

TESTIMONY OF

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ON BEHALF OF THE

HONEYWELL INTERNATIONAL INC.

FOR THE

ERISA ADVISORY COUNCIL

**Pharmacy Benefit Manager
Compensation and Fee Disclosure**

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Good afternoon. My name is Allison Klausner and I am the Assistant General Counsel – Benefits for Honeywell International Inc. (“Honeywell”). Thank you for inviting me to participate in a dialogue about pharmacy benefit manager fees and compensation in the context of disclosure and contracts.

Today I am here on behalf of Honeywell, a Fortune 100 company that invents and manufactures technologies, is located in almost 70 countries and employs over 130,000 individuals worldwide, approximately half of whom work in the United States. As such, regulatory issues involving employee benefits for our American workers are very important to Honeywell.

The scope of this hearing relates to compensation and fees earned by pharmacy benefit managers (PBMs) in the context of Section 408(b)(2) of ERISA which, in essence, is designed to ensure that contracts related to ERISA governed employee benefit plans involve reasonable compensation for the services provided by the supplier. More specifically, the Council is exploring whether there is a need for greater disclosure by the PBMs to promote a clear understanding as to the services provided by the PBMs and, with respect to such services, the compensation and fees earned by the PBMs. Furthermore, the Council seeks to understand whether there is a need to modify or develop the regulatory landscape to foster compliance with ERISA 408(b)(2). Importantly, as noted in the issue statement released by the Council, this hearing is, to some degree, a continuation of the issues I discussed during my testimony at the Department of Labor’s 2010 hearing titled “Hearings on Reasonable Contracts or Arrangements for Welfare Plans under 408(b)(2) – Welfare Plan Disclosure.”

The management and administration of employee benefit plans is complex and, as discussed at the recent Council hearing on outsourcing, is one that inevitably results in plan sponsors leveraging the expertise of suppliers through a variety of outsourcing arrangements. Indeed, the utilization of PBMs to deliver prescription drugs covered

under an employer sponsored welfare benefit plan is an outsourced arrangement. In that regard, as the Council considers whether any new regulations should be drafted, I encourage the Council to reflect on whether any such regulations should be focused narrowly on PBMs or whether they should have broader applicability to the vast array of suppliers to which plan duties are, or may be, outsourced. In any event, Honeywell would support new regulations, so long as they do not interfere with the ability of companies to engage suppliers, including PBMs, which in turn provide companies with access to expertise, innovation, and technology and allow them to focus on their core business, rather than the business of managing its employee benefit plans.

Turning my attention to your specific questions, the following are some thoughts for your consideration.

PBM Services

The scope and type of services provided by PBMs is varied and vast. PBMs do not merely acquire prescription drugs from manufacturers and dispense the same by mail to individuals covered by employer sponsored health plans.

PBMs negotiate contracts and rebates with the manufacturers. Notably, the PBMs' leverage their size and scope (based in part on the number of clients, plans, and covered lives which they support) to negotiate prescription drug costs that are often significantly lower than they would be if each plan sponsor were to negotiate independently with each manufacturer for each prescription drug.

PBMs negotiate with national, regional and local pharmacies for purposes of providing a network of pharmacies from which individuals can obtain prescription drugs which, in accordance with the terms of the employer sponsored plan, are not required to be purchased via mail. With respect to the pharmacies within the retail network, the PBMs

may also have the contractual responsibility to ensure that the participating retail pharmacies have proper credentials and adhere to the plan's rules, including but not limited to those related to the plan's formulary and generic substitutions.

PBMs process claims and appeals, and facilitate external appeals with independent review organizations (IROs). PBMs also provide services relating to medical management and utilization review. Likewise, PBMs provide services necessary for coordination with the non-pharmacy related terms and provisions of the employer sponsor's health care plan. Indeed, there is a tremendous amount of collaboration, and sharing of data, that occurs between and among the PBM and the plan's other suppliers and/or third party administrators. By way of example, the PBM will often provide data and reporting to other suppliers to ensure that the employer sponsored plan is operated in accordance with its terms, including for example, those terms relating to cost-sharing, deductibles, and out of pocket maximums.

PBMs may perform a variety of other services to support and satisfy the covered employees. PBMs will issue identification cards and provide dedicated toll free telephone lines for covered individuals, pharmacists and physicians. PBMs will develop written communications for covered persons and provide other education, outreach and coaching to members for reasons such as improving drug adherence and decision-making.

PBM Compensation

PBMs compensation most certainly will vary depending upon the structure of the relationship with the company sponsoring the health care plan with prescription drug coverage. At a minimum, one must consider whether the PBM is supporting an employer health plan that is fully insured or self insured and whether the PBM is also the insurer or third party administrator for the medical benefits covered under the plan.

In terms of what compensation is direct and what compensation is indirect, a tremendous amount of diligence must be performed by plan sponsors while negotiating with a PBM. Indeed, because there is a very complex multi-dimensional system that supports the delivery of prescription drugs to individuals covered under a company sponsored health plan, an understanding of the fees and compensation earned by a PBM cannot be fully known by a plan sponsor until the PBM discloses how that system is leveraged and utilized. As such, regulatory rules regarding disclosure of the multi-dimensional framework that supports the delivery of prescription drugs would be welcomed by plan sponsors.

