Interview with Kim Monk, managing director, Capital Alpha
11/29/16

Jackie: Hello. I'm Jackie Doherty, contributing editor with Yardeni Research. Today I'm interviewing Kim Monk, a founding partner of Capital Alpha, a research boutique specializing in the investment implications of government actions. Kim has analyzed health care policy in Washington DC for roughly 20 years. Given the changes expected to occur under the Trump administration, we're especially lucky to talk with her. Before we start, please see the hedge clause on our website. In brief, Yardeni Research does not recommend individual securities. All views expressed by our guests, especially on stocks, are solely their own views without any explicit or implied endorsement by Yardeni Research.

Let's begin. The timing of our interview is fortuitous. President-elect Trump today announced that Tom Price is his pick to become Secretary of Health and Human Services. Kim, you expected Price to be Trump's pick. Why do you think he got the nod?

Kim: Thanks for having me on. Price is currently the chairman of the House Budget Committee and he's also a physician, an orthopedic surgeon, and has been very involved in House Republican efforts around ACA repeal and replace. He was also very early to endorse President-elect Trump. So, I think his role in health care policy, his physician credentials, his relationships with the Hill and his early endorsement of Trump made him the obvious choice. I think it's going to be very important with the Republican sweep that the agencies work very closely with Congress. He seemed like the ideal choice. He's very conservative, but he also, I think, will have a great working relationship with the Hill.

Jackie: Do you think we can read into the pick as to what Trump's priorities will be?

Kim: Trump hasn't spoken a lot about health care. He expressed a few populist views and, of course, has weighed in on ACA, but I think (health care) is not really an issue that he's personally super comfortable with. So, it's very important to pick a good staff and good cabinet members and regulatory folks to help lead those efforts and to help guide him and advise him. Obviously, ACA repeal and replace is something that Trump campaigned on and is pretty serious about. It's very consistent with what Republicans on the Hill want to do. ACA repeal and replace is a top priority. When you do ACA repeal and replace, that covers a lot of issues. First and foremost, it covers insurance market reform, at least for the individual market. It also covers Medicaid. So, Medicaid reform is a top priority, what they do with the expansion and how they want to change that going forward.

Jackie: Trump hasn't laid out specifically what he wants to do in those two subsectors. Do you have a feel for what he'll do or will he be pushed in a certain direction by the Republicans?

Kim: Trump actually sent some mixed messages on the campaign trail in terms of what he would like to do in those areas. He very strongly said he wants to repealed the ACA and believes it has not
delivered on its promises. When it comes to replacement he was kind of all over the map, which definitely gave some conservatives some pause. He basically said we have to replace it with something fantastic or we have to replace it with suggested single payer. I think his personal instinct is whatever happens with the ACA, you have to take care of sick people. He said that repeatedly. I think his words were, "You can't leave people dying in the streets." But I take that as a signal of, if you repeal the ACA, you do in fact have to replace it with something, with a mind towards taking care of the people who were, before the ACA, priced out of the individual insurance market because of pre-existing conditions.

(Trump) also sent somewhat mixed messages around Medicaid and talked about it as something that's an important part of the safety net and then seemingly speaking in favor of expansion or at least supporting the states that have expanded it. That could be the influence of Pence. He hasn't spoken in a lot of detail about replacement, which brings me back to (the fact that) I think he will be quite deferential to working with Congress, Republicans on the Hill led by Paul Ryan, Tom Price and others. Price actually has his own replacement plan. I think Trump will largely defer to Congress and his HHS pick to figure out what the replacement should look like, which is no easy feat by the way.

Jackie: There's talk of Congress using budget reconciliation to make ACA changes. Can you explain the process?

