

The American Consumer Institute

**The Impact of Pharmacy
Benefit Managers on
Prescription Drug
Affordability**

Nate Scherer and Steve Pociask

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Overview: *The role of Pharmacy Benefit Managers (PBMs) is to administer prescription drug plans for sponsors (e.g., employers and insurers), negotiate drug prices with manufacturers, and negotiate reimbursement terms with pharmacies. This paper analyzes the impact of PBM’s market power and lack of transparency on industry business practices and consumers. Our analysis concludes that the combination of market power and the lack of pricing transparency results in substantially higher prescription drug prices for patients.*

PBMs and Prescription Drug Affordability

Prescription drug affordability has become a tremendously important public policy issue, as drug prices have continued to climb faster than inflation, thereby stretching Americans’ budgets and putting millions of consumers’ well-being in jeopardy. Over the years, prices for prescription drugs were among the fastest products in the Consumer Price Index. In recent years, one report found drug prices to have increased 35%, while the cost of all other items and services increased by only 21%.¹ Today, Americans now spend on average more than \$1,500 annually on drugs.²

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¹ Anna Wells, “Were Prescription Drug Prices the Fastest Growing Commodity or Service in 2021,” GoodRx Health, updated March 2, 2022, <https://www.goodrx.com/healthcare-access/research/drug-prices-growing-faster-than-commodities-and-services>.

² “The Inflation Reduction Act Lowers Health Care Costs for Millions of Americans,” Centers for Medicare & Medicaid Services, October 5, 2023, <https://www.cms.gov/priorities/legislation/inflation-reduction-act-and-medicare/lowers-health-care-costs-millions-americans>.

Unsurprisingly, 36% of Americans struggle to afford their medications, putting many in the difficult position of deciding whether to borrow money, skip out on other essential expenses like food and shelter, or forgo treatment entirely.³ Nearly 40% report having made at least one change in medication adherence due to cost.⁴ So why are prescription drug prices rising?

Although many factors influence drug prices, a growing body of research⁵ suggests that Pharmacy Benefit Managers (PBMs) play a leading role.⁶ These industry middlemen negotiate drug prices and manage prescription drug benefits on behalf of health insurers, employers, and other payers. Initially created in the early 1960s to help process claims and negotiate lower prices with drug makers, PBMs have, over time, lost sight of this original mission.⁷ They now increasingly leverage their position as third-party administrators to enrich themselves at the expense of everyone else, including consumers who, researchers say, routinely overpay for drugs.⁸

At the heart of the issue is a lack of PBM transparency that leads to asymmetric market information and predatory business practices. Improving transparency and regulatory oversight of PBMs would go a long way toward resolving these problems and promoting consumer welfare.

³ Sasha Guttentag, “Survey: More Than a Third of Americans Still Struggle to Afford Their Prescription Medications,” GoodRx Health, July 13, 2023, <https://www.goodrx.com/healthcare-access/research/medication-debt-survey-2023>.

⁴ Anna Wells, 2022.

⁵ Karen Van Nuys, et al., “Frequency and Magnitude of Co-payments Exceeding Prescription Drug Costs,” *JAMA Network*, Vol. 319(10), 1045-1047, March 13, 2018.

⁶ “Pharmacy Benefit Managers and Their Role in Drug Spending,” The Commonwealth Fund, April 22, 2019, <https://www.commonwealthfund.org/publications/explainer/2019/apr/pharmacy-benefit-managers-and-their-role-drug-spending>.

⁷ “Pharmacy Benefit Managers,” National Association of Insurance Commissioners, updated June 1, 2023, <https://content.naic.org/cipr-topics/pharmacy-benefit-managers#:~:text=Background%3A%20When%20insurance%20companies%20began,formularies%20and%20administered%20drug%20claims>.

⁸ Erin Tirsh, et al., “Comparison of Spending on Common Generic Drugs by Medicare vs Cosco Members,” *JAMA Network*, Vol. 181(10), 1414-1416, July 6, 2021.

A Lack of Transparency and Market Failure

Who does the PBM represent when a company hires a PBM to manage its employee prescription plan? Typically, when a firm engages with a company to work on its behalf, it expects the hired company to act as a fiduciary, i.e., with the firm's best interest in mind. However, in some cases, conflicts of interest create a *principal-agent problem*, in which the hired company acts in its interests instead of the company that hired it.⁹ These problems can arise from a lack of transparency between the principal (the firm) and the agent (the contractor). For sponsors that hire PBMs, this is indeed a problem.

While a plan sponsor faces the direct financial costs of the particular prescription plan being offered to its members or employees, only a PBM understands the prices and costs flowing between the various players involved in the plan.¹⁰ This unique insight comes from a PBM's involvement in administering prescription plans for sponsors (and their employees and beneficiaries) and from the PBM acting as a middleman in a series of opaque transactions involving sponsors, beneficiaries, pharmacies, and manufacturers. These interactions among various parties create an environment of conflict that drives PBMs to work in their self-interest, unbeknownst to the plan sponsor or beneficiary.

