Weekly Checkup

Delinking Deduction

JACKSON HAMMOND | SEPTEMBER 15, 2023

Pharmacy benefit managers (PBMs) are all the rage – often literally – on Capitol Hill these days, and they've been targeted with a variety of legislative proposals in the past several months. On Tuesday, **Dr. Casey Mulligan, a PhD economist at the University of Chicago** (full disclosure: Dr. Mulligan has written for the American Action Forum previously), **released a working paper on the consequences of legislation that would "delink" PBM remuneration from the rebates they negotiate. Let's explore that research and what it means for current and future PBM reform proposals.**

First, a bit of background on PBMs and delinking. PBMs negotiate payments for drugs on a plan's formulary (the list of drugs the plan covers) and adjudicate claims, among other things. There are a couple of models on how PBMs are compensated, but most plans pay most PBMs a percentage of the rebate (the discount on the list price of the drug) that PBMs negotiate from drug manufacturers. The larger the rebate, the more money a PBM makes. PBMs use the plan's pool of beneficiaries as negotiation leverage (the larger the utilization volume of a drug, the larger the rebate will be), as well as a tiering system in the formulary that puts drugs into preferred vs. non-preferred categories. **The bigger the discount a pharmaceutical manufacturer can offer compared to its competitors, the better its tier placement on the formulary. The PBM keeps a percentage of that rebate, and the rest goes back to the plan sponsor, which then may use it to keep premiums lower or offer more benefits.**

The trouble is that this system may incentivize higher list prices of drugs. For example, a pharmaceutical company knows that a PBM is most likely to choose the drug with the biggest rebate. If that company raises the list price, it can give a larger rebate and still end up at the same price it was originally willing to offer. That wouldn't be a problem, except most co-pays for the patient at the pharmacy counter are based off the percentage of the drug's list price, in large part because the full rebate amount won't be known until months later when the plan's utilization volume targets are achieved. **While net drug prices have**

gone down over the last decade, list prices have been steadily increasing, and the PBM rebate structure is potentially one reason (the 340B Program is potentially another). Insurance plans still prefer this system and choose to compensate PBMs this way because it saves the entire plan – and thus its beneficiaries – money.

In an attempt to prevent higher list prices, Congress has introduced legislation to "delink" PBM payment from discounts on the list price in Medicare Part D. **Dr. Mulligan's research shows that delinking PBM payment from the discounts is likely to increase annual federal Part D spending by $3–$10 billion, demonstrating that paying for performance matters for outcomes.** With no incentive for PBMs to negotiate lower net prices, those net prices will increase. Additionally, delinking would put stand-alone PBMs at a disadvantage relative to vertically integrated PBMs – which already own around 80% of the market – and this consolidation would further increase prices. **Furthermore, Dr. Mulligan notes delinking would lead to lower drug utilization, as PBMs lose incentive to hit their utilization volume goals and individuals leave plans that had to increase their premiums to pay for more expensive drugs.**

The pharmaceutical money-product web is extremely complex, and PBMs are merely one player among several. Ultimately, what a patient pays at the pharmacy counter is decided by the plan sponsor's choice of co-pay, deductible, and other out-of-pocket requirements, on which the PBM has no input. **Delinking PBM payments from the discounts they negotiate isn't going to help any of this and could even make the problem worse. Dr. Mulligan puts it best when he says, "The advantages of pay for performance is one of the most cited conclusions in economics, where it is frequently noted that 'incentives matter.'"** Let's hope Congress catches on.