



# CO-OP Point of View

## CO-OPs: Learning from history

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The consumer operated and oriented plans (CO-OPs) created by the Patient Protection and Affordable Care Act (PPACA) will soon be the newest entrants in the health insurance marketplace. However, they are the next in a long history of entities aiming to sustain competition and innovation in the provision of prepaid healthcare. A careful review of the successes and failures of HMOs and health insurers that have come before can provide key insights into the challenges that CO-OPs face in creating, growing, and sustaining a plan. CO-OP managers can learn from this history and gain valuable insights that will help them formulate strategies on what to do—and what not to do—to build a viable, thriving, and competitive health plan.

### Avoiding the common reasons for failure as a health plan

A first step to succeeding is not failing. For CO-OPs to develop into viable organizations they should first think about possible pitfalls and avoid the common causes of failure.

A Society of Actuaries study of health carrier insolvencies offers suggestions of what not to do.<sup>1</sup> The study listed, in order of reported importance, the following as reasons for insolvency among health carriers:

- Inadequate pricing and/or inadequate surplus
- Rapid growth
- Affiliate problems
- Significant shift in business
- Overstated assets
- Fraud
- Reinsurance failure

In addition, mismanagement was cited as a common feature of all insolvencies.

The top two reasons in this list contributed to more than 66% of the insolvencies, according to the study of 117 insolvent commercial health insurers. Adequate capitalization is clearly a crucial element to ensure a health plan's success.

CO-OPs are eligible to receive loans from the U.S. Department of Health and Human Services (HHS) to pay for start-up costs and the seed money (solvency loans) required to get licensed and running. In providing these loans, HHS expects CO-OPs to use them to price their plans competitively to gain market share. For many CO-OPs and established insurers, a key strategy might be to secure as much market share as they can in the early days of the exchanges. While established insurers may possess the financial strength to withstand the risk of temporary aggressive pricing, pricing that results in insufficient premium revenue (i.e., less than medical benefits and administrative costs) is not a sustainable strategy. Prolonged inadequate pricing will lead to the inability of CO-OPs to pay back their loans and threaten the very existence of the plan.

While all CO-OPs want to grow and thrive, history shows that rapid growth can also actually lead to failure. The failure may come from a strain on surplus that exceeds the availability of federal loan funds. In that case, CO-OPs would need to explore alternative capital sources that might be accessed in that situation—which will be difficult for a member-owned, nonprofit entity. With rapid growth, management also has less time to understand product risk and correct pricing. In addition, rapid growth can put strain on systems and networks that are not designed for such high growth.

CO-OPs will begin their operations and start enrolling members in 2014. The timing coincides with the effective date of the PPACA health insurance exchanges, a new marketplace to buy health insurance, and the entry of many previously uninsured members

<sup>1</sup> Ross, James B. & Woodruff, Criss (1995). Analysis of health carrier insolvencies. *Transactions of Society of Actuaries* 47: 545-597.

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whose risk characteristics are not known. New premium constraints will result in cross-subsidies between insureds; how consumers will respond to this remains to be seen. Risk-pooling features such as risk adjusters, reinsurance, and risk corridors are designed to reduce the risk to early participants in the exchanges, but until the details are defined, those features are an additional element of uncertainty. The initial years of operations will be especially critical for the CO-OPs and will very likely determine whether a CO-OP will be viable over the longer term. Inadequate market research or inappropriate operational strategies during the next two years leading up to 2014 will put any CO-OP at a material disadvantage.

Risk of failure can be further reduced through the adoption of proper business and operational controls. New CO-OPs must be ever mindful of the importance of these functions in their health plans.

## Going beyond not failing, and thriving as a health plan

To not just succeed but thrive, new CO-OPs need to offer the market a new value proposition. This comes from a combination of true product differentiation, delivery of effective healthcare in an efficient way, and reduced administrative and overhead costs. Fortunately, the local aspect of healthcare can provide an opportunity for CO-OPs to excel in each of these areas.

True pricing power comes from product differentiation. In a *Health Affairs* article, James C. Robinson said, "The most radical form of competition comes from substitute products rather than from new purveyors of existing products."<sup>2</sup> While adequate premiums without additional value won't attract participants, competitive pricing without additional value won't retain them. CO-OPs will need to differentiate themselves from other health plans by service, benefit, plan design, or other patient-centric techniques to drive enrollment growth.

In addition to product differentiation, there may be an opportunity for some CO-OPs to partner with health providers to better align incentives to deliver care in the most cost-effective manner. This may include provider contracting at competitive rates so that the CO-OPs are not at a unit cost disadvantage relative to existing large health plans. While large carriers are able to capitalize on economies of scale for price competitiveness, CO-OPs may be able to more nimbly build or contract for administrative services that meet today's technology demands without the ongoing expense of legacy systems. And, being member-owned and nonprofit, CO-OPs are also free of the need to deliver a return to shareholders.

## Conclusion

CO-OPs have the challenge of innovating strategically while using experienced management to avoid overly optimistic pricing and enrollment growth. In order to avoid insolvency, CO-OPs will need to put in place a team skilled in health insurance pricing, patient-centric managed care, and overall enterprise governance. However, without significant innovation, CO-OPs may be subject to the very same pressures that have created today's consolidated market.

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2 Robinson, James C. (2004). Consolidation and the transformation of competition in health insurance. *Health Affairs* 23.6: 11-24.