The lack of transparency leads to asymmetric information about the pharmaceutical market, a *market failure*. PBM's access to better information about costs and prices gives it leverage in dealings with these other parties.¹¹ Market failures can require regulatory and legal remedies to protect consumers when substantial costs are at stake.¹² The following sections

⁹ Joseph E. Stiglitz, *The New Palgrave: A Dictionary of Economics*, Vol. 3, pp. 966–71, 1987.

¹⁰ Allison Dabbs Garrett and Robert Garis, "Leveling the Playing Field in the Pharmacy Benefit Management Industry," *Valparaiso University Law Review*, Vol. 42, Rev. 33, 2007, pp. 33-80.

¹¹ Asymmetric information always favors the party with better information. For example, say that a consumer negotiates to buy a used car. If the used car dealer has better information on the vehicle than the consumer has, then the consumer is more likely to overpay than the dealer is to undercharge.

¹² Some of the policy options are laid out and discussed by Ruth G. Thomas, "Consumer Protection, Education and Information: A Consumer Incentives Perspective," *Review of Policy Research*, Volume 2, Issue 3, p. 445-454, February 1983. Thomas analyzes policy alternatives as they impact consumer incentives in the context of different characteristics among consumers, products, and market contexts. Also, see Aidan R. Vining and David L. Weimer, "Information Asymmetry Favoring Sellers: A Policy Framework," *Policy Sciences*, 21:4, 1988, p. 281. Vining and Weimer give the following guidance: "Three questions are important: First, under what conditions does the potential

will evaluate the industry structure, conduct, and performance to determine whether there is a presence of sustained market power that poses serious anticompetitive risks for consumers and requires a public policy remedy.

Market Conduct and Performance

Plan sponsors hire and pay PBMs to run prescription insurance plans and manage costs. However, PBMs cut deals with pharmacies, promising them access to these plans subscribers in return for cutting fees or reimbursement for what the pharmacies normally earn for filing a prescription. This tactic, called *spread pricing*, adds additional profits for the PBMs over and above what plan sponsors pay PBMs for managing their plans.¹³ In other words, as the middleman, PBMs receive additional profit from the spread between the plan sponsors' payments and pharmacies' normal prices. This profiting occurs without the sponsors knowing the various wholesale and retail prices and about the recovery of pharmacy fees.¹⁴ The Congressional Budget Office (CBO) estimates that prohibiting PBM spread pricing for Medicaid would generate \$929 million in federal savings over ten years, with some state estimates suggesting even more significant cost savings.¹⁵ For instance, a recent audit of contracts between the District of Columbia and PBMs found that PBMs kept \$23.3 million in spread pricing between 2016 and 2019.¹⁶

for significant inefficiency due to information asymmetry exist? Second, under what conditions are private responses likely to prevent the inefficiency from being realized? And third, what are the different potential, public interventions for reducing any inefficiency that does occur?"

¹³ "Spread Pricing 101," National Community Pharmacists Association, accessed September 11, 2023, <https://ncpa.org/spread-pricing-101>.

¹⁴ Henry C. Eickelberg, "The Prescription Drug Supply Chain Block Box – How it Works and Why You Should Care," American Health Policy Institute, The Terry Group, December 2015, https://terrygroup.com/app/uploads/2015/12/December-2015_AHPI-Study_Understanding_the_Pharma_Black_Box.pdf.

¹⁵ Rachel Garfield, Rachel Dolan, and Elizabeth Williams, "Costs and Savings under Federal Policy Approaches to Address Medicaid Prescription Drug Spending," KFF, June 22, 2021, <https://www.kff.org/medicaid/issue-brief/costs-and-savings-under-federal-policy-approaches-to-address-medicaid-prescription-drug-spending/#:~:text=Prohibiting%20spread%20pricing%20by%20pharmacy,of%20spread%20pricing%20across%20states>.

¹⁶ "The District of Columbia has Taken Significant Steps to Ensure Accountability Over Amounts Managed Care Organizations Paid to Pharmacy Benefit Managers," U.S. Department of Health and Human Services Office of Inspector General, March 16, 2023, <https://oig.hhs.gov/oas/reports/region3/32000200.asp>.

In addition, PBMs establish menus and tiers of drugs available on the plan – called a *formulary*.¹⁷ In building a formulary, PBMs negotiate prices with manufacturers, sometimes promising manufacturers higher volumes of drug sales in return for lower prices or in return for promising formulary restrictions on competitive drugs through administrative steps. In many cases, PBMs have abused the power over formulary design to exclude lower-cost generic medications from the list of covered medications simply because manufacturers provide more lucrative rebates on brand-name drugs.¹⁸ For instance, a recent report from Xcenda found that in 2022, “the 3 largest PBMs placed a total of 1,156 unique medicines on their standard formulary-exclusion lists.”¹⁹ This represents a nearly “1000% increase in the number of excluded medicines since 2014,” with more expensive branded medicines without a generic or biosimilar alternative comprising 47% of all these exclusions.²⁰

To make matters worse, any cost savings generated from manufacturer rebates are not typically shared with plan sponsors or consumers. The Pharmacy Benefit Manager Institute provides guidance on this practice for its members:

*Rebates and/or negotiated price concessions from manufacturers are typically based on the predicted volume of drugs from covered lives. Additionally, price reductions (discounts) may be negotiated for including a single manufacturer’s drug on the PBM’s formulary and excluding competing drugs or by putting the drug on lower cost-sharing tiers.*²¹

As noted previously, the specific terms and conditions agreed to between PBMs and manufacturers are unknown to outside parties, including the pharmacies that fill the prescriptions and the plan sponsors. In other words, in addition to having plan sponsors pay

¹⁷ “Formulary,” HealthCare.gov, accessed September 11, 2023, <https://www.healthcare.gov/glossary/formulary/>.

