WHAT'S AT STAKE WITH THE COLORADO PUBLIC OPTION?

Key Questions for Guiding the Discussion

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JANUARY 2020

Conducted By

COMMON SENSE Policy Roundtable

COLORADO CONCERN

DENVERSOUTH ECONOMIC DEVELOPMENT PARTNERSHIP

COLORADO THE BANKERS ASSOCIATION

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ABOUT THE REMI PARTNERSHIP

A partnership of public and private organizations announced in July 2013 the formation of a collaboration to provide Colorado lawmakers, policymakers, business leaders, and citizens, with greater insight into the economic impact of public policy decisions that face the state and surrounding regions. The parties involved include the Colorado Association of REALTORS®, the Colorado Bankers Association, Colorado Concern, Common Sense Policy Roundtable and Denver South Economic Development Partnership. This consortium meets monthly to discuss pressing economic issues impacting the state and to prioritize and manage its independent research efforts.

Table of Contents

Understanding the Full Impacts of a Public Option for Colorado

In the United States generally and Colorado specifically, health care costs and premiums are high and increasing, and thereby unsustainable. The challenges surrounding this problem are complex and require thoughtful, in-depth discussions that could ultimately disrupt the status quo. The goal of reducing health care costs is laudable and deserves to be considered a legislative priority.

Today, roughly 15.3% of consumption in Colorado goes to all aspects of health care, including pharmaceuticals, hospitals and health insurance. In 2001, the share of consumption was 12.5%. This increase, a crowding out of income, amounts to just over $1,140 per Coloradan in 2020 and is projected to grow[1]. Yet while it is agreed that there are problems and challenges within the system, finding the right solutions, that do not cause larger problems, is no small task.

The discussion surrounding the establishment of a public option for insurance in Colorado, has acknowledged the issue and many drivers of rising costs, yet those same discussions have limited the scope of trying to solve the problem. Focusing exclusively on reducing insurance premiums for some in the individual insurance market via direct government actions, could come at the expense of all other health care stakeholders, including patients, employers, insurance carriers, hospitals and others.

House Bill 19-1004, passed during the 2019 Colorado state legislative session, required the Colorado Division of Insurance (DOI) and Department of Health Care Policy and Financing (HCPF), to jointly produce a report on a recommended policy design for a public option. The REMI Partnership released a report in September 2019, which included several scenarios that described a range of economic impacts for the potential public option design. While those scenarios were never intended to model the final report, they did reflect the fundamental trade-offs still posed by the current recommendations. As of the release of this paper, a legislative bill has yet to be introduced. Therefore, this report is intended to respond directly to the recommendations within the final report for a public option, and many of the questions posed in the following pages will remain relevant once a public option bill is introduced.

The charge of HB19-1004 was to have DOI and HCPF create a proposal for creating ***"A state option for health care coverage that uses existing state health care infrastructure may decrease costs for Coloradans, increase competition, and improve access to high-quality, affordable, and efficient health care."*** The three core elements of recommendations from the final report for a public option concern the development of:

- a public option health insurance plan, initially offered in the individual market, that health insurance companies would be required to offer if they choose to sell in the individual market
- a formula, established by the government, that would set hospital rates for the public option, unique to every hospital across the state
- a mandate for insurance companies to pass 100% of drug rebates on to consumers

What are the Possible and Likely Impacts of a Public Option?

- **Patients/Insured**
- **Hospitals**
- **Insurance Carriers**
- **Other Medical Provider**
- **Employers**
- **State and Local Government**

[1] Calculation from REMI PI+ model baseline.

The final report focused narrowly on premium savings for individual consumers but failed to fully explore the potential unintended consequences and impacts, as the policy would ripple across all health care stakeholders. One should not expect to change a single element of the complex structure of health care, and not face trade-offs.

High prices in health care, are a symptom, not a cause. To reform the system that has led to higher premiums for consumers, the key underlying causes must first be identified and then addressed. The public option primarily chooses to further regulate negotiated hospital charges, already capped health insurer administration and profit margins, and pharmacy rebates for the Individual market. Underlying causes not directly addressed include social determinants of health, unhealthy behaviors, supply and location of health care providers due to market barriers to entry and expensive care for the elderly, just to name a few.

