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Implementing Obamacare

Within a few months, the bulk of the sweeping health care reform law signed by President Obama in 2010 is set to take effect. Health care providers, insurance companies, businesses and state and federal governments are scrambling to prepare for huge changes in the way health care insurance is purchased and how health care is delivered.

Will everyone be ready?

Reform is intended to provide health insurance coverage for up to 30 million previously uninsured Americans. The law includes a mandate for individuals to have insurance, and for businesses with over 50 employees to provide coverage. The law is intended to drive down the nation's overall level of health care spending and improve quality of care for patients, but critics are voicing increasingly loud concerns about bureaucratic nightmares.

OUTLOOK turned to author and health-care expert Ian Morrison, a founding partner in Strategic Health Perspectives, for his take on the nation's overall state of readiness for "Obamacare" and how the law is being implemented. Morrison, a supporter of health care reform, believes the roll-out will be very difficult – but that the country will nonetheless be better off in the long run.

OUTLOOK: Is the federal government ready for the January 1, 2014 implementation of the health care law?

Ian Morrison: The short answer is no. The bottom line is this thing could get off to a very rocky start.

OUTLOOK: Remind us what changes have already gone into effect.

IM: The most prominent one is the inclusion of children up to 26 years old on their parents' health care plans. That actually knocked the number of uninsured down by about 2.5 million. The other is increase in Medicare taxes to fund Obamacare that started on January 1 of this year on higher-income households.

Generally, though, it has been a lot of back-office activity getting ready for the big play, which is 2014. That's when health insurance exchanges need to be up and running, and the individual mandate kicks in requiring every American to purchase health care insurance.

About this article

Ian Morrison is an author, consultant and futurist specializing in long-term forecasting and planning regarding health care and the changing business environment. He is the author of several books including “Leading Change in Health Care: Building a Viable System for Today and Tomorrow.” His book, “The Second Curve – Managing The Velocity of Change,” was a *New York Times* and *BusinessWeek* best-seller.

Mr. Morrison is a founding partner in Strategic Health Perspectives, a forecasting service for clients in the health care industry, and is president emeritus of the Institute for the Future. He is a director and past chair of the California Healthcare Foundation; a past director of the Health Research and Education Trust, the research arm of the American Hospital Association; and a past director of the Center for Health Design.

OUTLOOK: What are some of the biggest hurdles to implementation right now?

IM: Sixteen states and the District of Columbia have established state health insurance exchanges, which are where people who don’t have Medicaid, Medicare or employer-provided health benefits will go to buy insurance. Another seven states have agreed to form a so-called “Partnership Exchange” with the federal government.

But over half of the states – 27 – have said they’re not going to go forward with the establishment of a state-run health insurance exchange. In those states, people will need to go to an exchange managed by the federal government. Most of those same states have also declined to expand eligibility for Medicaid, which is another key way the law is supposed to expand access to health care.

As we roll this thing out, it’s going to become very apparent that we have two Americas. Some states are committed to both the expansion of Medicaid and the expansion of coverage through health insurance exchanges. But about half of Americans will be in states where the federal exchange will be the law of the land.

OUTLOOK: What’s specifically wrong about so many states defaulting to the federal exchange?

IM: Unfortunately, the feds don’t have the implementation dollars needed for integration, outreach and enrollment. They had \$1 billion in the original bill but that wasn’t enough – many believe they actually need \$5 billion to \$10 billion. The Obama administration has gone to Congress a couple of times in the past six months to ask for additional appropriations, including \$441 million to cover the IRS portion of the implementation, and have been turned down.

This is not what was imagined. What was imagined was you would go on a website organized at the state level and apply for health insurance if you’re uninsured. Then the website helps to determine whether you’re eligible for Medicaid, based on your income, or the health insurance exchange, where you’re given a subsidy to buy insurance. But no one is quite sure how the federal exchange is going to make the determination as to who is eligible for Medicaid, since each state has different eligibility requirements and different application forms. Apparently none of that integration work has been done.

The Obama administration insists they are ready, but many people suspect it's going to be pretty bad.

