DMA:2011 - The Next Extraordinary Marketing Opportunity: Health Care Reform

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Carl McDonald, CFA
(617) 247-6312
carl.mcdonald@citi.com

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These Days, Everything Seems To Be Going Well For Health Plans

- **For the second consecutive year, health care utilization is rising a lot less than anticipated**
  - Earnings have been much better than expected; at United, for example, the company believes pre-tax earnings in 2011 will be $1 billion higher than its forecast at the beginning of the year; last year, pre-tax earnings at United were $1.9 billion above the company's initial guidance
  - Health care utilization is highly correlated with the economy
  - Health plans tend to do the best when the economy is at its worst; plans lose enrollment, which is bad, but there is far more earnings leverage to changes in margin

However, Health Reform (And The Environment) Are Taking A Toll

- **We estimate the publicly traded plans would have paid $1.3 billion in rebates in 2010 had minimum medical loss ratios (MLRs) been in place**
  - For 2011, we wouldn't be surprised to see minimum MLR rebates approach $2 billion for the publicly traded plans
  - While not related to health reform, commercial risk membership continues to decline on a regular basis; this is the most profitable group of members plans enroll
  - There is much greater focus on premium rate increases, and plans now have to justify any rate increase above 10%, beginning September 1, 2011
  - Health insurance exchanges are coming in 2014
  - The new health insurance regulations also begin in 2014

The Mechanics Of The Minimum MLR

- **Minimum MLRs took effect on January 1, 2011**
  - The industry now has a soft cap on margins
  - It skews the risk / reward for shareholders; investors bear all the risk when things go wrong, but the upside now goes to customers in good times
- **Most plans are close to the minimum MLR on an overall basis**
  - However, minimum MLRs will be applied on a state-by-state basis, and every plan has at least one market that is really, really profitable
  - So those very profitable markets become average profitability markets on January 1, 2011, while the less profitable markets presumably stay less profitable (unless cost trends are down a lot, as has been the case in 2011)
  - The disparity of earnings across markets / products is the issue for the industry

United's Individual Business In 2009 – A Minimum MLR Example

Individual	Lives	Member Months	PMPM	Premiums	Medical Expenses	MLR	Statutory Entity Refund To Get To 80% MLR
Golden Rule Insurance Co	73,844	816,562	$194.29	$158,646,978	$101,276,650	63.8%	$25,640,932
Oxford Health Plans NY Inc	24,741	303,377	$493.75	$149,791,156	$153,050,174	102.2%	
Oxford Health Insurance Inc	23,784	277,571	$311.60	$86,490,806	$70,032,801	81.0%	
Pacificare Life & Health Insurance	25,310	229,875	$166.78	$38,339,005	$30,172,293	78.7%	$498,911
Unison Hlth Plan Of The Capital Area	15,085	186,430	$193.24	$36,025,289	$39,051,840	108.4%	
Oxford Health Plans NJ Inc	4,314	54,893	$519.04	$28,491,458	$28,995,928	101.8%	
Health Plan of Nevada	8,762	115,752	$213.72	$24,737,976	$19,127,566	77.3%	$662,815
Sierra Health & Life Insurance Co	12,564	142,232	$145.92	$20,754,871	$11,996,298	57.8%	$4,607,599
American Medical Security Life Insco	28,226	374,286	$55.14	$20,637,853	$20,833,013	100.9%	
Optimum Choice Inc	4,794	64,974	$301.18	$19,568,641	$15,036,318	76.8%	$618,595
Unison Family Health Plan Of Pa Inc	5,281	66,916	$243.78	$16,312,477	$12,897,056	79.1%	$152,926
Pacificare Life Assurance Company	2,669	38,944	$240.26	$9,356,568	$8,337,374	89.1%	
Total	**231,402**	**2,702,346**	**$231.93**	**$626,754,561**	**$528,950,691**	**84.4%**	**$33,389,905**

