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SPOTLIGHT REPORT

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Biden Healthcare Plan: Radical Incrementalism

What's Happening: Former Vice President Joe Biden is the frontrunner for the Democratic nomination for president and his healthcare platform, though much criticized by his progressive opponents including Senator Bernie Sanders (I-VT), is now likely to be the foundation for any reforms in 2021 if he is to beat President Trump. This Spotlight Report will examine how we believe Biden would approach health policy, focusing on: the political dynamics necessary to achieve certain reforms; how it would impact health insurance; provider payments, including for hospitals; prescription drug pricing; and antitrust action against healthcare companies.

Why It Matters: Vice President Biden is incorrectly characterized as a moderate, particularly on healthcare. While this is true relative to some of his opponents in the Democratic primary, we believe that his healthcare agenda, if broadly implemented and passed into law, would be the biggest ever change to that sector. Although his rhetoric of "build[ing] on the Affordable Care Act by giving Americans more choice, reducing healthcare costs, and making our healthcare system less complex to navigate" sounds moderate, the detail of how he would achieve these goals is anything but. While wholesale adoption of the campaign policy is unrealistic due to the myriad challenges involved in passing it into law and potential electoral constraints, we do expect that if Biden defeats Trump he will (eventually) push through substantial changes via executive action that will be broadly popular with the general public, but have a seriously negative impact on revenues of some of the aforementioned sectors, specifically drug manufacturers.

What's Next: We expect that Biden will offer more specific healthcare-related plans in the months ahead, although we do not expect him to dwell on this topic in the short-to-medium term while the coronavirus pandemic monopolizes the public's attention. Should that crisis recede by summer, we expect that there will be an all out battle at the Democratic convention in July to push Biden towards embracing additional progressive policies on many fronts, but for healthcare in particular. Additionally, with the US Supreme Court likely to hear oral arguments on the constitutionality of the Affordable Care Act (ACA) immediately before the election, we suspect that Biden will use this opportunity to emphasize his politically popular policies as a foil against Trump's almost non-existent health policies and his failed attempt at repealing and replacing the ACA in 2017.

Biden Plan Is Not Moderate Compared to Status Quo

Although he has run his campaign thus far as the known and trusted moderate candidate who will return the US to a pre-Trump era of civility and process-driven governing, Biden's healthcare plans are far to the left of the Obama administration and in totality would be the largest change to healthcare since the advent of Medicare and Medicaid. He is also being politically quite shrewd and proposing only to do policies that are generally popular with the voting public and do not result in significant change, material tax increases on most Americans, or the loss of something, whether private employer provided insurance or access to a wide swath of drugs.

Vox very astutely characterized Biden's plans as "a series of crowd-pleasing ideas designed to make healthcare prices lower by squeezing providers and hav[ing] patients pick up a smaller share of the tab by offering more generous subsidies. That accepts the left's basic diagnosis of the health care situation—the government should step in to make things better with a mix of price controls and subsidies—while trying to step gingerly around the public option land mines involved in middle-class tax hikes and banking private insurance...The upside is that for the vast majority of Americans, Biden's plan offers some concrete upside paired with essentially no downsides for anyone other than industry insiders [we would expand this to include well paid healthcare workers] and a small handful of very rich people."

We realize that in the short-to-medium term investors will rally around certain healthcare companies (coronavirus notwithstanding) due to their relief about Sanders not being the Democratic nominee and their perception that Biden is a known quantity who would govern akin to former President Obama. While this herd mentality takes hold, we urge investors to look deeper at the substance of Biden's plans and use the next few months to do scenario planning for two of the possible results that could govern healthcare policy starting in 2021 -- Biden as president with a unified Democratic Congress, or Biden as president with the Democratic House, but the Senate remaining under Republican control.

Political Dynamics

In the first scenario of unified Democratic control of the White House, House, and Senate, the market is likely to have a substantial fear of more far-reaching reforms that would negatively impact various parts of the healthcare sector.

