

Why Are Co-Ops Failing?

Statement for the Record

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“From Premium Increases to Failing Co-Ops: An Obamacare Checkup”

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Chairman Jordan, Ranking Member Cartwright, and members of the committee, thank you for the opportunity to submit written comments about the challenges facing COOPs. I am Devon Herrick, a senior fellow at the National Center for Policy Analysis. We are a nonprofit, nonpartisan public policy research organization dedicated to developing and promoting private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector.

Many supporters of progressive health reform wanted a public plan option to compete with the private insurers offering insurance in the state and federal health exchanges. To draw support from progressives, proponents of the Patient Protection and Affordable Care Act (ACA) proposed creation of a type of nonprofit health insurance cooperative that would compete with established health insurers. Consumer Operated and Oriented Plans, or health insurance COOPs, as they are commonly known, were a political compromise during the health care debate, primarily serving as an alternative to the public plan option many progressives wanted.¹

COOPs are not traditional health insurers. Rather, the organizations are taxpayer-funded, nonprofit health insurance cooperatives established under the ACA.² COOPs borrowed funds from the government for start-up costs and solvency reserves. Twenty-four applicants were selected out of a pool of 147 applications. Just over \$2 billion was loaned to the 23 applicants that began operations prior to January 1, 2014.³

Advocates hoped COOPs would function similar to nonprofit, enrollee-owned mutual insurance companies that would supposedly put the needs of people ahead of profits. Proponents thought COOPs could outperform established, for-profit insurers and undercut their premiums. In retrospect, this idea proved naïve. These member-led plans had little chance to succeed because their political agenda overshadowed economic considerations — dooming them.⁴ For instance, advocates of public health coverage have long complained that insurance company profits and marketing waste money and drive up premiums. As a result, COOPs were barred from using federal startup funds to advertise and market their plans. But without access to equity markets and advertising dollars, COOPs were doomed to failure.

Even without policies that hampered COOPs' chance of success, the COOP program is plagued by numerous flaws. When COOPs were established, they had no customers and no

¹ James T. O'Connor, "Comprehending the compromise: Key Considerations in Understanding the CO-OP as an Alternative to the Public Plan," Milliman, Inc., June 26 2009; available at <http://www.milliman.com/insight/healthreform/Comprehending-the-compromise-Key-considerations-in-understanding-the-co-op-as-an-alternative-to-the-public-plan/>; and Julia James et al., 'Health Policy Brief: The CO-OP Health Insurance Program,' *Health Affairs*, updated January 23, 2014, available at http://www.healthaffairs.org/healthpolicybriefs/brief.php?brief_id=107.

² Devon M. Herrick, "Consumer Oriented and Operated Plans: An Idea whose Purpose has Come and Gone," Statement before the Committee on Oversight & Government Reform Subcommittee on Energy Policy, Health Care and Entitlements and the Subcommittee on Economic Growth, Job Creation and Regulatory Affairs, hearing on "Health, Health Insurance CO-OPs: Examining ObamaCare's \$2 Billion Loan Gamble," February 5, 2014.

³ Andy Slavitt (Centers For Medicare & Medicaid Services) On Healthcare Co-Ops: A Review of the Financial and Oversight Controls Before the United States Senate Committee on Finance, January 21, 2016.

⁴ Jerry Markon, "Health Co-Ops, Created to Foster Competition and Lower Insurance Costs, Are In Danger," *Washington Post*, October 22, 2013. Available at http://www.washingtonpost.com/politics/health-co-ops-created-to-foster-competition-and-lower-insurance-costs-are-facing-danger/2013/10/22/e1c961fe-3809-11e3-ae46-e4248e75c8ea_story.html.

historical actuarial data to assist in setting plan premiums. Startup funds and cash reserves were borrowed from the government, with funds allocated by the ACA. In any other industry the members of an operating cooperative are the owners of the entity and provide its capital. Yet, this model does not easily apply to health insurance cooperatives. The customers of a health insurer are unlikely to spend, say, an additional \$1,000 each to fulfill capital requirements. Thus, it stands to reason the cooperative business model was ill-suited to an industry requiring vast amounts of capital mandated by insurance regulations.⁵

From the start, there were many critics — even among Democrats. Nobel Laureate Paul Krugman stated nonprofit co-ops were a sham.⁶ Then Senator Jay Rockefeller expressed a similar sentiment.⁷ Indeed, when I appeared before the Committee on Oversight & Government Reform Subcommittee on Energy Policy, Health Care and Entitlements and the Subcommittee on Economic Growth, Job Creation and Regulatory Affairs (February 5, 2014), I too explained that COOPs were unlikely to survive.⁸ Yet, the fact that COOPs had no competitive advantage seemed to matter little to those promoting the idea when the ACA was being debated.

The COOPs' first-year performance was dismal for many reasons. Exchange enrollees in the first year of operation were far less healthy than average. Thus, members' first-year claims were exceptionally high, which also hurt the COOPs' chances for success. They also had to recruit managers, hire employees, establish protocols and perform outreach to enroll members despite an exchange system that was working poorly. Many of these individuals were poor risks. COOPs suffered the perfect storm of problems: sicker than average enrollees, premiums set low compared to the risk and generous benefits that did little to encourage prudent utilization.⁹

Two-thirds of the COOPs have now failed. A University of Pennsylvania Wharton School health economics professor estimates that most of the remaining COOPs in operation are also likely to fail.¹⁰ His view is shared by others as well.¹¹ Today only eight of the original 23

⁵ Tim Worstall, "CoOpportunity Health Isn't an Obamacare Problem, It's a Cooperative Problem," *Forbes*, December 29, 2014. Available at <http://www.forbes.com/sites/timworstall/2014/12/29/cooportinity-health-isnt-an-obamacare-problem-its-a-cooperative-problem/>.

