

Deceptive Drug Pricing

Who Profits from Hidden Pharmacy Costs—
and How to Avoid Them



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Who this is for:

An employee benefits plan sponsor, HR professional, or business owner seeking more information about what's driving high pharmaceutical costs and how they can prepare for conversations with a potential pharmacy benefit manager.

Reading time:

10 minutes

Commissioned by:

Providence Health Plan

Introduction

The high cost of hidden pricing

Choosing the right pharmacy benefits can feel like a balancing act. Weighing the evolving needs of your employees with the very real concerns of maintaining a healthy bottom line is a challenge, especially when your decision impacts how your business attracts top talent, retains your best people, and grows into the future. Trying to compare different benefit plans only adds to the complexity—numbers often don't give a full picture of which plan is better in the long run.

Amid all the uncertainty, however, one thing is clear: Pharmacy costs seem to keep going up as new specialty drugs and advanced therapies become more popular and treatment plans start earlier.

A key driver of rising costs that's getting a lot of attention lately is Pharmacy Benefit Managers (PBMs)—intermediaries who manage prescription benefits and negotiate with drug manufacturers and pharmacies on behalf of businesses like yours. You may have heard about some PBMs in the news, as legislators around the country look at ways to lower costs and increase transparency in drug pricing.

Understanding how a typical PBM operates tells you plenty about the state of pharmacy costs today—and how you can make informed decisions to protect your business from paying too much. This white paper will explore what traditional PBMs do, how the biggest PBMs profit from higher pharmacy costs, and how you can avoid paying more than you expect.

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Prescription drug prices in the U.S. compared to the cost of identical drugs in other high-income nations.¹

The middlemen driving up drug costs

Once simply pharmacy claim processors, PBMs' role has grown along with the healthcare sector as a whole since they came about in the 1960s. These days, PBMs design and implement pharmacy networks that create access to medications and therapies for millions of Americans. They review pharmaceutical quality, efficacy, and safety of new medications on the market, then decide which sets of drugs your employees can choose from. They negotiate rebates and coverage terms with pharmaceutical manufacturers, then turn around and negotiate with health plans, pharmacies, and businesses like yours.

“PBMs feature in almost all of the key transactions that drive the price of a drug.”

United States Senate Committee on Finance, June 2018²

The idea behind a typical PBM's role as middlemen makes sense on its surface: The more people they negotiate on behalf of, the better deals they can get—buying power that would theoretically reduce costs for all involved. But as the United States House Committee on Oversight and Accountability put it, “Instead, the opposite has occurred: patients are seeing significantly higher costs with fewer choices and worse care³.”

So, what happened? It's hard to say—and that's sort of the point. Longstanding transparency questions have led to increased scrutiny of the biggest PBMs, especially as pharmacy costs keep rising. Consumer advocates say many PBMs hide payment terms and rebates during negotiations with manufacturers, plan sponsors, and pharmacies to pull in profits. Traditional PBMs have argued that disclosing rebates and terms would harm competition and lead to even higher drug prices.

In any case, such secrecy leaves plan sponsors like you in the dark when making what are hugely consequential decisions for your business and your people. It doesn't help that contracts are often filled with jargon that's hard to understand. Or that some traditional PBMs answer an RFP with a low price to drum up business, but avoid calling out—or clearly explaining—when common fees or caveats will pop up. It all adds up to skyrocketing costs for Americans, who spend more on prescription drugs than any other country.¹

Here are three common ways many PBMs avoid transparency to set themselves up for profits:



Formularies

A list of drugs covered under a benefits plan, formularies are either created or purchased by a PBM and organized by cost tiers. It's hard to know precisely why certain medications show up on which tiers because many PBMs don't disclose their rationale. Critics say traditional PBMs are incentivized to place more expensive meds in prime positions on their formularies, even when there are cheaper options that are just as safe and effective.



Rebates

To place a drug in a favorable spot on its formulary, many PBMs pressure drug manufacturers behind the scenes to offer a discount or pay out a rebate, which often isn't disclosed to plan sponsors or pharmacies. This not only makes it harder for lower-cost competitors like generics or biosimilars to make it onto formularies, it also doesn't allow your employees any visibility into another drug that may work just as well for them—and cost less. Plus, it incentivizes some PBMs to choose more expensive drugs that pay out a higher rebate, or even switch patients to therapeutically similar drugs that they'll pocket more profits from.



