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Why a budding drug-price revolution isn't quite what it seems

Story by David Wainer

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Why a Budding Drug-Price Revolution Isn't Quite What it Seems © ELENA SCOTTI/WSJ; ISTOCK

Imagine walking into a travel agency in the pre-internet days. You ask for a beachfront hotel on a Greek island. Two similar options fit: One is \$250 a night, the other \$350. But only the pricier one pays the agent a commission. Which one do you think they will steer you toward?

Thankfully, travel stopped working that way. Transparent online pricing exposed those incentives, forcing real competition.

Drug pricing, though, still resembles that old travel-agent model—only far more complex and opaque. The middleman here, the pharmacy-benefit manager, still earns money in ways that don't always align with what patients or employers want. And while transparency is finally creeping into the drug world, it is arriving slowly and with no guarantee it will meaningfully lower costs.

The core distortion is that pharmaceutical companies pay PBMs for access. Drugmakers pay hefty rebates—effectively kickbacks—to PBMs like CVS Health's Caremark and Cigna's Express Scripts. These help the drug companies secure preferred placement on insurance formularies, the list of covered drugs. That means the drug with the [higher list price](#) can be more attractive to a PBM if it delivers a bigger rebate.

Patients with deductibles or coinsurance then get hit with out-of-pocket costs tied to that inflated list price, while the rebate money flows back to insurers or employers to lower premiums for the broader pool. This system effectively punishes the sickest people.

PBM Market Share

That model is now under strain. Policymakers and the media [have dragged PBMs](#) into the spotlight. New federal rules in the Medicare and Medicaid programs removed pharma's incentives to increase list prices on some drugs. Discount cards and Mark Cuban's Cost Plus Drugs [routinely sell the same medications](#) for a fraction of what insurance charges. And a wave of more transparent PBMs is pulling away some corporate clients.

As Adam Fein of Drug Channels Institute puts it, these forces are finally puncturing the "[gross-to-net bubble](#)"—the vast gap, worth over \$300 billion annually, between a drug's inflated list price and the real price that actually changes hands.

The most dramatic cracks are appearing in the [weight-loss drug market](#). Because insurance coverage remains patchy, a growing cash-pay channel opened up there almost by accident. Eli Lilly and Novo Nordisk are now selling GLP-1 drugs directly to patients for a few hundred dollars a month. These same medicines once carried prices over \$1,000 a month before PBM rebates.

The pressure is forcing the middlemen to respond in ways that look, at first glance, transformational. In October, Cigna said it would roll out a "[rebate-free](#)" pharmacy model for part of its business. The new approach will cut out the post-purchase rebate process by making the discounted price of the drug available upfront. That is good news for many patients, who will see lower out-of-pocket costs

Cigna, which owns its own PBM, will automatically make this change for all the customers it fully insures in 2027. But companies that only use Cigna's PBM will be able to adopt it later on an optional basis, and many employers—who value rebates for helping offset premiums—might be slow to switch.

To some extent, UnitedHealth Group and CVS Health's PBM units have offered similar plans. But Adam Kautzner, president of Cigna's Evernorth Care Management and Express Scripts, says Cigna's model goes further. Under the traditional point-of-sale-rebate model offered by competitors, "legacy rebates still exist and are applied as an estimate at the counter," he notes. Under Cigna's new plan, people "instantly get discounts at the pharmacy counter, while drug companies get assurance upfront that their discounts are going straight to the patient."

The move is far from symbolic and won't be easy. [Cigna's stock plunged](#) after executives warned that the new model would require heavy investments that will squeeze margins in the near term.

Yet some of the incentives won't exactly change. That is because Cigna's PBM will continue to collect payments from drugmakers, just through different channels. The company has said nothing about changing the [manufacturer fees](#) that flow through Ascent, a Switzerland-based group-purchasing entity closely affiliated with its PBM. Those payments [have quietly overtaken](#) traditional rebates as the main driver of PBM profitability. They remain intact and largely invisible to employers.

Think of the shift this way: The travel agent stops taking a commission on the room rate but instead earns a "marketing fee" from the hotel. "In either model, pharma is still paying for preferential treatment in the formulary," notes Charles Rhyee, an analyst at TD Cowen.

Kautzner says "any retained fees will no longer be tied to the price of the medications to ensure our compensation is fully delinked from list prices set by drug companies." These fees are fully transparent to clients, he adds. Rhyee argues that the move is strategically smart: PBMs have become the political villain in the drug-pricing debate, often in ways he considers exaggerated given their margins tend to hover around 4%. Cigna is essentially betting it can stay ahead of regulators and competitors.

