12 APRIL 2018

Height Commentary

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Managed Care, Hospitals, Short-Term Health Plans

The 2019 ACA Sabotage Threat - Two Decisions That Will Impact Enrollment

THE TAKEAWAY

As ACA insurance issuers begin filing premiums for the 2019 plan year this spring, we expect significant headline risk regarding increased premiums and reduced plan availability, which would be negative for managed care organizations Centene (CNC), Anthem (ANTM), and Molina (MOH) as well as hospitals. Insurers will point to the mandate repeal and a pending rule on short-term plan regulations as justifications for increasing premiums, but we believe that neither should have a significant impact on final premiums or enrollment. What investors should watch, however, is a decision by CMS to prohibit "silver loading," the practice that had the effect of increasing premium subsidies for 2018. If CMS "sabotages" the ACA markets by prohibiting silver loading and Congress does not pass stabilization legislation, we predict premiums across all plans will spike and enrollment will decline for 2019. This would be negative for CNC, ANTM, MOH, and hospitals, and it is positive for short-term plan issuers and brokers like Health Insurance Innovation (HIIQ), Independence Holding Company (IHC), and eHealth (EHTH). This report explains that the most impactful policy changes to 2019 ACA enrollment would be the Administration prohibiting silver loading and/or Congress passing stabilization legislation by October.

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Introduction

On April 9, the Centers for Medicare and Medicaid Services (CMS) finalized its annual Benefit and Payment Parameters (NBPP) rule for Affordable Care Act (ACA) plans sold in 2019. As explained below, we do not believe this rule will materially impact premiums or enrollment levels for 2019. Furthermore, we believe that insurers are overstating the impact that the individual mandate repeal and short-term insurance plan rule will have on 2019 premiums.

In our view, the two decisions that would have the greatest impact on ACA enrollment for 2019 are:

(1) whether the Administration will prohibit issuers from continuing to "load" onto benchmark silver plans the premium increases resulting from unpaid cost-sharing reduction (CSR) subsidies; and

(2) whether Congress will "stabilize" the ACA market through a federal reinsurance program.

Both of these decisions have implications for investors in ACA managed care companies Centene (**CNC**), Anthem (**ANTM**), and Molina (**MOH**), hospitals, and issuers and brokers of short-term health plans including Health Insurance Innovation (**HIIQ**), Independence Holding Company (**IHC**), and eHealth (**EHTH**), as summarized in Figure 1 below.

Figure 1: Projected Impact of Select Policies on Subsectors

	Managed Care (enrollment)	Hospitals (uncompensated care)	Short-Term Health Plan Issuers and Brokers (enrollment)
NBPP Rule	n/a	n/a	n/a
Short-Term Plans Rule	Minimally negative	n/a	Minimally positive
Individual Mandate Repeal	Moderately negative	Moderately negative	Moderately positive
Prohibiting Silver Loading	Most negative	Most negative	Most positive
Stabilization Legislation	Most positive	Most positive	Most negative

Source: Height analysis

Policy Changes with Minimal Impact on 2019 ACA Enrollment

Annual Notice of Benefit and Payment Parameters Rule

The rule allows issuers more flexibility in plan design by eliminating the requirement that plans meet "meaningful difference" standards, allows states to request lower medical loss ratio (MLR) standards, raises the rate review default threshold from 10 percent to 15 percent, allows states to design their essential health benefit (EHB) benchmarks based on plans offered in other states (beginning in 2020), and authorizes new exemptions from

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the individual mandate penalty for 2017 and 2018. We do not expect any of these changes CMS made in the annual rule will have a significant impact on premiums or enrollment for 2019.

Short-Term Limited Duration Insurance Rule - minimal impact on enrollment, but fuel for political fight around ACA premium increases

In January, CMS proposed a rule that would increase from 90 days to 364 days the limit on the duration of short-term health plans, which are not subject to ACA benefits requirements or underwriting prohibitions. Insurers contend that allowing the sale of one-year plans will siphon so many healthy lives away from ACA markets that it will drive up ACA premiums significantly. CMS estimates between 100,000 and 200,000 younger/healthier enrollees will leave ACA plans, which would increase premiums by just a few dollars per month. An estimate from the Urban Institute, a left-leaning think tank, are markedly higher; they project 2.6 million will leave ACA plans, increasing premiums by 18.3 percent in the 45 states that currently allow short-term plans.

While we expect to see additional estimates closer to the April 23 deadline for comments, ***we believe marketing short-term plans will play a more significant role in their uptake than whether the Trump Administration finalizes its short-term plan rule***. Enrollment in short-term plans began to wane in 2016 when they could still be sold for up to 364 days. We believe this is due to increased awareness of ACA plans and subsidies. Furthermore, short-term plan issuers developed a workaround for the 90-day limit by selling four 90-day plans under one application.

We do, however, expect insurers to raise premiums under the assumption that the short-term plan rule will worsen the ACA risk pools. We expect regulators in at least some states to reject premium increases on this basis in advance of the rule being finalized. CMS Administrator Seema Verma reportedly told insurance commissioners that CMS will not finalize the rule until the fall, potentially after 2019 ACA premiums are finalized. ***We expect uncertainty around this policy to fuel issuer threats to leave ACA markets and increase premiums, both of which will place political pressure on Congress to intervene by stabilizing the ACA markets.***

Repeal of the Individual Mandate

The most recent (November 2017) Congressional Budget Office (CBO) estimate suggests repealing the mandate will increase premiums by 10 percent and reduce enrollment by 4 million people in 2019. Since that estimate, Congress passed tax cuts and eliminated the health insurer fee (HIF) for 2019, which should have a downward effect on 2019 premiums. In March, the CMS Office of the Actuary estimated that repeal of the mandate would reduce enrollment by 2.7 million people.

