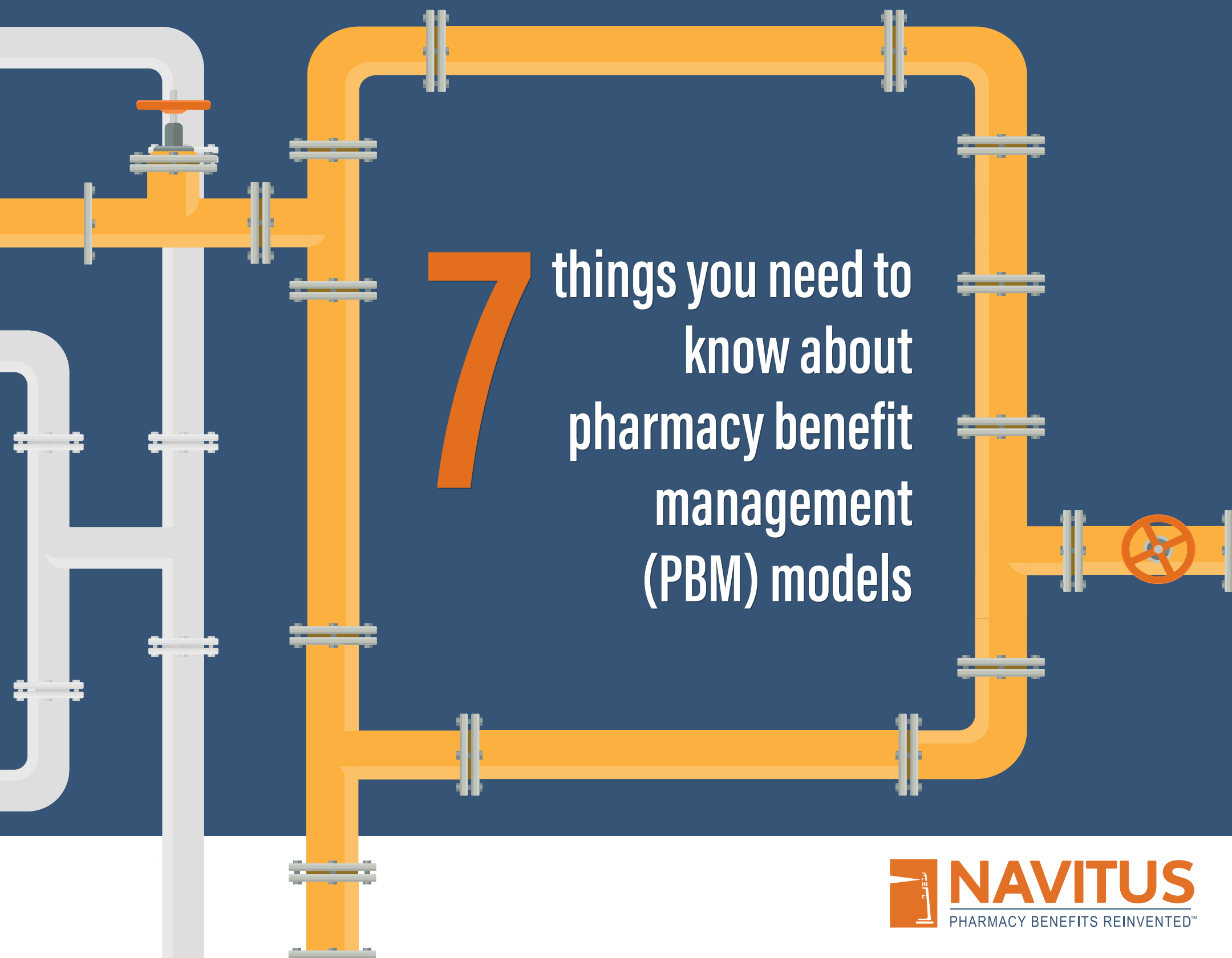


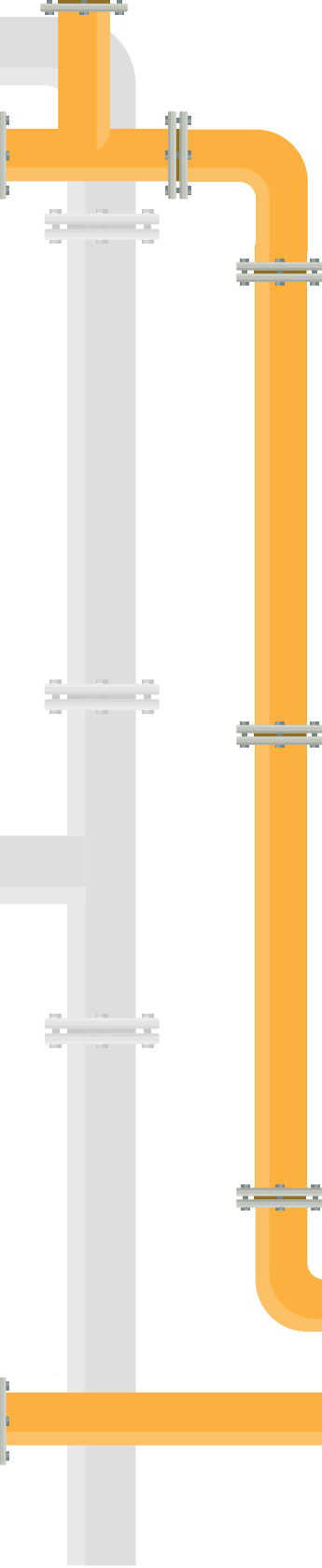


7 things you need to know about pharmacy benefit management (PBM) models



NAVITUS
PHARMACY BENEFITS REINVENTED™

E-Book Disclaimer: This e-book is produced by Navitus Health Solutions with the intent of offering a fair and balanced overview of different PBM models. However, we are a pass-through PBM that is fully-transparent, so some of our findings may favor our business model.



