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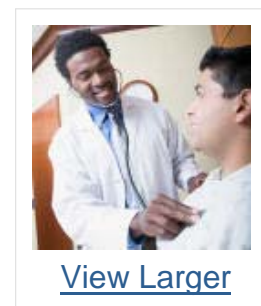
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## Anger rises over bigger HMO profits

Health plans defend increase in premiums at a time when many employers are struggling

Sacramento Business Journal - by [Kathy Robertson](#) Staff writer



HMO profits in California rose 46 percent last year, with nonprofit Blue Shield leading the pack, almost doubling its profit margin from the prior year.

The health plans say they caught a break through lower-than-expected costs, and 2008 doesn't look as rosy. Blue Shield notes that an accounting change boosted its numbers this year. But the response from many of their customers ranges from frustration to anger.

The tally comes while health plans are taking heat for their controversial practice of rescinding individual coverage after members become ill and file claims, leaving patients with mounting medical debt (see related story, page 7).

Solid profits in the HMO industry also raise questions about rising premiums at a time when health plan revenue exceeds expenses by billions of dollars, many employers are struggling in the down economy and comprehensive health care reform in California appears dead for the year.

"To see that kind of profitability when rates continue to go up is more than a little frustrating," said Linda Hunter, a senior vice president and managing director at ABD Insurance and Financial Services, a Wells Fargo & Co. unit. "A lot of us in the industry feel our hands are tied; there's so little we can do."

Employers and their insurance brokers continue to tinker with plan design and benefit levels to cut costs, or increase copayments and the amounts workers must contribute for their coverage, Hunter said.

"So every time something comes out about health plan profitability, they get upset," she said.

One reason for the profit surge is that medical costs have been lower than expected, and premiums are set in advance to cover expected trends, industry sources said.

"To the extent health insurers project certain utilization and it comes in low, it's gravy, and puts them ahead of projections," said Allan Baumgarten, a Minnesota health care consultant who writes annual market overviews for several states. "But it's very much a gamble, and you can get hit with higher costs."

The prognosis for 2008 is unclear.

Managed care stocks tumbled Tuesday after UnitedHealth Group Inc., parent company to PacifiCare of California, reported lower-than-expected profits for the first quarter.

Lawsuits and aggressive state action on rescinding coverage could mean reinstatement of thousands of claims, costing plans millions.

"Looking forward, the numbers do fluctuate," said Chris Ohman, president and chief executive officer at the California Association of Health Plans, an industry trade group. "The signs so far this year are that it will be more challenging in 2008 for plans."

#### **Profits up, enrollment down**

The six HMOs that dominate the Sacramento market reported combined net profit of close to \$4.2 billion statewide in 2007, up about 46 percent from almost \$2.9 billion in 2006.

The plans posted revenue of more than \$74.2 billion, up 7.7 percent from almost \$69 billion in 2006, according to financial reports posted on the state Department of Managed Health Care's Web site. The numbers reflect California business, except for Kaiser Permanente, which includes Hawaii in its data.

All the numbers are preliminary, based on quarterly reports. Annual filings are due at the end of this month.

Profits are up even though HMO enrollment is down slightly -- off 334,406 members, or 1.9 percent, statewide -- as employers and other customers gradually shift to less-expensive alternatives, such as high-deductible preferred provider organization plans.

Three of the six plans -- Kaiser, Blue Shield of California and Western Health Advantage -- are nonprofit companies that plow profits back into the business. Health Net Inc., Anthem Blue Cross of California and PacifiCare are public companies that pay dividends to shareholders.

#### **Accounting change inflated profit**

The numbers posted by Blue Shield have raised eyebrows. The nonprofit, San Francisco-based health plan reported net income of \$726.8 million on revenue of \$8.1 billion in 2007, up more than 90 percent from net income of \$381.6 million on revenue of \$7.9 billion in 2006.