We find CMS's more conservative estimate to be the more realistic of the two because we are believed the individual mandate was not a strong incentive to purchase insurance in the first place, and premium subsidies were a more impactful inducement to enroll. Enrollment trends so far in 2018 support this view. In 2018, premium subsidy levels were the highest they have ever been and enticed a record percentage of new enrollees into ACA plans. Despite the Administration dramatically reducing ACA marketing and outreach funding, a record 27 percent of enrollees were new to ACA plans. In our view, this and the overall stable total enrollment level (just a 3 percent reduction in overall enrollment) can be attributed the "carrot" of more generous subsidies rather than the "stick" of the mandate.

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Potential Policy Changes with Significant Impact on 2019 ACA Enrollment

Prohibiting "Silver Loading" - Significant Impact on Subsidized and Unsubsidized Enrollees; Would Drive Congressional Action

As noted above, net premiums for subsidized ACA enrollees in 2018 are the lower than they have ever been due to more generous premium subsidies. In 2018, the average premium after a tax credit is $89 while in 2017 and 2016 the average premium was $106. In fact, in the vast majority of counties, at least some consumers had an option for a plan with a $0 premium. This resulted from a last-minute decision made by state insurance regulators in response to the Trump Administration's cancelation of CSR payments to allow issuers to increase premiums only on second-lowest cost silver plans that serve as the benchmark for premium subsidies tax credits. This practice is known as "silver loading."

CMS Administrator Verma is reportedly considering prohibiting silver loading for future plan years, which would have the effect of increasing premiums across all ACA plan types for both subsidized and unsubsidized consumers. It would also have the effect of increasing net premiums for subsidized enrollees because it would reduce the value of the premium subsidies that were inflated due to silver loading. ***In our view, prohibiting silver loading and increasing net premiums across all plans for all consumers would reduce enrollment significantly, which would be negative for managed care companies and hospitals.*** However, higher premiums in the ACA market may drive additional healthy lives to short-term plans.

If CMS decides to prohibit silver loading without a plan to avoid premium increases for all consumers, we believe Congressional Democrats would view this as an act of sabotage and be motivated to revive bipartisan negotiations to pass stabilization legislation to fund CSRs and a reinsurance program.

"Stabilization" of the ACA Insurance Market - Significant Impact on Unsubsidized Enrollees

Bipartisan Senators have been developing legislation to stabilize the ACA insurance markets since September 2017, and they seemed close to bringing a bill to a vote on several occasions. ***Our non-consensus view is that it is not too late for Congress to act to stabilize markets for 2019. As insurers file premium increases and CMS adds to uncertainty by considering to end silver loading, mounting political pressure will lead Congress to consider stabilization legislation before adjourning in October.***

In order for Congress to fund CSRs, CBO must clarify that they adjusted their baseline so funding CSRs will score budgetary savings, which they suggested they will do. We believe Democrats will insist those savings be used to increase subsidy levels so as to hold harmless subsidized enrollees from premium increases between 2018 and 2019. While possible, this is likely a non-starter for many Republicans. Therefore, the path of least resistance to decreasing premiums across ACA markets would be to establish a federal reinsurance program, which would reduce premiums by 10 percent in 2019 and have the greatest effect on consumers who do not qualify for subsidies. ***We believe reduced premiums would at least marginally increase enrollment among unsubsidized consumers, which would be positive for MCOs and hospitals and only modestly negative for short-term plan issuers.***

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In our view, Congress has until mid-June to stabilize the market in time to impact the number of plans issued in a given market. Lawmakers have until mid-September to influence premiums for 2019 by passing legislation. While this would be administratively burdensome for issuers, state regulators, and CMS, 2018 offers a precedent for further delaying these deadlines.

Catalyst Timeline

- **Mid-May** - Issuers begin filing premiums in states without an effective rate review program (due by June 1). Headlines resulting from premium increases will begin to pressure Congress to act.
- **June** - Issuers file applications to offer plans in the federally facilitated marketplace (FFM) ahead of the June 20 deadline. Headlines resulting from markets with no offer of insurance will further pressure Congress to stabilize markets.
- **July** - Additional issuers file premiums in states that have an effective rate review program (due by July 25). Premium increase headlines will place greater pressure Congress to act.
- **August** - Facing constituents during the August recess will further pressure Congress to stabilize the ACA market.
- **September 25** - Current deadline for finalizing plans and premiums for the FFM. CMS could delay this, and we think they will if it appears Congressional action is imminent.
- **September 30** - Date by which Congress needs to fund the government's fiscal year 2019 operations. This could serve as a vehicle for stabilization legislation.
- **November 1** - ACA Open Enrollment begins
- **November 6** - Midterm election day

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COMPANIES MENTIONED IN THIS REPORT

Anthem Inc (ANTM), Centene Corp (CNC), Health Insurance Innovations Inc (HIIQ), Molina Healthcare Inc (MOH), Independence Holding Co (IHC), Tenet Healthcare Corp (THC), HCA Healthcare Inc (HCA), eHealth, Inc. (EHTH)

RISKS

The legislative and regulatory agendas are subject to change at the discretion of leadership. Unprecedented economic conditions could instigate unanticipated and/or sweeping shifts in policy. Predicting the future is a hazardous endeavor and economic / market forecasting is an imprecise science. Actual outcomes may differ substantially from our forecasts. The predictions and opinions expressed herein are subject to change at any time.

ANALYST CERTIFICATION

I, Andrea Harris, certify with respect to each security or issuer covered in this research report that (i) the views expressed in this research report accurately reflect my personal views about those subject securities or issuers and (ii) no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this research report.