¹⁸ Robert Popovian, Anne M. Sydor, and Peter Pitts, “Analysis of Drug Formulary Exclusions from the Patient’s Perspective,” *Health Science Journal*, Vol. 16, Issue 3, May 17, 2022, <https://www.itmedicalteam.pl/articles/analysis-of-drug-formulary-exclusions-from-the-patients-perspective.pdf>.

¹⁹ “Skyrocketing growth in PBM formulary exclusions continues to raise concerns about patient access,” Xcenda, May 24, 2022, <https://www.xcenda.com/insights/skyrocketing-growth-pbm-formulary-exclusions-concerns-patient-access>.

²⁰ “New Report Finds Large PBMs Restrict Access to More Than 1,150 Medicines,” PhRMA, May 25, 2022, <https://phrma.org/en/resource-center/Topics/Access-to-Medicines/New-Report-Finds-Largest-PBMs-Restrict-Access-to-More-Than-1150-Medicines>.

²¹ “Trends in Drug Benefit Design,” PBMI, 2016, pp. 40.

PBMs for managing the plan, they profit from their dealings with drug manufacturers and from squeezing pharmacies, driving some out of business in the process²² and contributing to the disturbing rise of pharmacy deserts.²³ Indeed, between 2017 and 2022 alone, the U.S. lost more than 2,300 pharmacies.²⁴

Prescription plans often require beneficiaries (consumers) to share costs through copays and deductibles. These sharing provisions are typically applied to the invoice or retail prescription price. In recent years, there has been an increase in invoice prices for beneficiaries, accompanied by a much faster increase in manufacturer rebates for PBMs – all unbeknownst to plan beneficiaries. This means consumers are paying more because of higher invoice prices, while PBMs are profiting more because of a surging increase in manufacturer rebates. These rebates are not flowing through to consumers through lower prescription drug prices. They often lead to higher prices for consumers.

A 2020 study by researchers at the University of Southern California's Schaeffer Center found that, on average, a "\$1 increase in rebates is associated with a \$1.17 increase in list prices" for branded medications.²⁵ That positive relationship held for branded drugs with and without generic substitutes.²⁶ Even so, PBMs frequently insist they pass along a large share of rebate savings. Yet, that claim is misleading because what savings are passed along rarely goes to consumers. According to the Drug Channels Institute, "employers typically use rebates to offset overall healthcare costs and reduce general premiums, rather than reduce the out-of-pocket prices paid by patients whose prescriptions generated the rebate funds."²⁷ In other

²² Arthur Allen, "Do PBMs, drug market brokers, have a stranglehold on prices that even Congress can't break," USA Today, May 11, 2023, <https://www.usatoday.com/story/news/health/2023/05/11/pbm-pharmacy-benefit-managers-explained/70202970007/?gnt-cfr=1>.

²³ Abiodun Salako, Fred Ullrich, and Keith J. Mueller, "Update: Independently Owned Pharmacy Closures in Rural America, 2003-2018," *Rural Policy Brief*, Vol. 2, pp. 1-6, July 1, 2018, <https://pubmed.ncbi.nlm.nih.gov/30080364/>.

²⁴ Robert, Yeakel, "Independent Grocery Pharmacies Need DIR Fee Reform Now," National Grocers Association, June 11, 2021, <https://www.nationalgrocers.org/news/dir/>.

²⁵ Neeraj Sood et al., "The Association Between Drug Rebates and List Prices," USC Leonard D. Schaeffer Center for Health Policy & Economics, February 2020, https://healthpolicy.usc.edu/wp-content/uploads/2020/02/SchaefferCenter_RebatesListPrices_WhitePaper-1.pdf.

²⁶ Ibid.

²⁷ "Surprising Data on Employer-PBM Rebate Pass-Through Arrangements in 2023," Drug Channels, August 15, 2023, <https://www.drugchannels.net/2023/08/surprising-data-on-employer-pbm-rebate.html>.

words, little of the cost savings generated from rebates go to reducing a patient's financial burden at the pharmacy counter, even when 100% of the refund is passed along to employers.

The fact is that PBMs remain one of the primary drivers of prescription price increases that distress consumers and rebate contracting is partially responsible.²⁸ This flow-thru problem was also recently highlighted in a Centers for Medicare and Medicaid Services (CMS) report.²⁹ Effectively, these tactics represent an implicit form of price gouging.