Contracting with a pharmacy benefit management (PBM) company, is no small task. With millions of dollars and member health at stake it's an important decision for any organization. That's why many plan sponsors hire a consulting firm to help with such a BIG decision. Whether you hire a consultant or decide to 'go it on your own' this e-book will help you better understand the 'ins and outs' of different PBM business models and how each can make an impact on your pharmacy spend. By the time you finish this e-Book, we think you'll feel more prepared the next time you consider a PBM. Better yet, by investing the time to understand PBM models, you may have an opportunity to shave 10-15%¹ off your Rx benefit costs and better manage ongoing trend.

Before jumping in, here are a few definitions that will help you make sense of the complex PBM industry.

¹ Navitus Internal Data. Clients new to Navitus.

3 PBM Financial Model Types

What are the various types of PBM Financial Models?

Traditional -- Hybrid -- Pass-Through

Is Transparency a Financial Model?

No. Transparency is a way of doing business. It means full operational and financial disclosure that reveals all PBM revenue streams.

Why is transparency important?

Transparent PBMs disclose how they generate revenue, with full visibility to pharmacy and manufacturer contract fees/charges. This allows plan sponsors to better monitor PBM performance and results, make informed decisions and fine tune their pharmacy benefits.

What is 'spread'?

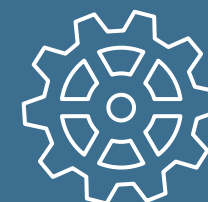
According to Drug Channels Institute, spread is the difference between "... the amount that a PBM charges to a plan sponsor and the amount that the PBM pays to the pharmacy that dispenses the drug to a consumer."¹ In a traditional arrangement, the PBM may take a spread (also known as margin or mark-up) and charge the plan sponsor more than the pharmacy was paid. In a pass through arrangement, the PBM bills the plan the same price it paid to the pharmacy.

What is average wholesale price (AWP)?

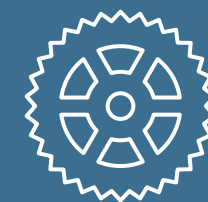
According to drugs.com, "AWP is a pharmaceutical term that describes the average price paid by a retailer to buy a drug from the wholesaler."² This is the industry standard and starting point used to determine drug pricing. Then based on several factors, discounts are applied to set the final cost for plan sponsors.

¹ The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, Drug Channels Institute, page 134, https://drugchannelsinstitute.com/products/industry_report/pharmacy/ (As viewed on 01/2019)

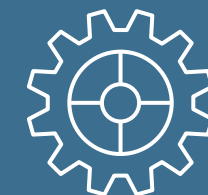
² Average Wholesale Price (AWP) as a Pricing Benchmark, Drugs.com, <https://www.drugs.com/article/average-wholesale-price-awp.html> (As viewed on 01/2019)



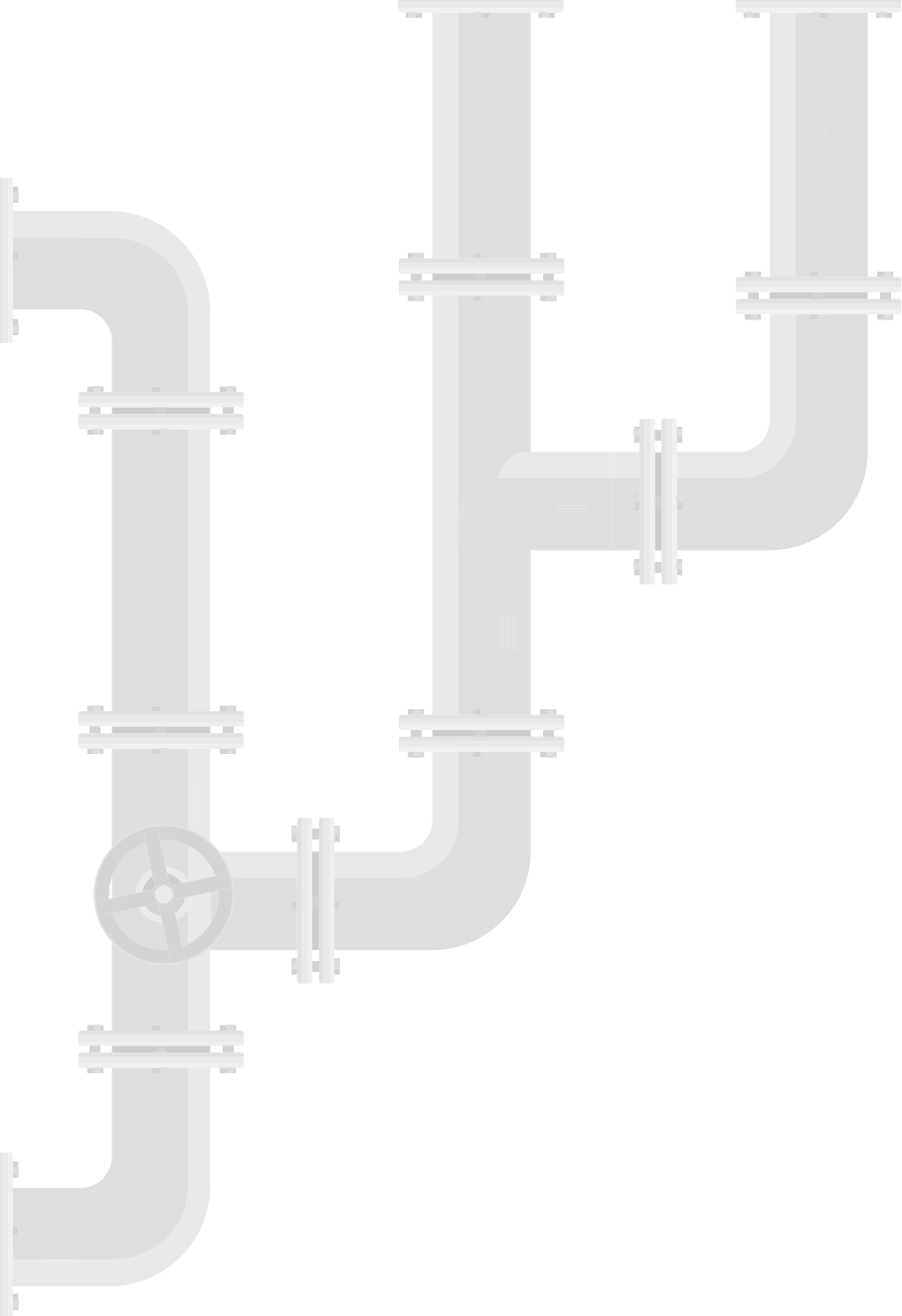
TRADITIONAL



HYBRID



PASS-THROUGH



What is drug trend?