Based on experience, an important element of indirect compensation that a PBM may receive is derived from rebates from prescription drug manufacturers, or other entities in the supply chain, and which are not passed on in full to the plan sponsor. This is not to suggest that rebates must be passed on in full to plan sponsors. Rather, while negotiating the terms of a PBM contract, the plan sponsor should be aware that rebates may occur and should be considered when calculating the true cost of the contract. There is no prescription (pun intended) as to how a contract should be structured, but it is imperative that if rebates are not passed on in full to the plan sponsor, then the value of those rebates should be disclosed and taken in to consideration when negotiating the price of the services and products provided by the PBM to the plan sponsor.

PBM Contractual Provisions – Rebates and Transparency

There are many contractual provisions that well informed health care benefit plan sponsors and administrators strive to include in their PBM contracts in an effort to determine whether the fees and compensation paid to or otherwise earned by a PBM are reasonable. Many of these provisions are not PBM or subject matter specific. For this reason, Honeywell's contracts with suppliers, including PBMs, involve (1) a master

agreement (which includes many base terms and conditions of the contractual relationship, including the term of the agreement, and the rights of the parties regarding notices, termination, audit, standard of care, indemnification, dispute resolution, data security, data privacy, etc.); (2) a statement of work (that describes the specific services to be performed); (3) service level agreements (with key performance indicators and performance guarantees); and (4) various other exhibits.

With regard to PBM specific contract terms (which for Honeywell typically will reside in the statement of work), key contractual provisions -- to ensure the ability to determine the reasonability of PBM fees and compensation -- are those related to rebates. However, I must stress that contractual provisions related to rebates will be of little to no value if the parties do not negotiate and agree on exceptionally clear definitions and other terms which are to be relied on to determine what is a rebate. Could you imagine a contract whereby the parties agree to a certain percentage of rebates being retained by the PBM but the contract fails to have a clear and complete definition as to what is or is not a rebate subject to the calculation? Or, could you imagine a contract whereby the parties agree that all rebates collected by the PBM are passed through to the plan sponsor; but, the contracting parties failed to discuss that 100 percent of the rebates earned by the PBM are not collected as the rebates collected by the PBM are less than the rebates earned, perhaps due to offsets for fees paid by the PBM to other entities in the supply chain? The PBM contract may be very complex in terms of pricing structure; however, the strength and integrity of the contract may stand or fall, in large part, based on the clarity of the defined terms.

In addition to PBM specific contract terms related to rebates, other key contractual provisions, integral to a determination as to the reasonability of PBM fees and compensation, are those related to transparency. In large part, the transparency provisions will be written to illuminate all the entities involved in the supply chain, whether they are the PBM's subsidiaries or affiliates or whether they are the PBM's

subcontractors or agents. I note that, like 401(k) revenue sharing, there is nothing inherently wrong with a PBM outsourcing a service (for which the PBM has contractually agreed to perform) to another third party. Rather, should there be outsourcing or subcontracting by the PBM, the plan sponsor and plan administrator will want to know what services have been outsourced and the amount of the PBM fee or compensation being shared with the third party. This information is necessary to determine the reasonability of the fees paid to and compensation earned by the PBM.

To illustrate the importance of transparency of the PBM supply chain, consider a PBM which outsources to another third party the obligation to negotiate rebate contracts. Depending on the complexity and structure of that arrangement, plan sponsors and administrators do not know whether that outsourced arrangement results in a financial and economic win/win outcome for the PBM and the subcontractor without a comparable financial or economic win for the plan sponsor or administrator.

PBMs and Disclosure

As we continue to discover more about the great complexity underlying PBM fees and compensation structures, it cannot be ignored that there is concern with respect to conflicts of interest. Such conflicts (real or perceived; actual or potential) cannot be overlooked as they create challenges to ensuring that fees paid to and compensation earned by PBMs are reasonable for the services provided which, in turn, create obstacles relating to compliance with ERISA 408(b)(2).

In light of these concerns and challenges, Honeywell would support a Department of Labor effort to draft new or modify existing regulations that demand PBMs to provide greater transparency with respect to how PBMs provide their services and with respect to their sources of fees and compensation. Indeed, any such effort by the Department would be consistent with my comments at the 2010 hearing whereby, on behalf of Honeywell

and other large employers, I respectfully requested that the Department identify areas where additional disclosure might provide support in assessing the reasonableness of plan services arrangements. At this time, since PBMs are service providers in a position to have a material impact on the plan, PBM compensation structure is complex and there are potential conflicts of interest, I think it has become abundantly clear that developing appropriate regulations regarding PBM disclosure could support parties as they strive to enter into or modify existing contractual relationships that are compliant with ERISA 408(b)(2).

Thank you for taking the time to hold this hearing and to explore the topic of fees and compensation related to pharmacy benefit managers. I would be delighted to continue this dialogue and entertain questions.