KEY PROVISIONS OF THE AFFORDABLE CARE ACT

- Individual mandate: Every American required to have health insurance as of January 1, 2014, or pay a fine.
- Employers with more than 50 employees required to provide health care coverage or face fines.
- Expand Medicaid to cover all individuals under 65 with incomes up to 133 percent of the federal poverty level.
- Government-created health exchanges, where individuals and small businesses can shop for insurance.
- Subsidies for low-income people to buy health insurance through exchanges.

OUTLOOK: So what will happen to people in that situation?

IM: Until we actually see this federal exchange up and running, we don't know how good or bad that experience is going to be. The Obama administration insists they are ready, but many people suspect it's going to be pretty bad.

OUTLOOK: Talk more specifically about the differences occurring at the state level.

IM: Think of it as three buckets: States that are fully opting in to Obamacare, states that want to do a hybrid program with the federal government, and states that are doing nothing.

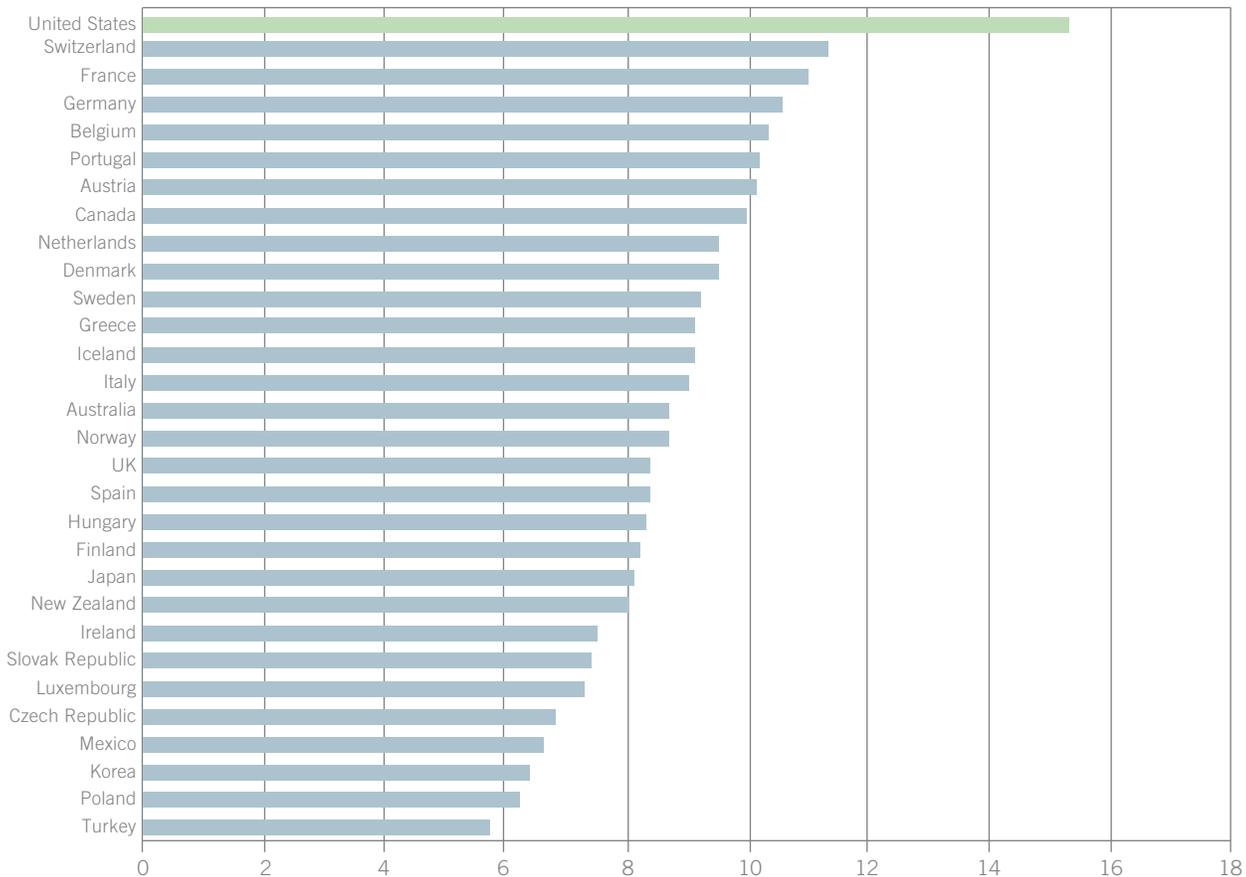
There are 17 states, including Washington, D.C., that are in the first category – mostly on the coasts. They are in the process of expanding Medicaid and setting up their own health care insurance exchanges. California is one that is farther ahead than most. California has a fairly robust budget for all of this and will spend close to \$1 billion to implement it. Its exchange has professional management and a board that has been doing a lot of work over the last three years. Even they are not quite ready yet in terms of full-blown implementation, but I think they will do their level best to get the thing off the ground.