Drug trend measures drug cost and plan member usage over time. Trend is typically measured on a year-over-year (YOY) basis. A low to neutral increase (or possibly negative) over time is a good thing as it equates to less Rx benefit costs for plan sponsors.

What is a Maximum Allowable Cost (MAC) list?

"It is a cost management program that sets upper limits on the payment for equivalent drugs available from multiple manufacturers."¹ This is the 'maximum amount' that a plan sponsor will pay for products. Typically this applies to the generic drugs, since they are manufactured and distributed by multiple companies. Lists are updated regularly and may change due to market conditions or repricing.

What is generated revenue?

Any rebates, incentives, 'fees' or volume discounts that are generated from pharmacy benefit purchasing activities.

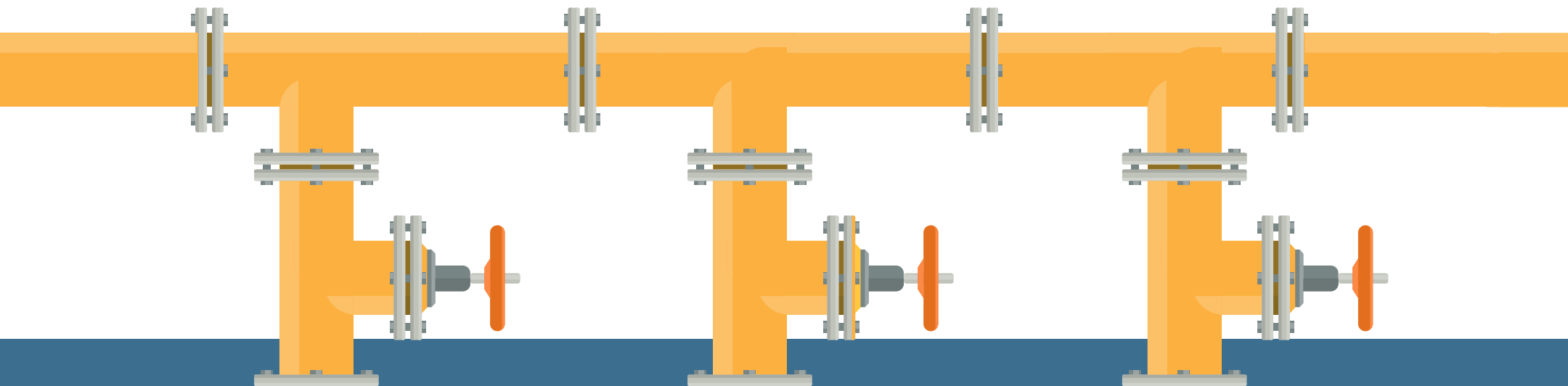
¹ PBM Purchasers Guide: A Quality Management Toolkit, URAC, 2009.



Why the model matters?

When it comes to pharmacy benefits, today's plan sponsors are demanding more transparency, greater accountability and higher performance. One way you can achieve this goal is to choose a PBM model that lines up with your goals. If your goal is to lower cost, then you're not alone. In a survey conducted by the **National Pharmaceutical Council (NPC)** of 88 U.S. employers with 5,000 or more employees, their top concerns were "related to controlling costs and the use of cost-effective treatments."¹ Let's take a look at the three models available.

What models are available?



TRADITIONAL

Traditional PBMs offer volume discounts and high rebates to achieve cost savings. They typically do not have an admin. fee since they earn a significant amount of revenue from spread. This model is less transparent about its business practices, and requires strict adherence to plan designs and contract details.

HYBRID

Hybrid PBMs are a cross between traditional and pass-through. They earn less from spread, and share more revenue with plan sponsors. They disclose more of their business practices but still have fees/charges built into the contract. Hybrid models may or may not offer contracts and plan designs that are flexible.

PASS-THROUGH

The PBM focuses on the pass through of costs and revenue back to the plan sponsor. This model is fully transparent, so the PBM's business practices and all fees/charges are visible. Plan design and contracts are more flexible because the PBM's only source of revenue is an admin. fee, instead of generating revenue from rebates and pharmacy transactions.

¹ TOWARD BETTER VALUE, National Pharmaceutical Council (NPC), Page 4, <https://www.npcnow.org/publication/toward-better-value> (As viewed on 01/2019)