Counterintuitively, we believe that this scenario will actually result in Biden attempting legislation to enact a public option and reform prescription drug pricing policy while holding off on far-reaching unilateral executive actions that would anger the stakeholders involved in reforms, as well as moderate Democrats and all congressional Republicans. In this scenario, the healthcare sector is under dramatic headline risk, but in reality, it remains business as usual for many months, while both of these efforts have varying degrees of success going through the committee process and, we believe, eventually failing to get the necessary 60 votes to beat back a filibuster.

While Biden is barnstorming to support Democrats in Congress in their attempt at major legislation, he will also do everything he can to shore up the ACA exchanges and try to get the number of Americans with health insurance to swing back up (over 1.4 million more people are uninsured than the end of 2016) rather than the falling numbers we have seen under President Trump. In this effort, we expect him to rescind every single Trump executive action that is ACA-related so that at a minimum, the ACA markets revert to December 2016.

Only when Biden and his team realize that despite controlling both chambers of Congress their healthcare agenda is not going anywhere legislatively, and they have done all they can to improve the ACA marketplace, do we expect that he will turn to rolling out a series of executive orders to change the narrative towards one of action and fulfilling the spirit of his campaign promises.

Due to the way in which many healthcare-related laws are written, we believe that prescription drug pricing is the easiest area in which to change the status quo towards one that is more consumer-friendly without needing to pass a new law.

Although the second half to end of 2021 is ages away for investors, that is the likely timeframe for Biden to start to announce any radical changes, particularly because he will want to be on the offensive so as to minimize any losses in the midterm elections that would hinder his ability to pass substantive legislation for the remainder of his term in office.

Despite our view that far-reaching drug pricing and public insurance option bills are unlikely to pass even with a Democratic majority, the option of budget reconciliation does remain a powerful tool for Biden. The question though is what topics would he use that power for in the first year of his term — if he chooses healthcare then he will also realize, as Republicans in Congress did in 2017, that it is more constrained on this topic than most other policy areas because it does not allow many reforms to the commercial insurance market that does not utilize federal funds.

With those types of constraints and the memory of substantial losses in the 2010 midterm elections in mind, we expect that Biden chooses another topic besides healthcare for his 2021 budget reconciliation attempt — such as infrastructure, student loans, or another expansion of the social safety net, such as the Earned Income Tax Credit — something that is not so heavily opposed by a powerful industry and would not result in the knock-down drag out battle that bogged down the Obama administration.

In the second scenario where Biden wins but the Senate remains Republican, we still expect that he would attempt to use his influence and bully pulpit to push for legislative changes, but that he would recognize that a public health insurance option is the more unlikely to garner any Republican support in the Senate and instead drug pricing would be the main legislative attempt.

With that choice, Biden and his House allies would move out first, passing something akin to House Speaker Nancy Pelosi's (D-CA) HR 3 bill, although it would likely have some new changes based on the preferences of the Biden team and whomever he chooses as secretary of Health and Human Services (HHS). We are doubtful that a Senate that is still led by Majority Leader Mitch McConnell (R-KY) and a Senate Finance Committee led by a new chairman, likely Senator Mike Crapo (R-ID), would advance their own drug bill, let alone be able to negotiate a compromise with Pelosi on HR 3.

This is possibly the most important aspect of the political dynamics that investors should plan for — Biden's team will realize that legislation is not possible due to insurmountable political opposition sooner if Republicans retain the Senate and this realization will lead to the executive actions to come faster, compared to unified Democratic control.

So while the conventional wisdom is that there is more risk with Democrats controlling all the levers of government, we believe the opposite to be true and the split control of Congress will usher in more radical executive action in a more accelerated timeframe.

Health Insurance

In this section, we will walk through the list of policies impacting health insurers that the Biden campaign highlight as the key part of their platform. These should be divided into two different parts — efforts to shore up the ACA exchanges and expand health insurance further via a public option. Some of the ACA changes can be done administratively, although we expect that Biden would want to at least attempt to do them legislatively so that they cannot be changed as easily in the future by a Republican administration.

The campaign lists the following as its policy priorities in regard to the exchanges:

1. For the tax credits offered to lower income Americans to purchase insurance on the ACA exchanges, Biden would increase their value by basing the credits off of a more generous gold plan versus the status quo of using a silver plan.

