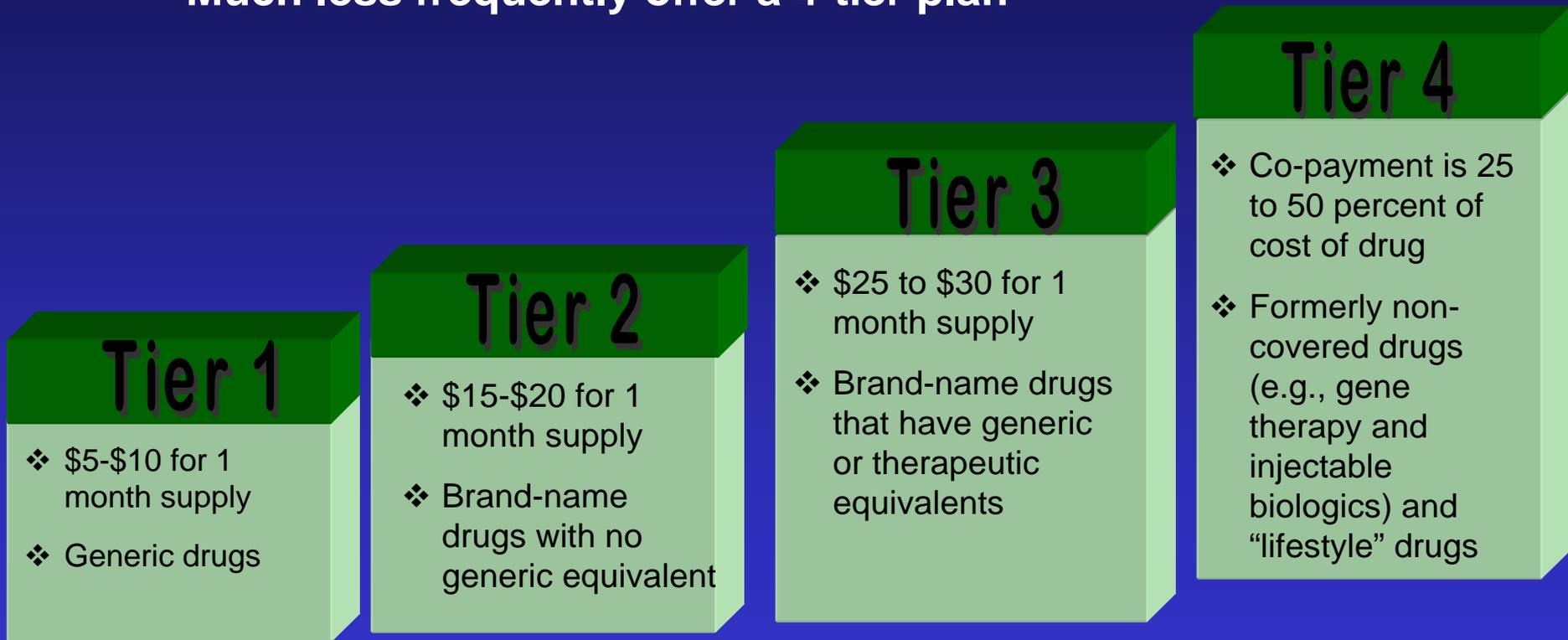
- ***Closed or Partially closed:*** Requires justification for drugs not listed on formulary
  - ***Open preferred:*** Encourages use of certain drugs through incentives
  - ***Open passive:*** Includes drugs that are only passively promoted
  - ***No formulary with Prior Authorization:*** Selected drugs require prior authorization process
  - ***No formulary with Drug Utilization Review:*** No formulary or PA but physician-focused retrospective reviews conducted
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# Manufacturer Rebates

- **Calculations of rebates are complex; depend on wide variety of contract arrangements between PBM, plan sponsors and manufacturers**
- **Fundamental questions in each contract are:**
  - ◆ Which party owns the rebates?
  - ◆ What are the audit rights of each party?
  - ◆ What fraction of rebates is retained by PBM as part of its fee?
- **In general, purchasers who are able to more closely manage the pharmacy benefit are likely to receive greater rebates than those who do not**
- **Rebates are “back-end” discounts; usual lag is 6 to 12 months before rebates received by PBM**

# Tiered Co-Payment Structures

- PBMs frequently offer a 3-tiered co-payment structure
- Much less frequently offer a 4-tier plan



Source: AIS, *A Guide to Drug Cost Management Strategies*, 2002.

