



Executive Summary | November 2017

Follow the Dollar

*Understanding How the Pharmaceutical
Distribution and Payment System
Shapes the Prices of Brand Medicines*

Executive Summary

Drug pricing is a complex and often confusing issue, shaped by a pharmaceutical distribution and payment system that involves multiple transactions among numerous stakeholders.

While there has been significant public discussion about the prices of prescription medicines, it is rarely clear what price is being discussed. There is no one price for a medicine, as prices paid by wholesalers, pharmacies, pharmacy benefit managers (PBMs), and health plan sponsors all vary and are determined by negotiations between stakeholders, each with varying degrees of negotiating power.

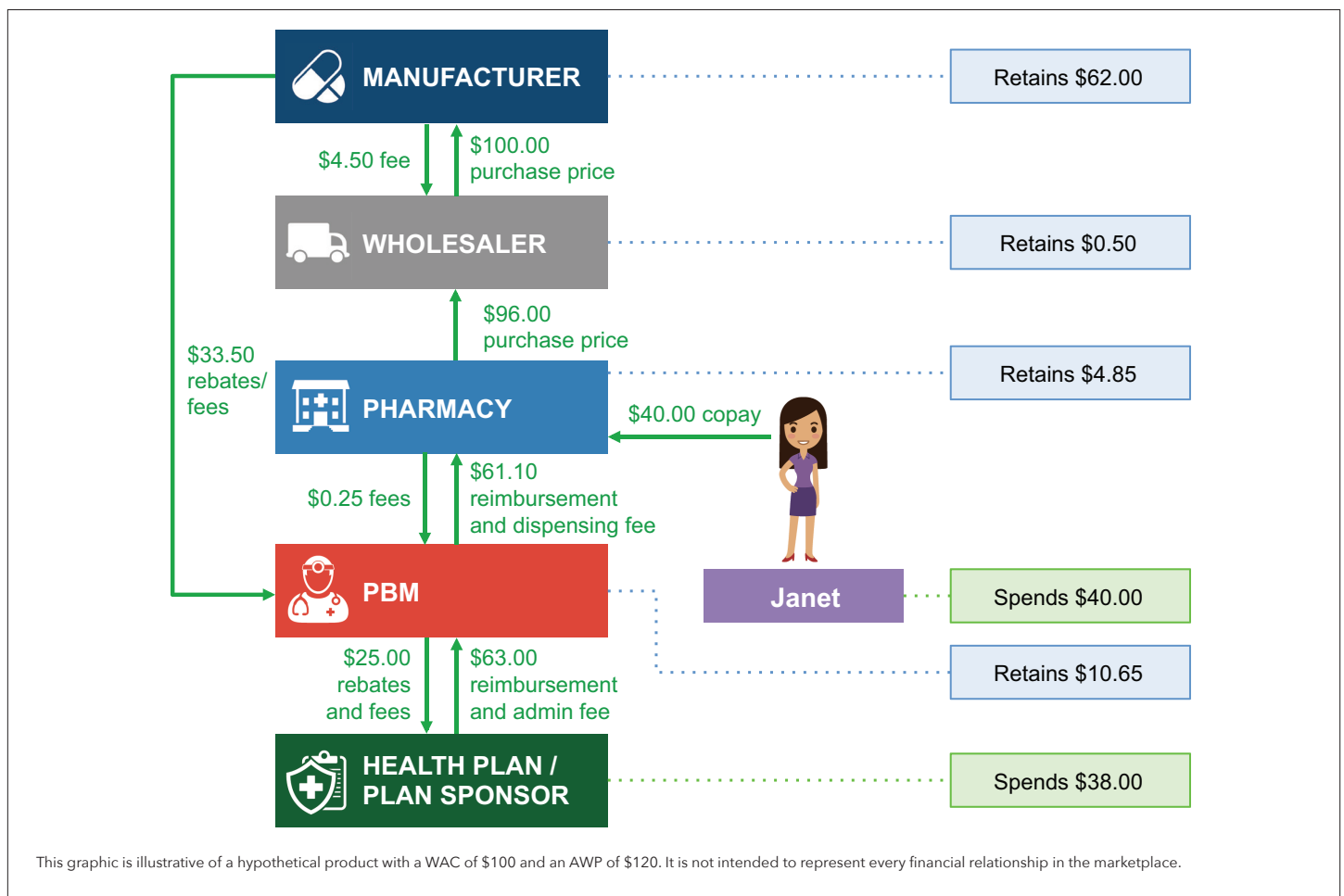
A better understanding of the players involved in the pharmaceutical supply chain, and the role each plays in determining what patients ultimately pay for their prescriptions, can help consumers and policymakers find answers to their questions and concerns about affordability and access to medicines. Drawing from published materials and interviews with industry experts, this paper explains the financial flows that occur as brand medicines move through the supply chain for retail, mail-order, and specialty drugs. Illustrative examples are provided for 3 patients: Janet, Scott, and Diane. Because payment terms are determined through confidential negotiations between stakeholders, the terms of individual contracts are highly variable and may differ from these hypothetical examples.

