MARWOOD GROUP

June 2020

DEVELOPING A NEW VALUE MODEL IN THE WAKE OF COVID-19

The COVID-19 pandemic has forced a rethinking of value in healthcare. Just 10 years ago, the structural changes in risk pools imposed by the ACA drove pharmaceutical and medical device companies to consider the broader cost impact of their drugs and devices. The COVID-19 crisis reveals the potential value of avoiding interaction with facilities of care that may become hot spots of infection for coronavirus or future viruses. As payers become inundated by costs associated with fighting a pandemic, it is reasonable to expect that manufacturers will need to rethink how payers will raise the bar for value and what they need to consider.

As the pandemic progresses through the global population, payers see themselves entering into a deeper and deeper cost hole with potential spending on COVID-19 alone expected to range from $100 to $500B over the next 2 years.

In mid-May, President Trump unveiled Operation Warp Speed, an effort to drastically reduce the time it takes to develop a coronavirus vaccine. This initiative would incentivize companies to deliver new drugs that reduce or eliminate patient susceptibility to novel coronaviruses. Five finalists have been named in Operation Warp Speed. Such a vaccine would be in extremely high demand with its value increasing as the world enters into a winter flu season, increasing the urgency for access among payers.

The investment in COVID-19 response by payers to date has been significant. Marwood estimates that the average COVID-19 patient with a 3-week ICU stay can cost a payer ~$150,000 at an average discount rate. Across a cumulative 200,000 hospitalizations due to COVID-19 estimated by CDC, the cost for ICU stays associated with hospitalizations alone would reach $30B. The financial costs of managing and reimbursing the care of infected patients is unsustainable. Despite current efforts, payers are still facing the possibility that the US may face a second wave of infections. In addition, payers must now consider the possibility that coronavirus infections may create longer-term inflammation and Kawasaki-like symptoms in young patients that may create unanticipated future care needs.

TABLE 1: How Payers Are Responding to COVID-19				
	Aetna	**Blue Cross**	**Cigna**	**UnitedHealth**
Waived co-pays for testing	X	X	X	X
Waived cost-sharing for inpatient visits (in-network)	X (until June 1)	X (until May 31)	X (until May 31)	X
Waived cost-sharing for inpatient visits (out-of-network)	X (until June 1)			
Waived out-of-pocket costs	X (for MA members)		X (until May 31)	
Paying for telemedicine at in-person rates/waiving cost-sharing for telehealth visits	X	X	X (until May 31)	X

The near-term cost focus is not just on inpatient care but also on testing and outpatient treatments. Payers have eliminated member cost-sharing, such as copays or coinsurance payments, for COVID-related diagnostic testing and treatment. Payers have nearly eliminated prior authorization for COVID-19 patients to accelerate access to care. In addition, payers are facing increases in more broadly reimbursable telehealth consultations. However, while the near-term costs continue to rise, the potential sequelae of COVID-19 are expected to include a broad set of increased mental health needs and as yet unknown health problems ranging from cardiovascular, respiratory and other potential problems. The Insurance Information Institute describes COVID-19's economic impact on the insurance industry as "deeper and wider" than expected.

The cost impact is compounded by a lack of revenue as layoffs mean fewer covered lives in the market. With more unemployed, it is likely that payers in the managed Medicaid market will see a more diverse population of patients entering their plans. This can potentially lead many managed Medicaid plans to face higher MLR in a labor environment reaching nearly 12-15% unemployment. Loss of employer per member per month payments are going to be significant. In mid-May, Kaiser Family Foundation estimated 27M people in the US have lost employer sponsored insurance, a number that will likely increase as more workers are unemployed.

As states have opened up over the past few weeks, the rebound in elective procedures and behavioral health has come into focus as a near-term barometer for the broader healthcare industry recovery. States are lifting bans on stay-at-home orders and for elective surgeries but in a very limited way that focuses on reducing access to hospitals and ASCs to providers and patients who show no signs or symptoms of COVID-19. The rise in elective surgeries will send

additional costs to payers. As hospitals are eager to bring patients back into the operating rooms, they will most certainly be making sure the insurance carriers are getting the bills.

