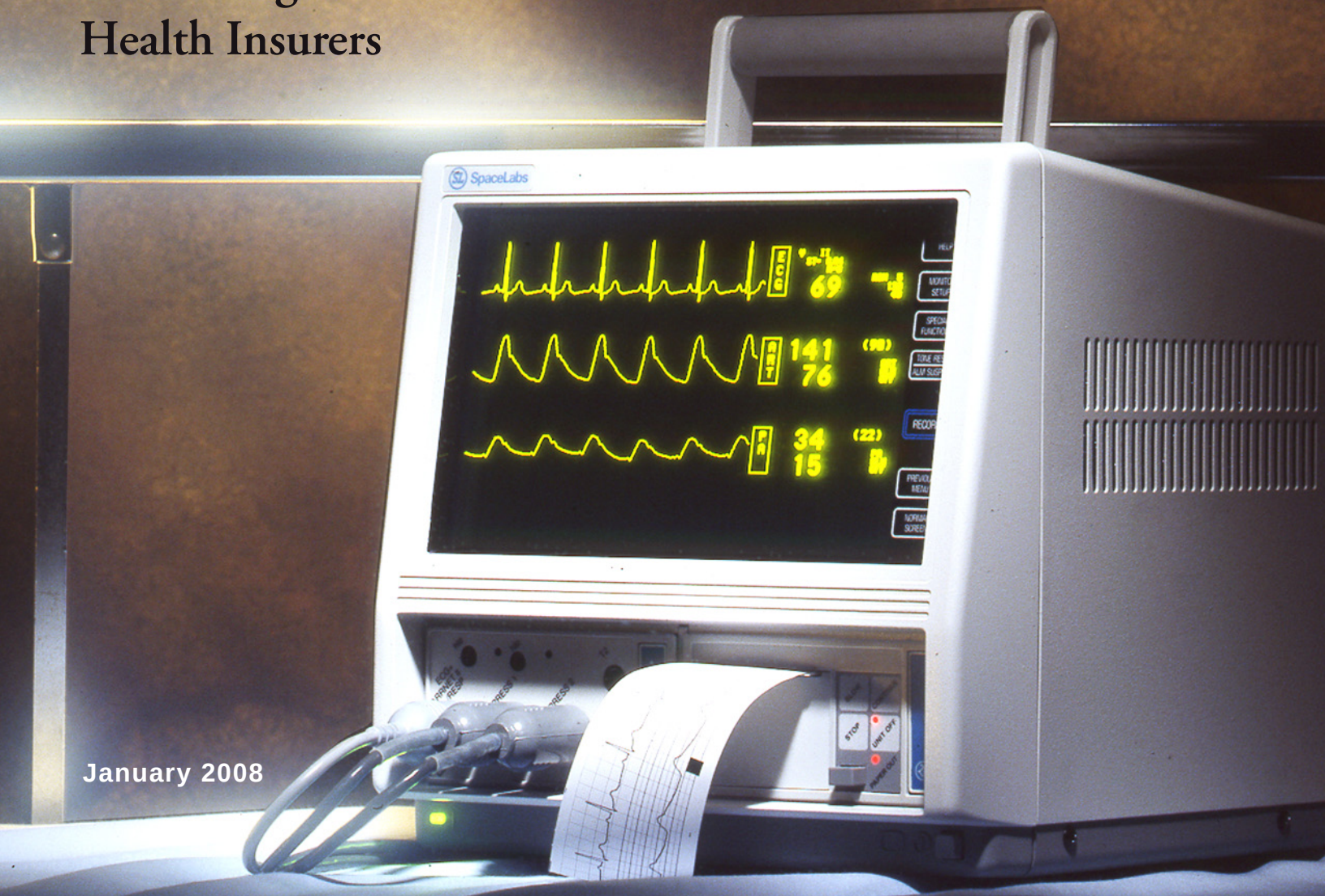
Insuring Health or Ensuring Profit?

