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The Pharmaceutical Product Liability Insurance Environment since 2004 and beyond

The last decade has seen an unprecedented number of major drug recalls and a dramatic increase in mass tort litigation against the pharmaceutical industry. The reaction of the industry's product liability insurers, who bore much of the financial pain of this litigation, was entirely predictable.

By the close of 2004, pharmaceutical companies were experiencing huge difficulties in obtaining meaningful liability insurance for their drugs, and negotiations with insurers had become tougher than ever. Premiums and retentions were at an all time high, many products were routinely excluded from the coverage, and capacity had shrunk to an all time low. And those companies unlucky enough to be hit by large claims were taken aback at the confrontational stance taken by many insurers.

There were many reasons for this explosion in pharmaceutical product litigation. A clear contributory factor was the relative laxity of the regulatory environment. A record number of products were approved for market during the mid- to late-nineties, closely correlating with a significant increase in product recalls a few years later. This coincided with a period when the US plaintiff bar, enriched through major wins in asbestos and tobacco litigation, was casting around for new 'targets'.

In any event the net result was that product liability insurers' loss ratios spiralled out of control, reaching an estimated average of around 200% by 2004. Clearly, radical action was needed. Some insurers and reinsurers pulled out altogether; those that continued to write this class of business had a complete rethink about the way they wished to provide cover to pharmaceutical companies.

There has been much written and said about this period between 1997 and 2004, a difficult time for both the pharmaceutical industry and its insurers, but surprisingly little about what has happened since then. In this bulletin we look at how the pharmaceutical product liability landscape has changed since Vioxx became front page news over 2 years ago, and assess what impact this has had to date or may have in future.

A - The Environment

The Regulatory Environment

In terms of drug regulation the US certainly leads the way, and this paper concentrates on how its regulators, the Food & Drug Administration (FDA), have responded to the events of the last ten years. We can expect many of these trends to be followed elsewhere, although of course the high cost of prescription drugs and the high frequency of expensive litigation tends to magnify the importance and impact of reform in the US.

The number of new molecular entities (NME's) approved by the FDA has fallen substantially since the high point in the mid 1990's (see graph below). The low number of 2005 approvals suggests that companies are finding it increasingly difficult to obtain the backing of the regulatory authorities to market an NME in the US.

The FDA now require more clinical data than ever before in order to understand and demonstrate a product's risk-benefit profile; furthermore they also require risk management plans to be drawn up for each product. Clinical studies now tend to be longer and incorporate specific at-risk populations.

From 1995 to 2002 the FDA's review period varied between 13 and 20 months. By 2005 the median approval time for NME's under standard review had increased to 24 months. Clearly a more cautious approach is being undertaken, almost certainly as a direct result of the political fall-out caused by high profile product safety issues and increased public pressure to protect

Year	Priority Approvals	Standard Approvals	Total Approvals
1993	13	12	25
1994	12	9	21
1995	10	19	29
1996	18	35	53
1997	9	30	39
1998	16	14	30
1999	19	16	35
2000	9	18	27
2001	7	17	24
2002	7	10	17
2003	9	12	21
2004*	21	15	36
2005*	15	5	20

* From 2004 figs include new Biologics License Application Process for therapeutic biologic products.

Source: FDA, Center for Drug Evaluation and Research. Data as at 31st December 2005.

them. The FDA's decision to force companies to display their clinical trial results was welcomed by many.

The FDA would also appear to have taken a harder line since 2004 on emerging product issues, as evidenced by their speedy response to the safety concerns surrounding the multiple sclerosis drug Tysabri. In this case, following reports of two deaths, the FDA took prompt action to work alongside the drug's manufacturer, who agreed to temporarily withdraw Tysabri from the market in order to formally reassess its safety profile and take corrective action as deemed necessary.

Of course the whole subject of post marketing pharmacovigilance is hugely relevant today, for all stakeholders in the industry. The science and practice are far from perfect; indeed many note that resources and efforts to monitor risk-benefits decrease once a product is approved. Much work still needs to be done by regulators to ensure as much relevant data is captured as possible from many sources.

Regulators have certainly been criticised for not doing enough to ensure that promised post-marketing studies are completed¹. There is no doubt that they have taken steps to improve, and there are calls for more power to be given to the FDA to enable them to force such studies to be carried out. Irrespective of the outcome of such demands it seems that the FDA will need to look more closely at this area in the future. High profile cases such as Vioxx bring increased public scrutiny on the role of the regulators in ensuring public awareness and drug safety.

So have the FDA done anything to improve matters? The answer is yes. As highlighted in our June 2005 bulletin, the FDA announced a number of actions it was going to take to strengthen the safety programme for marketed drugs. In terms of post-marketing monitoring they have increased staff dedicated to post-marketing safety by nearly 25% in the last two years, and have established a Drug Safety Board, which has led to improved communication on emerging safety issues.

The FDA is also committed to their 'Critical Path Initiative' (CPI), which attempts to modernise the drug development process and also introduce state-of-the-art methods of analysis and scientific understanding in order to prevent safety problems arising after product launch. To help achieve their goal, the FDA is developing tools with key partners, and new areas of science such as genomics are being employed.

Despite these improvements, a report by the Institute of Medicine (IOM) released in September 2006 and entitled 'The Future of Drug Safety: Promoting and Protecting the Health of the Public' made many recommendations on how the FDA could further improve. The study was commissioned by the FDA themselves and recommendations covered a number of areas, key amongst which were:

- Labelling requirements and advertising limits for new products
- Clarified authority and additional enforcement tools for the FDA
- Role clarification in information gathering and communication on product risks versus benefits
- A large increase in FDA funding and staffing and an increased role for FDA's drug safety staff.