In the second category are states where they have agreed to expand Medicaid but are not setting up state-level exchanges.

Finally you have states that are basically resistant to Obamacare, politically, and they're playing that card by not expanding Medicaid and not being helpful or cooperative with the exchange implementation. Those are mostly Republican states controlled by Republican governors and state legislatures.

The Obama administration will use its limited promotion and enrollment budgets by targeting specific states with high uninsured populations. For example, half of all the uninsured between 18 and 35 years old are in just three states: California, Texas and Florida. California will have a robust outreach effort because of its state-run exchange. Texas and Florida will be a target of federal promotional efforts.

HEALTH CARE SPENDING AS PERCENTAGE OF GDP



Source: Organization for Economic Cooperation and Development, *OECD Health Data, 2008* (Paris OECD, 2008).

Note: For countries not reporting 2006 data, data from previous years is substituted.

At the end of the day this could end up being like the initial implementation of Medicaid, which was approved by Congress in the 1960s but not adopted by every state until 16 years later. We may be looking at same thing here. Or it could be a complete bloody disaster and we re-litigate this in the next two elections, which is what the Republicans are hoping for.

OUTLOOK: What are some of the specific challenges that states are facing?

IM: The first priority for states is to get their exchange networks up so people who are not on Medicaid, Medicare or employee plans can buy health insurance. The state and federal exchanges are all supposed to be ready to enroll people on October 1 of this year. If a state wanted to have an exchange up and running it really should have started three years ago. Five states, including California and New York, have decided to offer a limited choice of affordable plans, most of which will have a restricted set of providers within those plans. It is not clear yet what the choices in the federal exchange will look like or how affordable they will be.