A Look at the Financial Gains of Washington State's Health Insurers



January 2008

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Acknowledgements

This report would not have been possible without the contributions of Joshua Welter and Bill Daley of the Washington Community Action Network.

The authors would also like to thank Aaron Katz of the University of Washington School of Public Health and Community Medicine, Gerald Kominski of the UCLA Center for Health Policy Research/UCLA School of Public Health, Janet Varon of Northwest Health Law Advocates, and Lauren Sobel of Consumers Union for their invaluable assistance.

In addition, the authors are grateful to Chris Carlson, Dennis Julnes, and Barbara Flye of the Washington State Office of the Insurance Commissioner for their assistance.

Layout & Design by Peg Ogle Design

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Introduction

Over four million Washington residents receive health insurance through the private market. [1] However, as premiums rise, it becomes increasingly difficult for individuals and employers to hold onto quality coverage. Meanwhile, the state's major health insurance carriers are enjoying record gains and increasing profitability. These trends suggests that financial health and positive market conditions for Washington insurers do not necessarily translate into quality, affordable coverage for the state's residents. Furthermore, these trends raise the question of whether profitable practices for health carriers may in fact contribute to inefficiency and inequity in the health care system.

The private health insurance market is not meeting the state's needs, even in what are good financial times for the industry. This failure indicates the need for a stronger governmental role in making quality, affordable insurance available to all state residents. Given the absence of a connection between carriers' financial health and improved access to health insurance, the state should provide all residents with a public alternative to private market coverage. Additionally, the state should apply greater oversight of health carriers.

The private health insurance market in Washington

Quality insurance is a key gateway to health care for Washington residents. As of 2006, 73.6 percent of Washington residents received health coverage through the private market. Most of these (62.5 percent) were covered in an employer plan. Eleven percent (11.1) purchased coverage in the individual market. Nearly 29 percent (28.6) received public coverage, such as Medicaid or Medicare, while approximately nine percent (9.3) was uninsured. [2] (Some have coverage from more than one source.) The uninsured rate has grown in past years. It was 8.4 percent in 2002 and 7.7 percent in 2000. [3]

Washington's private health insurance market is dominated by three large carriers: Premera Blue Cross, Regence BlueShield, and Group Health Cooperative. Together, they account for 50 percent of Washington's health and accident insurance market – or 58 percent when all subsidiaries of their parent companies are included. In 2006, they provided coverage to 1.98 million enrollees (2.3 million including subsidiaries). [4]

Premera and Regence represent fairly equal market share: 17.14 percent (18.86 with subsidiaries) and 17 percent (18.96 percent with subsidiaries), respectively. Group Health Cooperative accounts for 15.55 percent of the market. However, when the three Group Health Cooperative parent company subsidiaries (Group Health Options, Group Health Cooperative, and KPS Health Plans) are combined, Group Health claims the largest market share: 20.14 percent. [5]

Karen LaCasse, Seattle

"I am self-employed as a travel agent and Executive Leisure Consultant. I started my own small business three years ago, after the company I worked for got rid of the department where I had worked for fifteen years.

I have rheumatoid arthritis and take a medication infusion every seven weeks that would cost $7,000 without health insurance. I have an individual health insurance policy with Regence BlueShield. Earlier this year, Regence raised rates for individuals. They leveled the largest rate increases on those of us who are older. My premium jumped 42 percent!

I thought, well, maybe they're trying to give me a heart attack so they won't have to insure me any longer.

Health care costs are now getting to the point where they are affecting my standard of living. After this rate-hike, I had to cancel a family vacation I had planned to celebrate

my daughter's 18th birthday. I've even had to dip into my retirement savings to make sure I can keep up with the rising costs.

Pretty soon, my health insurance will cost as much as my house payment. Enough is enough!

Regulation and deregulation in the individual health insurance market

All health carriers doing business in Washington are subject to regulation by the Office of the Insurance Commissioner (OIC). However, the nature and extent of that regulation has shifted over time, particularly in the individual market.