# Mail Order Pharmacy

- Generally used for patients with chronic conditions for maintenance medication
- Orders typically filled with 90-day supply
- Aggressive use of therapeutic and generic substitution
- In 2001, 87 percent of large employer groups offered mail order services
- PBMs able to negotiate deeper manufacturer discounts by driving share, automating process
  - ◆ HHS estimates 2 to 25 percent rebates on certain brands

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Sources: Mercer/Foster Higgins, *Nat'l Survey of Employer Sponsored Plans*, 2001; U.S. Department of Health and Human Services, *Report to the President: Prescription Drug Coverage, Spending, Utilization and Prices*, April 2000.

# Generic Substitution & Therapeutic Interchange

- **Generic Substitution**
  - ◆ Dispensing of a drug product that contains the same active ingredient(s) and is chemically identical in strength, concentration, dosage form, and route of administration to the drug product prescribed
- **Therapeutic Interchange**
  - ◆ Interchange of therapeutically equivalent but chemically unique drugs in accordance with established policies and procedures within a healthcare system's evidence-based formulary

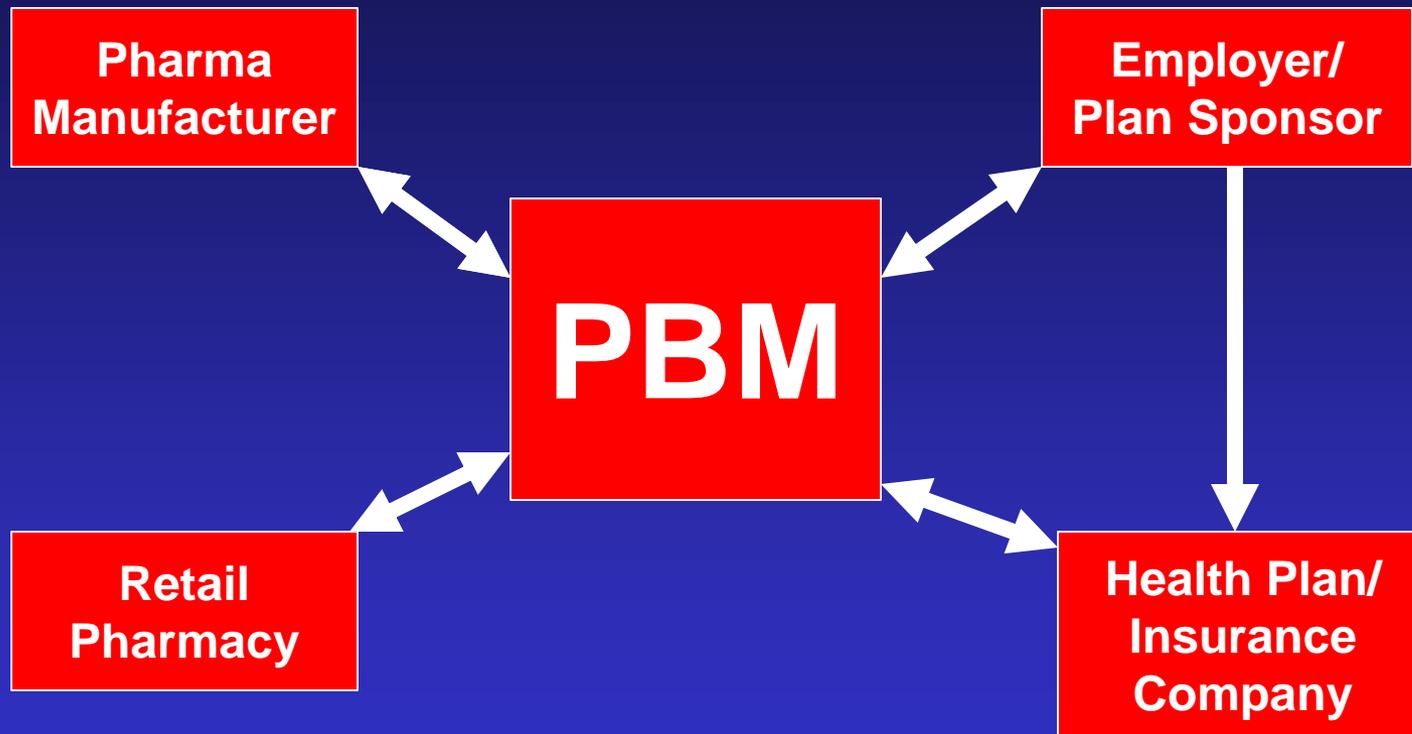
# **PBM Value-Added Services: *Real-Time Medication Check***