Association / Trust	Lives	Member Months	PMPM	Premiums	Medical Expenses	MLR	Statutory Entity Refund To Get To 80% MLR
Golden Rule Insurance Co	514,500	6,137,750	$182.53	$1,120,335,158	$702,695,912	62.7%	$193,572,214
American Medical Security Life Insco	47,906	649,816	$213.06	$138,446,990	$92,157,052	66.6%	$18,600,540
United Healthcare of OH Inc	264	3,491	$477.77	$1,667,878	$1,334,302	80.0%	$0
United Healthcare of KY Ltd			NMF	$1,355,759	$1,250,614	92.2%	
Total	**562,670**	**6,791,057**	**$185.80**	**$1,261,805,785**	**$797,437,880**	**63.2%**	**$212,172,755**

Source: Company notes, National Association of Insurance Commissioners, and Citi Investment Research and Analysis

Rebates By Product Line

- Large group employers (50+ employees) are by far the most important demographic to the industry, although we'd keep in mind that many of these "large" employers may only have 75 or 125 employees
- We estimate that 39% of the industry's rebates will come from the individual product line, 21% from small group and 40% from large group.

	Individual		Small Group		Large Group		
	Premiums	MLR	Premiums	MLR	Premiums	MLR	Total
Aetna	$1,213,105,687	74.7%	$4,274,438,139	83.0%	$9,176,505,336	82.1%	$14,664,049,162
CIGNA	$169,833,213	65.7%	$307,554,010	93.3%	$5,573,014,789	81.1%	$6,050,402,012
Coventry	$317,048,615	67.2%	$2,094,513,313	76.3%	$3,156,721,714	83.6%	$5,568,283,642
Humana	$681,125,558	61.9%	$1,690,361,895	75.9%	$2,578,796,854	82.1%	$4,950,284,307
United	$2,092,961,680	69.4%	$12,941,754,843	78.4%	$19,752,187,104	80.7%	$34,786,903,627
WellPoint	$4,040,825,699	75.5%	$8,806,483,302	78.0%	$15,823,830,944	81.9%	$28,671,139,945
Totals	**$8,514,900,452**	**73.1%**	**$30,115,105,502**	**78.8%**	**$56,061,056,741**	**81.6%**	**$94,691,062,695**

Rebates

	Individual - 500 bp	Small Group - 500 bp	Large Group - 500 bp	Total
Aetna	$34,189,503	$6,732,092	$10,882,244	$51,803,839
CIGNA	$16,553,871	$106,976	$9,187,294	$25,848,141
Coventry	$27,405,699	$21,291,438	$11,915,684	$60,612,820
Humana	$91,208,485	$76,192,599	$51,892,096	$219,293,180
United	$268,638,205	$45,539,033	$386,914,788	$701,092,026
WellPoint	$89,077,836	$131,857,230	$67,368,796	$288,303,862
Totals	**$527,073,599**	**$281,719,368**	**$538,160,903**	**$1,346,953,869**

Source: Company notes, National Association of Insurance Commissioners, and Citi Investment Research and Analysis

Health Insurance Exchanges In 2014

- **Exchanges turn the individual & small group market into a commodity**
  - Products in each tier have to be standardized, so consumers will likely focus primarily on price
  - ISG margins today are generally 8-10%; margins in a more regulated exchange environment are likely to range from 3-5%, similar to other government businesses
  - A 500 basis point reduction in ISG margins would cost the publicly traded plans around $2 billion in earnings
  - Plans get a lot more membership, but the business model is much more highly leveraged to changes in margin

Employer Behavior In 2014

- **What will large employers do?**
  - Most will likely make no changes
  - Employee disruption, and the desire to be a competitive employer
  - The exchanges only make sense if the penalty stays at $2,000
  - If large employers dumped employees into exchanges in significant numbers, it would be the biggest structural positive we can think of for this industry
- **What will small employers do?**
  - It's hard to see why they wouldn't push their employees onto the exchange
  - Employees can make more in salary, and receive comparable health benefits
  - No impact on health plan revenue, but likely lower margins

The New Health Insurance Regulations In 2014

- **Reform brings more regulation to the industry**
  - Starting in 2014, plans must provide coverage to everyone; they can no longer decline coverage to people with pre-existing conditions
  - Premium rates have to be relatively similar; the most plans can charge for their oldest, sickest customer can't be more than 3x higher than the premium for their youngest, healthiest customer
  - The requirement that people buy coverage in 2014 is pretty weak, in our view (see next slide)