One goal of health insurance regulation is to limit risk segmentation. Risk segmentation involves the division of enrollees (or potential enrollees) into smaller pools according to how much health care they are expected to need. Health carriers have an incentive to engage in effective risk selection – identifying high risk patients and limiting their coverage or charging premiums according to health status and age. Insulating against bad risk and attracting good risk plays a large part in competition in the private health insurance market. [6] However, risk segmentation undermines the spreading of risk, resulting in higher costs for those who are older or sicker, driving many of them out of the market entirely.

In 1993, Washington passed a number of small group and individual market reforms intended to increase the availability of coverage and limit the ability of carriers to select for risk. These included guaranteed issue and renewal of health insurance policies, health insurance rate regulation, and adjusted community rating (under which age and health may not factor into cost of premiums), as well as the elimination of riders and permanent exclusions for preexisting conditions. In 1995, the community rating criteria were modified to allow carriers to factor enrollees' age into pricing, and new legislation allowed individuals to buy small group products, attracting many healthier enrollees into the small group market and out of the individual market. [7]

In 1998, Premera stopped selling new individual plans, followed by Regence and Group Health in 1999. The carriers claimed they were losing money on these plans as a result of regulation. [8] In 2000, the Legislature scaled back the remaining individual market reforms, and the large carriers reentered the market. By 2002, an estimated 157,298 residents were enrolled in individual plans – still only slightly more than half the 295,586 enrolled in 1995. [9]

Under the 2000 laws, carriers may reject up to eight percent of new applicants for individual coverage based on health status. Rejected applicants may enroll in the Washington State Health Insurance Pool, a high-risk pool with very high premiums. Additionally, rate regulation was replaced with a requirement that insurers maintain a 72 percent "medical loss ratio," requiring them to spend at least 72 percent of premiums on health claims.

The 2000 deregulation represented an attempt by the Legislature to increase access to the individual health insurance market. The premise of the deregulation was that a healthier environment for carriers would result in greater availability of affordable individual health insurance products. However, analysis of financial data for carriers' business overall suggests that they are benefiting from a loosely regulated market – but they are not passing the benefits on to the state's residents in the form of more stable premiums or coverage of the uninsured.

Health carriers have an incentive to engage in effective risk selection . . .

Health insurers' financial gains

This report analyzes major financial trends for the state's top three health carriers, Regence BlueShield ("Regence"), Premera Blue Cross ("Premera"), and Group Health Cooperative ("Group Health"), based on data from carriers' annual statements filed with the Office of the Insurance Commissioner (OIC). Subsidiaries filing separate statements are not included in this analysis.

All three carriers are nonprofits, although their parent companies may own for-profit subsidiaries, such as Premera's Lifewise Health Plan. Additionally, as the analysis that follows indicates, even nonprofit insurers may experience robust financial times without passing those gains along to the general public.

Jennifer McWethy, Kirkland, WA

"I am a self-employed small business owner. I provide retirement plan services for employers ranging from high-tech to not-for-profit agencies. My husband, Kam, and I purchase health insurance for ourselves as individuals.

We pay $450 a month for Kam's insurance through Regence BlueShield. Earlier this year, his doctor recommended he have back surgery. We were told that both the surgeon and the hospital called Regence to assure it'd be covered, and were told it would be. So, we went ahead with the surgery.

Initially, Regence paid the surgeon about $1,500 of the $5,000 bill. The difference was written off by the surgeon "per agreement with the insurer," as we were told – since insurance companies can negotiate better prices than individuals can. Upon reviewing the doctors' notes, though, Regence reversed its decision, denied our claim based on a "preexisting condition," and took back payments made to the surgeon.

