EXECUTIVE SUMMARY

Pharmacy Benefits Manager Reforms: Can Congress Fix the Market Without Breaking It?

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Pharmacy benefit managers (PBMs) play a central role in determining access and spending for prescription drugs in the United States. PBMs earn revenues from negotiating price and payment concessions from the prescription drug supply chain — pharmaceutical companies and pharmacies — on behalf of health plans. This arrangement encourages them to control prescription drug prices and spending but has recently become controversial. Multiple stakeholders argue that PBMs use their market power to serve their own interests over those of health plans and their beneficiaries. Others assert that PBMs under common ownership with pharmacies and health plans disadvantage their unaffiliated rivals in these markets.

These complaints have prompted multiple bipartisan Congressional reform proposals, many of which focus on regulating how PBMs earn money. Legislation to this effect raises questions about whether Congress can ensure that PBMs use their market power on behalf of health plans and beneficiaries without sacrificing their motivation to control prescription drug costs.

In this project, we reviewed PBM reforms proposed by the current Congress to understand their potential effect on this tradeoff, and whether modifications were possible to improve or enhance their impact. We found that some proposals would reduce PBMs' incentive to negotiate effectively, and others could lead to tacit collusion. However, we also identified several ways in which reforms could improve the balance in PBM incentives: encouraging competition, increasing accountability, and addressing vertical integration.

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This research was informed by a confidential roundtable and interviews with industry stakeholders. West Health and ATI Advisory gratefully acknowledge the contributions of Amy Herr, William Scanlon, and Marta Wosinska.

A central finding of our work is that the market for PBM services does not encourage them to compete head-to-head. This suggests that losses from revenue regulation could at least be mitigated by increasing competition for plan sponsors' business. This is particularly notable in the market for employer-sponsored health plans, where PBM competition could be increased by requiring that their bids for plan sponsors' business be based on standardized terms that allow sponsors to compare offerings more directly.

Lawmakers could also modify provisions guaranteeing employers data about their PBM's performance by allowing them to assign their audit rights to a federal agency. Federal oversight may also be helpful to ensure that competition from nascent PBMs is protected from foreclosure by incumbents, since many depend on incumbents for access to rebates.

In addition, lawmakers can sharpen proposed studies on the effects of vertical integration involving PBMs. This is particularly important to the markets for Medicare Part D and Medicare Advantage, where health plans under common ownership with a PBM cover the majority of beneficiaries. For these markets, it is critical to investigate whether the theoretical benefits of vertical integration — lower costs and more competition — have been realized by unaffiliated plan sponsors and their beneficiaries.

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When Congress returns to the topic of PBM reforms, provisions that have already been introduced will serve as the foundation for a consensus deal. Our review suggests that lawmakers can limit the downsides of current reform proposals while enhancing their beneficial aspects. Many of the modifications we identified can also be implemented as standalone policies to improve the current functioning of the PBM market, which would allow policymakers to avoid revenue regulation provisions that have the potential to raise pharmaceutical and pharmacy costs.