



**Consumer Oriented and Operated Plans:
An Idea whose Purpose has Come and Gone**

Statement of

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

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Chairman Lankford, Chairman Jordan and Members of the Committee, I am Devon Herrick, a Senior Fellow at the National Center for Policy Analysis, 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. I welcome the opportunity to share my views and look forward to your questions.

Consumer Oriented and Operated Plans, or health insurance CO-OPs as they're commonly known, were a political compromise dreamed up in 2009 during the health care debate.¹ Congressional support for CO-OPs was primarily because they could serve a political purpose. Whether or not CO-OPs could serve an economic purpose — and are economically viable — seemed to draw less scrutiny at that time. Proponents envisioned CO-OPs as an alternative to a *public plan option*, which Progressives advocated as a means to boost competition with established insurance companies.²

Health insurance CO-OPs were chosen to fill a “middle-ground” of sorts that would appeal to moderate voters, some of whom might be turned off by a government-sponsored public plan. In a nutshell, this explains the only real purpose for CO-OPs; a political alternative that served its purpose in 2009, but is no longer needed; and was never economically viable.

This is the conclusion of critics both on the Left and the Right. Nobel Laureate, Paul Krugman called CO-OPs a “sham,” saying... “And let’s be clear: the supposed alternative, nonprofit co-ops, is a sham. That’s not just my opinion; it’s what the market says...” “Clearly, investors believe that CO-OPs would offer little real competition to private insurers.”³ In interviews, Senator Jay Rockefeller expressed the same sentiment, referring to CO-OPs as a “...dying business model for insurance,” arguing “...there has been no significant research into consumer co-ops as a model for the broad expansion of health insurance. What we do know, however, is that this model was tried in the early part of the 20th century and largely failed.”⁴

Proponents viewed CO-OPs through rose-colored glasses. CO-OPs were envisioned as a type of non-profit, enrollee-owned mutual insurance company that would do what for-profit insurers supposedly refused to do — put the needs of people over profit.⁵ The member-led plans would

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/>.

² Julia James, et al., “Health Policy Brief: The CO-OP Health Insurance Program,” *Health Affairs*, updated January 23, 2014. http://www.healthaffairs.org/healthpolicybriefs/brief.php?brief_id=107.

³ Paul Krugman, “Obama’s Trust Problem,” *New York Times*, August 20, 2009. Available at: <http://www.nytimes.com/2009/08/21/opinion/21krugman.html>.

⁴ “Rockefeller Decimates Co-ops in Letter to Baucus and Grassley,” *Daily Kos*, September 16, 2009. <http://www.dailykos.com/story/2009/09/16/782985/-Rockefeller-Decimates-Co-ops-in-Letter-to-Baucus-and-Grassley>.

⁵ Department of Health and Human Services, 45 CFR Part 156 [CMS–9983–F] RIN 0938–AQ98 “Patient Protection and Affordable Care Act; Establishment of Consumer Operated and Oriented Plan (CO–OP) Program,” *Federal*

feature all the latest patient-centered fads, despite little evidence these fads were cost-effective or would make a difference. One plan in New York waives all cost sharing for primary care and primary care services. Members don't even have to meet a deductible first.⁶ Indeed, that's a deal most of people would welcome — if it can be sustained while keeping premiums affordable. The Office of Inspector General fears the member-owned aspect of CO-OPs would result in low-premiums at the expense of financial viability.

Proponents hoped CO-OPs would outperform established, for-profit insurers and undercut their premiums. In retrospect this idea was rather naïve. CO-OP proponents' political agenda overshadowed the economic purpose — dooming what little chance of survival CO-OPs ever had.⁷ 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, CO-OPs were designed as non-profit organizations and barred from using federal startup funds to advertise and market their plans. But without access to equity markets and advertising dollars, CO-OPs are doomed to failure.