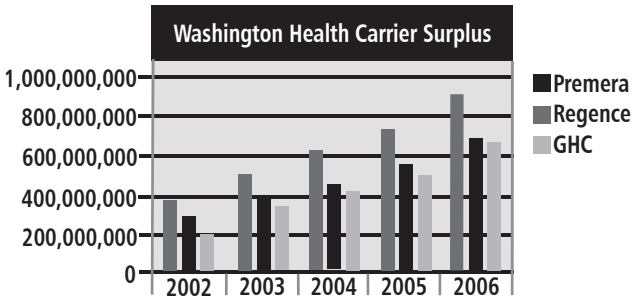
The hospital sent us to collections for about $14,600. The collections agency immediately tacked on over $2,300 in interest and penalties. They ruined our credit and were after us for almost $18,000.

Regence paid after a year-long appeals battle that caused us extreme anxiety and consumed an incredible amount of time and energy. The hospital accepted the reduced insurance payment of $10,000 (instead of the $14,600 they wanted from us as individuals), but left us to deal with the collection agency mess.

Our insurance premiums are very high and we are lucky we can barely afford to pay the increasing premiums. Isn't it about time we had a humane health insurance system that is fairly priced and covers the needs of all?"

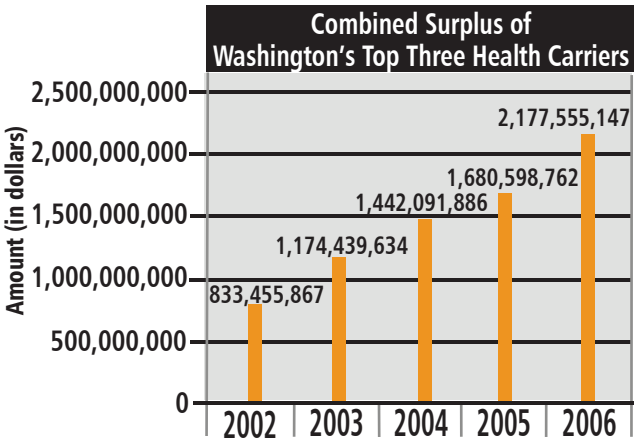
Growing surpluses

In recent years, the surpluses of the major health carriers have increased steadily, reaching the combined amount of nearly $2.2 billion. [12] In 2002, the three major carriers reported a combined surplus of $833 million. By 2006, this combined surplus had more than doubled. Among the three carriers, Regence BlueShield reports the highest surplus, reaching almost $881 million.



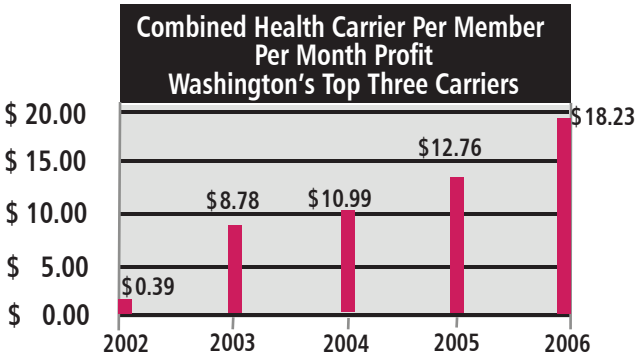
Surplus differs from claims reserves, which are funds set aside to pay for services that customers have received or it is anticipated they will receive. Surplus has been defined as the excess of assets over liabilities. [13] It represents the earnings or funds that carriers retain for investment, to compete for market share, or for other purposes. [14]

According to data available from the OIC, the three major carriers had a combined average premium of $264.86 in 2006. [15] To illustrate, at this level, the carriers' combined surplus of almost $2.2 billion would provide one year's coverage for approximately 685,000 people. However, carriers – even nonprofits – are not required under current state law to use surpluses or profits to improve or expand coverage for health care, either by covering those without insurance, lowering rates, or improving the quality of coverage of those currently insured.