The Exchange Structure

- **Adverse selection is a big concern**
  - A $95 penalty won't be enough to compel someone young and healthy to buy insurance (if it is ruled constitutional)
  - Open enrollment periods will help to mitigate some selection issues
  - The risk corridor on the exchange will put a limit on the losses the plans can suffer
  - If the individual mandate is ruled unconstitutional, is that a bad thing?
  - Premium penalties, or allowing plans to underwrite those that could have purchased insurance but didn't would seem to be a lot more effective at deterring people from waiting until they are sick

It Could Be Worse – You Could Be An Individual Health Broker

- **The most significant way insurers are mitigating the impact of minimum MLRs is by cutting individual commissions**
  - Individual broker commissions have fallen 30-50% in most markets
  - Commissions are now generally tied to base premiums, so brokers will no longer benefit from medical inflation
  - It's not clear that brokers will receive any commission on an exchange
  - The changes make life very difficult for eHealth, a publicly traded company that focuses almost exclusively on the individual health insurance market

Aetna's 2011 Individual Commission Schedule

Broker Tier / Category	2011 Commission Rate for New Business	2011 Commission Rate for Renewals Months 13-24	2011 Commission Rate for Renewals Over 24 months
Platinum (50+ enrolled applications)	10%	4%	3%
Gold (25-49 enrolled applications)	8%	4%	3%
Silver (12-24 enrolled applications)	6%	4%	3%
Bronze (1-11 enrolled applications)	4%	4%	3%

Source: Company notes and Citi Investment Research and Analysis

The Big Strategic Question: To Diversify Or Not?

- **Focus on providers**
  - Provide data to hospitals and doctors (Aetna and United)
  - Become a provider (Highmark and Humana)
- **Focus internationally**
  - The expatriate business and ancillary insurance in developing countries (CIGNA)
- **Stay in health insurance, but focus on the areas of growth**
  - Medicare and Medicaid
- **Stay the course**
  - WellPoint
- **Whatever the strategic decision, diversification is hard to achieve because the health insurance business at these plans is so large**

Big M&A Transactions In Managed Care Aren't Too Likely

- **The strategic issue**
  - Do the CEOs of any of the big plans want to pay a premium to buy another health plan that isn't really growing and where margins will probably be lower in three years, rather than higher?
- **The regulatory issue**
  - Plans need approval from every insurance regulator they do business with, and in this political environment, it will be hard to get them all to sign on
- **Acquisitions of government plans, non-traditional businesses, and the roll-up of small health plans will likely be a lot more common**
  - There have been several small plans that have decided to exit the industry, while there has been a number of Medicare and health IT deals this year

Accountable Care Organizations (ACOs)

- **The federal Medicare ACOs aren't going anywhere, although there is still an opportunity to make some changes in the final regulations**
  - Providers make less money
  - The shared savings is relatively modest
  - Members are attributed to ACOs retrospectively
  - Members still have the ability to self-refer to other providers
- **There are a number of commercial ACO and other arrangements that have more promise**
  - CareFirst and primary care reimbursement
  - Many proposals appear to be a variation on the capitation theme
  - Most providers in the country don't have the ability to assume risk

There Is Some Good News – A Lot Of New Members

- **In total, the Congressional Budget Office projects 32 million people will gain coverage because of health reform**
  - This includes around 16 million low income people that will become eligible for Medicaid, and another 16 million that will be able to purchase insurance on exchanges with government subsidies
  - Exchanges change the way plans sell product; rather than appealing to a benefit manager, they must now go direct to the consumer
  - There are implications for provider networks – instead of needing a broad network to appeal to everyone, plans can use much more limited (lower premium) networks to appeal to specific individuals