For example, if a manufacturer pays a PBM an incentive to offer a higher-cost generic drug by adding the drug to the plan's formulary, the sponsor's costs increase, as do the PBM's profits. However, this money is often not passed on to consumers. Instead, the PBM usually pockets the money, and consumers are left with a more expensive drug. This apparent conflict of interest illustrates why PBMs do not necessarily act in the best interest of the plan's sponsors or their subscribers. Thus, the incentive for PBMs to do what is best for the plan and consumers directly conflicts with the PBM's incentive to profit.

There are many cases where generic drug prices are lower than plan deductibles.³⁰ Because some plan beneficiaries do not know this and pharmacists are not permitted to disclose this information under their agreements with PBMs,³¹ consumers are paying more than the actual cost of their medications under their plans. The practice is called *clawbacks*,³² and it's just one of several ways that PBMs are increasing drug costs and lining their pockets.³³ A 2018 research study found that 23% of pharmacy prescriptions from a large

²⁸ "The Truth About Pharmacy Benefit Managers: They Increase Costs and Restrict Patient Choice and Access," National Community Pharmacists Association, September 2020, <https://ncpa.org/sites/default/files/2020-09/ncpa-response-to-pcma-ads.pdf>.

²⁹ "Medicare Part D – Direct and Indirect Remuneration," Centers for Medicare & Medicaid Services, January 19, 2017, <https://www.cms.gov/newsroom/fact-sheets/medicare-part-d-direct-and-indirect-remuneration-dir>.

³⁰ Megan Thompson, "Why a patient paid a \$285 copay for a \$40 drug," PBS, August 19, 2018, <https://www.pbs.org/newshour/health/why-a-patient-paid-a-285-copay-for-a-40-drug>.

³¹ "Gag Clause," PLEXIS Healthcare Systems, accessed September 11, 2023, <https://www.plexishealth.com/glossary/gag-clause/>.

³² Susan Hayes, "Pharmacy Clawback Issue," Pharmacy Investigators & Consultants, https://piconsulting.org/latest_news/pharmacy-clawback/.

³³ Julie Appleby, "Filling a Prescription? You Might Be Better Off Paying Cash," CNN, June 23, 2016, <http://www.cnn.com/2016/06/23/health/prescription-drug-prices-pbm/>.

commercial insurer involved a patient copayment that exceeded the pharmacy's reimbursement rate by more than \$2.00, with the average overpayment equaling \$7.69.³⁴

Fortunately, a new CMS rule curtailing PBM's retroactive application of Direct and Indirect Remuneration (DIR) fees,³⁵ of which PBM clawbacks are a part, is set to take effect in January 2024.³⁶ However, this final rule will not eliminate DIR fees. Instead, it will require that these fees be reflected in the negotiated price that the patient pays at the pharmacy counter. PBMs will still be able to impose arbitrary DIR fees by moving them to the point of sale and continue demanding other unreasonable concessions.³⁷ Therefore, additional regulatory or legislative action will likely be necessary. Some states aren't waiting around to find out. According to the National Academy for State Health Policy, 21 states have passed laws prohibiting clawbacks and retroactive denials.³⁸ More are likely to consider similar legislation in the future.

Another significant problem relates to what is known as copay accumulator adjustments programs. These programs are designed to "prevent any co-payment assistance that may be available for high-cost specialty drugs from counting toward a patient's deductible or maximum out-of-pocket expenses."³⁹ While PBMs have traditionally allowed copay assistance to count toward meeting a patient's deductible under their health insurance plan, PBMs increasingly require patients to pay their full deductible before cost-sharing protections kick in, negating potential cost savings. As a result, many patients struggle to afford these types of lifesaving specialty drugs. Fortunately, some states are acting. As of 2023, 20 states and Puerto Rico have

³⁴ Karen Van Nuy et al., "Overpaying for Prescription Drugs: The Copay Clawback Phenomenon," USC Leonard D. Schaeffer Center for Health Policy & Economics, March 12, 2018, <https://healthpolicy.usc.edu/research/overpaying-for-prescription-drugs/>.

³⁵ "DIR fees," National Association of Chain Drug Stores, accessed August 22, 2023, <https://www.nacds.org/dir-fees/>.

³⁶ Keith Loria, "Upcoming DIR Fee Changes Still Causing Concern for Pharmacists," Drug Topics, August 12, 2023, <https://www.drugtopics.com/view/upcoming-dir-fee-changes-still-causing-concern-for-pharmacists>.

³⁷ "CMS eliminates retroactive DIR fees," American Pharmacists Association, accessed September 11, 2023, <https://www.pharmacist.com/Advocacy/Issues/CMS-Eliminates-Retroactive-DIR-Fees>.

³⁸ "State Pharmacy Benefit Manager Legislation," National Academy for State Health Policy, updated September 13, 2023, <https://nashp.org/state-pharmacy-benefit-manager-legislation/>.

³⁹ "Accumulator Adjustment Programs," Arthritis Foundation, accessed September 11, 2023, <https://www.arthritis.org/advocate/issue-briefs/accumulator-adjustment-programs>.

passed legislation banning copay accumulators or requiring any discount made by or on behalf of a patient to be applied to meet that patient's annual out-of-pocket cost-sharing requirements.⁴⁰ Even so, copay accumulators remain a serious problem that require federal attention.