"One of the things I love about the term 'nonprofit' status is most people misunderstand the term," said Dard Hunter, regional health and benefits manager at benefits consultancy Mercer. "It's a tax designation and has very little to do with the amount of money an organization can make."

"A 9 percent profit margin, when you don't pay taxes, is a real 9 percent," added Tom Sher, an analyst with Driver Alliant Insurance Services.

Big profits in 2007 were a one-time blip related to changes in federal tax-exempt status in 1986, countered Blue Shield spokesman Tom Epstein.

A transition plan approved by federal regulators allowed Anthem Blue Cross and Blue Shield plans to pay the alternative minimum tax while they built up equity to pay for the full federal income tax rate of 35 percent. The full rate kicked in last year for Blue Shield, and the company reported the banked equity of \$374 million as income.

"It was simply a paper transfer," Epstein said. "We did have a respectable year, but not nearly so good as it appears to be."

The plan for now is to keep a lid on prices for competitive reasons, which, in turn, is expected to mean a drop in profits, Epstein said.

### **The other players**

Oakland-based Kaiser, both an HMO and a health care delivery system, reported a profit margin of 5.8 percent. In the horse race of HMO finances, Kaiser led in profits at the first half of the year but reported a \$233 million loss in the fourth quarter from the cost of opening new facilities and a rise in retirement benefits and medical expenses.

In other developments:

- Anthem Blue Cross of California posted a 6.1 percent profit margin, but lost more members than any other plan serving the area. It was down 235,606 as of December, off 5.4 percent from the previous year.
- Revenue and net income rose at PacifiCare, but the margin remained at 4 percent. The health plan is down more than 72,000 members, or 4.45 percent. "Since our merger with UnitedHealth Group, we've had some issues with integration," spokeswoman Cheryl Randolph said.
- Health Net was the only plan that reported a drop in profits, to \$214 million in 2007 from \$216.9 million in 2006. The figures are deceptive because the annual report will show a one-time legal charge in 2007, spokesman Brad Kieffer said. Without that, net income was up.

The company lost 14,000 members in Sacramento when Sutter Health switched to self insurance, Kieffer said, but picked up Wells Fargo & Co. and the University of California on Jan. 1.

- Western Health Advantage -- a much smaller, Sacramento-based plan -- reported big increases in revenue and net income but lost 20,000 members on Jan. 1 when the plan was dropped by the California Public Employees' Retirement System.

The plan remains profitable and is aggressively pursuing new members to pick up the slack, chief executive officer Garry Maisel said.

### **No regulation of profits**

Consumers, regulators and others frustrated by rising costs bemoan the lack of comprehensive health care reform and say they are stumped by the numbers amid a drumbeat for ever-higher premiums.

The trend this year appears to be for low double-digit percentage increases, said Stephen DeLapp, vice president for benefits consulting for The Segal Co. But premiums vary widely.

"Kaiser renewals are almost schizophrenic," DeLapp said. "Some are 2 percent. Some are 20 percent. ... It's very difficult to understand how much is true cost and how much is working backwards: 'We need this amount of revenue, so we're going to charge you that.' "

"Insurers always complain in the Capitol about rising health care costs and make excuses for increases in premium, but they always seem to be doing well when we look at their books and profits," said Anthony Wright, executive director of Health Access, a San Francisco-based consumer group.

Current law does not regulate profits, said Cindy Ehnes, director of the state Department of Managed Health Care. There's an old regulation on the books that says administrative costs can be no more than 15 percent, but that rule was drafted when most health plans were nonprofit, she said. How that applies to public companies is unclear.

The state Department of Insurance recently released a new regulation that allows up to 30 percent of every dollar to be spent on expenses not related to health care, and that creates a disparity between the two regulatory agencies, Ehnes said. DMHC regulates only managed-care plans.

"We want California to be a good place to do business because we want consumers to have access to good products," Ehnes said. "Yet we do have concerns about unreasonable profits and executive compensation."

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