To date, the state agencies responsible for studying and recommending policy design elements for a public option have released a final report, and several actuarial consulting reports. While these reports describe much of the current landscape, along with limited findings about the potential direct impacts for a relatively finite set of assumptions, they do not adequately describe the full range of potential impacts across every group of stakeholders. Given the final report recommends expanding the public option beyond just the individual market, it is also critical to better understand how the impacts play out beyond the first year.

Savings resulting from government set rates passed to consumers have to come from somewhere, and by just lowering negotiated rates, without truly addressing underlying costs, a public option stands to benefit a few Colorado consumers, at the expense of every other stakeholder. Current actuarial estimates show just 5,700 Coloradans who were previously uninsured, enrolling in the public option.

This paper summarizes a series of outstanding questions, that remain unanswered, which are critical to informing the implementation of the public option in Colorado and should be considered by policymakers.

Along with specific questions regarding the impacts of a public option, broader questions about this area of policy reform are also warranted.

What is the proper role for government in private markets? Through setting rates for private firms (hospitals) and requiring other private companies (insurance carriers) to sell a specific product the public option becomes not only a policy relevant to health care reform but should raise questions about the ability of government to intervene in this way across any sector.

What changes to the current system can be made that would better align the incentives of market actors to improve access, affordability and quality? Given the multitude of recent reforms, and large outstanding questions, it would seem that a range of other policy options should be explored. While all policy reforms face trade-offs, the potential unintended consequences of the final report could be significant.

Summary of Potential Unintended Consequences

HOSPITALS (impact of lower revenue, attempts to recoup elsewhere)

- Reduced expansion and less profitable services
- Cost shift to less-regulated payors and markets
- Diversification into less regulated ventures
- Departures or closures in certain areas (ie. Rural) due to accumulation of recent regulatory changes
- Shareholder dissatisfaction

CARRIERS (impact of more restrictive regulations)

- Departure from individual market
- Departure from fully-insured programs (only run self-funded administration)
- Departure from Colorado
- Fewer services and/or shifting of margin requirements to other lines of business as result of lower administrative allowance (MLR from 80% to 85%)
- Attempts to limit hospital cost shifting to other lines (group insurance, self-funded administration)

EMPLOYERS (indirect or eventual impact)

- Cancellations of employer-sponsored insurance plans and moving of employees into lower-cost public option plans
- Higher group costs stemming from hospital cost shift from individual to group markets leading employers to pass on higher group costs through higher employee contribution requirements and/or reduced benefits
- Renewed interest in self-funding options

INSUREDS/PATIENTS (resulting from impacts to hospitals, carriers, employer and other stakeholders)

- Increased premiums/contribution requirements for some (those with employer coverage or Individuals with tax subsidized coverage)
- Fewer carrier choices for some (should carriers leave or contract)
- Limited provider access for some if public option plans create more limited networks or providers choose to cut back services on less profitable services
- Displacement from employer-sponsored coverage (with a level of premium paid by employer) to individual market (with or without stipends from employers)

Insured and Patients

If savings for buyers of public option insurance come through lower revenue to both hospitals and insurance companies (with restrictions), without significant change to their costs, how will their decisions impact patient access and choice?

If Colorado implements some type of public option, it is clear that the marketplace for health care and insurance will change, and likely not necessarily to the benefit of all patients and insureds. Trade-offs will need to be made. While certain customers in the individual market will see lower premiums, based upon the reaction across all stakeholders, consumers could face consequential indirect effects involving choice, cost, access and even quality.

The stated purpose of the public option is to increase the number of insurance options for consumers, yet rather than make it easier for health insurance companies to compete, the public option would create a more heavily regulated insurance policy that will be forced to be sold with a smaller allowance for administration and pays hospital rates below current market levels for many. With this type of uncertainty, hospitals and health insurers may retrench, through a combination of reductions in staff, charity care, or services.

While some customers in the individual market will see lower rates, given the dynamics of the health care market, lower health care rates paid by some patients are often made up by higher prices on others. This is most evident in the difference in rates paid by public payers, Medicare and Medicaid, and private insurance carriers. Current estimates suggest public payers in Colorado cover 69 cents of every dollar of expenses incurred by hospitals while private insurance pays over 165 cents for every dollar of expense[2].

