

National Congress On Health Insurance Reform Mini Summit XV: Wall Street's Assessment

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Health Reform Is Bad News For The Insurance Industry

- **Minimum MLRs in 2011 make the industry a lot less attractive**
 - The industry now has a 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
 - Minimum MLRs will pressure earnings in 2011, particularly in the individual business

- **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 have to become average profitability on January 1, 2011, while the less profitable markets presumably stay less profitable
 - 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

If Medical Costs Are Low Again In 2011, Isn't Margin Upside Possible?

- **Yes, but the margin improvement won't be sustainable**
 - Every plan has subsidiaries, particularly in the large group market, with loss ratios above the 85% minimum
 - So another year of below average utilization could result in margin expansion and earnings upside

- **However, higher margins probably aren't sustainable, unless the competitive environment ceases to exist**
 - We'd have to argue that some markets, like large group, could operate at a higher margin than they ever have before
 - There's a long history of managed care plans attempting to pick off business from competitors
 - The non-profit Blue Cross plans currently have more capital than ever before

Aetna's Large Group Business In 2009 – A Minimum MLR Example

Large Group	Lives	Member Months	PMPM	Premiums	Medical Expenses	MLR	Statutory Entity Refund To Get To 80% MLR
Aetna Life Insurance Co	1,340,098	16,385,011	\$342.17	\$5,606,537,140	\$4,952,544,725	88.3%	
Aetna Health Inc PA Corp	384,102	4,830,189	\$347.85	\$1,680,201,891	\$1,389,059,096	82.7%	\$39,112,511
Aetna Health Inc FL Corp	298,328	3,675,931	\$339.83	\$1,249,185,697	\$1,144,919,494	91.7%	
Aetna Health Inc NJ Corp	138,648	1,778,842	\$365.81	\$650,715,102	\$556,236,832	85.5%	
Aetna Health Inc TX Corp	114,728	1,454,268	\$324.58	\$472,027,181	\$411,405,502	87.2%	
Aetna Health Inc NY Corp	65,576	851,848	\$433.04	\$368,881,420	\$307,069,010	83.2%	\$6,480,197
Aetna Health Inc Co Corp	36,439	448,901	\$376.42	\$168,976,997	\$139,605,697	82.6%	\$4,024,750
Aetna Health Inc CT Corp	32,737	412,751	\$398.39	\$164,436,414	\$141,805,997	86.2%	
Aetna Health Inc GA Corp	30,387	439,899	\$315.49	\$138,785,273	\$118,134,461	85.1%	
Aetna Health Inc ME Corp	19,234	147,198	\$709.99	\$104,509,326	\$89,882,383	86.0%	
Aetna Hlth Ins Co	307,951	3,826,442	\$15.84	\$60,591,901	\$53,213,104	87.8%	
Aetna Health of The Carolinas Inc	11,738	138,330	\$330.82	\$45,762,770	\$42,223,368	92.3%	
Aetna Health Inc DE Corp	6,043	69,125	\$383.77	\$26,528,026	\$19,433,508	73.3%	\$3,115,314
Aetna Health Ins Co of NY	23,850	334,364	\$26.20	\$8,759,697	\$8,266,270	94.4%	
Aetna Health Inc	839	15,583	\$347.22	\$5,410,734	\$4,539,554	83.9%	\$59,570
Aetna Health Inc MI Corp	0	0	NMF	-\$5,881	-\$28,994	493.0%	\$23,995
Total	2,810,698	34,808,682	\$308.87	\$10,751,303,688	\$9,378,310,007	87.2%	\$52,792,343

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

Pricing Will Be What We Talk About For The Next Six Months

- **There is a lot more attention now (at both the state and federal level) on the magnitude of premium rate increases**
 - A number of states have blocked or reduced premium rate increases already
 - States are passing laws giving insurance commissioners more power to regulate rate increases
 - The HHS Secretary now has the power to regulate excessive rate increases, something the market hasn't paid a lot of attention to
 - In December 2010, HHS announced that starting July 1, 2011 every rate increase that exceeds 10% for individual and small market plans must undergo a review.

- **The large EPS upside from 2010 will not help the rate environment**
 - It is going to be very difficult for plans to justify a 2011 rate increase right after having reported record profitability
 - Premium rates rose more in 2010 than in 2009, and cost trends have decreased

Exchanges Will Not Be A Good Thing For Industry Margins In 2014

- **The important point is that benefits will be standardized within each tier**
 - Coupled with transparent pricing, and the individual and small group products will become commodities
 - Price will be the single most important item consumers look for; if pricing is roughly equivalent, brand, network, and other items will be a consideration
 - California did not set a good precedent, since the state appears to want to combine the factors above with a limited number of plans, and choose those plans based on who offers the best deal
 - Sounds a lot like the Medicaid business to us, and Medicaid plans only earn a 3-5% pre-tax margin, or about half of what plans generate today
 - From a consumer's perspective, exchanges seem like a pretty good thing
 - There will continue to be an off exchange market, too, but it will likely mirror many aspects of the exchange, as has been the case in Massachusetts

The Other Major Reform Issues To Consider

- There are a whole host of other changes coming, too, contributing to the margin pressure, but most of the changes don't occur until 2014
 - Adverse selection causes losses in the individual business
 - Products that go away (student health insurance)
 - The incentive for employers to shift from fully insured to self-funded products because of the health insurance industry tax
 - Will employers continue to offer insurance after 2013, or will they push their employees into the insurance exchange?
 - Health insurers are being asked to run their business in a very different way, and risk selection will no longer be a viable option

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

There's Probably Not Going To Be A Lot Of Traditional M&A

- **There is both a strategic and a regulatory issue to commercial M&A**
 - Most large companies don't have the inclination to spend billions buying a regulated business where margins can't go any higher, but could go a lot lower
 - It would be difficult to obtain the regulatory approvals necessary to close the deal. Anti-trust is a hurdle, but the real issue is obtaining approval from all the state regulators a plan does business with

- **The M&A focus will be diversifying into non-regulated areas that have growth**
 - UnitedHealth spent \$1.9 billion buying health care IT companies in the fourth quarter, and Aetna just spent \$500 million on an IT company that generates very little revenue
 - CIGNA spent \$410 million to bulk up its international business, and others are looking internationally, too

- **Medicaid makes the most sense to us as an M&A target**
 - Lots of growth, and the ability to leverage the existing infrastructure

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