Pricing

For a reduced administration fee and guaranteed prescription price at the pharmacy counter, some plan sponsors may agree to let PBMs keep the difference between what a pharmacy charges an employee for a medication and what a PBM pays that pharmacy. However, with no transparency into how much the PBM is pocketing, it's hard to know the difference between the amount you're billed and what your pharmacy is being reimbursed—so you never know how good of a price you're really getting.

How some PBMs profit from higher costs

Anyone who's booked a hotel or bought a concert ticket knows the frustration of seeing some vague surcharge suddenly appear at checkout. Surprise charges on your pharmacy benefits statement aren't just frustrating, they're often hugely consequential—especially when those hidden fees push your net cost past what your business (or your employees) have budgeted.

Many traditional PBMs deploy practices and charge fees that do more than tick up costs and tick off your employees—they make it nearly impossible to understand how much you're paying and what you're actually paying for. As the U.S. House Committee on Oversight and Accountability said in a recent report on PBMs and prescription drug markets: “PBMs frequently tout the savings they provide for payers and patients through negotiation, drug utilization programs, and spread pricing, even though evidence indicates that these schemes often increase costs for patients and payers³.”

Here are some common fees and practices to look out for:

■ Admin fees

PBMs and other pharmacy benefit solutions charge administrative fees to negotiate and manage benefits on your behalf. Just how much they charge, however, varies quite a bit. A low admin fee may look appealing at first, but often isn't inclusive of additional fees (sometimes undisclosed until invoicing) that add up to a higher net cost for you and your employees later.

■ Rebate retention

When a manufacturer offers a rebate on a drug, you might expect a PBM to pass on the savings—but that may not be the case. Many PBMs retain rebates without disclosing them. And because they're incentivized to include drugs in their formulary that put the biggest rebate back in their pocket, your net costs may be higher without you ever knowing it. Plus, high rebates may just be a sign you're paying too much in the first place.

- **Spread pricing**

When a PBM charges a plan sponsor more for a drug than they pay a pharmacy—then pocket the difference—it’s called spread pricing. Traditional PBMs keep the spread without telling you how much they’re paying (and profiting from) each transaction.

- **Prior authorization processing fee**

Prior authorization (PA) is a decision made by an insurer whether a healthcare service, treatment plan, prescription drug, or equipment is medically necessary. Your plan may require such approval before an employee receives such a service, or in certain non-emergency situations—and some PBMs may charge a fee each time a PA claim is processed. Many traditional PBMs also decide which drugs require a prior authorization—setting themselves up make even more.

- **Prior authorization review fees**

Some PA reviews are electronic, but a PBM may charge you for the time spent inputting and reviewing a request manually, which may also lead to delays that frustrate employees.

- **Formulary utilization fee**

Most PBMs create or purchase their formularies—a list of drugs covered under a health insurance plan—and then charge you a fee to use it. It’s a bit like getting billed for something you’d need to use anyway: It simply wouldn’t make sense for a PBM to use a formulary they didn’t design or approve.