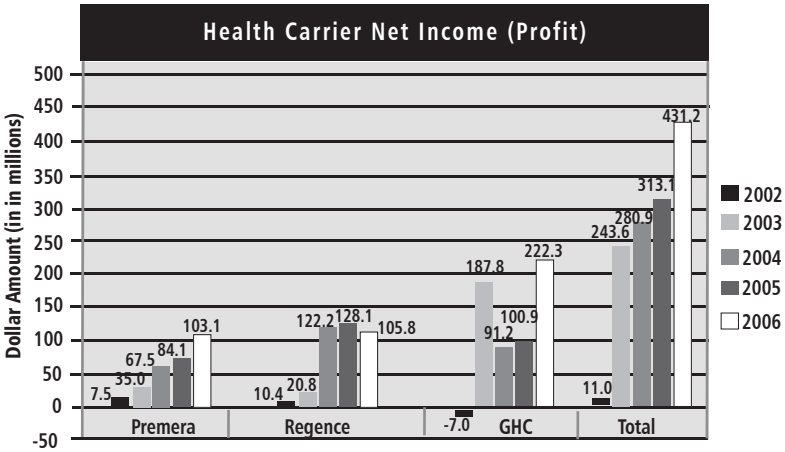
Increasing profitability

The amount that a health carrier earns for each member enrolled each month, above claims expenses, provides another window onto carrier financial trends. Since 2002, the major carriers' per member per month profits have been growing. That year, the combined per member profit was under $1.00 a month. By 2006, the three major carriers posted combined per member profit of $18.23 a month, with Group Health Cooperative leading at $45.66 a month.



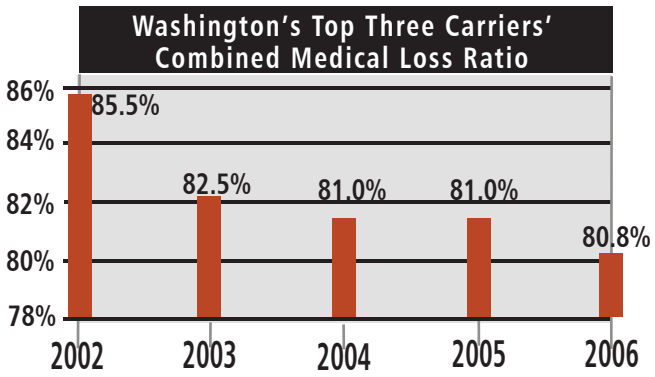
Even though carriers are serving fewer people than they did in 2002, their net income (overall profits) has increased significantly.

In 2002, the carriers covered over 28 million member months (2.37 million insured individuals, assuming full-year coverage). This number had dropped by 17 percent as of 2006, when the carriers covered fewer than 24 million member months (1.97 million insured individuals, assuming full-year coverage). During this same period, total profits for the carriers climbed. In 2003, the carriers reported combined profits of $244 million, a figure that reached $431 million by 2006.



Declining portion of premiums spent on health care

The medical loss ratio represents the portion of premiums or revenue used to pay for health care expenses as opposed to administrative overhead. [16] Two of Washington's largest carriers, Premera and Regence, currently spend approximately 80 percent of revenue for health care, while Group Health spends slightly above this amount. [17]



Between 2002 and 2006, Premera's medical loss ratio dipped from 85.7 percent to 80.8 percent. Regence's medical loss ratio has also dropped. As of 2006, it was spending 79.4 percent of revenue on health care, compared to 83.7 percent in 2002. In 2004 and 2005, Regence used nearly a quarter of revenue toward expenses other than health care.

"While it is true that costs of health care claims paid by major health insurers have increased over the last five years, their revenue has increased faster."

Jeanne McMenemy, Walla Walla

My husband Wayne and I are both self-employed, successful artists. Wayne is a sculptor who is currently working on a piece commissioned by the City of Seattle.

For a number of years, both of us had individual catastrophic policies with Regence BlueShield. We'd like to have better coverage, but catastrophic plans were all we could afford. For the most part, we really never used these policies because they have high individual deductibles, and regular "maintenance," such as mammograms or physicals, isn't covered. So we pay for most of our health care expenses out of pocket, in addition to the monthly premium.