Highlighted Industry Reports

Industry Analyses	***Publication date***
You're Getting Old When You Enjoy Remembering Things More Than Doing Them -August Medicare Enrollment	August 15, 2011
Be Nice To People On Your Way Up, Because You'll Meet Them On Your Way Down: TBV Analysis	August 8, 2011
All That's Necessary for the Triumph of Evil Is for Good Men to Do Nothing: 1Q11 NonProfit Blue Cross Analysis	June 29, 2011
We Make A Living By What We Get, But We Make A Life By What We Give - 2010 Minimum MLR Rebates	June 13, 2011
Good Players Skate Where The Puck Is. Great Ones Play Where The Puck Will Be:NonProfit Blue Cross Pricing	June 7, 2011
Money, If It Doesn't Bring Happiness, Will At Least Help You Be Miserable In Comfort: 2010 Risk Based Capital	May 17, 2011
If One Has To Submit, It's Wasteful Not To Do So...: Upgrading Commercial Managed Care	May 12, 2011
Company reports	
CVH: Success Usually Comes To Those Too Busy To Be Looking For It - 2Q11 EPS Analysis	August 11, 2011
HNT: Confusion Is Always The Most Honest Response - 2Q11 EPS Analysis	August 8, 2011
UAM: Money Isn't The Most Important Thing In The World. Love Is. Fortunately, I Love Money - 2Q11 Analysis	August 2, 2011
HUM: Get Your Facts Straight First, And Then You Can Distort Them As You Please - 2Q11 EPS Analysis	August 2, 2011
AGP: The Only Function of Financial Forecasting Is To Make Astrology Look Respectable - 2Q11 EPS Analysis	August 1, 2011
WLP: What Do You Think Of Your Team's Execution? Right Now, I'm In Favor Of It - 2Q11 EPS Analysis	July 28, 2011
AET: The Only Reason For Time Is So That Everything Doesn't Happen All At Once - 2Q11 EPS Analysis	July 27, 2011
EHTH: I May Be Bad But I'm Perfectly Good At It - 2Q11 EPS Analysis	July 26, 2011
CNC: The Only Thing We Learn From Experience Is That We Learn Nothing From Experience - 2Q11 Analysis	July 26, 2011
UNH: Do You Mind If I Dance With Your Date? - The United / Medco Break-Up	July 22, 2011
MCH: No One Trips Over Mountains. It's Always The Small Pebble - 2Q11 EPS Analysis	July 22, 2011
AGP: A Small Cap Becomes A Large Cap - Highlights From Management Meetings	July 16, 2011
WLP: If You Want To Feel Rich, Just Count The Things You Have That Money Can't Buy - Acquires CareMore	June 8, 2011
HS: Democracy Is Four Wolves & A Lamb Voting On What's For Lunch - Investor Day Highlights	April 8, 2011
CI: Sometimes A Man Can Meet His Destiny On The Road He Took To Avoid It - Investor Day Analysis	March 14, 2011
AET: The Farther Backward You Can Look, The Farther Forward You Are Likely To See - 2011 Investor Day	March 7, 2011
HUM: When Everyone Thinks Alike, Everyone Is Likely To Be Wrong - Highlights From Management Meetings	February 28, 2011
MGLN: The Two Most Powerful Warriors Are Patience And Time - Signs Blue Shield Of California Contract	February 1, 2011
GTS: Whoever Said Money Can't Buy Happiness... Acquires American Health	January 26, 2011
UAM: Be Ready At Any Moment To Give Up What You Are... Sells PDP Business to CVS	January 3, 2011
Medicaid Updates	***Publication date***
Don't Insult The Alligator Until After You Cross The River: Texas Awards Medicaid RFP	August 2, 2011
If You Have An Important Point To Make, Don't Try To Be Subtle Or Clever: Louisiana Medicaid RFP Awarded	July 25, 2011
Managed Care: I've Never Let My Schooling Interfere With My Education: Kentucky Medicaid RFP Awarded	July 8, 2011
Managed Care: Well Done Is Better than Well Said: Highlights from The Louisiana Medicaid RFP	June 30, 2011
Courage Is Fear Holding On A Minute Longer: Kentucky Medicaid RFP Analysis	May 30, 2011
Who Are You Going To Believe, Me Or Your Own Eyes?: Texas Medicaid RFP Analysis	May 16, 2011
Many Foxes Grow Grey, But Few Grow Good: Arizona Long-Term Care RFP Awarded	May 9, 2011
Most Of Us Don't Look As Handsome To Others As We Do...: Arizona Medicaid Long-Term Care RFP Analysis	April 11, 2011

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