The low-hanging fruit in the insurance business is large group employer plans. CO-OPs are barred from competing for large groups. Co-OPs can only compete in the individual and small group market — the most risky segment of the health insurance market, according to Robert Laszewski, a well-known insurance industry consultant.⁸ Avik Roy, a public policy analyst affiliated with both Forbes.com and the Manhattan Institute, also points out that CO-OPs are likely to suffer from an insurance industry problem, *adverse selection* — attracting more sick people than healthy ones. Lacking experience and the ability to use startup funds for marketing; and ongoing problems with the exchanges; all culminate into the problem where the only people who have an incentive to seek out coverage are those who cannot get affordable individual coverage outside the exchange because of pre-existing health conditions.

According to actuarial firm, Milliman, starting a non-profit health insurer is no easy task; but establishing a non-profit CO-OP adds additional complexity.⁹ According to an HHS Office of Inspector General report, “CO-OPs face tight timeframes, market uncertainty, and other challenges.” Despite few initial enrollees, CO-OPs still need the costly infrastructure in place the day they open for business — preferably in time to sell policies on the exchanges. CO-OPs need

Register, Vol. 76, No. 239, December 13, 2011 pp. 77392 – 77415. Available at <http://www.gpo.gov/fdsys/pkg/FR-2011-12-13/pdf/2011-31864.pdf>.

⁶ Michelle Andrews, “Health Insurance Co-Ops Offer New Option for Some Marketplace Shoppers,” Kaiser Health News, October 15, 2013. Available at: <http://www.kaiserhealthnews.org/features/insuring-your-health/2013/101513-michelle-andrews-insurance-co-ops-in-the-health-law.aspx>.

⁷ Jerry Markon, “Health Co-Ops, Created to Foster Competition and Lower Insurance Costs, Are In Danger,” Washington Post, October 22, 2013. 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.

⁸ Christopher Weaver, “HHS Sets Rules for Consumer-Controlled Health Plans,” Kaiser Health News, Jul 18, 2011. Available at: <http://www.kaiserhealthnews.org/Stories/2011/July/19/coop-health-plans-hhs.aspx>.

⁹ Courtney White, Health Insurance Co-Ops: Challenges and Opportunities. Milliman, July 2011. Available at: <http://www.milliman.com/uploadedFiles/insight/healthreform/health-insurances-co-ops.pdf>.

to assemble provider networks; and educate doctors and hospitals on how they are different than commercial insurers and non-profit insurers.¹⁰ The best examples of successful CO-OPs that preceded the Affordable Care Act 50 years operate on the prepaid-HMO model.¹¹ An integrated HMO requires more infrastructure than merely underwriting risk, enrolling customers and paying claims.

Finally, with no prior claims data, and no idea who will enroll (or how many enrollees), CO-OPs will find it difficult to accurately assess risk and price premiums.¹² With the exchanges off to a rocky start, many CO-OPs found they had no way to reach potential customers. The actuarial firm Milliman believes CO-OPs have a limited window of opportunity and need to gain market share early to be financially viable.¹³ Moreover, the exchange problems and the stopgap fix – allowing insurers to sign up customer directly — disadvantaged CO-OPs even more.¹⁴

The selection process and awarding of loans appears to contain an element of political cronyism. Common Ground, an affiliate of the Industrial Areas Foundation, a well-known network of community organizers, was awarded \$56 million in 2012.¹⁵ The Freelancers Union, an 11-year old organization of freelance workers and sole proprietorships that has progressive roots and activist ties received the largest grant made. The organization received \$341 million despite questionable eligibility.¹⁶ The Freelancers Union already sponsored a for-profit member owned insurance company. This topic has been investigated by this committee in the past so I won't comment further than to say, although it's understandable that Administration officials would view past experience as an asset, one has to wonder a grant proposal from a similar organization with conservative ties would have been viewed as favorably.