Of course the industry must take some responsibility for improving safety and awareness. In some areas pharmaceutical companies have indeed been proactive. For example a number of companies do not now advertise new products directly to the consumer in the US, a practise that many blame for exacerbating safety issues because of its potential to diminish the role of the 'learned intermediary', the family physician. Many companies have realised the need to change marketing behaviours and have acted accordingly.

Since the IOM report was published Scott Gottlieb, the FDA's then deputy commissioner, has said that pharmaceutical companies should contribute additional funds to assist the FDA to study their drugs' safety performance once those drugs hit the market. At present companies pay some fees to FDA but these have been predominantly used to review the profile of new drugs before they reach the market.

Pharmaceutical companies began paying such fees to the FDA in 1992 through legislation enshrined in the Prescription Drug User Fee Act (PDUFA). PDUFA has been renewed three times since then, and the act's next renewal (due in October 2007) is currently under discussion. The outcome of these discussions between regulators, legislators and industry could materially improve the pharmacovigilance landscape.

At present, fees from pharmaceutical companies make up approximately 50% of the FDA's budget for product reviews, which leads many commentators to claim that the industry has too much influence on the product approval process. But it is interesting to note that the industry's contribution to the European Medicines Agency (EMA) budget is 75%, and to the UK's regulatory body's budget is 100%.

The Legal and Political Environment

The importance of the US to the pharmaceutical industry is well known; so is the American appetite for litigation. Most actions brought against pharmaceutical companies in the US allege a failure to adequately warn patients of a drug's side effects. Pharmaceutical companies have often relied on the "learned intermediary" defence where the prescribing physician has failed to pass on proper drug usage advice. Direct-to-consumer advertising has often reduced the effectiveness of this defence, which in any case may fail if it can be proved the pharmaceutical company provided inadequate labelling or that they encouraged off-label use.

Federal pre-emption is another defence available to pharmaceutical companies. This has been used more frequently since 2004, especially since the FDA allowed labels to be simplified. Notable successes have been achieved in defending state claims alleging failure to warn in cases where the company were able to prove that the FDA determined that a warning for a potential side effect was not needed. In some cases pre-emption has been successfully used to avoid punitive damages. However, by no means do all state courts follow these guidelines.

The pharmaceutical industry has always enjoyed significant support in Capitol Hill, particularly amongst Republicans, and has enjoyed favourable prescription drug subsidies in the US healthcare programme. However, the recent Democrat success could well threaten this position, a sentiment shared by many investors as evidenced by the tumble in many pharmaceutical stock prices when the result of the recent elections was announced.

The industry can expect increased pressure on drug prices, and possibly further calls for restrictions on marketing practices. At the same time it is unlikely that the pace of tort reform will be maintained. From a drug safety perspective there may well be increased scrutiny on the FDA, who in turn could receive a higher level of funding thereby enabling resources to be strengthened both from a drug approval and post marketing perspective. Post-approval studies may become mandatory in the future.

Insurance Market Environment

Since the end of 2004 the insurance market for pharmaceutical product liability has been 'cautiously stable'. Capacity has largely remained unchanged with no notable

new entrants, nor any notable exits. Perhaps the greatest 'change' over the last two years has been the acquisition of Gerling by HDI's owners, Talanx. Whilst the full impact of this merger is still to be seen it would appear that in 2007 we will see HDI's traditional underwriting approach prevailing.

Those insurers and reinsurers that experienced large losses in the previous decade have seen little by the way of major new claims notifications, and are showing a gradually improving loss ratio. There has been a continued frequency of smaller claims but increased retentions have resulted in pharmaceutical companies themselves financing these claims to a great extent, as self-insured losses. Some insurers readily admit that the current premium and retention levels, if they had been imposed over the last ten years, would have resulted in acceptable loss ratios.

Smaller pharmaceutical companies are still able to buy insurance with relatively low retentions and are able to access as much capacity as they require, thereby introducing a measure of competition. Larger companies, however, have little chance to benefit from competition, and those that still purchase struggle to achieve their target capacity without accepting coverage restrictions and large corporate retentions.

Many insurers are looking at the developments described earlier and are reasonably optimistic that we are witnessing an improving risk landscape. Some have admitted, however, that they will require proof of such improvement over a longer period of time before they are prepared to substantially change their underwriting approach. Many seem very reluctant

to put their complete faith in the legislators, regulators and industry to resolve their concerns over risk management, and insist on interpreting drug safety profiles themselves.

B - The Future?

Although many people would argue that drug regulators have failed to respond in a timely way to the ever increasing demands placed on them by the public, by government and by industry, there are definite signs of improvement. Whilst there is some way still to go, there is a definite desire and impetus for material changes to be made which would go a long way to producing an environment acceptable to insurers wishing to offer pharmaceutical product liability cover. The recent political changes in the US may catalyse such changes.

Of course the industry is still skating on thin ice. It would probably take only one more, maybe two more, high profile drug recalls on safety grounds to further erode the regulators' reputation and the fragile confidence of insurers, leading to further capacity withdrawal and price increases. Not surprisingly, the outcome of the ongoing Vioxx litigation is of great interest to many in the insurance world.

If, on the other hand, there is a period of consolidation with no new major safety issues, then we might actually see new insurance capacity venturing back to the market. A redressing of the supply/demand equation would inevitably lead to greater flexibility in the language of the insurance contracts and a review of pricing and retention models. 2007 will be an interesting year.

Our capabilities

JLT's Life Science Team has an excellent knowledge of the risks faced by life science companies, including product liability. If you are interested in this particular area and wish to find out more about it, or would like to discuss any other risk-financing needs, do not hesitate to contact the individuals below.

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