After Regence announced its rate increase, which would have raised our premiums by $100, we began looking at alternatives. Wayne switched over to Lifewise in June or July, which was marginally cheaper than the new Regence rate with a little better coverage. I couldn't switch. Lifewise rejected me because of a health condition that hasn't caused me any problems in the last 30 years. So, I had to stay with Regence, and pay the higher rates.

As self-employed individuals, health care costs were already a strain on our budget. With the Regence rate increase, it's becoming even more of a challenge. And now we've learned that Lifewise is following in Regence's footsteps with a 22 percent-plus rate increase in January.

What's particularly galling is the fact that these rate increases are going on at a time when the insurance companies are increasingly profitable. We need government to be a stronger watchdog over the insurance industry to protect individuals and the self-employed.

The public's experiences in the private health insurance market

As of 2006, approximately nine percent of Washington residents, nearly 600,000 individuals, were uninsured, a rate that has remained relatively steady since 2004.

How many Washington residents are "underinsured" remains unknown. One national study recently estimated that, in 2003, sixteen million working-age adults were "underinsured" – they had year-round insurance but "inadequate financial protection" against the costs of a major illness. The study found that, compared to those with quality coverage, the underinsured were "significantly more likely to go without care because of cost." [18]

Meanwhile, some of Washington's major carriers have recently raised premiums significantly over the past year. These increases have been especially dramatic in the individual market, over which the OIC lacks authority to regulate baseline rates.

In May 2007, it was reported that Regence BlueShield would increase premiums for individual policies by an average of 19 percent, with some enrollees moving into an older age group and experiencing a 40 percent hike. Regence raised small group rates by 9.9 percent after requesting an 11.5 percent increase. [19] Meanwhile, in November 2007, Premera LifeWise Health Plan (a subsidiary of Premera Blue Cross) announced plans to raise rates by 22.5 percent. [20]

The carriers have explained these increases as the result of rising costs for health care claims. While it is true that costs of health care claims paid by major health insurers have increased over the last five years, their revenue has increased faster. Between 2002 and 2006, Washington revenue for the top three increased by 23 percent, whereas total hospital and medical expenses increased by only 16 percent. [21] LifeWise, too, has seen similar gains, with hospital and medical expenses going up by 293 percent and revenue rising by 334 percent during the 2002 to 2006 period. [22]

The carriers' increasing profitability raises questions about the need for premium hikes of this magnitude. For example, to what extent do the increases reflect a response to perverse incentives in the private market – including those that encourage carriers to avoid risk by insulating themselves from the cost of older or less healthy enrollees? Such practices may be profitable for carriers, but they undermine the efficiency of the health care system and often result in coverage becoming unaffordable for those most in need of care.

Financial health and favorable market conditions for Washington insurers have not translated into greater access to coverage for the state's residents, and their recent premium increases may price coverage out of reach for many. This suggests the need for a strong and effective response from lawmakers to guarantee quality, affordable health care for all residents.

The legislative response to the health insurance challenge

Washington residents face numerous health insurance challenges. Lawmakers have taken a number of steps in response. Although these changes still fall far short of the public's need, they represent important advances in the effort to make quality, affordable health coverage available to all.

In 2007, building on the state's system of publicly administered health insurance programs, lawmakers expanded public health coverage for all children with family incomes at or below 250 percent of the federal poverty level (FPL) (to be followed in 2009 by an expansion for children with family incomes up to 300 percent FPL and an opportunity to buy into coverage for all other children). [23] In addition to extending insurance to more people, public coverage also generally provides risk-pooling efficiencies. However, despite the recent children's expansion, many adult residents will remain ineligible for any form of public coverage, even if they have very low incomes.