- **Care management or clinical program fees**

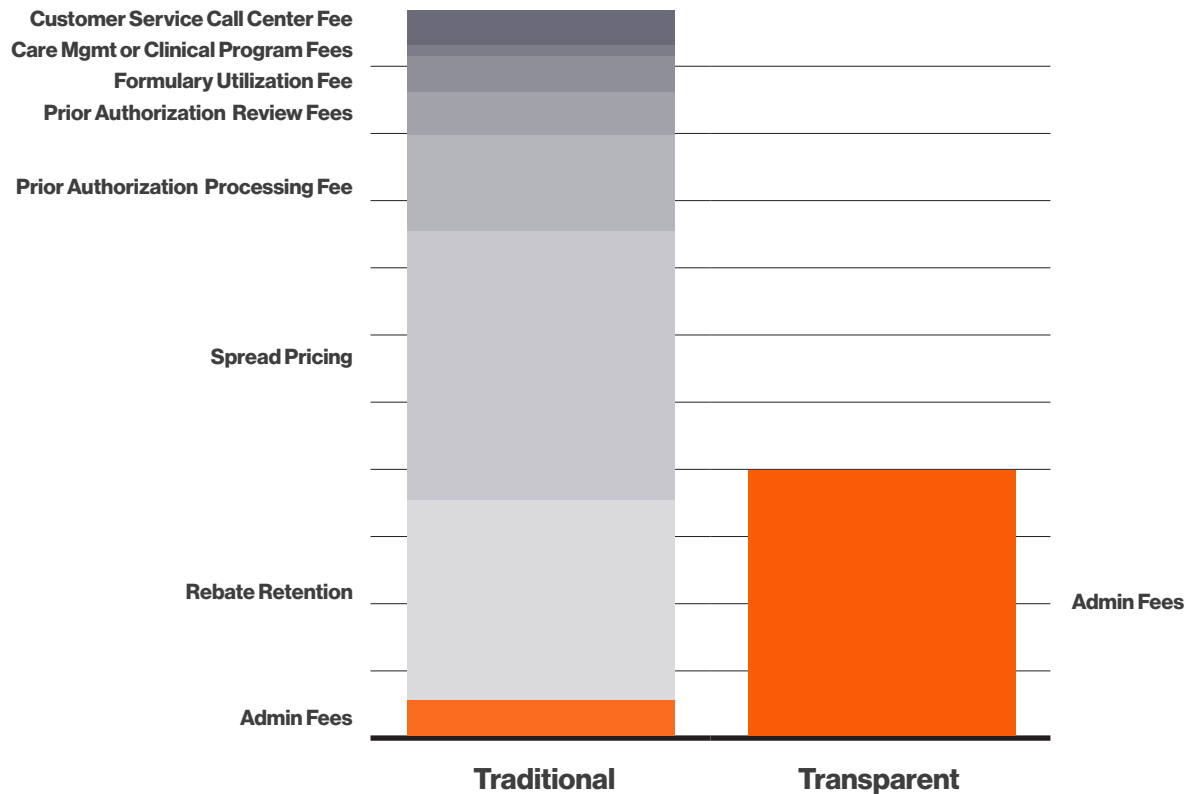
Some PBMs charge you for a provider to manage an employee’s care and services, or each time your employee receives a service from a healthcare provider, such as a test or office visit.

- **Customer service call center fee**

When one of your employees has a question or issue at the pharmacy, their health—and at the very least, their patience—may depend on how quickly they can speak to someone. Talking through an issue with an expert is a vital service, and one many traditional PBMs charge for each and every time.

These charges all add up over time and can lead to higher net costs for your business and employees in the long run. Here’s an example of how a traditional, profit-driven PBM might structure its business versus one that charges a flat, transparent fee:

Hidden pricing, higher costs



On the other end of the spectrum are transparent PBMs and other pass-through benefit solutions that charge a flat fee for services. Compared to traditional, profit-first PBMs, such pass-through agreements may come with higher up-front admin costs, but often offer more transparency and lower net costs once rebates and other savings are passed back to the plan. Plus, with a flat fee, you know what you’re paying up front. To further increase visibility into drug pricing, coverage, and formulary alternatives, some PBMs and PBM services may also provide real-time benefit tools for specific lines of businesses.



How legislators are responding to rising drug prices

For every **\$100** spent on a drug at a retail pharmacy, it's estimated about **\$5** goes to PBMs—and **\$2** of that is net profit.²

It's no wonder reigning in drug costs by reforming how some PBMs do business has become a bipartisan issue, with increased scrutiny from Congress and state legislatures alike.

Legislation has mainly been focused on national healthcare conglomerates in an attempt to counter the price-raising effects of market consolidation over the years.

Critics say it's a long time coming, especially for the biggest PBM players—the top three of which processed nearly 80% of the approximately 6.6 billion prescriptions dispensed by U.S. pharmacies in 2023.⁴

Congress has also expressed concern with vertical integration, which is when large insurers also own PBMs, pharmacies, or both. Vertical integration allows single companies to control who can access a particular pharmacy and how much they reimburse themselves for a particular drug. This is especially acute when the same conglomerate owns the PBM, drug manufacturer, and pharmacy: They can afford to lose money on one side, and then offset that loss on another side of their business.