PBMs have steady sources of profit when they manage sponsors' plans: 1) beneficiaries and plan sponsors pay the PBM for its service; 2) PBMs funnel sales to favored manufacturers in return for rebates and discounts; 3) PBMs threaten to drop qualified pharmacies to squeeze concessions for prescriptions filled at pharmacies; and 4) PBMs may even cash in on copay assistance programs available for lifesaving medications. Nowhere are the wholesale and average selling prices between the various parties published or transparent – not to drug manufacturers, consumers, pharmacies, and sponsors who offer their employees prescription plans.

It should be clear who PBMs represent. By one estimate, PBMs fail to pass \$120 billion back to consumers and retain another \$30 billion in additional out-of-pocket costs.⁴¹ That extra money contributes enormously to PBM's profits while doing nothing to improve access to affordable prescription drugs. For instance, between 2012 and 2022 alone, total profits at the three largest PBMs increased an astounding 438%, from \$6.3 billion to \$27.6 billion.⁴² This contrasts sharply with Bureau of Economic Analysis data, which shows that across all industries, after-tax corporate profits declined 4.1% in the first quarter of 2023 after falling 2% in the fourth quarter of 2022.⁴³ As middlemen, PBMs are making money on all sides.

⁴⁰ "Copayment Adjustment Programs," National Conference of State Legislatures, updated June 19, 2023, <https://www.ncsl.org/health/copayment-adjustment-programs>.

⁴¹ Jonathan Wilcox, "PBMs Must Put Patients First," HuffPost, February 28, 2017, http://www.huffingtonpost.com/entry/pbms-must-put-patients-first_us_58b60bd8e4b02f3f81e44dcc.

⁴² Wendell Potter, "Big Insurance 2022: Revenues reached \$1.25 trillion thanks to sucking billions out of the pharmacy supply chain – and taxpayers' pockets," Health Care un-covered, February 27, 2023, <https://wendellpotter.substack.com/p/big-insurance-2022-revenues-reached#:~:text=IBM%20Profit%20Generation&text=Collectively%2C%20their%20IBM%20profits%20increased,Aetna's%20Caremark%2C%20and%20UnitedHealth's%20Optum>.

⁴³ "Corporate Profits," Bureau of Economic Analysis, June 29, 2023, <https://www.bea.gov/data/income-saving/corporate-profits>.

Unsurprisingly, numerous opinion surveys have found broad public dissatisfaction with the status quo. For instance, in a recent national survey of American voters, 79% reported being concerned that “PBMs drive up prescription drug prices,” with 82% expressing support for requiring “PBMs to pass discounts along to patients that they get from negotiating with prescription drug manufacturers.⁴⁴ A further 81% favor introducing “more transparency into PBMs’ contracts and the prescription drug pricing process,” with 73% indicating that regulating PBMs should be a “high priority” for federal and state lawmakers.⁴⁵ A separate survey of large employers published in August by the Business Group on Health found that 73% supported requiring PBMs to disclose their compensation and pricing data.⁴⁶ Another recent poll of national pharmacists found similar support.⁴⁷

Market Structure

According to the Pharmaceutical Care Management Association (PCMA), a PBM trade industry organization, PBMs manage pharmacy benefits for more than 275 million Americans.⁴⁸ Today, the three most significant are Cigna (Evernorth/Express Scripts), CVS Health (Caremark), and UnitedHealth (OptumRx). Together they control 79% of the PBM market.⁴⁹

High market concentration and information asymmetry have allowed PBMs to become *price makers* and pharmacies *price takers*. Imagine a pharmacy working with only two PBMs in a community. In this example, the pharmacy’s access to the total market of consumers is highly

⁴⁴ “Research on Pharmacy Benefit Managers,” PBM Accountability Project, March 2023, https://www.pbmaccountability.org/files/ugd/b11210_1626b4e7d4d942a990f6aa0c9685b076.pdf?index=true.

⁴⁵ Ibid.

⁴⁶ “2024 Large Employer Health Care Strategy Survey,” Business Group on Health, August 22, 2023, <https://www.businessgrouphealth.org/resources/2024-large-employer-health-care-strategy-survey-executive-summary>.

⁴⁷ Michael D. Hogue, “APhA releases survey results quantifying the impact of PBMs,” American Pharmacists Association, March 1, 2023, <https://www.pharmacist.com/CEO-Blog/apha-releases-survey-results-quantifying-the-impact-of-pbms>.

⁴⁸ “The Value of PBMs,” Pharmaceutical Care Management Association, accessed September 11, 2023, <https://www.pcmnet.org/value-of-pbms/>.

⁴⁹ “The Top Pharmacy Benefit Managers of 2022: Market Share and Trends for the Biggest Companies,” Drug Channels, May 23, 2023, <https://www.drugchannels.net/2023/05/the-top-pharmacy-benefit-managers-of.html>.

restricted since it must work through one or two PBMs to reach customers. Unless these pharmacies accept the terms of the PBMs, they are left serving a narrow cash market.

