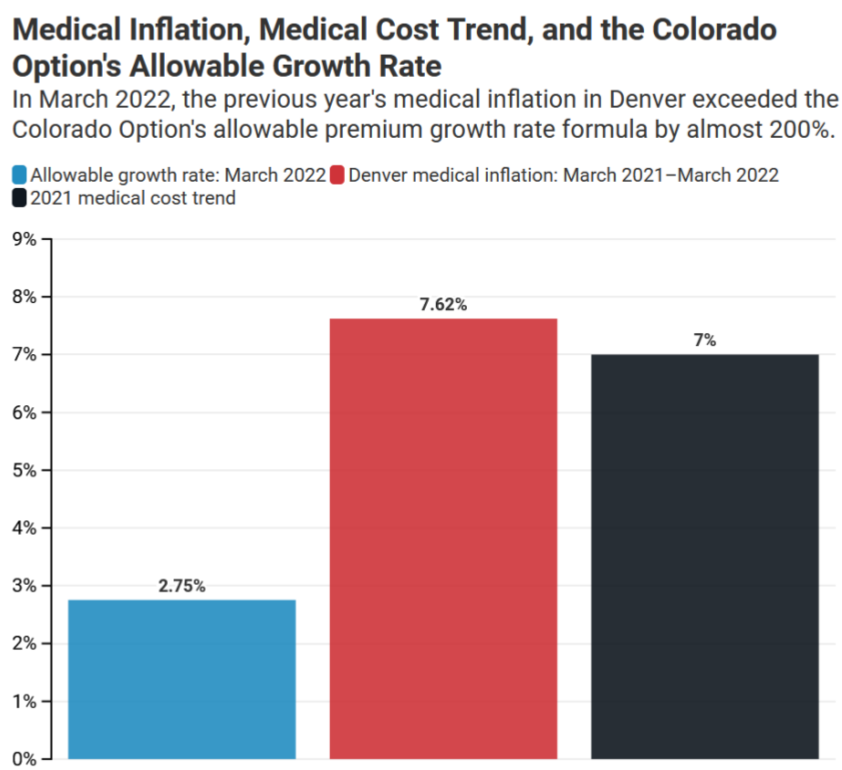
# Inflation and the Colorado Option Plan

May 2022

## Introduction and Key Findings

The Colorado Option, signed into law in 2021, is a state-regulated health insurance program which requires carriers to offer "standardized plans" within the individual and small-group markets at reduced prices. It includes a provision which caps the allowable growth of standardized plan premiums each year at the average annual rate of national medical inflation over the previous ten years. CSI's analysis finds that, due to several factors, this allowance is too restrictive to properly account for the actual medical costs that the healthcare industry will face in the coming years. If the Colorado Option insurance payments do not keep pace with rising costs, health care providers will likely be forced to choose between **cutting services and passing on costs by raising prices for most insured Coloradans**.

- Metro Denver medical inflation between March 2021 and March 2022 was 7.62%—almost 3 times higher than the 2.72% allowable premium growth rate estimated by the Division of Insurance and Wakely Consulting Group.
  - High inflation accentuates the cost pressures facing health care providers and health insurance carriers who also are required to deliver premium reductions of 5%, 10%, and 15% over the first 3 plan years.
- The medical cost trend during 2022 is projected to be more than double the allowable growth rate applied to the first year of the standardized plan.
  - The Department of Health Care Policy and Financing (HCPF), in its FY23 budget request, cited PwC's 6.5% medical cost trend estimate as a representation of the rising costs of maintaining Colorado's Medicaid program.
  - **The Colorado Option's allowable growth cap more than doubles the premium reduction required of insurance carriers** below what premiums would be if they were instead allowed to grow at the cost trend cited by HCPF.
  - The wider the disparity between the allowable growth rate and the actual cost trend, the greater the pressure that providers will face to either cut services or pass costs to the remaining private insurance market.
  - **This problem will worsen in the future** as more of the Colorado Option's premium reduction requirements come into effect and as medical cost trends continue to exceed allowable growth rates.