2. He would also eliminate the 400 percent income cap on tax credit eligibility and lower the maximum cost limit to 8.5 percent from the current 9.86 percent of annual household income.

3. For those individuals living in the 14 states that have not expanded Medicaid under the ACA, Biden would offer free coverage under the public option, bringing 4.9 million more individuals into coverage.

4. States that have expanded Medicaid could opt for their beneficiaries to shift into the public option, but they would have to continue paying their current share towards their coverage.

Interestingly, although the Democratic campaign has thus far seen the most bitter battles waged on the issue of expanding health insurance beyond the ACA, we expect that even if Democrats control Congress under a Biden administration, there would not be significant changes made to the current system of health insurance in the US, although there would be dramatic headline risk for much of 2021 and 2022, or until this effort flames out. The public option under consideration is also far to the left of the public option that created so much market concern during the ACA debate.

If we are wrong and some type of public option does pass (most likely via budget reconciliation), then it would most likely be administered by existing managed care companies, creating the potential for a contracting bonanza, although we are certain that the campaign team is not contemplating the public option being managed by incumbent managed care companies, as when the costs of starting up a whole new line of insurance come to light, it will either doom the effort or this alternative will arise.

Specifically, Biden's platform allows the public of any age and financial status to purchase a public health insurance option similar to Medicare. The benefits that would be on offer are not formally laid out, but one promise that Biden makes is that it would reduce costs by negotiating lower prices from hospitals and providers (more on this in the provider section.)

If in fact Biden is looking to reduce costs in the most expensive part of the healthcare sector (hospitals), he would in turn be reducing salaries for millions of doctors and nurses and likely also reduce payments to med tech and medical device manufacturers who sell equipment to providers. While we do not expect a public option to pass, if it did, paying the Medicare rate or a rate between commercial rates and Medicare would be a huge obstacle due to the pay cut that it would guarantee for millions of workers who currently are well compensated and well organized.

Provider Payments

Although the issue of surprise medical billing is currently under debate in Congress, with the continued fight between committees over how to proceed and the coronavirus pandemic occupying everyone’s attention, we are uncertain whether or not a legislative solution on this issue will be found by the expected deadline of this May. We will be better able to update our view on this closer to the May 22nd deadline, but if it is not dealt with this year, then Biden has said that he would take on the issue and ban surprise and balance medical billing.

Biden has not said who would be responsible for paying providers that are out-of-network and he also has not indicated the mechanism by which any disputes between providers and insurers would be decided. We expect that Biden would face fierce pressure from progressives to use a benchmark rate and arbitration hybrid and not give in to pressure from private equity and specialty doctors groups that want to preserve their ability to operate out-of-network with impunity.

In addition to provider pay and billing practices, the even more important, yet vague promise of the Biden campaign is to reduce the amount paid to hospitals and providers in the new public option. Looking to other state-level experiments will be illustrative for investors, specifically Washington state and Colorado. Colorado in particular could be a great example for a Biden administration to follow, as it has chosen to compensate providers at a rate between Medicare and commercial rates — 143 percent of Medicare. It also has a stick that every provider and hospital that takes any state funded insurance has to take the public option, preventing opt outs en masse. We expect that Biden would also include such common sense features and if there was any hope of passage, the rate would have to be higher than Medicare or risk serious financial difficulty from hospitals if it were to be widely adopted and usurp the exchanges, Medicaid, and a portion of commercial employer-based insurance.

Another complicating factor for Biden is his promise that he would increase wages for lower paid workers in healthcare, noting home care workers (who are increasingly unionized) in particular as a target for increased compensation. Either he is for decreasing spending and reimbursements to providers and the institutions and companies that employ them, or he is not. It would be hard, for example, to increase wages for home health workers and also cut reimbursement for the corporations that employ many of them, although instituting some sort of Medical Loss Ratio to segregate out wages and patient care costs from profits could be constructed, but we expect that this could have severe disruptions for that sector.

Drug Pricing

The Biden drug pricing plans are far-reaching and, if fully implemented, could be more challenging for the sector to overcome than the public option would be for insurers. What we find interesting is that nearly all of what Biden proposes regarding drugs would take an act of Congress and much of it already is encompassed in the House-passed HR 3. Biden also focuses largely on Medicare and the public option and is far less focused on changing drug pricing policies for commercial insurance plans.