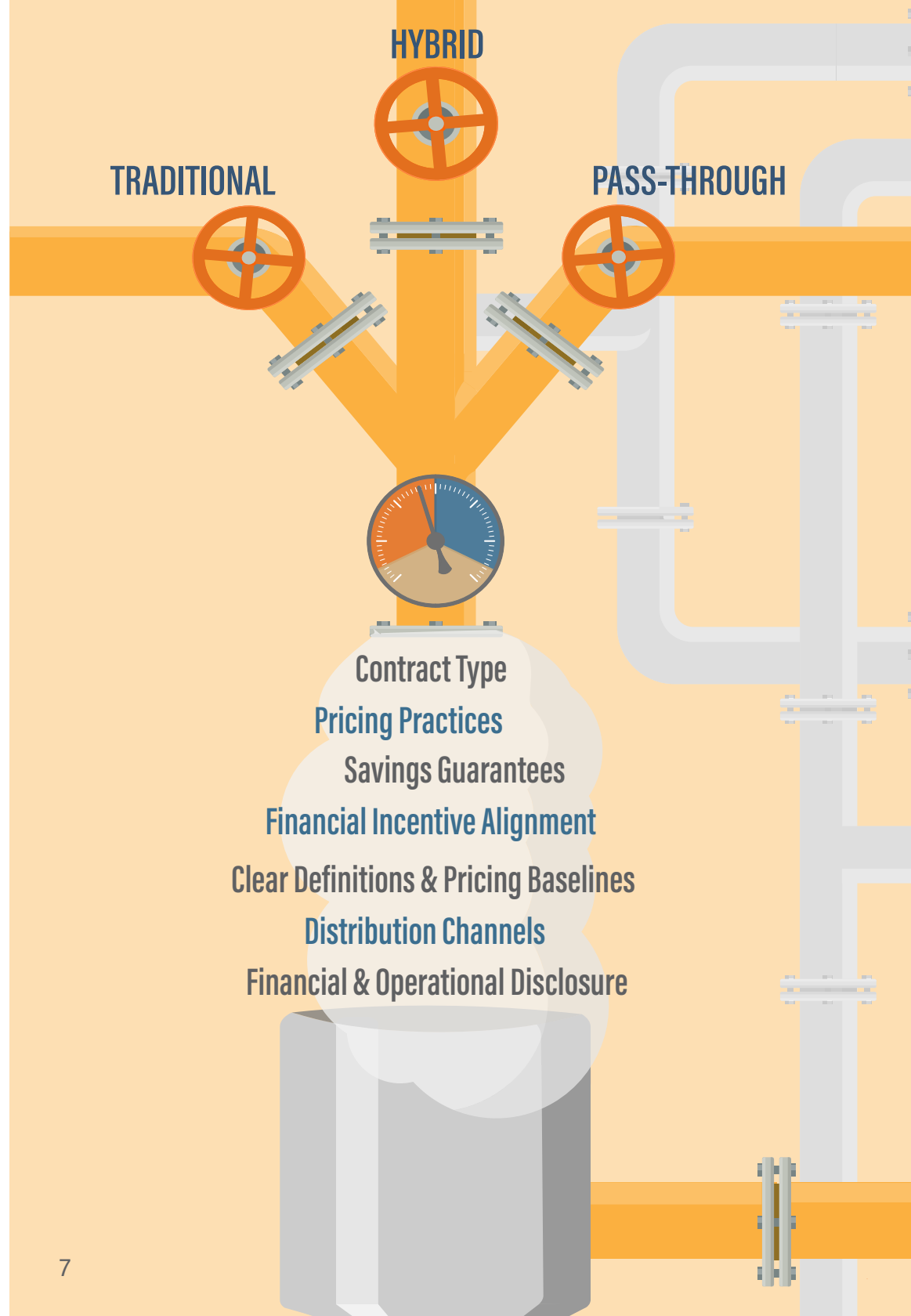
PBM Model Comparisons

All PBMs negotiate discounts with pharmacies and rebates with manufacturers on behalf of their clients. However, depending on the PBM model, what the plan sponsor receives and/or pays may vary. What's more, the model influences every aspect of the PBM contract, and effects how your pharmacy benefit functions and performs.

Let's take a look at how each model impacts critical PBM components and compare the differences.

For plan sponsors willing to invest the time to understand PBM models, there's an opportunity to save 10-15%¹ on their Rx benefit costs. Whether they're spending 50 million or 500 million, these savings can make a BIG difference.

¹ Navitus Internal Data. Clients new to Navitus.



1. Contract Types

Traditional and Hybrid

In these models, contracts are somewhat rigid and offer less flexible plan designs. PBMs are **looking to lock-in contract terms**, so if plan sponsors want changes, mid-contract requests are often denied or modified to meet PBM spread pricing goals. **Over a three year contract, costs will vary after the first year.**

Pass-through

Contracts are more flexible and plan design is aligned with plan sponsor goals. When mid-contract changes are requested, they are often collaboratively made to choose programs and services that add value.

Over a three year contract, costs are known upfront and are consistent year after year.

A traditional contract is advantageous if plan sponsors are looking for zero or low admin. fees but are ok with costs that go up after year one. Alternatively if looking for consistent baseline pricing, then a pass-through contract may be a better fit for some.

According to **Drug Channels Institute** a spread pricing model, requires “...More complex contract management. To monitor their ongoing expenditures, clients must build disclosure into the contract to define where spreads exist. Clients must review reports and audits to ensure they are receiving the discounts that a PBM has guaranteed.”¹ Additionally, pass-through pricing models offer “Greater transparency: The plan sponsor can better understand total costs. That’s because the PBM earns no spreads and is paid fees only for program administration.”²

^{1,2} Adapted from PBM Purchasers Guide: A Quality Management Toolkit, URAC 2009, as used in: The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, Drug Channels Institute, page 136, https://drugchannelsinstitute.com/products/industry_report/pharmacy/ (As viewed on 01/2019)

2. Pricing Practices

Traditional

Revenue is generated from pharma purchasing activities, so traditional models typically use a formulary with emphasis on high volumes to offer BIG discounts. **On paper, big rebates and large discounts appear to be in everyone's best interest**, however, only **some** of the pharma generated revenue (rebates/discounts/incentives/fees) is passed back to plan sponsors.

Hybrid

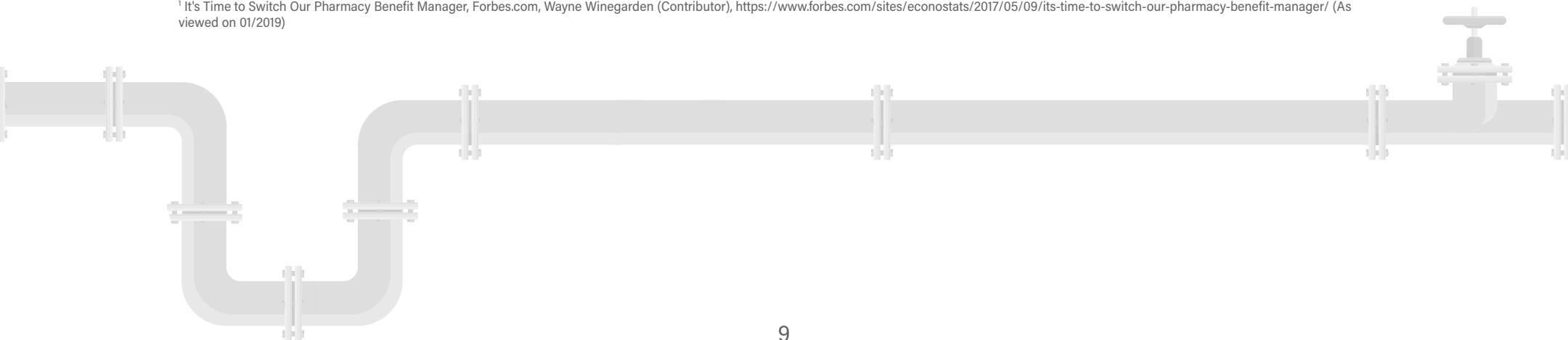
This option has **more** pharma generated revenue that is passed back to plan sponsors. They may take some spread, and only in certain channels (i.e. mail and specialty) and use a mix of rebates and lower costing drug formularies to offset costs.