Kim: Sure, it’s the process by which the ACA became a law in the first place. Just to jog your memory, when Ted Kennedy passed away and Scott Brown was elected to Massachusetts, it was the first time in I don't know how many years that Massachusetts elected a Republican. Democrats lost their filibuster-proof majority, so they used budget reconciliation to pass the ACA in the first place. The process is an arcane, complicated budget process, but it basically allows the majority party in the Senate to bring a measure to the floor that requires only a 51 vote simple majority, has limited debate time, no amendments are allowed and there are rules that it must comply with. It has to meet certain budgetary requirements. It has to impact the deficit and it has to impact entitlements or revenues.

There are rules as to what policies you can pass using that process. Republicans are considering using reconciliation to repeal the ACA. But even then, you can't completely, totally repeal the ACA. You can gut it. You can get rid of the subsidies, the mandates, the taxes. You can theoretically get rid of the Medicare cuts, but I don't think Republicans want to repeal those because they're kind of baked in and they're important in terms of deficit control. But what you have after you pursue a partial repeal via reconciliation, is you've taken away all the ACA's financing mechanisms and you've left in place all of the mandates on the insurance side, the managed care plan. So you still have guarantee issues. You still have to cover everybody. You can't risk-rate them.

Basically, all the requirements that make health insurance very expensive would still be in place, so that's going to be a problem. It certainly injects a ton of uncertainty in the health care sector for the managed care plans and for the hospitals, who rely on payments for those plans and frankly for the people who are covered now by the ACA. We believe that for all the talk of repeal and replace or what Republicans are talking about now, which is repeal now, delay the effective date, give us time to work on a replacement and we'll replace it later. We think when
it comes to the insurance market stuff, they're going to have to replace it sooner rather than later or the individual insurance market is going to go into a tailspin.

Jackie: How quickly do you think they'll have to turn things around?

Kim: I think pretty quickly. They think that they can repeal it but have a delayed effective date, so let's say next spring they have a reconciliation measure on the floor and they repeal it. Maybe it doesn't go into effect until let's say the 2018 plan year. But the problem is, if you wait until 2018 to do replacement, is you're sending the signal to the insurance market that, "Hey, we may or may not fix this in a timely manner", and if you want to continue to sell insurance either on the exchanges or in the individual market, because it's important to remember that the ACA didn't just create this exchange market, but it completely supplanted the entire individual market.

For insurers who want to continue to sell in that market, they're basically in a situation where all the expensive mandates might survive, but none of the help you get from the ACA. They don't know what will happen there, it's just the uncertainty. I can't imagine insurers would want to sell on a market where they don't know what the rules of the game are. We think Republicans will have to move very quickly, potentially moving an insurance replacement plan in conjunction with the repeal piece. Some people are referring to it as a side car measure and that measure would require a 60 vote threshold, so that means Republicans will have to work with Democrats to at least get 60 votes.

Obviously, that won't be easy. Republicans, first of all, have to agree among themselves what they want replacement to look like and then they would probably have to compromise some to get some Democrats on board. I think it's a fair question as to whether or not Democrats would be willing to help them pass a replacement plan if Republicans do pursue this kind of scorched earth repeal strategy. Our thinking is that Republicans are probably thinking that the exchange market is in trouble anyway. By next spring, plans will have to submit their rates. They'll have their second quarter of earnings. They'll know if they're continuing to lose money on the exchanges. Some of the remaining national carriers, the big carriers--Anthem, Cigna--I think if they continue to lose money, they've made it perfectly clear they're not going to stay in that market.

If the exchanges are in trouble anyway, it will require some sort of legislative intervention. That could serve as a catalyst to get Democrats and Republicans to come together with some sort of replacement plan. But there are a lot of ifs and a lot of uncertainty, for sure.

Jackie: It would be amazing if the stars aligned and both sides ended up having to sit down at the table because they both have an interest in doing so.

Kim: That's really what it ultimately boils down to. Do both sides have an interest in ensuring that there's a viable insurance market and that their constituents have a place to buy affordable health insurance coverage, particularly for the people who had coverage before the law even passed, and also for the people who have been helped by the ACA. The number of people who have been helped by ACA aren't as big as the Obama administration has been claiming. So, that's another thing they'll need to do is figure out: How many people have been truly been helped by the ACA.
Jackie: What do you think the numbers are?