Even if pharmacies concede heavy discounts to PBMs, there is no market pressure for the PBMs to pass these savings on to sponsors and consumers in the form of lower prices. Therefore, while PBMs benefit from market concentration, consumers do not. A 2017 U.S. generic prescription drug market analysis found that excessive market concentration within the industry has led to higher generic drug prices.⁵⁰ Of course, significant market concentration does not necessarily mean higher prices. Still, when an enterprise uses its monopoly on information to extract excessive profits while limiting patient access to that information, higher prices are a natural consequence.

There is yet another conflict of interest. Large PBMs also provide mail-order prescriptions.⁵¹ PBMs can easily capture customers for reoccurring business (typically for lower costs), thus bypassing the pharmacy entirely. In other words, PBMs can *cream-skim* customers to their own mail-order business. Because of conflicts of interest, self-dealing, and the lack of transparency contributing to a market failure, PBMs wield extraordinary market power. For this reason, some have concluded that the PBM industry's conduct is "anti-competitive and, in some cases, plainly illegal,"⁵² while others have called for industry regulation.⁵³

In summary, high market concentration provides PBMs substantial negotiating power in the marketplace and raises anticompetitive risks for consumers. Based on structure, conduct, and performance, there is market failure, and that failure calls for regulatory remedies to

⁵⁰ Ernst R. Berndt, Rena M. Conti, and Stephen J. Murphy, "The Landscape of US Generic Prescription Drug Markets, 2004-2016, July 2017, <https://www.nber.org/papers/w23640>.

⁵¹ "Pharmacy Benefit Managers: Mail Order Services," National Community Pharmacy Association, accessed September 11, 2023, https://www.ncpa.co/pdf/leg/aug11/pbm_mailorder101.pdf.

⁵² Mark Meador, "Squeezing the Middleman: Ending Underhanded Dealing in the Pharmacy Benefit Management Industry Through Regulations," *Annals of Health Law*, Vol. 20, 2011, pp. 77-112.

⁵³ Meador, at p. 111. Also see, Regina Sharlow Johnson, "PBMs: Ripe for Regulation," *Food and Drug Law Journal*, Vol. 57, 2002, pp. 323-369.

lessen PBM market concentration, increase market transparency, and reduce prescription drug prices.

PBM Legislative Reforms Gain Steam

Fortunately, PBM's unique tendency to use its monopoly on information to exploit consumers and industry stakeholders has garnered the attention of government leaders. Congress increasingly knows something must be done to reform the current system. For too long, misaligned incentives in the pharmaceutical supply chain and a general lack of transparency on the part of PBMs have enabled these industry middlemen to enrich themselves at the expense of everyone else.⁵⁴ Bold action is necessary to rectify this situation. To that effect, federal regulators and lawmakers at both the federal and state level are busy introducing various reforms.⁵⁵

At the federal level, almost every house and senate committee with healthcare jurisdiction is considering new PBM reforms and transparency measures. For example, the House Energy and Commerce Committee (E&C) recently proposed the Protecting Patients Against PBM Abuses Act (HR 2880),⁵⁶ which, if enacted, would prohibit PBM spread pricing in Medicare Part D plans. The E&C also recently introduced the PATIENT Act of 2023 (HR 3561), which would ban spread pricing and require PBMs to provide annual reports to plan sponsors detailing the amount of drug manufacturer copay assistance, formulary placement, and other information on covered and dispensed drugs.⁵⁷ A third proposal would combine aspects of several previous bills into a single comprehensive package known as the Lower Costs, More

⁵⁴ "Crapo, Wyden Release Legislative Framework to Address PBMs, Prescription Drug Supply Chain," United States Senate Committee on Finance, April 20, 2023, <https://www.finance.senate.gov/ranking-members-news/crapo-wyden-release-legislative-framework-to-address-pbms-prescription-drug-supply-chain>.

⁵⁵ Erin Slifer and Alyssa Llamas, "Bipartisan Congressional Support for PBM Reform Grows," June 21, 2023, <https://www.commonwealthfund.org/blog/2023/bipartisan-congressional-support-pbm-reform-grows>.

⁵⁶ "H.R.2880 – 118th Congress (2023-2024): Protecting Patients Against PBM Abuses Act," Congress.gov, April 26, 2023, <https://www.congress.gov/bill/118th-congress/house-bill/2880?q=%7B%22search%22%3A%5B%22hr+2880%22%5D%7D&s=7&r=1>.

⁵⁷ Rachel Stauffer, "Pharmacy Benefit Manager Reform: What's on the Horizon?" McDermott + Consulting, September 5, 2023, <https://www.mcdermottplus.com/insights/pharmacy-benefit-manager-reform-whats-on-the-horizon/>.

Transparency Act.⁵⁸ The Act is intended to increase healthcare price transparency by requiring PBMs to disclose negotiated rebates and discounts.