Also in 2007, the Legislature also established the Health Insurance Partnership, which is intended to allow many small employers to provide subsidized insurance to employees. [24] However, as currently established, many Washington residents will not be eligible for the Partnership, including individuals and employees of large businesses. Furthermore, the premiums, fees, and benefit package standards have not yet been determined – and no public coverage option now exists within the Partnership. Therefore, questions remain as to its affordability, quality, and efficiency. Nonetheless, the Partnership has the potential to bring quality, affordable coverage to many Washington residents.

Furthermore, in 2006, the Legislature passed legislation to increase transparency in the health insurance industry, requiring the OIC to compile information (such as that discussed above) and make it available to the public. However, this legislation does not address shortfalls in the OIC's oversight powers, and a 2007 bill that would have allowed the OIC to regulate rates in the individual market did not become law.

A more robust response from lawmakers is needed to resolve the apparent disconnect between insurers' financial gains and improved public access to quality, affordable insurance. This response should include both public coverage options for all residents of the state and improved regulatory oversight of private health insurers.

Conclusion

Does a robust business environment for Washington's health insurers translate into quality, affordable coverage for Washington residents? The trends discussed in this report suggest that the answer may well be "no." Washington's major carriers are seeing their profits and surpluses increase while providing coverage to fewer people. This situation calls for policymakers to strengthen the public role in making quality, affordable insurance available to all residents of the state – both through expanded oversight of private insurance carriers and expansion of public alternatives to private coverage.

"A more robust response from lawmakers is needed to resolve the apparent disconnect between insurers' financial gains and improved public access to quality, affordable insurance."

Recommendations

Provide a public alternative to private insurance. Public coverage fares well against private insurance in efficiency, affordability, and accountability. The creation of the Health Insurance Partnership presents an opportunity for lawmakers to develop a comprehensive, affordable public alternative to private market policies – and lawmakers should seize on this opportunity.

Expand the Health Insurance Partnership. Creation of the Partnership represents an important step in the right direction. The Partnership should be open to all individuals, businesses, and associations – the greater the membership in the Partnership, the more risk-pooling efficiencies it has the potential to yield.

Ensure the affordability and quality of coverage available through the Partnership. Quality and affordability will be key to the Partnership's success. All insurance available through the Partnership should be required to meet coverage quality standards and be affordable on a sliding scale, according to income.

Expand the role of government as a watchdog over private insurers. This oversight applies to rates, risk sharing, and carrier financial practices overall. Washington should implement reasonable rules and increase the oversight capacity of the Office of the Insurance Commissioner to ensure that carriers charge fair prices, maintain low overhead costs, and do not discriminate in coverage or profit excessively from the system.

References

1 Erica Gardner, Washington State Office of Financial Management, 2006 Washington State Population Survey, Research Brief No. 39 (Revised), November 2006, Table 2.

2 *Ibid*.

3 Thea N. Mounts, "2002 Washington State Population Survey," Research Brief No. 16 (Revised), August 2003, Table 1.

4 Washington State Office of the Insurance Commissioner, "2005 Insurance Commissioner's Annual Report, Appendix F: Top 10 Insurance Companies by Line of Business in Washington, 2006," accessed at: www.insurance.wa.gov, November 21, 2007. [Hereinafter OIC, Annual Report, Appendix F.] Figures are rounded. The Regence Group's subsidiaries include Asuris Northwest Health, Regence Life & Health Insurance Company, Regence BlueShield, and others. Premera Blue Cross Group's subsidiaries include Lifewise Assurance Company, LifeWise Health Plan of Washington, and Premera Blue Cross. Group Health Cooperative's subsidiaries include Group Health Options, Inc., Group Health Cooperative, and KPS Health Plans.

5 OIC Annual Report, Appendix F.

6 See, Elliot K. Wicks, "Coping with Risk Segmentation: Challenges and Policy Options," Economic and Social Research Institute, February 2003.

7 Nancy C. Turnbull, et al, Insuring the Healthy or Insuring the Sick?: The Dilemma of Regulating the Individual Health Insurance Market, Short Case Studies," The Commonwealth Fund, February 2005. [Hereinafter Turnbull, Short Case Studies.]