Patient Profile: Janet

Janet is enrolled in a commercial health insurance plan and has a \$40.00 copay for her blood pressure medicine. Because Janet's health plan receives a 25% rebate off of the list price of her medicine, her copayment of \$40.00 is slightly more than the \$38.00 net price paid by her health plan. After rebates and fees, the manufacturer retains \$62.00, roughly two-thirds of the original list price of \$100.00.

Flow of Payment for a \$100 Blood Pressure Medicine

(Patient Pays a Copayment)

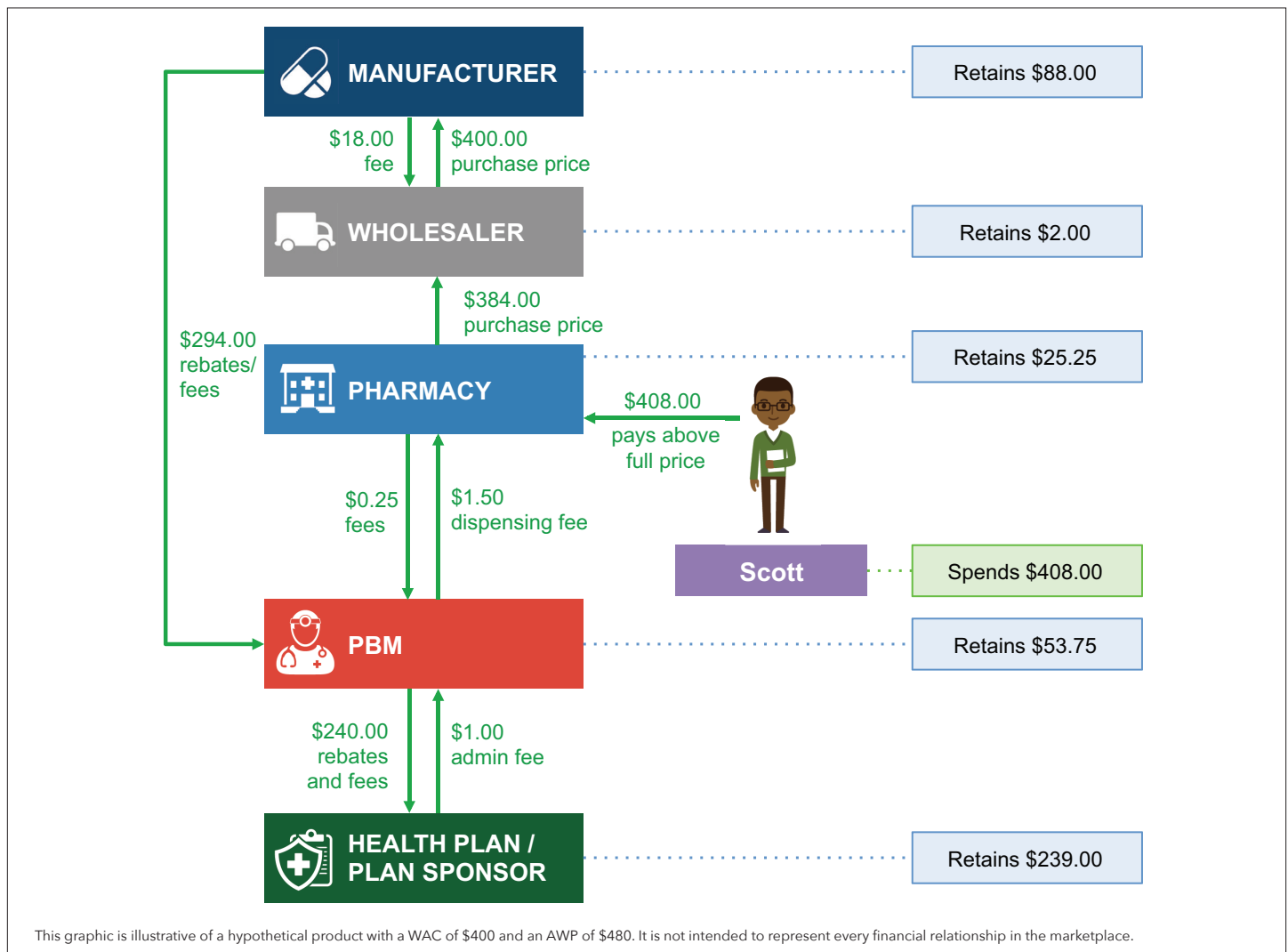


Patient Profile: Scott

Scott takes insulin for his type 2 diabetes and has a health plan with a high deductible. Prior to meeting his deductible each year, he has to pay more than the full undiscounted cost of his medicine, \$408.00, even though his health plan receives a rebate from the manufacturer that reduces the list price by 65%. Scott is paying the amount that is contracted between the health plan and the PBM which, in this case is higher than the list price of the medicine. Although the health plan does not pay for Scott's insulin while he is in his deductible, it still receives the negotiated rebate and earns \$239 per prescription. The PBM earns \$53.75, including fees and a share of the rebate it negotiated, while the manufacturer retains \$88.00.

Flow of Payment for a \$400 Insulin

(Patient Is in Deductible Phase)