Pass-through

Spread based pricing is non-existent in this model. So PBM revenue is based on an admin. fee, so both plan sponsors and the PBM interests are the same. Because of this alignment, **100% of all pharma generated revenue is passed back to plan sponsors.**

Using a consumerism mindset, plan sponsors should keep an eye on what they are actually paying for. The reason for this is because, "PBMs are incentivizing higher list prices for medicines that enable them to create large rebates and discounts,"¹ according to an article posted on forbes.com.

¹ It's Time to Switch Our Pharmacy Benefit Manager, Forbes.com, Wayne Winegarden (Contributor), <https://www.forbes.com/sites/econostats/2017/05/09/its-time-to-switch-our-pharmacy-benefit-manager/> (As viewed on 01/2019)



3. MAC Lists and Distribution Channels

Traditional

Multiple MAC lists may be used for **retail, mail and specialty** which is one pricing strategy that traditional PBMs use to generate spread. They **may retain more than 10-15% spread in all channels**. Many PBMs own their own mail order and specialty and may be funneling/steering volume to offer more discounts, but this may not be the lowest cost option.

Hybrid

Multiple MAC lists may be used for retail, mail and specialty to generate spread. They **may retain only 10-15% spread in certain channels**, and may own their own mail order and specialty to offer more perceived discounts.

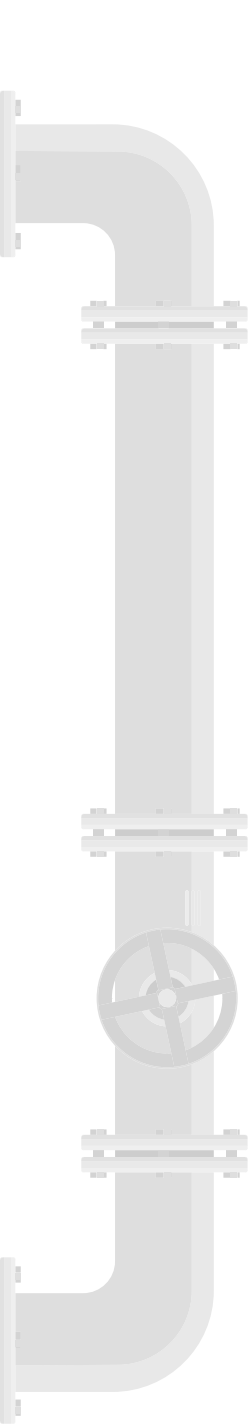
Pass-through

Uses one MAC list across all channels because when pricing is a pass-through, there is no need to have multiple lists, and they **do not retain any spread**. Additionally, rather than focusing on volume discounts, a pass-through model focuses on lowest net-cost, recommending the best channel to use based on plan sponsor need.

According to an article on fortune.com, "MACs, however, allow PBMs to charge health plans far more than what they pay pharmacies." As an example: Mail order and specialty may not be the lowest cost option. Plan sponsors should ask their PBM for a cost comparison across all channels; retail, mail and specialty for 30 and 90 day supply options. According to Drug Channels Institute, "Average revenues per equivalent prescription are about four times larger at mail pharmacies,"² which explains why some PBMs focus on mail-order.

¹ PBMs Are Hogging Our Drug Discounts, Fortune.com, Peter J. Pitts, <http://fortune.com/2018/08/28/express-scripts-pbm-drug-prices/> (As viewed on 01/2019)

² The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, Drug Channels Institute, page 20, https://drugchannelsinstitute.com/products/industry_report/pharmacy/ (As viewed on 01/2019)



4. Financial Incentive Alignment

Traditional

This model focuses on generating large rebates and high volume discounts in order to offer cost savings. The reason is to have the appearance of zero or low admin fees they need to make money on the spread. Some of the generated revenue is shared with plan sponsors, **because most of the financial incentive is used as revenue for a traditional PBM.**

Hybrid

Incentives are more aligned with plan sponsors as they may only take 10-15% spread. This model has low admin. fees because they make money on spread, but plan sponsors may see a higher share of generated revenue.

Pass-through

This model focuses on lower costs as a starting point, and then applies rebates and discounts to drive lower costs. It can do this because an admin fee is their only source of revenue, and **100% of all financial incentives are passed back to plan sponsors.**

It's your pharmacy benefit budget, shouldn't you be getting all of the generated revenue that you are entitled to?

And, just how much generated revenue are we talking about? This is illustrated in an article on Fortune.com, "If just one-third of the total discounts PBMs negotiate for Medicare's drug benefit were passed on to patients at the pharmacy counter, seniors and others in Medicare would have nearly \$20 billion more in their pockets over the next decade. Indeed, the top three PBMs..., who together control 75% of the market—collected more than **\$10 billion in profits in 2015.**"¹

In a pass-through model, plan sponsors need to decide what to use all of that generated revenue for, here are some ideas: In a published study by Drug Channels Institute, 68% of employers used formulary rebates to reduce plan spend, while 15% used rebates for a combination of plan and member savings, and 11% were used to offset member premiums.²

¹ PBMs Are Hogging Our Drug Discounts, Fortune.com, Peter J. Pitts, <http://fortune.com/2018/08/28/express-scripts-pbm-drug-prices/> (As viewed on 01/2019)

² Employers' Use of Formulary Rebates, 2017, Drug Channels Institute, <https://www.drugchannels.net/2018/01/employers-are-getting-more-rebates-than.html> (As viewed on 01/2019)

5. Financial & Operational Disclosure

Traditional

Some visibility to and disclosure of PBM business practices on how they generate revenue and what they do with it. Typically, sample sets of data are provided for reporting/auditing purposes.