However, as this crisis endures, other critical healthcare needs remain unmet. In this challenging environment, the pharmaceutical industry is still planning drug launches to meet these needs. As of May 2020, there have been 19 novel drugs approved so far this year. By comparison there were 48 novel drug approvals in all of 2019 and 20 were approved by June. Similarly, the number of medical device clearances since January 2020 is similar to the number cleared by mid-May 2019. Most of these products may seem unrelated to the COVID-19 pandemic. In reality, payer priorities have changed and these new drug launches may pose additional value in light of COVID. As anticipation of COVID-19's resurgence in the fall and winter grows, value of new therapeutics in 2020 and beyond will need to look not only at traditional safety and efficacy, but also at a new category of value: how the treatment can potentially lessen impact of this or a future pandemic. That can happen in two ways:

1. Reduce or eliminate the patient's susceptibility to the virus
2. Reduce the number of days patients are potentially exposed to the virus

Value models from Marwood, the Institute for Clinical and Economic Review (ICER), and others have typically looked to reduction in facility costs in determining the value of new therapeutics, but in a post-pandemic world the new value equation can put a premium on avoiding facilities that expose patients to infectious diseases. New therapeutics that reduce days in hospitals, skilled nursing facilities (SNFs), and nursing homes where patients may be exposed to a virus carry considerably more value than treatments that may improve outcomes but may keep patients in a facility with even a moderate risk of infection.

Pharma and device manufacturers will need to work with payers as the country emerges from the pandemic. Payers will want to consider how drugs they provide access to can blunt similar pandemics in the future. Marwood believes that consideration will be part of payers' overall value assessments of new products coming to market. To prepare for this new line of value, new drug reimbursement models will need to consider a treatment's contribution to protecting payers from increases in costs due to a future pandemic by focusing on four key factors:

1. What population does the treatment address?
2. What is the cost of that population in the presence of a pandemic?
3. How will the treatment limit future costs to its target population with or without a pandemic?
4. How robust is the treatment supply chain?

In the near term, pharma and device manufacturers will benefit from placing these lenses over their development programs to demonstrate the maximum value of their innovations. In a post-COVID world, the value equation has shifted giving pharma and medical device leaders the opportunity to reinforce the ultimate value that they bring to market.

About the Author

Stephen Morales is a Senior Vice President for Strategy and Advisory at the Marwood Group. Prior to joining Marwood, Mr. Morales led strategy and diligence project teams at Navigant and L.E.K. Consulting, where he developed thought leadership in transformational healthcare leadership, risk-based contracting, and value proposition development. Stephen is frequently engaged by clients to speak to the long term value their products and companies bring to US and global healthcare markets.

Stephen's 20-year healthcare career began working in strategy with large pharmaceutical and medical device companies like Baxter, Merck, Schering-Plough, and Guidant. Stephen is an alumnus of MIT and Duke's Fuqua School of Business.

Marwood Group is a healthcare advisory firm offering strategic consulting services, with expertise in the U.S., E.U., and Asian markets. Marwood advises investors and life sciences companies on growth strategies and new business models, product lifecycle management, commercialization, market access and pricing strategies, and legislative and regulatory concerns.

Contact Information: For more information on the content in this publication or to learn more about Marwood Group Advisory's capabilities, we encourage you to contact us:

Nayan Ghosh, Vice President, Life Sciences
Office: 212-532-3651
nghosh@marwoodgroup.com

Kyle Holmes, Vice President
Office: 212-532-3651
kholmes@marwoodrgoup.com

Lee Alvarez, Senior Managing Director
Office: 212-532-3651
Mobile: 646-369-5279
lalvarez@marwoodgroup.com