- **PBMs typically conduct electronic clinical reviews before medications are dispensed**
- **Prescription is checked for:**
  - ◆ Drug-drug interactions
  - ◆ Drug-disease interactions
  - ◆ Drug age
  - ◆ Appropriate dosage
  - ◆ Excessive utilization
  - ◆ Other factors
- **Pharmacist at point-of-sale receives real-time alert**

# **PBM Value-Added Services: *Pharmacy Case Management***

- **Some PBMs offer sophisticated case management programs which may include the following:**
  - ◆ Patient screening/risk assessment through claims data
  - ◆ Patient/Physician education
  - ◆ Prescription drug management
  - ◆ Coordinated care programs
  - ◆ Performance feedback

# Key PBM Relationships



# Plan Sponsor/Health Plan-PBM Relationship

- PBMs contractually responsible for assuring quality, safety, and cost containment
- Contracting very competitive among PBMs
- PBMs generally do not assume insurance risk, but do assume performance risk
- PBMs paid through administrative fees, share of rebates, or some combination
- PBMs also held accountable through evaluations by third-party benefits companies (e.g., Mercer)

# Pharmacy-PBM Relationship

- Ability to create contracted pharmacy networks is a key PBM tool
- PBM quality, safety and cost-containment programs require additional administrative tasks by pharmacies
  - ◆ Phone calls to doctors for switching programs
  - ◆ Benefit plan counseling
- Pharmacies can obtain higher compensation from non-PBM customers
- Political tensions have resulted

# Manufacturer-PBM Relationship

- **Manufacturer-PBM relationship is key to producing savings and also often revenues to PBM**
- **Rebate revenue estimated between 5-25% on brand-name drug spend**
- **Calculations of rebates complex; generally based on PBM's ability to achieve market share targets**
- **U.S. DHHS Inspector General is increasing scrutiny of relationships for Medicare-Medicaid participation (April 2003 OIG Guidance)**

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Source: California HealthCare Foundation, *Navigating the Pharmacy Benefits Marketplace*, January 2003.

# What is the Role of PBMs in the Rx Decision-Making Process?

- **Prescription decision-making process still driven by physician and patient**
- **PBMs set parameters for physician prescribing**
  - ◆ Formularies structured differently; many allow access for non-preferred Rx through PA and/or increased patient copayments
- **Other entities exert influence on physician**
  - ◆ Manufacturer marketing and incentives
  - ◆ Pharmacist/physician dialogue to implement generic or therapeutic substitutions, can override PBM recommendations

# Industry Challenges

- **Erosion of pricing power**
  - ◆ Employers/health plans demanding more accountability yet less willing to pay
- **Difficulty in differentiating service offerings**
  - ◆ Purchasers not able to draw distinctions between PBM firms
  - ◆ Innovative services quickly picked up by competitors
- **Diminishing returns from industry concentration**
  - ◆ Future mergers/acquisitions may not create dramatic change in overall competitive landscape
- **Flat enrollment growth due to market saturation**
  - ◆ Must create organic growth by winning business from competitors and developing potentially riskier government markets
- **Competition from “Provider Synergies” business model**
- **Potential legal, political, and resulting PR threats**

# In Summary

- **PBMs manage the majority of prescriptions that flow through health care system**
  - **PBM industry has evolved from one of numerous, small, claims processing firms to more concentrated industry with comprehensive service offerings**
  - **Key relationships with manufacturers, pharmacies, and health plan sponsors drive success**
  - **Future growth opportunities exist in disease management, specialty pharmacy, mail order, generic substitution**
  - **Challenges likely to alter face of the PBM industry -- again**
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