## Background

Last year, the passage of HB21-1232 set into motion the process of drafting a standardized marketplace health insurance plan which insurers in Colorado will be required to offer to their customers at prices dictated by the state. This program, the "Colorado Option," is the culmination of a years-long effort by legislators and activists to create a state-operated and price-controlled health insurance system within the individual and small-group markets. The regulatory process for implementing this law is underway and the program will commence in January 2023. **Read more about HB21-1232 and the Colorado Option [here.](here.)**

Beginning in 2023, health insurance providers within Colorado will be required to offer gold, silver, and bronze tiers of the standardized plan at significantly lower premiums than they charged for their average plans in 2021. To account for changes to health care providers' underlying costs, each year's standardized plan premium cap will be adjusted according to a measure of medical inflation defined within the Colorado Option law. According to CSI's analysis, this allowable premium growth mechanism is likely to underestimate actual health care cost trends and may force providers to curtail their services or pass costs to consumers as a result.

## What is Medical Inflation?

The Bureau of Labor Statistics, the chief statistical agency of the U.S Department of Labor, records the price levels of eight industry-specific baskets of goods within several dozens of the country's major metropolitan areas, one of which is Denver's. One of the price levels it tracks is that of medical care (worth 8.5% of the total inflationary weight),[i] which represents the goods and services which doctors, pharmacists, hospitals, and health insurance companies buy and sell. Among some other things, this price index includes medical equipment, inpatient and outpatient hospital services, dental care, and drugs.[ii] In its totality, it is a measure of the costs of providing and receiving health care which reflects both broad and narrow trends within the healthcare industry.

## Problems with the Allowable Growth Formula

Under HB21-1232, each health insurer in Colorado is required to offer the standardized plan at a premium 5% in 2023, 10% in 2024, and 15% in 2025 lower than it charged for a comparable plan in 2021. These reductions are applied alongside an adjustment for medical inflation, which also designates the allowable yearly growth of standardized plan premiums after 2025.

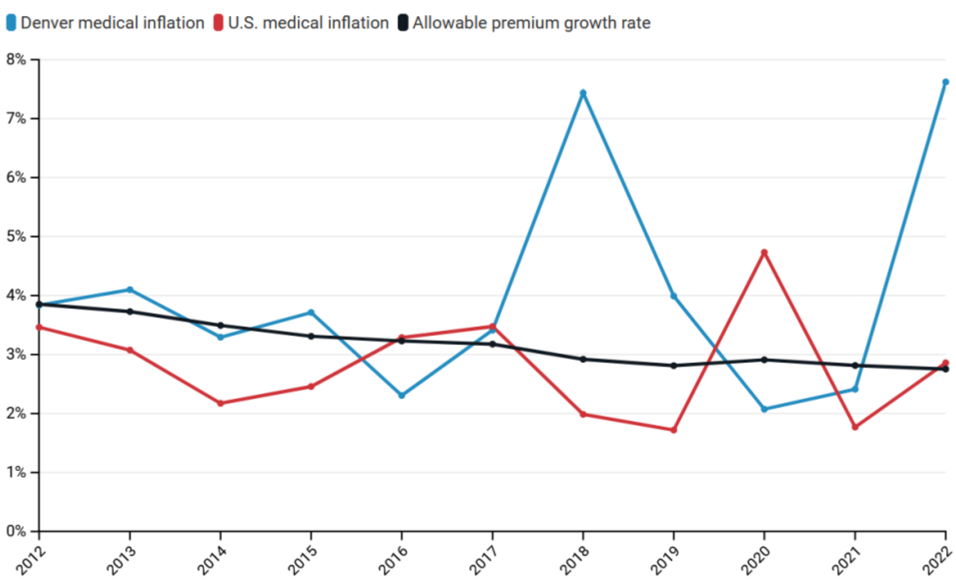
The law defines annual medical inflation as the 10-year annual average of national medical care price growth (CPI-U) prior to each plan year. Allowing premiums to grow at the rate of medical inflation is meant to address the medical trend. According to the Colorado Division of Insurance, the medical trend is "the projected increase in the costs of medical services assumed in setting premiums for health insurance plans."[iii] External projections of the medical trend, like PricewaterhouseCoopers' 6.5% projection, are much higher than the allowable growth rate.[iv] The Colorado Department of Health Care Policy and Financing, the state government agency responsible for administering Colorado's Medicaid program, cited this estimate of the medical trend in its budget request.

