

March 30, 2010

Healthcare Reform: Investment Implications



Current Status

Comprehensive healthcare reform legislation was signed into law last week by President Obama. The legislation is being enacted in two phases. President Obama signed the Patient Protection and Affordable Care Act (known as “the Senate bill”) on Tuesday, March 23, 2010. The Health Care & Education Affordability Reconciliation Act of 2010 (known as “the reconciliation bill”) resolves differences between the Senate bill and a prior bill passed by the House of Representatives, and has been approved by both chambers and has been signed into law.

Timeline

Different aspects of the legislation go into effect at different points in time, and many will require regulatory rulemaking by the Department of Health and Human Services. However, the regulations will be governed by the new legislation listed above, unless it is amended. Here is a brief summary of the major policies and effective dates.

Date	Affected Party	Policy
2010	Managed Care	Insurance reforms that prohibit rescinding existing policies due to illness, restrict annual and lifetime limits on coverage and require an appeals process for disputed claims
	Medicaid	Higher government rebates for generic and branded drugs administered to Medicaid patients
2010–2013	Long-Term Care Hospitals, Inpatient and Outpatient Hospitals, and Home Healthcare Providers	Rate reductions
2011–2014	Medicare Advantage	Rates reduced over time to match those paid by Medicare fee for service
2013	Medical Device Manufacturers	Excise tax
2014	Managed Care	Annual health insurance provider fee
	Managed Care	Insurance reforms in the individual and small group markets Activation of the “exchange” for the individual and small group market, as well as related subsidies for those who cannot afford insurance premiums
	Individuals, Employers	Employer fee for companies whose employees receive subsidized insurance coverage on the exchange Fees imposed on individuals who do not carry health insurance
2018	Managed Care	“Cadillac tax” on high-cost insurance plans

Impact on High-Income Individuals

One of the major differences in funding between the original Senate bill and the reconciliation bill was raising the threshold for, and pushing back implementation of, a tax on high-cost “Cadillac” insurance plans. The resulting loss of revenue was offset by the addition of a 3.8% tax on unearned income for high earners (\$200K individual/\$250K joint filers) beginning in 2013, on top of the 0.9% increase in the Medicare payroll tax on those same individuals (also beginning in 2013) already called for in the Senate bill. Ironically, the loss of a filibuster-proof majority in the Senate—forcing the Democrats to rely on reconciliation—resulted in a larger tax burden on high-income individuals than might have otherwise occurred.

Implications for Healthcare Stocks

The passage of the basics of healthcare reform has removed a great deal of speculative uncertainty and downward pressure on health stocks; the market can now more easily quantify the impact of the new policies. Since the announcement of the new law, hospitals have rallied, as investors expect them to benefit from lower bad-debt expense, reduced uncompensated care and higher admissions. HMOs have also rallied as the reconciliation bill moderates some of the more onerous provisions of the original Senate bill. Shares of pharmaceutical and biotechnology companies have not responded as much, since fundamentals and “normal” regulatory risk (such as FDA approvals) are more significant determinants of stock performance for these firms.

While the effect of reform varies by subsector, many healthcare companies will benefit from an increase in demand for products and services. Based on the proposed changes, we see minimal additional impact for large-cap pharmaceutical companies, specialty pharmaceutical companies and generic drug manufacturers. Biotechnology companies stand to benefit from both lengthy periods of data exclusivity for their products as well as an orderly, scientifically based approach to approving generic biologics.

The situation for large-cap managed-care companies is more dependent on the specific regulations that will be developed to implement the new laws. While the new legislation will create a larger pool of participants, many of whom were previously uninsured, the ability of health insurers to develop policies that are profitable for this market remains to be determined. For some insurers, it appears that cost escalation from hospitals and other healthcare service providers may be easing; near term, they may even benefit from rising premiums. HMOs that specialize in the Medicaid market (the state-run program that provides health coverage to the poor) will benefit due to expanded Medicaid eligibility and increased federal funding. We see positive effects for hospitals as well as firms that sell hospital products and medical devices, as expanded coverage should stimulate demand for healthcare services and medical procedures. The impact looks neutral for long-term acute care hospitals and skilled-nursing facilities.

We anticipate that the changing regulatory environment will prompt executives of some healthcare companies to transform their business models to respond to new business opportunities—but others may fail to adapt. As the details of the regulations evolve, we will anticipate and evaluate the investment implications closely. ■

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