As the recent impacts of the reinsurance bill demonstrate, unsubsidized customers in the individual market will see price reductions while most subsidized customers will actually see net premiums increase. Again, the impact on this largest segment of the individual market–those with subsidies–is unclear.Among the recommendations of the final report for the public option are polices that will lower health insurance premiums for some yet do not address major cost drivers. As the medical community reacts to a public option plan, the decisions its actors make could lead to further negative impacts on patients.

Outstanding Questions about Impacts to Insured and Patient Stakeholders

1. Will customers in the individual market in different regions of the state have more options for insurance or will the public option make it so that other insurance products are unable to compete due to lower prices and mandates?
2. How many insured people will face higher costs, either due to medical cost shifting to employer plans, net premium interaction with tax subsidies in the individual market, or exodus of carriers to different markets?
3. What is the estimate for the total number of Coloradans who will enroll in the public option, both initially and longer-term, from both the pool of uninsured as well as currently insured in either the individual or group markets?
    a. Can recent reforms (e.g. reinsurance) be used to refine assumptions about migration to a potential public option plan and reduction in the number of uninsured or underinsured?

[2] https://www.colorado.gov/pacific/sites/default/files/2019%20CHASE%20Annual%20Report.pdf

Hospitals

What choices will hospitals have to make if facing lower revenue and lesser/no change in costs or expectations from investors and community partners?

The immediate and direct impact of a pricing formula to set hospital rate caps could result in substantial changes to hospital administration and operations. While a government imposed rate formula intended to reduce the price of medical services at hospitals could lower insurance premiums for those on the public option plan, it does not address the underlying challenges and costs that hospitals – particularly rural hospitals – face.

Those costs include paying clinical and non-clinical staff and investment in new equipment, research, and services, prices of which are driven by both local and national markets. Hospital costs also include the capitalization of expansions and new facilities in order to keep pace with Colorado's growing population which are subject to the same construction and land costs that everyone living in Colorado faces.

By reducing rates and not equivalently reducing the costs associated with delivering care for those enrolled in the public option, hospitals will be faced with difficult decision about how to respond. Therefore, while hospitals will be directly impacted, so too will their patients, employees, and their surrounding communities.

Wherever market forces of choice and competition are limited in the hospital market, policy reforms targeting those market failures should be considered. However, establishing price caps does not addresses underlying causes of high prices and only treats the symptoms. Government-set price caps can lead to shortages, as evidenced by the impact of rent-control policies[3]. Solutions should address the

Outstanding Questions on Impacts to Hospital Stakeholders

1. Will hospitals cut jobs/services/quality, or will they find ways to charge more in remaining markets without price caps? What incentives will the pricing formula create?
2. What is the range of the net change in hospital revenue, across the entire industry and individually, from various enrollment estimates in the public option?
    a. How will those estimates change if enrollment increases as the public option expands to the group markets?
3. Will hospitals evolve, acquire or diversify into other business opportunities?
4. Will the formula be used to lower rates across all hospitals or would some turn out having higher rates?
5. Given the large discrepancy between what the existing data suggests the average rates at hospitals are, what level of confidence will the administration have in the ability of the formula to accurately set rates?
6. What's the cumulative impact of recent state and national regulations impacting hospital revenues (e.g. reinsurance, Health First Colorado HTP, etc.)
7. How would other economic changes (e.g. recession, change in payor mix, etc.) influence the impact of the public option?

[3] https://web.stanford.edu/~diamondr/DMQ.pdf

issues of competition and choice within health care rather than tightening government control and exacerbating the market distortions.

The more aggressive the public option pricing formula is about cutting rates, the more currently insured individuals will enroll in the public option and the larger the unintended consequences. Our previous research explored these potential impacts and described the broad impacts associated with hospitals decisions to either cut expenditures or make up for lost revenue by charging higher rates to the rest of the private insurance market.

Insurance Carriers

How will insurance carriers respond to a mandate to sell the public option insurance product?

One of the arguments for establishing a public option sold by private insurance companies, rather than through the state government, is that this path will eliminate the risk to the state taxpayer associated with acting as an insurer. The risk, under the public option in the final report, is transferred to the private health insurance companies. While it is standard for insurers to assume the risk surrounding potential default on claims, the public option includes several provisions that both heighten the risk insurers face and lower their rewards.