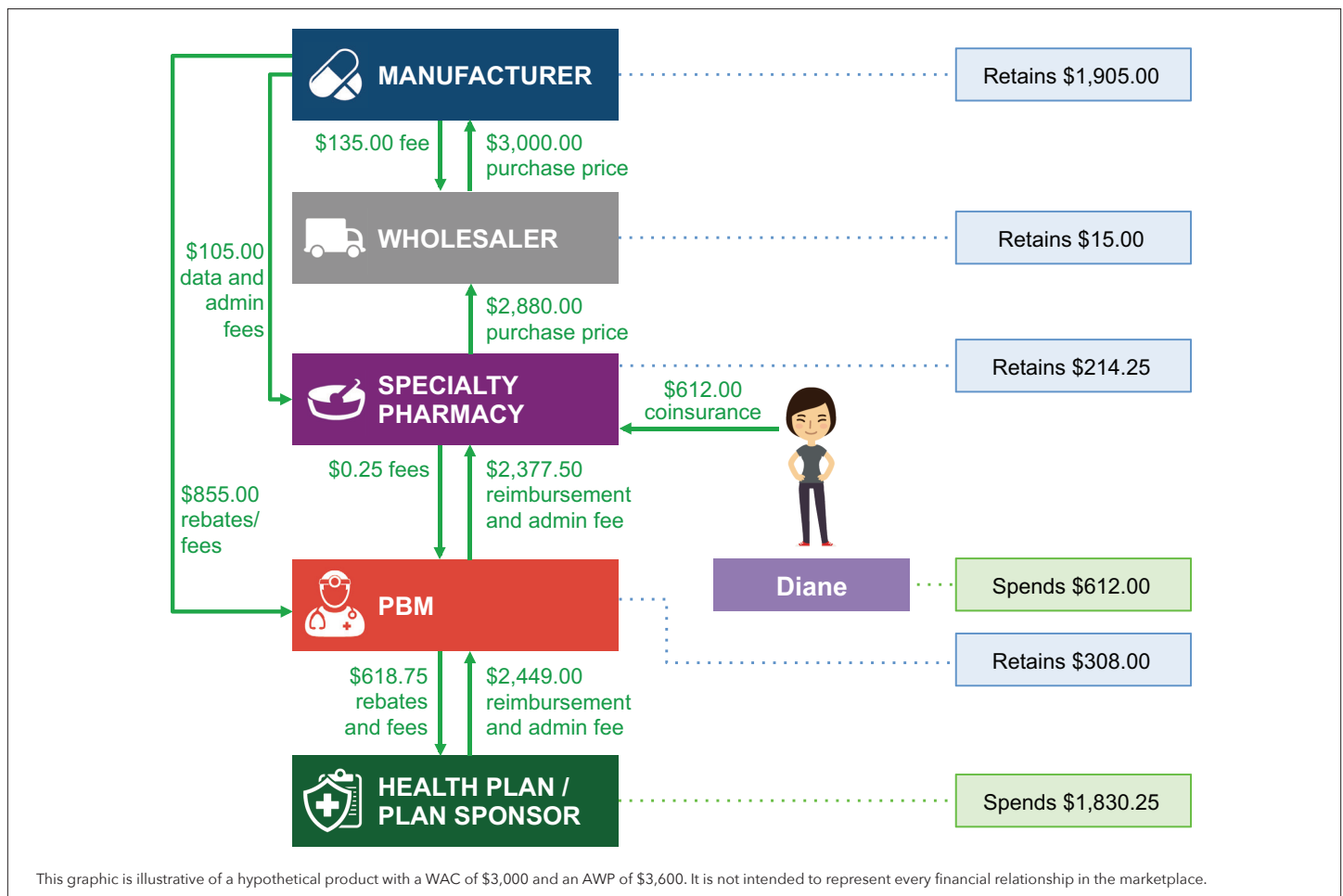


Patient Profile: Diane

Diane has HIV and has commercial coverage with a coinsurance of 20%. Even though Diane’s insurer receives a rebate that reduces the cost of her medicine by 20%, her coinsurance is calculated based on the medicine’s full undiscounted price. In exchange for negotiating the rebate on behalf of the insurer, the PBM retains a share of the negotiated savings and earns service fees, which are also calculated as a percentage of the medicine’s full list price. Because the medicine is dispensed by a specialty pharmacy owned by the PBM, the PBM earns a total of \$522.25 on Diane’s prescription (\$308.00 + \$214.25). Additionally, if instead of offering a 20% rebate, the manufacturer were to independently lower the list price of Diane’s medicine from \$3,000 to \$2,400, the PBM would earn \$169.65 less on this prescription. Because PBMs determine formularies and patient cost-sharing, and thus hold the keys to patient access to the medicine, reductions in the list price may jeopardize market access and formulary position of a medicine.

Flow of Payment for a \$3,000 HIV Medicine

(Patient Pays Coinsurance)



Over the last decade, as the market for prescription medicines has evolved in response to changes in the insurance, regulatory, and business landscapes, interactions along the supply chain have evolved as well. Changing market dynamics—including the approval of innovative new medicines for complex conditions like cancer and hepatitis C; increased use of tiered cost-sharing and utilization management tools that drive rapid uptake of generic medicines; and increased consolidation among entities along the pharmaceutical supply chain—have altered the financial arrangements between manufacturers, wholesalers, pharmacies, PBMs, and health plan sponsors.

Many manufacturers are offering larger rebates on medicines every year. But patients—who are facing larger deductibles and higher coinsurances than ever before—are increasingly facing cost-sharing that is based on the full undiscounted price. As the examples in this paper show, patients often do not benefit from discounts and rebates negotiated between manufacturers and payers and may end up paying more than their insurer for their medicine. This needs to change. Patients should benefit more from negotiated rates in the form of lower out-of-pocket costs at the pharmacy, just like they do for other types of health care services.

As the market begins to move in the direction of a system that better aligns the price of prescription medicines with their value, biopharmaceutical companies are working with private health insurers to implement new payment arrangements for a variety of diseases. Biopharmaceutical companies and health plans are also considering new ways to pay for treatment when a patient needs multiple high-priced, innovative medicines and experimenting with money-back guarantees if a medicine does not work as intended. These new types of arrangements offer the potential to increase the choice of therapy, ensure that patients have affordable access to the newest medicines, and enable our health care system to achieve better outcomes at even more affordable prices.