The House Committee on Ways and Means has also recently proposed reforms, including the Health Care Price Transparency Act of 2023 (H.R. 4822).⁵⁹ This critical Act includes new PBM pricing transparency and reporting requirements, such as mandating that PBMs report to “plan sponsors and employers data relating to copayments, rebates, discounts, net payments, and costs of covered drugs,” and that the GAO report on all “vertical integrations” between PBMs, insurers, and pharmacies.⁶⁰ In addition, the Act includes the Ways and Means Committee’s recently approved Protecting Patients from Middlemen Act, which, if signed into law, would prohibit PBMs in Medicare Part D or Medicare Advantage from charging patients more in drug cost-sharing than the net price of the drug.⁶¹

On the Senate side, the Committee on Health, Education, Labor, and Pensions (HELP) recently approved the Pharmacy Benefit Manager Reform Act (SB 1339), which, if enacted, would require PBMs to remit “all rebates, fees, alternative discounts, and other remuneration received” to plan sponsors.⁶² Meanwhile, the Senate Finance Committee is busy considering the Modernizing and Ensuring PBM Accountability Act, designed to separate PBM income from the drug’s price and establish new reporting requirements for PBMs relating to drug prices and formulary placement.⁶³ Also in the works is the Senate Committee on Commerce, Science, and

⁵⁸ Denise Myshko, “New House Bill Focuses on Healthcare Price Transparency,” Managed Healthcare Executive, September 11, 2023, <https://www.managedhealthcareexecutive.com/view/new-house-bill-focuses-on-healthcare-price-transparency>.

⁵⁹ “H.R.4822 – 118th Congress (2023-2024): Health Care Price Transparency Act of 2023,” Congress.gov, July 24, 2023, <https://www.congress.gov/bill/118th-congress/house-bill/4822>.

⁶⁰ “H.R. 4822, The Health Care Price Transparency Act of 2023,” United States House Committee on Ways & Means Chairman Jason Smith, 2023, <https://waysandmeans.house.gov/wp-content/uploads/2023/07/HR-4822-Section-Summary.pdf>.

⁶¹ “Wenstrup, Malliotakis Bill To Lower Drug Costs Passed out of Wasy & Means Committee,” Congressman Bradoo Wenstrup, July 27, 2023, <https://wenstrup.house.gov/updates/documentsingle.aspx?DocumentID=407649>.

⁶² “S.1339 – 118th Congress (2023-2024): Pharmacy Benefit Manager Reform Act,” Congress.gov, April 27, 2023, <https://www.congress.gov/bill/118th-congress/senate-bill/1339?s=9&r=1&q=%7B%22search%22%3A%5B%22s1339%22%5D%7D>.

⁶³ Denise Myshko, “Congress is Expected to Bring PBM Transparency Legislation,” Managed Healthcare Executive, September 6, 2023, <https://www.managedhealthcareexecutive.com/view/congress-is-expected-to-bring-pbm-transparency-legislation-2023-pbmi>.

Transportation’s Pharmacy Benefit Manager Transparency Act of 2023 (SB 127), intended to increase transparency in prescription drug pricing and end deceptive practices like spread pricing and clawbacks.⁶⁴ Preliminary estimates by the CBO suggest the bill would save taxpayers \$740 million over ten years.⁶⁵

Numerous other bills are also under consideration by Congress. While the vast majority of these are unlikely to pass in their current form, the pure volume of them provides hope that consensus legislation, which addresses many of the most grievous PBM abuses, is possible.⁶⁶

Federal regulators have also recently weighed in on PBM abuses. In July, the Federal Trade Commission (FTC) formally voted to withdraw their prior support for PBMs.⁶⁷ In their official statement, the FTC acknowledges that the “PBM industry has changed significantly over the last two decades” and that the “current market structures and business practices may undermine patients, pharmacies, and fair competition.”⁶⁸ For these reasons, the Commission now discourages public reliance on its previous advocacy letters and reports until its new PBM study is completed and these earlier materials can be reevaluated.⁶⁹ The Commission has also since expanded its 2022 inquiry into PBMs, which required the six largest PBMs to hand over information related to their business practices, to include a group purchasing organization that

⁶⁴ “S.127 – 118th Congress (2023-2024): Pharmacy Benefit Manager Transparency Act of 2023,” Congress.gov, January 26, 2023, <https://www.congress.gov/bill/118th-congress/senate-bill/127>.

⁶⁵ Dulane Morris, “Pharmacy Benefit Manager Transparency Act Passes in Senate Committee Vote,” March 27, 2023, https://www.duanemorris.com/alerts/pharmacy_benefit_manager_transparency_act_passes_senate_committee_vote_0323.html.

⁶⁶ Joyce Frieden, “Congress Making Progress on Bills to Regulate PBMs,” MedPage Today, August 3, 2023, <https://www.medpagetoday.com/publichealthpolicy/washington-watch/105756>.

⁶⁷ “FTC Votes to Issue Statement Withdrawing Prior Pharmacy Benefit Manager Advocacy,” Federal Trade Commission, July 20, 2023, <https://www.ftc.gov/news-events/news/press-releases/2023/07/ftc-votes-issue-statement-withdrawing-prior-pharmacy-benefit-manager-advocacy>.