Hybrid

More visibility to and disclosure of business practices, with a varied degree of transparency. Typically shares a limited set of data for claim and invoice auditing.

Pass-through

100% visibility to financial and operational business practices. Plan sponsors have access to 100% of their data, and have visibility down to the claim/invoice.

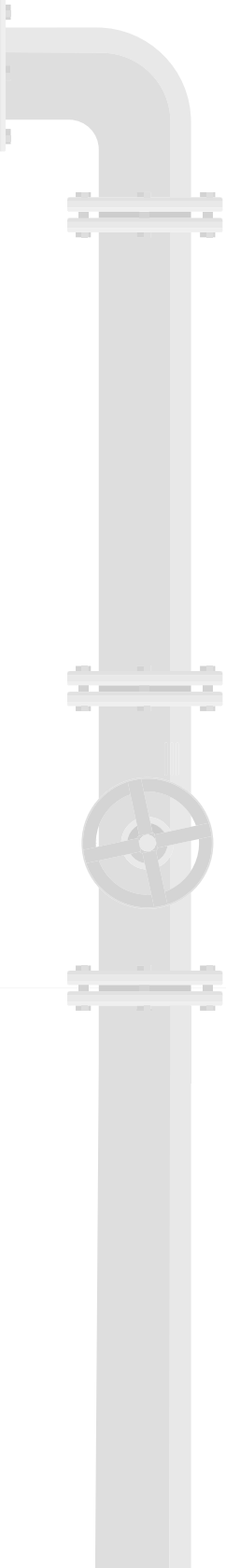
Transparency is important because when you have access to all of your data you can make informed plan decisions, and it enables you to better monitor PBM performance and results.

According to a benefits article published in the Society for Human Resource Management (SHRM), "When negotiating their... pharmaceutical benefits, employers should ask for more transparency in their PBM contracts so they can keep track of hidden costs, experts advise."¹

This is important because **the more transparent a PBM is, the happier plan sponsors are:** According to Drug Channels Institute, "Plan sponsors satisfaction was strongly correlated with perceived degree of transparency. Plan sponsors using PBMs that were described as "not at all transparent" got a satisfaction rating that averaged at 5.8 out of 10. That compares with an 8.7 rating for plan sponsors with a completely transparent' relationship."²

¹ Negotiating Price Transparency with PBMs Pays Off, **Society for Human Resource Management (SHRM)**, Greg Goth, <https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/negotiating-drug-prices-pbms.aspx> (As viewed on 01/2019)

² The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, pages 137-138, https://drugchannelsinstitute.com/products/industry_report/pharmacy/ (As viewed on 01/2019)



6. Clear Definitions and Pricing Baselines

Traditional

In this model, the PBM defines brand and generics using contract caveats and definitions. Drug pricing is set by the PBM using a 'proprietary algorithm' (based on the PBM's internal pricing strategies).

Hybrid

Under this model, the PBM may define brand and generic definitions. Drug pricing may be set by the PBM or in some cases using industry baselines.

Pass-through

With this option, the PBM defines brand and generics using clearly defined contract definitions. Drug pricing is **based on industry acknowledged baselines**. Sources include **Medi-Span, First Databank and the CMS** (Centers for Medicare & Medicaid Services) published national average drug acquisition cost.

According to a ProPublica article published on NPR.org, "... pharmacy benefit managers often don't disclose the size of the rebate, which allows them to keep some or most of it for themselves." In a pass-through PBM model, when contracts are clearly defined and pricing is set using industry baselines, nothing is hidden and the PBM can focus on passing savings back to plan sponsors.

¹ A Tough Negotiator Proves Employers Can Bargain Down Health Care Prices, Marshall Allen for ProPublica (published on NPR.org), <https://www.npr.org/sections/health-shots/2018/10/02/652312831/a-tough-negotiator-proves-employers-can-bargain-down-health-care-prices> (As viewed on 01/2019)



7. Savings Guarantees

Traditional

In this model, Rx benefit costs are based on pricing guarantees on high volume and BIG rebate discounts. Guarantees are based on a 'ceiling' or cap on financial performance and rebate and discount improvements are not shared with plan sponsors. **Cost saving programs like prior authorization don't work as well as they should because they focus on approving more drugs to achieve more volume savings.**

Hybrid

May use some traditional and some pass-through practices.

Pass-through

This approach factors in all costs to provide a bottom line per member per month (PMPM) number. Your all-in actual Rx benefit costs are based on spend versus the health trend of your plan members. Guarantees are considered a starting point or 'floor,' because negotiated rebates and discount improvements are passed back to plan sponsors in real time. **Cost savings programs like prior authorizations save more because they only approve what is needed, and recommend what is in the best interest of plan members.**

Guarantees that place a cap on costs are good for those looking for a 'do not exceed' model (with ceiling capped guarantees). For plan sponsors looking for a share of any upside cost savings should look for a minimum guarantee model (with floor starting point guarantees). An example of this is 'Price Protection,' according to Drug Channels Institute, "List price increase above the ceiling (guarantee) trigger additional rebate payments."¹ Depending on your PBM contract you may or may not be getting these extra rebates.

¹The 2018 Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, Drug Channels Institute, page 122, https://drugchannelsinstitute.com/products/industry_report/pharmacy/ (As viewed on 01/2019)



Traditional Model



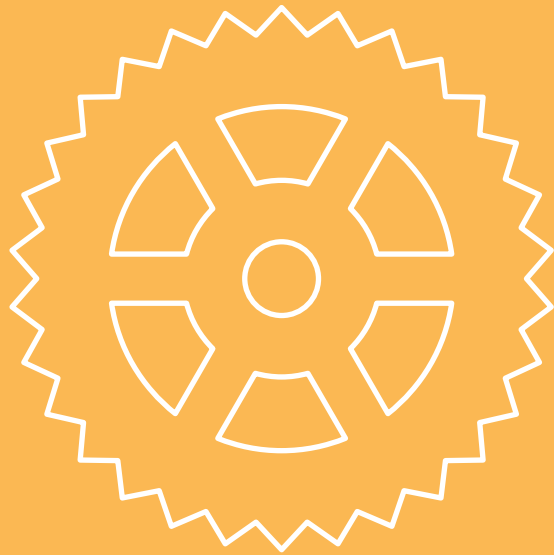
From the topics we've discussed in this e-book here is a **summary** of each model and the differences between each one.