8 Looking at the market before and after deregulation, Turnbull et al. suggest that Premera's pre-deregulation claim of financial loss may not be supported by its financial filings: Premera "stopped writing new individual insurance in 1999, claiming large financial losses due to the individual market regulations," the authors write, pointing out that the carrier's individual market medical loss ratios (MLRs) are lower than for total business. "While there generally are higher administrative costs associated with the individual business, a 20 percent administrative expense ratio seems more than adequate considering Premera claimed that it was making money on the individual line since the 2000 reform," the authors note. "And yet the post-2000 MLR is several percentage points higher after the reforms." Turnbull, Short Case Studies, p. 16.

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9 *Ibid*.

10 *Ibid*.

11 In 2006, Premera, Regence, and Group Health and their respective subsidiaries accounted for 58 percent of Washington's health insurance market. Washington State Office of the Insurance Commissioner, "2006 Annual Report," Appendix F: Top 10 Authorized Companies or Groups of Companies," p. 2. Unless otherwise indicated, the analysis does not include subsidiaries filing separate annual reports.

12 Surplus includes both capital and surplus. However, capital accounts for a small portion, if any at all, of this figure for Washington's three major carriers.

13 Tim Barclay, Milliman Consultants and Actuaries, "Information Gathering Hearing Related to Insurer Surplus, Office of the Insurance Commissioner," December 8, 2005.

14 Lewin Group, *Policy Options Regarding Surplus Accumulation in the Washington Health Insurance Market*, prepared for the Washington State Office of the Insurance Commissioner, January 25, 2007, pp. 8-9.

15 Average is weighted.

16 Families USA, "Understanding How Health Insurance Premiums Are Regulated," Issue Brief, September 2006, accessed at: www.familiesusa.org, December 10, 2007.

17 In 2006, the Washington State Legislature passed legislation requiring the Insurance Commissioner to make public various data on its Washington business, including medical loss ratio. See, Washington State Legislature, Substitute House Bill 2500, 2006. The legislation requires the medical loss ratio to be "computed by dividing the total amount of hospital and medical payments by the total amount of revenues." Accordingly, in this report, we also use total revenue in our calculation. In their annual reports, Premera and Regence do not show significant sources of revenue other than premiums. Group Health revenue includes risk revenue and fee-for-service revenue. Our calculation is for Washington business only.

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19 Kyung M. Song, "Gulp! Regence Rate Boost Averages 19 Percent for Individual Plans," *Seattle Times*, May 16, 2007.

20 Cherie Black, "Health Insurer LifeWise Raises Rates 22.5 Percent for Individuals," *Seattle Post-Intelligencer*, November 2, 2007.

21 Analysis of carrier filings with the Office of the Insurance Commissioner. Figures are rounded.

22 Analysis of carrier filings with the Office of the Insurance Commissioner. Figures are rounded. Financial information for LifeWise Health Plan is taken from its Annual Statement, p. 7.

23 Washington State Legislature, Second Substitute Senate Bill 5093, Final Bill Report, 2007.

24 Washington State Legislature, Engrossed Second Substitute House Bill 1569, May 3, 2007.

About the organizations releasing this report:

Northwest Federation of Community Organizations (NWFCO) is a regional federation of four statewide, community-based social and econimic justice organizations located in the states of Idaho, Montana, Oregon and Washington: Idaho Community Action Network (ICAN), Montana People's Action (MPA), Oregon Action (OA), and Washington Citizen Action (WCA). Collectively, these organizations engage in community organizing and coalition building in 14 rural and major metropolitan areas, including the Northwest's largest cities (Seattle and Portland) and the largest cities in Montana and Oregon.

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Washinton Community Action Network is a statewide, grassroots organization. With over 35,000 members, we are the largest consumer advocacy group in the state. We work on a range of issues with the broad aim of bringing about greater economic justice in our state and the country. Our board represents a coalition of groups, including labor, senior, faith, and community organizations.

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