For example, Biden wants to repeal the non-interference clause in the law that created Medicare Part D to allow Medicare to negotiate with drug makers. Another is to limit launch prices for drugs that do not have competition, by passing a law to create an independent review board to assess a drug's value and set a price that would be paid by the federal government for all programs — the public option, Medicare, and presumably Medicaid, though that last program is not mentioned. The board would use external reference pricing, or their own metrics if it is not yet sold overseas. Biden also says that he would share that rate with the commercial market, but if he is using budget reconciliation to pass this program into law, that would be deemed non germane, limiting the likelihood of any impact on commercial markets.

The inclusion of such a board is sure to provoke howls of protest about rationing and reducing incentives to innovate and we are highly skeptical that it would pass into law even if Biden had a Democratic majority in Congress.

The topic of international reference pricing is one that could muster some support on the Hill, but more likely it would be the core of the fallback executive action that Biden would take if his legislation were to be stymied. This would likely be a demonstration project from the Center for Medicare and Medicaid Innovation (CMMI) that would test out paying either a rate based on averages of other wealthy nations' payments for a drug, or choose the most favored nation approach where out of a basket of countries the lowest price country is chosen and then Medicare pays that rate, or that rate minus an additional amount.

We would expect that Biden would apply any demonstration to both Medicare Parts B and D and in the campaign briefing on this issue a paper from Johns Hopkins is linked that specifically is about using reference pricing for Part D. This type of executive action is far more likely to occur than a statutory change allowing negotiation or setting up an independent board that will once again be likened to a “death panel” and it conveniently does not need Congress, so it is our base case outcome, though one that would only likely be turned to after legislation fails.

One aspect of drug pricing policy that is currently under discussion, but is not part of Biden’s plans, is to cap the out-of-pocket costs of drugs under Medicare Part D and change the financing mechanism of that program to put more of a burden on the drug makers. This idea has bipartisan support and it is something which we think would be wildly popular politically and could be included as a small down payment on drug pricing reforms in a 2021 budget reconciliation vehicle since it is narrowly targeted to Medicare and its spending.

Inflation caps on annualized price increase is yet another part of Biden’s plan, and he states that companies would not be allowed to increase prices more than the general inflation rate per year, with a tax penalty if they break this rule. As with the board to set prices for government payments, we do not expect that this type of proposal would be able to pass Congress, even with unified Democratic control.

Another plan is to allow importation, but that is already going to be on the books from the Trump administration’s pending rulemaking, though as we have written before, we expect that other countries would block such an effort to ensure that their supply of drugs is not interrupted or their own prices are not increased by angry drug companies.

Yet another purely cosmetic, yet possible action would be to end the tax break for advertising for drug companies, which would be a marginal hit to revenue but one that would be able to be coped with over time.

Biden does not mention anything about march-in rights and he has consistently been an advocate for intellectual property protections in the Senate and also during the organization of his cancer moonshot initiative. We do not think that he would support using march-in rights and that he also is friends with current National Institutes of Health (NIH)

Director Francis Collins who also opposes using march-in rights for cost containment and thus is unlikely to replace him.

Antitrust

Although we will publish a separate Spotlight Report on the potential Biden administration and antitrust enforcement, it is worth noting that Biden states that his team would "tackle market concentration across our health system." The policy says that there is too much corporate power consolidated in the hands of a few companies and that is driving up costs for consumers. The campaign site links to a report from the Open Markets Institute that mentions pharmacy benefit management, ambulance manufacturing, medical devices, electronic medical records systems, and surgical apparel manufacturing.

Biden also pointedly says he would use "existing antitrust authority" to address this policy failure, but we expect that his once rival and now supporter Senator Amy Klobuchar (D-MN) and progressives that we predict Biden would appoint at the Federal Trade Commission (FTC) and Department of Justice (DOJ) would have an impact on how Biden approaches consolidation in healthcare and many more mergers would, at the very least, be closely examined if not challenged outright.