Traditional PBMs offer volume discounts and high rebates to achieve cost savings. However, they may retain spread compensation from pharma revenue on rebates, discounts and incentives. They also may earn spread from pricing through various channels (i.e. retail, mail, and specialty). They may share some of the pharma revenue with the plan sponsors, but, with little to no transparency plans can't get visibility into how much the PBM is keeping. Additionally, traditional PBMs offer guarantees on savings, but they may place a cap on the amounts, so they can retain the difference.

Some plans sponsors prefer a traditional PBM model since it offers performance guarantees that may serve as a safety net to prevent Rx costs from going out of control.

This may be a good option, if, depending on the size of your organization, you are trying to improve on your year-over-year (YOY) Rx benefit costs. This is also a good choice if you are looking to lock in pricing for the contract term at a negotiated rate.

Hybrid Model

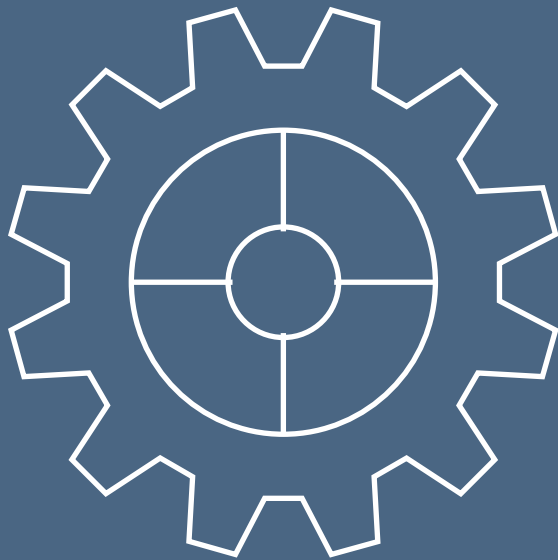


Hybrid models combine traditional and pass through to offer a slightly more transparent option, allowing visibility into pricing and revenue business practices. To provide a little more give and take, some channels (i.e. retail, mail and specialty) may be pass through while others may contain spread. A hybrid model may also share some pharma revenue such as rebates, discounts and incentives) with plan sponsors. But again, transparency is limited leaving little visibility into how much the PBM keeps. Hybrids may charge a minimal admin. fee or none at all.

For plan sponsors this may mean less admin. fees and the potential to maximize lower distribution channel costs (i.e. mail vs. retail).

This model may be a good option if you want more visibility into PBM pricing practices and if you want more of a stake in pharma-generated revenues.

Pass-Through Model



Pass-through PBMs offer the most transparency among PBM models. They pass 100% of all rebates and discounts back to the plan sponsor. Pass-through PBMs can do this since their only source of revenue is an admin fee. With that said, they typically provide full financial and operational disclosure and offer full audit rights down to the claim and invoice level so plan sponsors can verify the savings. Additionally, they focus on lowering overall drug spend with the right drug mix and selective rebates, to help plans achieve better drug trend and a low PMPM.

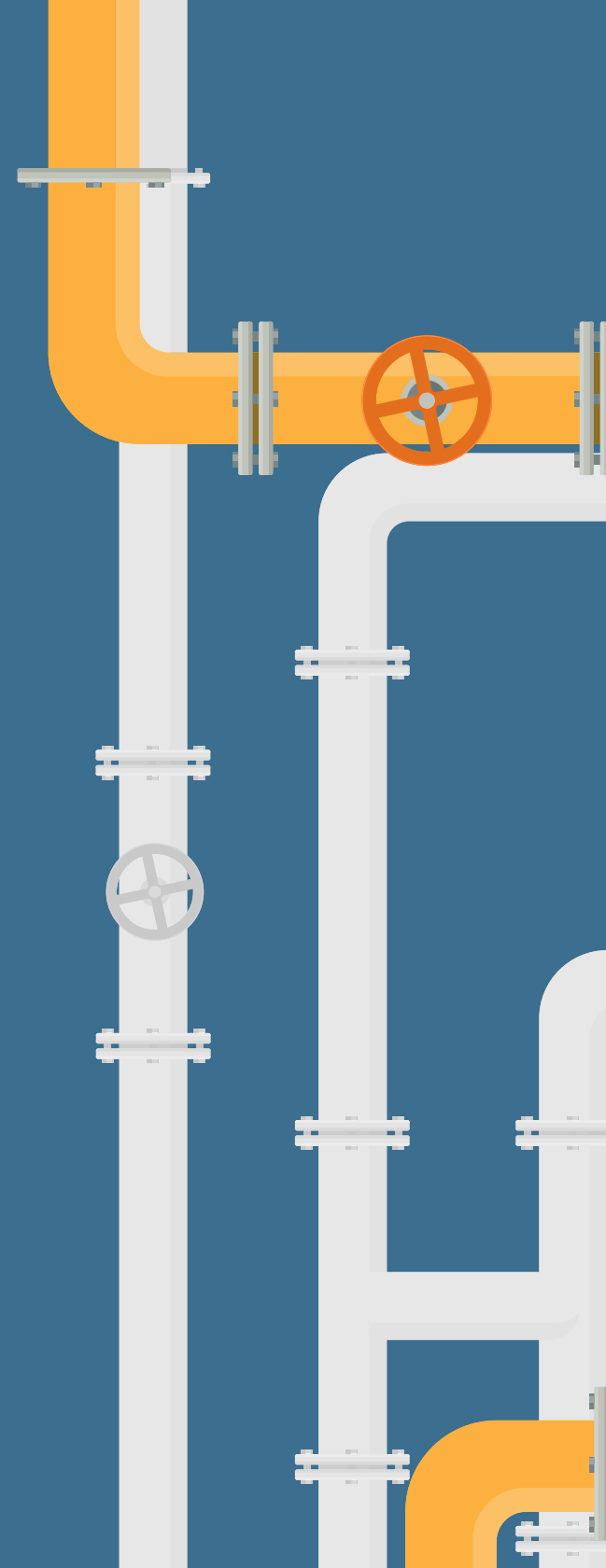
This model may be a good option if you want full visibility to where your Rx spend is going, and if your organization wants to recover 100% of all rebates and discounts (generated revenue).