Given they will not be able to negotiate the prices they pay hospitals, since those will be set by the rate-setting formula, the potential impacts to carriers could be significant and vary greatly by region.

Under current federal policy, private health insurance companies in the Individual market must operate under an 80% MLR (medical loss ratio). This means that at least 80% of all the revenue that is collected by insurance companies must be paid out to their customers in the form of claims. They are only allowed to retain 20% of all the money they collect for purpose of administration and profits.

The final proposal for a public option requires private health insurance companies to operate the public option plan at an 85% MLR, thereby reducing the amount of money they can retain by 5%. Coordinating the hospital fee schedule set by the state for the public option and other non-public option contracts created complexity. It potentially leaves insurance companies reliant on public-option rates to stay in business.

The final report on the public option recommended granting regulators the authority to require all hospitals accept public option insurance, therefore complicating private insurance companies' compliance with network adequacy requirements.

Outstanding Questions about Impacts to Insurance Carrier Stakeholders

1. How will a higher MLR and lower revenue impact the availability of insurance in all parts of the state, including those that historically have not been viable?
2. How will carriers react to a public option - will they remain in the Colorado markets, will they choose to leave the individual market, or will new companies choose to expand the regions they serve?
3. As insurance companies assume the risk of failure, how does this impact premium rate setting, particularly considering upcoming DOI affordability requirements?
4. How will the pharmacy rebate requirements impact carrier administrative costs and margins? How will a local requirement be incorporated into national or international pharmacy contracts?

Other Providers in the Medical Economy

How will other medical service providers, besides hospitals, be impacted by the implementation and possible expansion of the public option?

The final report recommends that only hospitals should be subject to the price caps under a pricing formula. Hospitals represent 45% of all health care expenditures, making them the single largest category of provider of medical services yet less than half of the entire market for health care services. The other 55% of the market includes primary care doctors, specialists, and pharmaceutical companies, all of which accept insurance purchased from the individual market and are therefore drivers of insurance premiums.

As was discussed earlier, the hospital pricing formula could create disincentives for hospitals seeking to compensate for revenue losses to support their communities and their investors. If hospitals, many of which are owned by larger health care companies, or government entities lose revenue, then hospital owners may have greater incentives to offer services in non-price regulated markets where there is more freedom to follow their mission.

The only other state in the country that has a similar policy for setting all hospital rates is Maryland. A recent report found that since the implementation of the hospital pricing formula, which is largely supported by hospitals for different reasons, "Maryland has relatively many anesthesiologists, radiologists, and surgeons—despite having relatively low hospital utilization—reflect[ing] the unregulated nature of physician fees." This would indicate there are "significant diversions of [patient] volumes to ambulatory surgery centers."

Outstanding Question about Impacts upon Other Providers in the Medical Community

1. Will the hospital pricing formula create incentives for hospitals to expand their ownership of medical services up and down the delivery chain?
2. Will the hospital pricing formula create incentives for hospitals to offer fewer services, and can those services be offered by other providers in the same market area?
3. Why are only hospitals subject to rate setting?
4. Could the public option stifle progressive payment alternatives such as global budgeting and financial alignment between hospitals and physicians?

Employers

How will employers react to a public option plan and will they be impacted by future cost-shifting?

Especially now, employers are vying for a compressed pool of talent. If health insurance isn't already a market necessity, it is at least a differentiator. While the current focus of the public option plan is to impact the individual insurance market immediately, and the small and large group markets very soon, employers will also be a key stakeholder. Employers choose to offer health insurance for their employees for several reasons. Among those reasons are a federal tax break and the ability to offer their workers non-salary benefits. Employers often prefer more highly valued insurance plans, yet if the cost of a public option is priced low enough particularly once there is a small and large group option available, it is very likely that employers, both large and small will look to move their employees to public option plans.

While the final proposal argues that cost shifting need not occur, meaning that hospitals will not raise have to prices on non-public option insurance holders including employers, it also indicates that it will monitor cost shifting and take necessary steps to prevent it should it occur.

There are signs that the markets are already changing. In 2018 employer health care expenditures declined 5%[4] as markets began to stabilize, and individual market premiums are set to come down by an average of 20%[5] in 2020 due to the reinsurance program. Other promising programs such as the Peak Health Alliance established in Summit County have also delivered net reductions in consumer insurance costs. While it will take time for full impacts of recent changes to play out, it is clear that some could serve as better metrics by which to gauge the impacts of a public option, especially with regards to how employers will choose to respond.

