Testimony Before a Joint Hearing of the House Committee on Oversight and Government Reform Subcommittee on Energy Policy, Health Care, and Entitlements; and the Subcommittee on Economic Growth, Job Creation, and Regulatory Affairs

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Health Insurance CO-OPs: Examining Obamacare's $2 Billion Loan Gamble

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Oral Statement

Chairmen Lankford and Jordan, Ranking Members Speier and Cartwright, and members of the Oversight Committee: thanks for inviting me to speak with you today about the Affordable Care Act's CO-OP program.

As you know, CO-OPs were introduced as a substitute for the so-called "public option" by Sen. Kent Conrad. The idea was that CO-OP plans, shorn of the profit motive, would offer lower premiums than would traditional insurers.

However, I regret to report that there are fundamental flaws in the way the CO-OP program was designed, making it unlikely that CO-OPs will achieve this goal. Failure of the CO-OP program could cost taxpayers as much as 2 billion dollars. In addition, failure could expose hundreds of thousands of CO-OP enrollees to unpaid medical bills.

CO-OPs will have difficulty developing a competitive product

The argument that CO-OPs will succeed because they're non-profit ignores the fact that non-profit insurers are already widespread in the United States. In Senator Conrad's home state of North Dakota, Wellmark Blue Cross and Blue Shield—a non-profit—controls 90 percent of the market. Massachusetts has the costliest health insurance

market in the country, despite the fact that the state's four largest health insurers are non-profits.

If the fact that CO-OPs are non-profit is not a genuine market advantage, what advantages do CO-OPs have?

Under the ACA, CO-OPs cannot be run by existing health insurance companies. As a result, CO-OPs will have to negotiate, from scratch, reimbursement contracts for every type of medical service with every hospital and doctor in their network. This is an extremely difficult and labor-intensive process. The likelihood that CO-OPs secure lower rates than established insurers is extremely low, because, as startups, CO-OPs lack the patient volume necessary to establish bargaining power with providers.

In addition, CO-OPs will lack the large databases and management experience that established insurers use to identify opportunities for higher-quality, cost-efficient utilization of medical services.

Despite these serious competitive issues, HHS claims that CO-OPs will be more efficient than existing insurers because "new entities are not saddled with existing administrative and information systems, which are often outdated and cumbersome to coordinate and upgrade."

A Silicon Valley venture capital firm would laugh this argument out of the room. Even large, well-capitalized insurance companies rarely stray outside of their established regional markets, because entering new states is extremely difficult. If all it took to succeed were new computers, they would have done it by now.

Taxpayers could lose billions on CO-OPs

Insurers are required to keep a certain amount of assets in reserve, in case their spending on medical claims exceeds the amount they have received in premiums. However, it is a long-standing accounting convention that loans are considered

liabilities, not assets, because they have to be repaid. As a result, HHS engaged in a kind of accounting legerdemain so that loans to CO-OPs could be counted as "assets," even though they are actually liabilities. This means that HHS is helping CO-OPs overstate their true financial health.

For all that, HHS still estimated in 2011 that only "65 percent of the Solvency Loans and 60 percent of the Start-up Loans will be repaid," a default rate of 35 and 40 percent, respectively. The Office of Management and Budget projected even higher default rates of 37 and 44 percent, respectively. And the government has no effective way to recover funds from CO-OPs that default on their debt.

CO-OP enrollees are at risk if CO-OPs become insolvent

According to one estimate, at least 11 of the CO-OPs were licensed in such a way that if they go bankrupt, they may not be able to pay outstanding medical claims before first relieving creditors.

This means that Americans who enrolled in CO-OP-based insurance in good faith, and paid their premiums on time, may not find that coverage is there for them when they actually need it. This problem could further damage consumer confidence in the broader exchange-based insurance marketplace.

It should be noted that skepticism about the viability of CO-OPs is not limited to critics of the Affordable Care Act. Indeed, according to Jerry Markon of the *Washington Post*, "White House officials…repeatedly suggested that funding for the CO-OPs be reduced…Some senior White House officials considered the CO-OPs risky, including for prospective policyholders, and questioned whether the loans would be repaid."

My recommendation to this committee would be to aggressively review the existing CO-OP loan recipients, and, at the very least, suspend the disbursement of loans to those CO-OPs with a below-average likelihood of future solvency. Stewards of taxpayer dollars should not throw good money after bad, and place vulnerable Americans at risk. The

2014 open enrollment period ends on March 31, giving CO-OP enrollees time to switch to a more financially stable insurer.

With anything as complex as health reform, sweeping changes enacted by Congress are bound to have unanticipated consequences. In the case of CO-OPs, future insolvency is not unanticipated but *assumed*, by experts in both parties. This should be an easy decision for both skeptics and supporters of the Affordable Care Act.

I look forward to your questions, and to being of further assistance to this committee.

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Avik Roy is a Senior Fellow at the Manhattan Institute. In 2012, Roy served as a health care policy adviser to Mitt Romney. In December 2013, he was named the Opinion Editor at Forbes, and also serves as principal author of The Apothecary, the influential Forbes blog on health care policy and entitlement reform. MSNBC's Chris Hayes calls The Apothecary "one of the best takes from conservatives on that set of issues." Ezra Klein of the *Washington Post* calls The Apothecary one of the few "blogs I disagree with [that] I check daily."

In addition, Roy is a columnist for *National Review Online*, where he writes on politics and policy. He is a frequent guest on television news programs, including appearances on Fox News, Fox Business, MSNBC, CNBC, Bloomberg, PBS, and HBO. His work has also appeared in *The Atlantic, USA Today, National Affairs*, and *The American Spectator*, among other publications. He is the author of *How Medicaid Fails the Poor*, published by Encounter Books in 2013.

At the Manhattan Institute, Roy's research interests include the Affordable Care Act, universal coverage, entitlement reform, international health systems, and FDA policy. Roy is the founder of Roy Healthcare Research, an investment research firm in New York. Previously, he served as an analyst and portfolio manager at Bain Capital, J.P. Morgan, and other firms.

He was born and raised near Detroit, Michigan, and graduated from high school in San Antonio, Texas. USA Today named him to its All-USA High School Academic First Team, honoring the top 20 high school seniors in the country. Roy was educated at the Massachusetts Institute of Technology, where he studied molecular biology, and the Yale University School of Medicine.

Committee on Oversight and Government Reform
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Required by House Rule XI, Clause 2(g)(5)

Name:

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2010. Include the source and amount of each grant or contract.

None

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

None

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None

I certify that the above information is true and correct.
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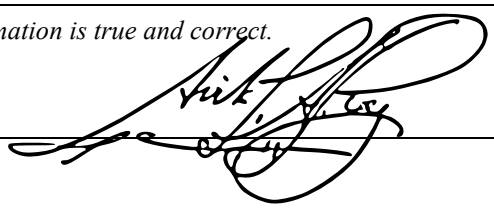

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