Congress wisely decided rather than make grants directly to CO-OPs, it would instead require loans with repayment schedules. This was a wise move — although it may do little to ensure taxpayer funds are repaid rather than defaulted on. The best decision to ensure taxpayers' funds are not lost was the decision by Congress to cut CO-OP's funding. Of the original \$6 billion allocated in startup funding for CO-OPs, Congress reduced that by \$2.4 billion in 2011. The

¹⁰ HHS Office of Inspector General, "Early Implementation of the Consumer Operated and Oriented Plan Loan," U.S. Department of Health and Human Services. Program, Report OEI-01-12-00290, July 2013. Available at: <https://oig.hhs.gov/oei/reports/oei-01-12-00290.pdf>.

¹¹ Julia James, et al.,

¹² Ibid.

¹³ Shyam Kolli, "How Can CO-OPs Gain Market Share?" Milliman, May 2012. Available at: <http://publications.milliman.com/periodicals/co-op-point-of-view/pdfs/co-op-05-14-12.pdf>.

¹⁴ Caroline Humer, "Small health insurers fear Obamacare woes will tilt playing field," Reuters, November 20, 2013. <http://www.reuters.com/article/2013/11/20/us-usa-healthcare-insurers-idUSBRE9AJ09C20131120>.

¹⁵ Guy Boulton, "Nonprofit health insurer lands federal loan," (Milwaukee) Journal Sentinel, February 21, 2012. <http://www.jsonline.com/business/nonprofit-health-insurer-lands-federal-loan-rm49ho7-139863553.html>.

¹⁶ Alex Wayne, "Union for Independent Contractors to Offer Health Insurance," *Business Week*, February 24, 2012. Available: <http://www.businessweek.com/news/2012-02-24/union-for-independent-contractors-to-offer-health-insurance.html>.

American Taxpayer Relief Act of 2012 further cut funding to \$1.98 billion. The recipients were 24 co-ops in 24 states.¹⁷

The Office of Inspector General audit found the opportunities for CO-OPs to obtain private funding are very limited.¹⁸ This suggests banks and financial institutions don't consider CO-OPs a good risk. Taxpayers and Congress both have reason to worry. Nearly a dozen CO-OPs are failing or have already failed. Eleven of sixteen CO-OPs that OIG investigated have startup costs that exceed their available startup funding.¹⁹ If they go under, taxpayers will lose \$1 billion in loans. This represents about half the co-ops in existence.

The Administration has all but admitted CO-OPs are risky. It estimated that between one-third to one-half the nearly \$2 billion of the federal funding lent to CO-OPs is at risk of default. In 2011 the government estimated that more than one-third of the 15-year Solvency Loans (35 percent), and 40 percent of the 5-year, Startup Loans, would ultimately go into default.²⁰ And this estimate was made before the most recent problems with the exchanges came to light! Considering problems getting the state and federal exchanges up and running smoothly, this initial estimate is probably much too low.

In conclusion, as with most ill-conceived ventures run by inexperienced or undercapitalized management teams, health insurance CO-OPs will likely muddle along until they run out of taxpayers' money.

¹⁷ HHS Office of Inspector General, "The Centers for Medicare & Medicaid Services Awarded Consumer Operated and Oriented Plan Program Loans in Accordance with Federal Requirements, and Continued Oversight is Needed," U.S. Department of Health and Human Services, Report A-05-12-00043, July 2013. Available at: <https://oig.hhs.gov/oas/reports/region5/51200043.pdf>.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ Department of Health and Human Services, "Patient Protection and Affordable Care Act; Establishment of Consumer Operated and Oriented Plan (CO-OP) Program," *Federal Register*, Vol. 76, No. 139, July 20, 2011, p. 43246. Also see Harris Meyer, "Feds Jump-Start Health Insurance Co-Ops With Loans," Kaiser Health News, February 21, 2012. <http://www.kaiserhealthnews.org/Stories/2012/February/21/health-coop-cooperatives-federal-loans.aspx>. Also see Darrell Issa and Trey Gowdy, Letter to Sara Horowitz, Committee on Oversight and Government Reform, U.S. Congress, October 2, 2012. <http://www.kaiserhealthnews.org/Stories/2012/February/21/health-coop-cooperatives-federal-loans.aspx>.