Making Informed Decisions and Evaluating PBM Performance

Regardless of which PBM model you prefer, here are some things to investigate with your current PBM, or if you are working with a new PBM, these are topics/questions that you will want to ask about:

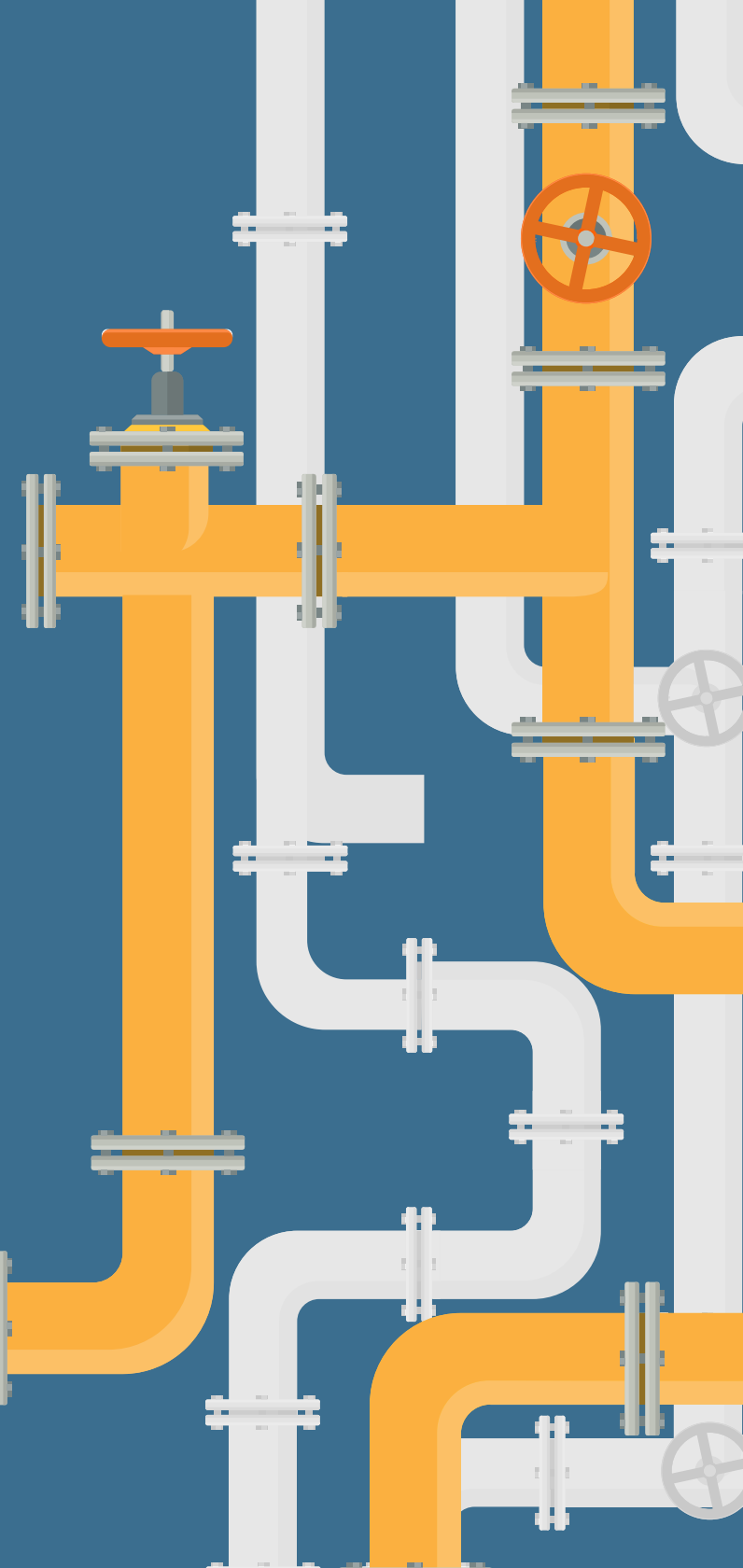
Questions to ask your current/prospective PBM:

1. Is your PBM model a traditional, hybrid or pass-through?
How are you different than other PBMs, and how can you help me save on my benefit costs?
2. What are my all-in costs going to be and what costs will I incur over the course of the contract?
3. What are your pricing practices, do you have spread built into your pricing? Will you disclose how much spread is included in all channels? Can I match pricing between claims and invoices?
4. What can I do to control costs:
 - ▶ Do you have recommended programs and services to help with this?
 - ▶ If recommending a prior authorization program (PA), what is its approval rate?
 - ▶ How do your recommended programs affect purchasing volume and the amount of rebates generated?



Questions to ask your current/prospective PBM:

5. How transparent are you, will I (do I) have access to all of the data (or just sample sets of data)? Can I audit down to the claim level with a 1:1 match on the invoices?
6. Are the drug prices set by you, or by an independent 3rd party source?
7. Do you use multiple MAC lists for each distribution channel for retail, mail order and specialty? Or, are you using one simplified MAC list for all channels?
8. How are financial incentives aligned in your business model:
 - ▶ Are you focused on BIG rebates and high volume discounts, OR focused on lower cost drugs as a starting point and then applying rebates and discounts?
 - ▶ What percentage of your client base is traditional vs. pass-through?
 - ▶ If comparing a traditional PBM to a pass-through PBM, does the spread retained in a traditional model justify zero or low admin. fees? Or in the pass-through model, are you saving more than traditional, even with admin. fees built into the final evaluation?



To learn more about PBM models and additional ways to save on your pharmacy benefit cost,
visit: **go.navitus.com/pbm_models**

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