Kim: We're working on that. It's difficult calculate for the insurance market. By the end of 2016 there will be 9.2 million people who still have coverage on the exchange market and of those, we do know, that a percentage who initially signed up for ACA coverage already had health insurance. Remember the whole "You can keep your health insurance if you like it". We're estimating about a third of those folks already had insurance. So really that market is about six million. It's unclear if that market is going to grow next year. On the Medicaid side, there are about 12 million people who have gained Medicaid coverage since the ACA passed, but, again, another 25-30 percent of those people were previously eligible for Medicaid but had not signed up. So if, in fact, the Medicaid expansion goes away (which we don't believe it will any time soon or even at all) it's not like 12 million people are going to lose Medicaid coverage. Again, it's probably eight or nine million people who truly qualify under the expansion definition.

Jackie: There has been some talk about the Republicans wanting to change Medicaid dramatically. What do you think will happen?

Kim: That's probably one of the biggest changes resulting from the Republican sweep. It's pretty clear that this was a top priority for Republicans even before the election. We were even saying that if Clinton had won, we still expected Medicaid reform to be potentially something that could happen. But obviously with Republicans sweeping, we're going to get bigger reforms. Republicans have proposed very dramatic changes like moving to a block grant program, which basically gives each state a particular sum of money based on their population, and maybe attaching a few strings, like requiring States spend it on health care and provide basic protections to the most vulnerable population, but other than that, letting states do what they want.

That is a big step and I think Washington is going to have to negotiate very carefully with the states who are going to really work hard to maintain their funding and their populations that they cover currently. I think at the end of the day while significant Medicaid reform is coming, it probably is not going to be as extreme as unfettered block grants with a federal funding cliff.

Jackie: Do they states want Medicaid reform and block grants?

Kim: States definitely want a lot more flexibility than they have under the current system. Some probably don't want a block grant because they don't want to have to make those decisions and would worry about any kind of a transition. But others probably would want block grants. They definitely want more flexibility. We think that Medicaid reform would have to include a couple of key elements. First, it would have to reduce federal spending over a ten-year period. That doesn't mean states would cut spending in year one, but it does mean they do have to show savings over a ten-year window. In exchange for that, states will get lot more flexibility in terms of what they do. So, you could get, for instance, blue states pursuing single payer and you could get red states pursuing reforms like putting some of the Medicaid population into the commercial market, having work requirements, or cost sharing.

You get a lot of variation. As to whether or not there's a trade off with a reduction in federal
spending with greater state flexibility probably gets to the question of whether or not you think the current Medicaid system is so inefficient that you can maintain or even reduce spending but still cover the same number of lives. I think that a lot of states think that they can do that, but that will be a big battle between states and Congress over how much funding is actually reduced.

Another thing Republicans want to do, and I don't know if they'll be successful is (change the federal matching commitment.) The way Medicaid and the entitlement system has grown over the years is that the federal match or the federal funding commitment to states is lowest for the most vulnerable populations. For the poorest of the poor, pregnant women and children, states get an average match of 53%. As they have expanded Medicaid, added to the SCHIP program over the years and then most recently with the ACA, expanded Medicaid to able-bodied, working, childless adults, they've had to offer more federal spending. So, states get 100% match to cover childless adults and only a 53% match to cover children under 100% of poverty. Republicans would kind of like to flip that.

I don't know if they'll be successful, but I think they would like re-prioritize how much the federal government is committing to spending on the various populations.

Jackie:  Couldn't they get a bipartisan agreement on that issue? It seems pretty logical.

Kim:  I don't want to speak for one party or the other, but I think for Democrats--who would like to see the entitlement programs grow to the point where they would cover everybody--are very comfortable with having the federal government pick up 100%. It's an area where Republicans and Democrats disagree. We might see a departure from those views when you get to the state level. It will be a big fight.