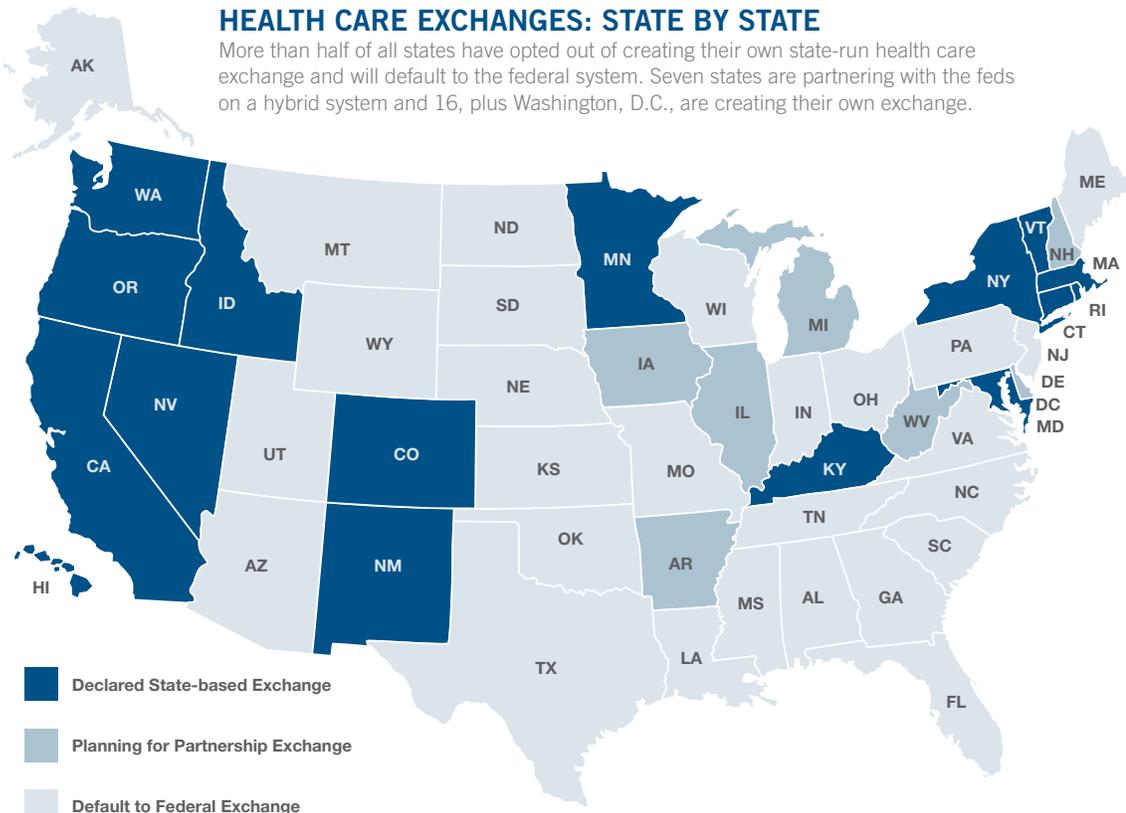
Another big worry is that all the sick people who currently don't have health insurance will sign up right away while healthy young adults, who you need in the pool paying the premiums and not using the services, are going to stay home and pay the fine required under the individual mandate. And the fine is much, much cheaper than the actual cost of purchasing insurance. Initially, it's \$95 bucks a year – less than one latte a week. The IRS even takes it out of your tax return at the end of the year, so you don't even notice it. In fairness, though, the fine does rise each year and goes up to peak at \$2,085 or no more than 2.5 percent of income, so it will start to matter.

OUTLOOK: What will the impact be on government budgets if that happens?

IM: States are not responsible for providing the costs of the subsidies for coverage expansion prescribed in the law, and there are new regulations for reinsurance, risk corridors, and risk selection designed to minimize the effects of adverse selection. But observers worry that the exchanges represent an open-ended federal liability.

HEALTH CARE EXCHANGES: STATE BY STATE

More than half of all states have opted out of creating their own state-run health care exchange and will default to the federal system. Seven states are partnering with the feds on a hybrid system and 16, plus Washington, D.C., are creating their own exchange.



Source: Kaiser Family Foundation



There are real benefits in Obamacare for small businesses and their workers.

OUTLOOK: How educated is the general public about how to access insurance and health services under the new law?

IM: People vaguely know about Obamacare, but they have no clue what's in the bill.

One issue will be the sticker shock after people see exactly what it's going to cost them. I think a lot of the public presumes that Obamacare is free, and that's not true. Many people will qualify for subsidies, but those subsidies won't cover the total cost of insurance. For example, a family of four at 300 percent of the federal poverty level – approximately \$67,000 per year – would still have to spend \$540 a month for the insurance after the subsidy. I think lower-middle income households who are currently uninsured are going to find sticker shock to be an issue.

There is a potential for backlash from providers and patients that the only affordable options will be so called “Narrow Network” plans where many providers are excluded. I think you're also going to get a lot of people complaining and saying “I've got Obamacare, I've written a check for this. Why can't I go to a higher-end research university hospital?”

There's also a challenge in terms of the provider backlash that may happen, particularly in California, if the reimbursement level attached to these new insurance cards is too low.

OUTLOOK: What about employers? How ready are they? Are they modifying their behavior as a result of the new law?