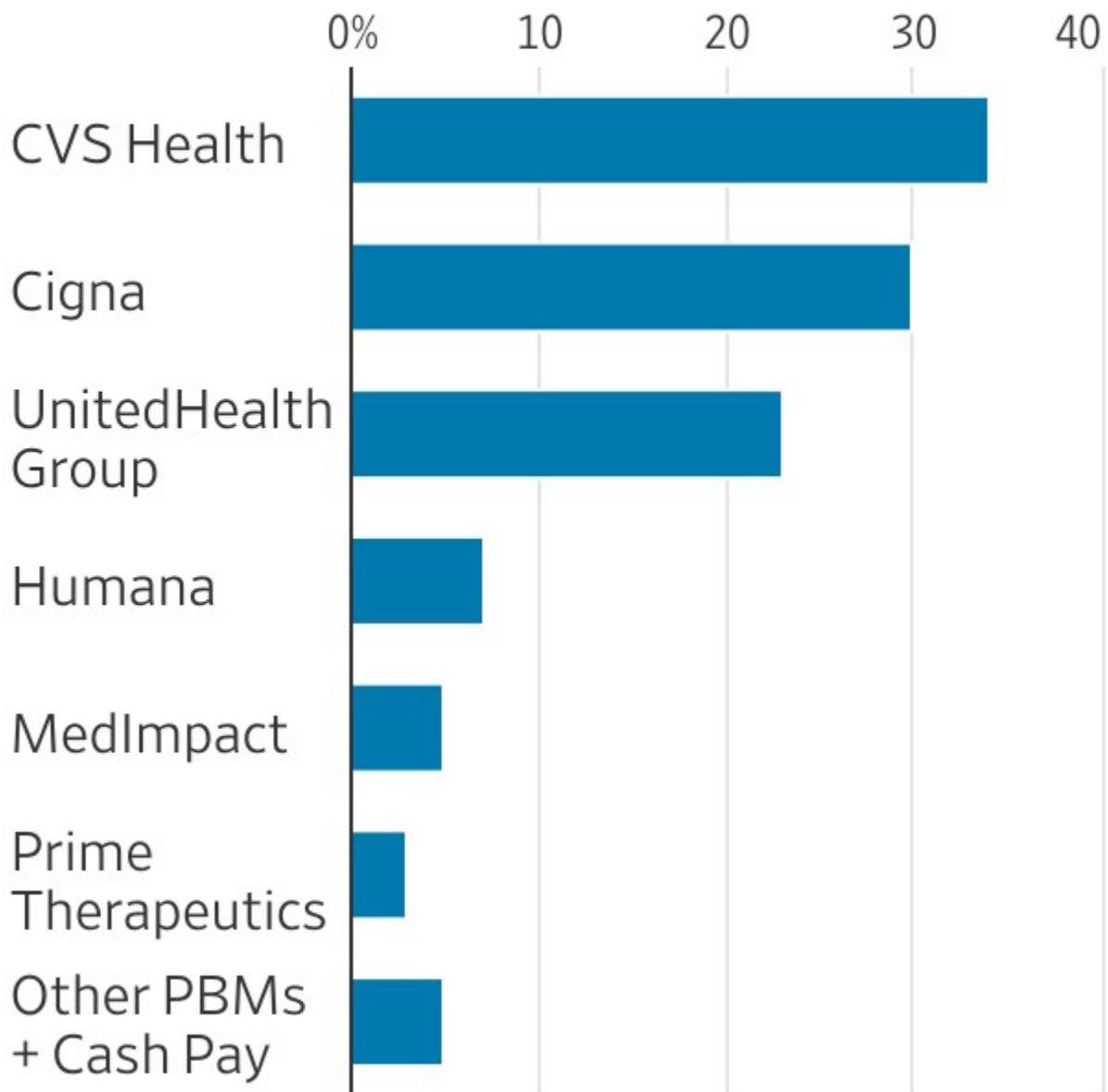
But PBMs will continue to face scrutiny, not simply because of how much money they make, but because of their opacity, which means employers and regulators can't easily tell whether they are getting good deals. AJ Loiacono, chief executive of Capital Rx—a fast-growing PBM with five million members—says that it is easier to find the cost of sending a satellite into orbit than the true price of a cholesterol drug. When the ultimate buyer can see what a drug really costs, efficiency follows, he says.

The big PBMs are now trying to pre-empt change before it is forced upon them. The question is whether incremental tweaks will be enough to preserve their market share and their bottom lines over the long term.

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PBM Market Share

By total equivalent prescription claims managed, 2024



Source: Drug Channels Institute