⁶⁸ “Federal Trade Commission Statement Concerning Reliance on Prior MBM-Related Advocacy Statements and Reports That No Longer Reflect Current Market Realities,” Federal Trade Commission, July 18, 2023, https://www.ftc.gov/system/files/ftc_gov/pdf/CLEANPBMStatement7182023%28OPPFinalRevisionsnoon%29.pdf.

⁶⁹ “FTC Launches Inquiry Into Prescription Drug Middlemen Industry,” Federal Trade Commission, June 7, 2022, <https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-launches-inquiry-prescription-drug-middlemen-industry>.

handles negotiated rebates on behalf of PBMs.⁷⁰ These actions illustrate just how quickly some federal regulator's opinions of PBMs have changed.

Not to be left out of the action, all 50 states have enacted at least one law on PBMs since 2016, accounting for more than 150 laws.⁷¹ Examples include transparency and reporting measures like a new Arkansas law that allows the Insurance Commissioner to examine the books and records of PBMs to determine aggregate rebate information.⁷² They also include essential measures like a 2023 New Jersey law that bans spread pricing and requires manufacturer rebates to be used to lower patient premiums and out-of-pocket costs.⁷³ As of October, 43 states have introduced 137 bills during the 2023 legislative session to address PBM abuses.⁷⁴ While 25 have failed, 21 have been enacted, and 91 are still pending in state legislatures.⁷⁵

The pure magnitude of bills recently introduced by state legislatures is a testament to the considerable bipartisan support for reforming PBMs. Unfortunately, this support has led to a complicated maze of state laws that have only achieved varying levels of success. It is, therefore, still incumbent upon Congress to pass comprehensive legislation that tackles all the significant abuses discussed in this paper. The question is, what precisely should be included in such legislation?

⁷⁰ "FTC Further Expands Inquiry Into Prescription Drug Middlemen Industry Practices," Federal Trade Commission, June 8, 2023, <https://www.ftc.gov/news-events/news/press-releases/2023/06/ftc-further-expands-inquiry-prescription-drug-middlemen-industry-practices>.

⁷¹ "State Action on Pharmacy Benefit Managers (PBMs) to Address Prescription Drug Pricing," National Academy for State Health Policy, July 24, 2023, <https://nashp.org/state-action-on-pharmacy-benefits-managers-pbms-to-address-prescription-drug-pricing/>.

⁷² "PBM bill signings in South Dakota, Arkansas," National Community Pharmacists Association, March 29, 2023, <https://ncpa.org/newsroom/qam/2023/03/29/pbm-bill-signings-south-dakota-arkansas>.

⁷³ "Governor Murphy Signs Legislative Package to Make Prescription Drugs More Affordable for New Jerseyans," State of New Jersey Governor Phil Murphy, July 10, 2023, <https://www.nj.gov/governor/news/news/562023/20230710a.shtml#:~:text=This%20bill%20requires%20rebates%20to,plan%20and%20reimburses%20a%20pharmacy>.

⁷⁴ "2023 State Legislative Action to Lower Pharmaceutical Costs," National Academy for State Health Policy, updated September 15, 2023, <https://nashp.org/2023-state-legislative-action-to-lower-pharmaceutical-costs/>.

⁷⁵ Gabrielle Wanneh, "More Than 20 Bills Passed at State-Level to Regulate PBMs in 2023," InsideHealthPolicy, August 14, 2023, <https://insidehealthpolicy.com/inside-drug-pricing-daily-news/more-20-bills-passed-state-level-regulate-pbms-2023>.

Summary and Recommendations:

After reviewing the principal-agent problem, market failures caused by asymmetric information, conflicts of interest, collusive pricing, spread pricing, price gouging, self-dealing, undisclosed rebates from manufacturers (including increases in manufacturer's rebates along with increases in invoice prices for beneficiaries), and establishing formularies that maximize profits instead of minimizing beneficiary costs – it can now be concluded that PBMs are one of the primary reasons that prescription drug prices are so high for consumers.

To address this problem, lawmakers and regulators need to implement the following public policy remedies:

- PBMs should be required to pass-through 100% of manufacturer rebates and discounts to patients;
- Patients paying coinsurance and/or deductibles should pay the negotiated price and not the full list price of drugs;
- PBMs should be prohibited from using clawbacks and spread pricing;
- PBMs should be prohibited from using copay accumulator adjustments to deny patients copay assistance as was initially intended by manufacturers; and
- The Department of Health and Human Services, or another federal agency, should be given greater supervision over PBMs' pricing practices, including auditing power to track wholesale and retail prices between the entire supply chain, if necessary.

The industry's structure, conduct, and performance confirm the presence of market failures, and it provides evidence that total consumer welfare is being adversely affected – consumer prices are being intentionally inflated, and PBMs have a fiduciary duty to sponsors that is not being honored.

The goal of this paper is to shine a light on PBMs and the role they play in driving up prescription drug costs. At a minimum, PBMs should be prohibited from using the types of

anticompetitive practices that harm consumers. The “light touch” regulatory remedies recommended here seek to reduce PBM market power, increase transparency, and heighten competition within the industry.