IM: Some small employers are claiming that they are postponing hiring to avoid going over the 50-person threshold established in the law.

But the reality is there are real benefits in Obamacare for small businesses and their workers, whether those employers provide health benefits today or not. Some businesses may end up using the small business exchanges as a more affordable way to cover their workers if they provide insurance already. Other businesses are already eligible for tax credits to help them provide coverage. And importantly, for those small businesses that don't provide coverage today, Obamacare provides generous subsidies for low-income workers who can access the exchange.

Most companies with more than 50 employees already, particularly those with skilled workforces, provide health benefits for their workers. For them, health insurance is part of compensation. Most have done the math and found that it is not cheaper to just pay the \$3,000-per-employee fine and send their employees to an exchange.

OUTLOOK: What about the insurance industry? What do they have to do to prepare for all of this?

IM: It's a mixed bag for them.

Overall, I think they're ready. Insurers were sort of singled out in all of this from day one and have had a series of rolling regulatory requirements which they have been scrambling to comply with.

The good news is that they get new customers through the individual mandate and the employer mandate. They get 15 to 20 million new customers with federal subsidies through the exchanges so it is net new revenue for an industry that was effectively flat in terms of enrollment. Similarly, Medicaid expansion may eventually add another 15 plus million to the Medicaid rolls. Most state Medicaid programs are converting to managed Medicaid (where private insurers play a key role) if they have not done so already, and that will generate more revenue as well. The question is, can they make money on the newly covered? Many insurers, particularly the Blues, make their highest margins and profits in the individual and small group market which may get commoditized by exchanges. Another challenge for insurers is whether they can really make money on Medicaid and this progressive conversion of Medicaid programs across the country to managed care.

OUTLOOK: What about the health care delivery system? Are doctors and hospitals ready for this?

IM: Hospitals are ready for Obamacare, doctors less so.

Increased demand will be significant in certain places such as Southern California with massive numbers of previously uninsured. In California the narrow networks we described will see more volume from the exchanges as will providers taking Medicaid, and their capacity will be stretched. A particular challenge will be finding specialists who will treat the newly covered.

But overall I don't think access to health care will be as big of an issue as you think. Volume is going down right now and there is some capacity opening up. Uninsured people are already getting some care now, it's just late in the illness and badly organized.

While there will be an initial surge in demand, it might not be as bad as some people think. Studies predict an increase in demand for health care of between 2 and 3 percent. It's not a 10 percent effect.

OUTLOOK: *But we're talking about adding 30 million to the system and we're not adding more doctors and nurses through the bill. You don't think it will be a problem because there will be enough capacity?*

IM: While there will be an initial surge in demand, it might not be as bad as some people think. There have been studies done on this, and they predict an increase in demand for health care of between 2 and 3 percent. It's not a 10 percent effect.

OUTLOOK: *Is it realistic to expect this will be up and ready January 1st?*

IM: I think there'll be something up and running because there has to be something, politically. The question is how well will it work. There's a chance that this thing could be both an implementation and public relations disaster.

I don't think the feds are going to blink. The problem is you come up against the political time clock. Obama is in his second term, and we'll be fighting the 2014 congressional election before we know it. There are a lot of Republican governors up for re-election in 2014 in states that have chosen not to do health care reform. There are also a number of prominent Republicans who are going to run for president in 2016 in that category. The feds are going to try and push it through.

I think their best hope is that some states and localities get off the ground and there's some positive momentum with regard to enrollment and they can point to some happy stories about previously uninsured people getting coverage and saving lives and stamping out disease. That is sort of the Democratic dream view. It then puts pressure on Republican governors who are running for election to explain to their voters why they're not bringing the same benefits to people in their states. The Latino vote will be key in all of this.

The Republican dream is to sit back in the weeds and jump on any opportunity to point to ineptitudes and malfeasance and stupidity on the part of the administration and its implementation of this stuff and make Obamacare repeal the center plank of the congressional elections of 2014 and the presidential election of 2016.

A lot of it depends on how badly the implementation goes as to whether either of those sides win.