Problems for carriers will arise when the allowable annual growth rate in premiums does not reflect the actual medical trend. When the medical trend in a given plan year significantly exceeds U.S. medical inflation's preceding 10-year average, or if medical inflation in Colorado is persistently higher than it is nationally, the standardized plan's allowable premium growth rate will not be sufficient to account for structural changes to the cost of care that providers face. This, alongside the plan's high minimum coverage requirements, could impact providers' abilities to offer diverse and high-quality services. Just as a household on a static income can afford less when consumer prices increase, a health care provider whose revenue can't keep up with rising medical costs can't afford to maintain its standard of care.

*The Current Medical Trend Exceeds the Allowable Growth Rate*

If the Colorado Option were implemented today, these risks would already be realized. Medical inflation in Colorado (represented by the Denver–Aurora–Lakewood MSA) has historically been higher than the corresponding U.S. urban average, and record-high overall inflation in late 2021 and early 2022 has resulted in a medical cost trend far above its latest 10-year average.

**Medical Inflation and Hypothetical Allowable Growth Rates (March 2012–March 2022)**




*What Impact Would the Colorado Option Have Right Now?*

If the allowable growth rates were set in March 2022, the allowable premium growth rate for 2022 would be 2.75%. Colorado's actual medical inflation over the year prior was almost three times higher. Even during a period of normal inflation, medical inflation in Colorado regularly exceeds the allowable premium growth rate—over the 20 years ending in 2021, average annual medical inflation was 3.55% in Colorado and 3.33% across the U.S. This discrepancy will compound with the law's required premium reductions in 2023, 2024, and 2025.

If the Colorado Option were in effect throughout the 10-year period ending in March 2021, the total allowable premium growth would have fallen short of the actual cost increase by 13.4%. If it were only in effect during the five years ending in 2021, allowable growth would have fallen short by 32.1%. Effectively, a health care provider in this circumstance would have experienced a revenue cut of that same magnitude from marketplace policyholders. This would have been disastrous for health care providers and for the level of medical care accessible to consumers.

*Examples of Standardized Plan Premiums*

On April 14th, the Colorado Division of Insurance, through the consulting firm Wakely, released the final rate-setting methodology for the Colorado Option.[v] The methodology covers the required rate reductions, the allowable growth rate, and several actuarial adjustments to the standardized plans' values. Two examples of Colorado Option insurance plans, presented in the report, illustrate the price impacts of the required premium reductions and growth limitations in 2023. The examples confirm that actuarial adjustments are small and that the allowable growth rate will begin far below recent medical inflation in Denver. The following table summarizes them and compares them to a scenario whereby the allowable growth rate reflects Denver's recent medical inflationary trends:

| **Example Standardized Plan Premium Growth through 2023** | | | | | |
|---|---|---|---|---|---|
| Market | 2021 Premium | Allowable Growth Rate | Value of Actuarial Adjustments | 2023 Premium | 2023 Premium under 5.02% Allowable Growth Rate |
| Individual | $299.55 | 2.72% | $30.45 | $330.71 | $399.15 |
| Small-group | $419.98 | 2.72% | $1.79 | $422.77 | $445.06 |

## Conclusion

As it stands, the Colorado Option's allowable premium growth mechanism will grievously underestimate the inflationary pressures which health care providers will face over the next several years and threaten their abilities to maintain constant levels of care. HB21-1232 was designed to allow health insurance premiums, after the initial reductions, to fluctuate in the long run according to the market trends by pegging premium growth to medical inflation, but the formula meant to achieve this does not properly account for the regionality and volatility of medical cost pressures. It is important that the regulators responsible for implementing HB21-1232 are aware of this problem, recognize that its outcome will be inconsistent with the spirit of the original legislation, and carefully consider feedback from stakeholders, many of whom have already identified this unintended consequence of the program.



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[i] https://www.bls.gov/cpi/tables/relative-importance/2021.htm
[ii] https://www.bls.gov/cpi/factsheets/medical-care.htm
[iii]
https://drive.google.com/drive/folders/0B_UoCf17OVmWfmdCd1g5bXJCZ2ZXZWdiWk1wbktpWUQwUTgwT2JiT3pMeWl1UU1zMEZOTG8
[iv] https://www.pwc.com/us/en/industries/health-industries/library/behind-the-numbers.html
[v] https://drive.google.com/file/d/1XBNBi6NhP3BkXf4PM85vVgYkZ5uZdy6u/view