Outstanding Questions about Impacts to Employer Stakeholders

1. How will businesses be impacted if health care costs increase or health care access worsens in the regions in which their employees work?
2. How will employers react to a cheaper plan on the individual market or eventually the small and large group market?
3. Can recent changes in insurance prices be used to refine actuarial assumptions about how employers will react to lower prices in individual market?
4. How will this change affect, directly, or indirectly, self-insured programs, which comprise the largest segment of the health care market?
5. How will lower hospital revenues impact businesses that support the health care industry?
6. Will the public option stifle local efforts such as the Peak Health Alliance for community solutions?

[4] https://www.kff.org/other/state-indicator/single-coverage/

[5] https://drive.google.com/file/d/1jy3LsG3CluyUqycxgQBUSsaztlc_-KwP/view

State and Local Government

As employers, regulators, and health care providers, how will Colorado state and local governments be impacted by a public option?

State and local governments act as three distinct types of stakeholders within the health care industry. They are the regulators which will be responsible for overseeing the public option plan and the advisory board responsible for establishing hospital rates. They employ teachers, state office workers, and all other government employees and are responsible for paying their health insurance costs. Government entities also own hospitals. According to 2017 data from the Kaiser Family Foundation, government-owned hospitals offer 21% of all hospital beds, about as much as do private for-profit hospitals[6].

The current estimates for costs related to implementation and management of the public option are assumed to be $750,000 for setup, and "less than $1 million annually for agencies to oversee and manage the public option – a tiny fraction of the projected savings for consumers."[7] However, if the estimate of 5,717 individuals enrolling in the public option who were previously uninsured, from the Wakely actuarial report, are the only enrollees in the public option plan, then the total savings to consumers, based on the annual statewide average savings of $685.08, would be $3,916,602. Therefore, the currently estimated ongoing administrative costs to the state of managing the state option would be 26% of all consumer savings.

Based upon our earlier questions, we believe it is likely that enrollment and total savings and reductions in medical revenue would be much higher. It could also be the case that management of the advisory board and the process of setting rates across every service across every hospital in the state will also cost significantly more than $1 million.

As employers, government departments at both state and local levels, could face the same set of questions confronting private-sector employers. Should cost shifting occur and employer premiums increase, then government budgets would not be unaffected.

Governmental entities such as the UCHealth system or Denver Health Medical Center will also be impacted and, like all other hospitals will be left with several choices on how to comply with potential substantial changes to their revenue, but not their underlying costs.

Outstanding Questions about Impacts to State and Local Government Stakeholders

1. What will be the costs to the state of administering and managing a hospital pricing formula?
2. Does the state face any financial liability for the solvency of public option insurance carriers?
3. How will state and local governments react if health care costs increase for their employee plans?
4. Who will be involved and who ultimately will be the accountable decision makers?
5. How would lower hospital revenues affect the many small populations of which hospitals are relatively large employers?

[6] https://www.kff.org/other/state-indicator/beds-by-ownership/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D

[7] https://www.colorado.gov/pacific/sites/default/files/Final%20Report%20for%20Colorados%20Public%20Option_Includes%20Appendix.pdf

Conclusion

There have been numerous structural changes to the health care system that have led to cost increases that are not sustainable. Yet, the system is complex, and involves multiple stakeholders, and layers of laws from both federal and state government. Thoughtful, meaningful reform, that does not cause further market distortions is necessary. The public option debate raises several very important concerns within our health care system; however, the final report still contains many outstanding questions.

Savings resulting from government set rates passed to consumers have to come from somewhere, and by just lowering negotiated rates paid to hospitals, without truly addressing underlying costs of delivering care, a public option stands to benefit a few Colorado consumers, at the expense of every other stakeholder.

Prior to proceeding, policymakers should consider:

- Does the public option solve the originally defined problem?
- The precedent of intervening in private markets through rate caps and requirements of private companies to sell a specific product.
- The pace of regulatory change and incorporation of multiple other state and federal policy actions with still unknown results.
- What trade-offs are necessary and acceptable: how many additional insureds and lower cost for a segment of the population are acceptable for this level of disruption?
- What data needs to be incorporated and constituents to be heard?