OUTLOOK: Given where we are, are you still a supporter of health care reform?

IM: I'm generally very supportive of the administration. Yes, it's a goofy law, partly because our political process is so broken. But the question is, compared to what? The law does provide coverage expansion and we need to do more work on making the system financially sustainable for the long run, and that requires payment and delivery system reform. We are making progress there too.

Ideally, we get off the ground. We pull off a minor miracle and eventually people come around over a long period of time and we implement something. We have an exchange marketplace and while we still have a number of people left out, such as undocumented workers, more Americans get covered. The alternative is it's a disaster and we're back to square one, re-litigating this in the political realm. ■

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 4/30/13. They are intended to provide rate or cost indications only and are for notional amounts in excess of \$5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC and Blue Chip Economic Indicators

US Treasury Securities

	2013	GDP	CPI	Funds	2-year	10-year
Q2	1.80%	1.90%	0.14%	0.28%	1.99%	
Q3	2.40%	2.10%	0.14%	0.35%	2.13%	
Q4	2.60%	2.10%	0.15%	0.43%	2.27%	
	2014	GDP	CPI	Funds	2-year	10-year
Q1	2.70%	2.10%	0.14%	0.54%	2.44%	
Q2	2.80%	2.20%	0.15%	0.66%	2.60%	

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.28%	0.29%	0.45%	0.84%	1.30%	1.85%
0.25	0.29%	0.31%	0.50%	0.93%	1.39%	1.93%
0.50	0.30%	0.33%	0.57%	1.03%	1.49%	2.01%
0.75	0.30%	0.35%	0.65%	1.13%	1.58%	2.09%
1.00	0.34%	0.39%	0.73%	1.23%	1.68%	2.18%
1.50	0.41%	0.49%	0.94%	1.46%	1.89%	2.35%
2.00	0.52%	0.65%	1.18%	1.70%	2.08%	2.52%
2.50	0.75%	0.91%	1.45%	1.93%	2.29%	2.67%
3.00	0.98%	1.16%	1.72%	2.17%	2.50%	2.82%
4.00	1.58%	1.72%	2.23%	2.60%	2.86%	3.10%
5.00	2.14%	2.30%	2.69%	2.94%	3.16%	3.32%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

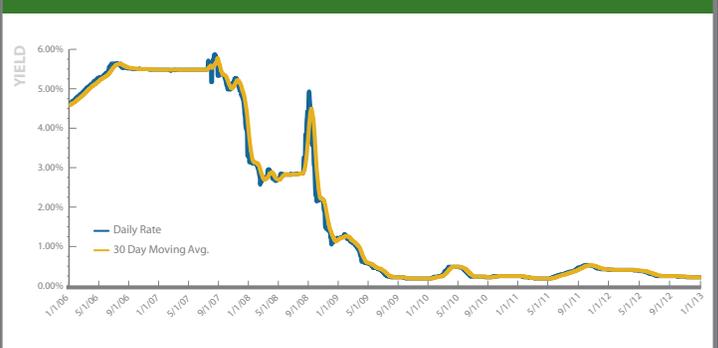
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	5	5
90	5	10	12	11
180	5	17	21	19
365	17	36	43	37

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

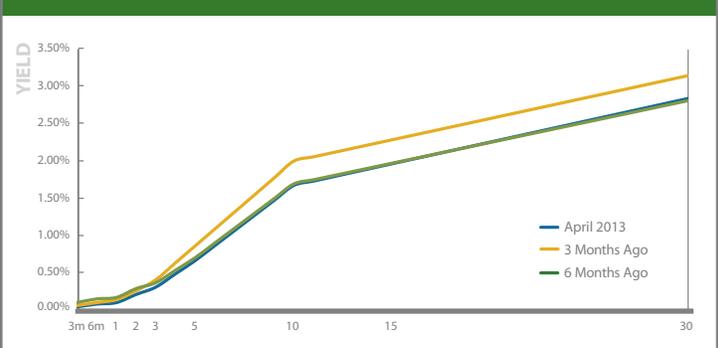
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE





About CoBank

CoBank is a \$95 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving farmers, ranchers and other rural borrowers in 23 states around the country.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy. Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore.

