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American Health Care Act

Senate & House Remain on Track to Complete ACA Repeal by August Recess

The Takeaway:

> *Press over the past week is illustrative of the volatile nature of the AHCA negotiations: on the one hand, many reports indicate that Senate Majority Leader Mitch McConnell (R-KY) expects his chamber to complete work on the AHCA prior to the July 4 recess; on the other hand, articles late last week cast doubt over whether any conservatives will be willing to vote for a more moderated version of ACA reform that's likely to move through the Senate, dooming the legislation to fail. In the end, we think neither of these scenarios is likely. Rather, we think final resolution is possible, but most likely not until mid- to late- July. Between now and then, we expect it will appear at times like the AHCA could fail entirely. Nevertheless, we still to believe it is likely – we put odds at 70% – that both chambers of Congress complete their work on ACA repeal by the August recess.*

Process steps that must be completed between now and passage

- **CBO scoring**. Procedural rules dictate that the Senate must send its version of AHCA to the Congressional Budget Office (CBO) for a score before they can vote on it. It's generally believed Senators will send a bill to the CBO early this week for them to begin scoring. As we've written previously, each iteration of AHCA is expected to take between 10-14 days for review. That means it's unlikely Senators can hold a vote until the final week of June at the earliest. And if any changes need to be made to the first version they send (which we expect will be likely), it could take up to an additional two weeks before the CBO sends back their updated score – pushing final resolution into July.

- **Senate negotiations**. We think it's more likely than not that Senators will not be able to pass the first version of AHCA they send to CBO. Case in point are the recent articles suggesting conservatives in the caucus are not yet on board with the core tenets of the AHCA in the Senate as it is trending currently, and they hope to see it do more to lower premiums in the end. What this reinforces to us is ***not*** that ACA repeal will fail but rather that cannot pass prior to the July 4 recess. Instead, we expect conservatives will end up placing pressure on Senate leadership to renegotiate provisions dealing with premiums, assuming they do go far enough in the initial version that's sent to CBO this week. Negotiations will be ongoing and will most likely all take place out of the public spotlight.

- **Something resembling failure**. Most likely (55%), we think the Senate will continue to manage expectations and only bring legislation forward for a vote if and when it can pass (most likely in mid-July). However, we think there is a not-insignificant chance (odds of 45%) that at some point between

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now and the end of June there is some sort of event that represents failure in the Senate – whether, similar to what happened in the House, the Senate sets expectations for a vote and then ultimately never holds a vote (the more likely scenario) or the Senate brings their version of AHCA up for a vote and it outright does not pass (much less likely, in our view). If an event of this nature occurs prior to the July 4 recess (scheduled to run from July 1 to July 9), we do ***not*** think it will indicate an end to the AHCA. Rather, we think the Senate can recover and, similarly to the House, make additional changes to the underlying legislation before holding a final vote that advances the measure.

- **Final Senate vote**. As we've written previously, once the Senate is ready to bring its final version of AHCA to the floor, debate will be limited to 20 hours (so about 2-3 days of floor time, including the "vote-a-rama" amendment process that ends essentially once Senators run out of amendments, are exhausted / hungry, etc.) We consider it highly likely that Senate leadership will only bring a bill to the floor once they're confident they have the votes for it to pass. So we think these 2-3 days will be mostly political and unlikely to make any substantive changes to the underlying legislation.

- **Final House vote & Trump signature**. Both chambers of Congress must approve the same version of legislation for it to be sent to the President for his signature. We continue to believe it is highly likely the House will ultimately approve with a simple up/down vote the Senate's version of AHCA, avoiding a formal "conference" process that would require prolonged, difficult, bipartisan negotiations. This means a final version of the AHCA can reach President Trump's desk in late July prior to the August recess, in our view. Like most observers, we expect the final version of AHCA that passes the Senate will trend more moderate than the version that passed the House in May. That will likely lose a handful of conservatives in the House but gain a handful of moderates who previously did not support the AHCA the first time. Republicans need 216 votes to pass legislation and currently hold 239 seats (they will get one more, likely at some point this month, when Greg Gianforte (R-MT) is sworn in after winning a special election in late May, and will lose another one when Rep. Jason Chaffetz (R-UT) resigns at the end of the month). The most conservative group in the House, the Freedom Caucus, is believed to have about 30 members – so even if every moderate Republican jumped back on board to support the measure, not all Freedom Caucus members can vote against it or the legislation will fail. We don't see this as a major roadblock to passage, however, as we believe some House Freedom Caucus members will support the bill because it will have garnered the support of key Senate conservatives like Sen. Ted Cruz (R-TX) and Sen. Mike Lee (R-UT) in order to pass. Conservatives in both chambers have been unified in their message that final legislation must lower premiums. Whatever the changes made to the legislation in the Senate, the end result must reduce premiums for young, healthy individuals or it won't be able to pass, in our view. In our estimation, this indicates that a final bill that can pass the Senate will also be able to cobble together the right number of votes to ultimately pass the House as well.

So what does a final bill look like?

The politics around protecting individuals with preexisting conditions and minimizing the rise in the number of uninsured is what we expect will ultimately force the Senate to walk back the House version of AHCA.

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But because the Senate version of AHCA must save $133 billion (the same amount as the House version), it means that they cannot really start from scratch – rather they are considering a number of tweaks (albeit in some cases, significant tweaks) to the version of the legislation that passed the House on May 4.