Critics contend these practices are anti-competitive: When a PBM's parent company also owns a pharmacy, it can squeeze independent pharmacies with “take it or leave it” contract terms they have little choice but to accept.⁵ The industry's top lobbying group says PBMs “support rural pharmacies through innovative programs that increase reimbursements on prescription drugs⁶,” but there's little denying independent pharmacies are struggling to compete and even stay open: According to the National Community Pharmacists Association, about one independent pharmacy closed every day in 2023.⁷

How the big PBM conglomerates have responded to their practices and lack of transparency being under the microscope is also telling. As legislators across the country consider PBM reforms, Congress has accused the three largest PBMs of starting corporate entities in notorious foreign tax havens, including those in Switzerland that focus on rebate and fee negotiation and companies in the Cayman Islands that produce and market generics and biosimilars known for their profitability.³

“The creation of entities in locations well-known for their lack of financial transparency... only heightens concerns that PBMs will do anything to avoid transparency.”

United States House Committee on Oversight and Accountability, July 2024

How to avoid hidden costs

Not all PBMs hide fees and engage in profit-padding practices that increase your pharmacy costs. Depending on the size of your business and the number of employees, you may be able to negotiate terms of payment for a PBM's services or choose a PBM that doesn't keep portions of rebates or price differences they negotiate.

So how do you know whether a PBM is more profit-based or pass-through? Before you sign a contract, here are a few questions to ask:

Fees and costs

- What specific services do your admin fees include?
- Are there additional fees not mentioned here I should expect?
- What will my total net cost be?
- Are there any additional exclusions or caveats that would affect my total net cost?
- Do you offer any real-time benefit tools to increase transparency around drug pricing, my coverage, and formulary alternatives?

Employee experience

- What will my employee experience be like?
- If my employee has an issue at a pharmacy, who can they call?
- Do you have local call center representatives?
- How knowledgeable or helpful can my employees expect a call center rep to be when calling about an issue?
- What steps will my employees have to go through to get a specialty med?
- How do you support local and rural pharmacies in terms of access?
- Does your company own your pharmacies and require their use?

Business practices

- What do you do with rebates you negotiate with drug manufacturers?
- What percentage of rebates do you retain? Is there a fee for this service?
- Do you practice spread pricing? Do you keep all of the difference or is a percentage passed back to me?
- Where do you make a profit or margin in this arrangement?

Conclusion

Your transparent choice

Pharmacy benefit decisions are hard enough. Few choices carry the financial and emotional weight of providing your employees the medication, treatments, and wellness tools they need to live healthy lives—and do their best work every day. Unfortunately, some PBMs only make these decisions harder with hidden fees and practices that are ripe for reform.

But your business doesn't need to wait for legislation to take effect before you can be confident in your benefits decisions: Not all PBMs or other pharmacy benefit solutions providers operate like profit-first conglomerates. Knowing what to look out for and what questions to ask will empower you to make these important choices with eyes wide open.

Many PBMs negotiate for clients like you, then pocket your savings to pad their profits. Look for a pharmacy benefit solution that passes rebates and discounts back to its clients, so there's clarity in pricing and lower net costs over time. You have a choice: When considering pharmacy benefits, seek out a straightforward fee structure that empowers you to make informed decisions, avoid complex pricing schemes, and sidestep hidden fees.

Footnotes

- ¹ International Prescription Drug Price Comparisons: Current Empirical Estimates and Comparisons with Previous Studies, RAND Corporation, Jan 2021.
- ² A Tangled Web: An examination of the drug supply and payment chains, U.S. Senate Committee on Finance, June 2018.
- ³ The Role of Pharmacy Benefit Managers in Prescription Drug Markets, U.S. House Committee on Oversight and Accountability Staff, July 2024.
- ⁴ Pharmacy Benefit Managers: The Powerful Middlemen Inflating Drug Costs and Squeezing Main Street Pharmacies, U.S. Federal Trade Commission Office of Policy Planning, July 2024
- ⁵ As drug middlemen influence grows, independent pharmacies face fresh challenges by McKenzie Beard, The Washington Post, Oct. 11, 2024
- ⁶ <https://www.pcmagnet.org/press-releases/pcma-statement-on-ftc-interim-pbm-report/07/09/2024/>
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