For more information about CoBank, visit the bank's web site at www.cobank.com.

Commentary in Outlook is for general information only and does not necessarily reflect the opinion of CoBank. The information was obtained from sources that CoBank believes to be reliable but is not intended to provide specific advice.

CoBank Reports First Quarter Financial Results

CoBank earlier this month announced financial results for the first quarter of 2013.

Average loan volume in the quarter rose 5.7 percent to \$73.4 billion, compared to \$69.4 billion in the same period last year. Net interest income declined by 3.4 percent, to \$302.4 million, and net income fell 9.4 percent to \$208.8 million. Total loans at March 31, 2013 were \$73.0 billion.

Growth in average loan volume was driven primarily by higher lending to affiliated Farm Credit associations, reflecting increased financing activity at the producer level of the U.S. farm economy, as well as increased borrowing by rural infrastructure customers. Nevertheless, profitability for the quarter declined due to lower net interest income, a higher provision for loan losses, higher Farm Credit System insurance premiums and a greater level of losses on early extinguishments of debt, net of prepayment income. Net interest income declined primarily due to continuing low interest rates, which impacted the bank's returns on invested capital, its funding position and its portfolio of liquidity investment securities.



Robert B. Engel

"We're pleased with the bank's results for the quarter, which were strong despite continued challenging conditions in the market," said Bob Engel, CoBank's president and chief executive officer. "Demand for financing remains stable across most of the industries we serve. At the same time, a prolonged period of extremely low interest rates has pressured net interest income for most banks, CoBank included. We expect to be dealing with this dynamic in our business until we return to a more normalized rate environment."

Credit quality in the bank's loan portfolio declined modestly during the quarter but remained favorable by historical standards. At quarter end, 1.20 percent of the bank's loans were classified as adverse assets, compared to 1.01 percent at December 31, 2012 and 1.02 percent at March 31, 2012. The bank recorded a \$15.0 million provision for loan losses during the first quarter of 2013, compared to \$5.0 million in the same period last year. Nonaccrual loans increased to \$245.8 million at quarter end from \$170.2 million at December 31, 2012 and \$125.0 million at March 31, 2012. The increases in the provision and nonaccrual loans related primarily to credit concerns involving a small number of communications customers. The bank's allowance for credit losses totaled \$619.2 million at quarter end, or 1.82 percent of nonguaranteed loans when loans to Farm Credit associations are excluded.

Capital levels at the bank remain well in excess of regulatory minimums. As of March 31, 2013, shareholders' equity totaled \$6.5 billion, and the bank's permanent capital ratio was 15.7 percent, compared with the 7.0 percent minimum established by the Farm Credit Administration (FCA), the bank's independent regulator. As previously announced, the bank further enhanced its capital position subsequent to quarter end by issuing \$200 million in additional non-cumulative perpetual preferred stock, which has a fixed dividend rate of 6.125 percent.



David P. Burlage

“One benefit of the low interest rate environment has been our ability to issue preferred stock at favorable rates,” said David P. Burlage, CoBank’s chief financial officer. “Third-party capital supplements our member capital and retained earnings, and increases our capacity to meet the needs of customers in all market conditions. We continue to monitor the capital markets closely and to look for additional opportunities to optimize our capital position and overall cost of capital.”

At quarter end, the bank held approximately \$20.9 billion in cash and investments. The bank averaged 193 days of liquidity during the quarter and had 189 days at March 31, 2013, compared with the 90-day FCA minimum.

“As we have said previously, we expect the near-term earnings environment to be less favorable for CoBank given continuing low interest rates, increased competition for our customers’ business and other economic and market challenges,” Engel said. “As a result, CoBank will be placing an increased focus on driving a higher level of operating efficiency. Nonetheless, we are confident in CoBank’s continued ability to deliver strong financial performance and patronage while reliably meeting the needs of its customers across rural America.” ■