Medicaid expansion – rolled back, just more slowly. In the House version of AHCA, no new states would be allowed to expand their Medicaid program beginning immediately. Beginning in 2020, no new individuals would be allowed to enroll in expanded Medicaid, and those enrolled would need to maintain continuous coverage (with no more than a one-month lapse) otherwise they would lose their Medicaid coverage permanently. We expect the Senate will likely provide a more generous window for new enrollees in states that have already expanded (beyond 2020), plus more generous "continuous coverage" terms that would enable current enrollees more leeway to leave and return to the program. The Senate version of a Medicaid expansion "roll back" will likely save the federal government far less money than the $834 billion reduction in the House version. Due to the budgetary requirements of moving AHCA on reconciliation, this will put pressure on Senators not to spend as much on other provisions.

Traditional Medicaid – per capita cap, but with more generous terms. The House version of AHCA would shift funding for traditional Medicaid to a per-capita cap system in 2020 from the current system, which is based on per capita income with no cap. Medicaid spending that first year would be based on per-enrollee spending in FY2016 and would be adjusted each year based on the medical care component of the consumer price index. In an ideal world, we expect Senate Republicans probably want to maintain the current Medicaid financing system, fearing that a per-capita cap would leave states without enough funds to adequately cover enrollees. But due to budgetary realities and the desire to repeal many of the ACA's taxes, we think in the end the Senate will agree to a more generously structured per-capita cap system. Most likely, in our view, the Senate will make changes to the date of implementation and / or base year rather than doing something to make the annual growth rate faster than medical-CPI.

Premiums – have to go down one way or another, but EHBs and preexisting conditions could be spared. The House version of AHCA would allow states to opt out of federally defined Essential Health Benefits (EHBs), increase the amount that insurers could charge based on age to 5:1 (from 3:1), and apply a continuous coverage penalty to individuals with preexisting conditions seeking to return to the market. We think it is highly likely the Senate will need to do something to reduce premiums for younger, healthier individuals. But we don't think changes to EHBs will be possible due to reconciliation rules, and we don't think changes to preexisting conditions will be possible due to political constraints. We expect this is one of the areas that Senate staff have been working furiously to try to resolve over recent weeks, and it could give legs to the proposal by Sen. Bill Cassidy (R-LA) to create an automatic enrollment system that requires individuals to opt-out rather than opt-in to the exchanges. In the absence of this or other new, creative solutions to the premiums problem, however, we wouldn't be surprised if additional increases to the age ratings band (to something greater than 5:1) are under consideration.

Tax credits & other support – likely to become more generous. The House version of AHCA would create a new age-based advanceable, refundable tax credit regime to replace the existing one based on

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income and geography. It would also create a few buckets of funding to backstop the most vulnerable individuals: $130 billion for a "state stability fund" to help continue coverage during a transition away from the ACA (including $15 billion for a federal high-risk pool) and $8 billion to directly offset premium increases for individuals in states that waive preexisting condition requirements. In the Senate's version of the bill, we think it is highly likely that lawmakers will designate additional funds to that "state stability fund" and / or more money will need to be put into older individuals' pockets via the age-based tax credit regime. Potentially, we could even see a hybrid tax credit system that is both based on age *and* adjusted for income. But spending more money to protect older, sicker individuals will mean the Senate version of AHCA will save even less than the House version.

Individual mandate – repealed immediately. The House version of AHCA would repeal the individual mandate and replace it with a 30% penalty that insurance companies may charge individuals who do not maintain continuous coverage (defined as >63 days out). We expect the Senate will maintain something similar to the House provision, potentially also with that auto-enrollment mechanism being advocated by Sen. Cassidy discussed above. Contrary to its policy objectives, this provision would make it easier for healthy people to forgo coverage, which means premiums will go up for those who continue their coverage. But the politics of the individual mandate are the lowest hanging fruit – Republican voters want it gone.

ACA taxes – repealed, just more slowly. Due to the budgetary constraints, repeal of any tax provisions must be offset with savings someplace else. However, nearly all the changes outlined above that we think happen to the bill in the Senate will make the AHCA more expensive, not less. Repealing all the ACA taxes would be most Republicans' top choice – and the tax repeal is essential to maintaining the (quiet) support of the health insurance and device industries – but the costs of all the above provisions we think will ultimately force Congress to wind down some of the provisions more slowly. The House version of AHCA would repeal nearly all the ACA's taxes. It would continue to suspend the so-called "Cadillac tax" on high-cost employer-sponsored plans through 2025 (the tax was supposed to take effect in 2018, but was previously delayed until 2020). It would repeal the increase in the Hospital Insurance payroll tax rate for high-income individuals beginning in 2023. And it would repeal a number of other ACA taxes effective immediately (on January 1, 2017), which includes most importantly the 3.8% net investment income tax, the health insurers providers tax, the medical device excise tax, and the branded prescription drug fee. All in, the non-coverage provisions (all industry fees and taxes on upper income households) in the House bill are projected to cost roughly $662 billion. We think it's highly likely that in order to pay for many of the Senate's changes to the bill, discussed above, the effective date of the tax repeal provisions will need to be delayed by a few years. Members will still be able to message tax repeal, but we think repeal of many of these will need to be pushed out to 2018 at the earliest on the AHCA. Another option is to keep some of the taxes but suspend them until later in the budget window, when it's the responsibility of a future Congress to address the issue. This would see continued delay to the medical device tax and health insurance tax, which are currently scheduled to come back online next year, but they could instead be pushed out until after the 2020 presidential elections (such as 2021 or 2022). We expect Members will get another opportunity to move these repeal dates back up when they turn to tax reform later this year.

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