Jackie: How about Medicare? That seems to be the last big bucket we have to discuss.

Kim:  I think during the campaign, Trump made it pretty clear that he wasn't interested in touching Medicare. He didn't want to touch benefits and has some pretty strong views. The problem with that is, he also promised deficit reduction. If you look at our entitlement spending in the US, it's very difficult to do anything about the deficit if you're not willing to touch entitlements, which are growing faster than anything. It’s a bit of a quandary. (Medicare reform is) a huge priority for House Speaker Paul Ryan and it's a pretty big priority for incoming HHS Secretary Tom Price. They have recently said they would like pursue Medicare reform sooner rather than later. Almost the first week after Trump was elected, on his website, greatagain.gov, his new health care principles were posted and they included the term, "modernizing Medicare." Health policy wonks read that to mean Medicare reform.

Honestly, while I think it's an important issue for a lot of Republicans, just realistically, I don't think they can tackle big, structural Medicare reform while they're also busy doing ACA repeal and replace, Medicaid reform, tax reform, maybe presenting an infrastructure spending plan, and maybe immigration reform. That's just more than they can possibly tackle. So, I don't see Medicare reform as a year one thing. Obviously, anytime Washington does anything dealing with the deficit or the budget, there's always an element of "Well we have to do something about entitlements". So you could see some piecemeal reforms that are driven by budget catalysts. But, again, I just don't see how they do everything at once.
Jackie: There's so many balls in the air. If you look into the future, what's your best guess as to what actually happens maybe a year or two out? What are the biggest changes that you think actually will make it through Congress?

Kim: I do think they will repeal large parts of the ACA and I do think they will have to replace them in a way that maintains something close to the real ACA coverage levels or to what the ACA coverage levels would be next year or the year after. I think the insurance market stuff, that's probably something that happens next year. Medicaid is a slow thing. It might take a couple of years to get that in place. I do expect to see some fairly significant Medicaid reforms, but I don't think it will go as far as block grants. That's probably a lot to accomplish in 2017 and 2018.

Then you throw on top of the list things that Congress and Washington really need to do. They need to re-authorize all the FDA user fee programs and the children's health insurance program either has to be reauthorized by the end of next year or has to be folded in to whatever Medicaid reform they do. I see all those issues eating up the next couple of years.

Jackie: No changes to Medicare, then?

Kim: I wouldn't say no changes, but I don't think we're going to see wholesale, comprehensive reform like Paul Ryan is proposing. We're not going to move to a premium support model. What you could see are some one-off legislative, maybe some minor tweaks to the program. Again, there could be changes because of budget catalysts. So for example, if they need to raise the debt ceiling, they might look to Medicare to find some cost reductions. You could see (negotiations around) drug pricing come into play if they're trying to extract money from Medicare.

Jackie: Do you think they'll raise the Medicare age requirement?

Kim: Probably not as a standalone measure. That would be part of a comprehensive reform. They wouldn't just do that as a standalone measure.

Jackie: You touched on drug prices briefly. It was a massive focus of Hillary Clinton. What do you think will happen to drug prices under the Republicans?

Kim: I think it's probably now a back-burner issue. It's not something that Republicans are going to prioritize. That said, obviously, drug spending is a concern. There are some Republicans who are interested in it. I think we'll see hearings. I think we'll see studies and Republicans trying to get smarter on the issue. But I don't see any big legislative change. Again, I would go back to this concept of, if we had some sort of grand bargain type of agreement where we had some minor deficit reduction and some small structural reforms to Medicare, again, not talking whole sale Paul Ryan type of reform, but a grand bargain type of thing, then you could see some changes around drug pricing. In that context, it would be focused on Medicare and it would have to reduce spending. That would be what Democrats would ask for (in exchange for) coming to the table around any kind of grand bargain.

Jackie: It's certainly going to be an interesting couple of years. Thank you so much for speaking with
us.

Kim: Happy to any time.