



THE SECRETARY OF HEALTH AND HUMAN SERVICES

WASHINGTON, D.C. 20201

SEP 13 2018

The Honorable Elizabeth Warren
United States Senate
Washington, D.C. 20510

Dear Senator Warren:

Thank you for your letter requesting clarification regarding the role pharmacy benefit managers (PBMs) and drug distributors play in drug pricing. As the Secretary of Health and Human Services, I fully support President Trump's Blueprint to lower drug prices and reduce out-of-pocket costs and am committed to enhancing and protecting the health and well-being of all Americans.

As I clearly stated in my testimony, drug prices are too high and must be lowered. The President has made this clear, and so have I. I applaud your efforts to better understand how drug manufacturers and PBMs have responded to President Trump's Blueprint. As I testified, we need to create the right incentives to lower list prices, and this is a complex challenge. I know firsthand the serious problems with today's system of drug pricing. Right now, everyone in the system makes money off a percentage of list prices: drug companies, distributors, and pharmacy benefit managers. Everybody wins when list prices rise—except for the patient, whose out-of-pocket cost is typically calculated based on that price.

President Trump's Blueprint clearly sets forth steps the Administration is taking to address these challenges in order to achieve lower drug prices and reduced out-of-pocket costs for consumers. Those steps include improving competition and ending the gaming of regulatory processes, supporting better negotiation of drug discounts through government insurance programs, creating incentives for pharmaceutical companies to lower list prices, and reducing out-of-pocket costs for consumers.

Staff at the Department of Health and Human Services have had conversations with a number of stakeholders in our efforts to provide pricing relief to Americans. Several manufacturers in those conversations have indicated that hurdles remain in enacting material reductions in list prices due to the complex nature of drug pricing.

Just one example is the arrangements that PBMs have with payers—insurers or employers—to manage prescription drug spending over multiple years. A typical contract between a PBM and a payer consists of pricing guarantees including a minimum rebate guarantee. A minimum rebate guarantee ensures that a plan will receive no less than a specified amount of rebate money for a given drug or set of drugs. Rebates are paid to the plan by the PBM based on a percentage of a drug's list price. If a manufacturer were to lower its price, it would reduce the rebate paid to the PBM, but the PBM would be contractually obligated to provide the original rebate to the payer even though the price has been reduced. The payer would likely hold firm that it was the PBM's

obligation to anticipate this risk when the original rebate agreement was reached. In this situation, the PBM would suffer significantly by a reduction in a drug's list price. We have been informed by manufacturers seeking to lower their list price that the PBM would hold them to the same rebate or treat the drug as a less-preferred option. As such, at least in part due to these contractual provisions, most manufacturers did not lower their list price.

It is worth noting here that all parties—the entire system—bear blame. This example is not meant to single out pharmacy benefit managers, who have played an important role in negotiating lower net prices for American patients, payers, and taxpayers. Rather, it is meant to demonstrate how the nature of parties' compensation (as a percentage of list price) and other aspects of the entire drug-pricing channel have stood in the way of change. There are alternative models, such as upfront discounts, that would maintain the role of PBMs and negotiators without encouraging skyrocketing list prices.

What I have described in this letter is just one prominent example of the many complicated challenges that impede fundamental changes in our drug markets. The comprehensive nature of the President's drug pricing plans reflects the scale of these challenges.

I support your efforts to understand the complex pharmaceutical supply chain and your efforts to seek common ground on solutions for lower drug prices.

The Department will continue to implement the policies described in the President's Blueprint in our effort to reform this complicated system and lower drug prices for all Americans. I will also provide a copy of this response to Senator Smith.

Sincerely,



Alex M. Azar II