⁶ Paul Krugman, "Obama's Trust Problem," *New York Times*, August 20, 2009. Available at: <http://www.nytimes.com/2009/08/21/opinion/21krugman.html>.

⁷ "Rockefeller Decimates Co-ops in Letter to Baucus and Grassley," *Daily Kos*, September 16, 2009. Available at <http://www.dailykos.com/story/2009/09/16/782985/-Rockefeller-Decimates-Co-ops-in-Letter-to-Baucus-and-Grassley>.

⁸ "Consumer Operated and Oriented Plans: An Idea whose Purpose has Come and Gone, Statement of Devon M. Herrick, Ph.D., Senior Fellow, National Center for Policy Analysis, Committee on Oversight & Government Reform, Subcommittee on Energy Policy, Health Care and Entitlements, and the Subcommittee on Economic Growth, Job Creation and Regulatory Affairs, Hearing on Health Insurance CO-OPs: Examining ObamaCare's \$2 Billion Loan Gamble, February 5, 20 14. Available at https://oversight.house.gov/wp-content/uploads/2014/02/Herrick_Testimony.pdf.

⁹ Louise Norris, "CO-OP Health Plans: Patients' Interests First," *GeaktgUbsryabce.org*, July 14, 2016.

¹⁰ Scott E. Harrington (University of Pennsylvania), "Review of the Affordable Care Act Health Insurance CO-OP Program" Before the Permanent Subcommittee on Investigations Committee on Homeland Security and Government Affairs, U.S. Senate, March 10, 2016.

¹¹ Sara Hansard, "All CO-OPs Likely to Fail, House Panel Chairman Says," *BNA, Health Care Daily Report*, July 13, 2016.

health insurance COOPs are going concerns. A 24th COOP to be located in Vermont, was poorly implemented and did not have adequate resources to qualify for a license to sell policies in Vermont.¹² It failed before it even got off the ground.¹³

While some of the COOPs are losing money because of their small size, others appear to have pursued the strategy of losing money to gain market-share at taxpayers' expense.¹⁴ Another problem with COOPs is that some appear to be plagued by cozy insider consulting contracts — a method that allows insiders to syphon revenue from nonprofit organizations. An analysis by the Washington Examiner identified self-dealing and conflicts of interest among the management team of the failed Louisiana COOP. For example, the COOP had signed a four year contract to pay consulting fees of \$7.3 million to a firm owned by the CEO. Several of his board members and three-quarters of top management team were also affiliated with the consulting firm he owned. That's how it sometimes works in the nonprofit world when there are no shareholders to police the activities of top management.¹⁵ A failed COOP in Nevada was sponsored by a union, that benefited from consulting and vendor fees paid to it by the COOP.¹⁶ Insiders at the failed *Land of Lincoln* COOP earned huge salaries despite losses that sunk the firm. Executives with the failed HealthCT and (Connecticut) and Minuteman Health (Massachusetts) also drew large salaries.¹⁷

Congress established three risk-spreading provisions in the ACA for insurers who experience adverse selection. One is a temporary risk-spreading program, made up of funds collected from fees and taxes on all insurers, to cover industry losses. To block further taxpayer bailouts, the omnibus spending bill passed in December 2014 limited the risk corridor funds HHS may distribute. In addition, Congress slashed funding for the COOP program by two-thirds over the past several years to reduce taxpayers' losses — from \$6 billion down to \$2 billion.

Virtually all the failed or failing COOPs blame the budget neutral risk corridors program for their problems.¹⁸ But that's basically admitting COOPs are untenable without perpetual taxpayer bailouts. There is plenty of blame to go around. Although the odds of success were low

¹² Richard Pollock, "Vermont Insurance Regulator Delivers Setback to Obamacare CO-OP," *Washington Examiner*, May 30, 2013. Also see Dale Schaft (Information Management Officer), "Vermont Health CO-OP Fails State Insurance Standards," Vermont Department of Financial Regulation, May 22, 2013.

¹³ Data through the third quarter, 2014. See "Briefing: Losses Persist at Majority of Health Co-ops," *BestWeek* (AM Best), January 15, 2015.

¹⁴ "Fannie Med Implodes: An ObamaCare-Funded Insurer in Iowa is Sent to the Morgue," *Wall Street Journal*, December 28, 2014.

¹⁵ Richard Pollock, "Obamacare's Louisiana Co-Op Riddled with Self-Dealing, Conflicts of Interest," *Washington Examiner*, August 21, 2013.

¹⁶ Jennifer Robinson, "Nevada Health CO-OP, Now Defunct, Still Causing Headaches," *Las Vegas Review-Journal*, May 28, 2016.

¹⁷ Richard Pollock, "The 8 Obamacare Co-Ops Most Likely to Fail This Year," *The Daily Caller News Foundation*, April 10, 2016.

¹⁸ Bob Herman, "Extremely Sick Newcomers, Risk-Corridor Shortfalls Sink Co-Op Plans," *Modern Healthcare*, December 22, 2015.

to begin with, most were mismanaged since their management teams often had no insurance experience.¹⁹

All told, about \$2.5 billion has been spent on health insurance COOPs through loans, three-fourths of which went to COOPs that have already failed.²⁰ The likelihood of getting any of those funds back is negligible. Congress should learn from and remember this expensive lesson the next time a poorly-conceived scheme is developed that relies on good intentions and taxpayer bailouts.

Thank you for the opportunity to submit comments.

¹⁹ Shannon Muchmore, “Lawmakers Blame Each Other For Imploding Insurance Co-Ops, *Modern Healthcare*, November 3, 2015.

²⁰ Sara Hansard, “All CO-OPs Likely to Fail, House Panel Chairman Says,” BNA, Health Care Daily Report, July 13, 2016.