

Health Premiums Grow More Slowly Than Expected

Blue Cross and Blue Shield, Under Pressure, Limit Hikes, Boosting Price Competition

Facing political pressure over their surging profits, the nonprofit Blue Cross and Blue Shield companies have been limiting the rise in their health-care premiums this year, contributing to a wider slowdown in the rise of premiums for some consumers and employers.

The Blues have been under pressure to limit growth in premiums after a banner 2003 for the nation's health insurers, in which profits soared as the escalating price of premiums far outpaced more slowly growing medical costs. At the not-for-profit Blues,

which dominate the market in 35 states and cover one in three people with health insurance in the U.S., earnings in 2003 more than doubled, thanks to a rise in premiums of anywhere from 10% to 16%, as well as stock-market gains on invested capital.

Those gains have increased political pressure on the nonprofits at a time when health-care costs are approaching crisis levels for many employers and squeezing the wallets of consumers. Legislators and regulators in

Rhode Island, Pennsylvania, North Carolina and other states have demanded that the Blues in their states roll back premium increases or give rebates to consumers to pare their surplus reserves. Those pots of money, which insurers sock away to pay claims in a catastrophic event or to finance new

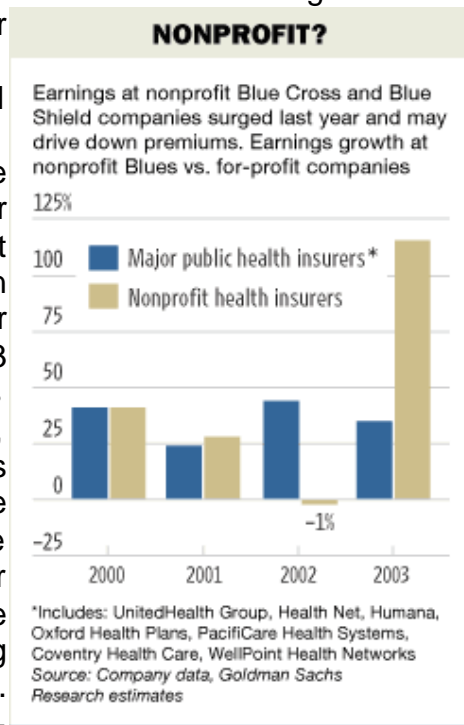
products or investments, have surged in size with the profit jump. Total reserves for the nonprofit Blues increased by about a third last year, to \$31.9 billion.

Eager to deflect public criticism, many of the Blues have offered lower premium increases and,

in some cases, even cut them. (Companies affiliated under the Blues name share some products and branding efforts, but act independently in setting their own premiums and product prices.) In the process, they have injected an extra dose of price competition into the health-care market. Though no single nonprofit Blue comes close to being as big as publicly traded companies like UnitedHealth Group Inc. or Aetna Inc., the Blues together are giants with their wide reach and powerful brand presence in the states in which they operate.

Blue Cross and Blue Shield of North Carolina said it has cut average premium increases for individual policies to 5%, the lowest increase in the eight-year history of the product, and sharply reduced from its roughly 14% premium increase last year. The goal is to trim the 6% profit margin it had in 2003 to 4% this year.

Plans in New Jersey and Tennessee, meanwhile, have refunded more than \$50 million each to employers and individuals, and slowed price increases for this year. Blues in Minnesota, Michigan, Kansas



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and other states also have moderated rate increases.

The costs of health-care coverage remain far from cheap and are still on the rise. Even with the rate of increases slowing, most premiums are climbing at several times the rate of inflation, and each year

are getting tougher for employers and consumers to absorb. Moreover, the efforts of the Blues to cut premiums aren't the only reason for growing price competition in managed care.

Commercial insurers have been eager to find growth in a fairly stagnant market for new members, and have been pitching premium increases that more closely match the estimated rise in medical claims costs -- and in some cases, undercut it.

But because of the Blues' influence on the industry, the question of how low the nonprofits will go in setting premiums is a wild card in calculating premiums and profits for the industry in the coming year.

In some especially competitive markets, employers are seeing a real break in pace after several years of double-digit increases. In Maryland, premiums for small employers climbed an average of 5.5% in 2003, the smallest increase since 1997, thanks to

moderating medical costs and a decision by CareFirst BlueCross BlueShield, the state's largest insurer, to forgo premium increases on some products this year, according to the Maryland Health Care Commission.

More slowdowns could be in store.

Though premium increases are less, the amounts insurers pay out in medical

costs to

hospitals, doctors and other providers also are slowing as more plans require consumers to pay higher deductibles and co-payments. That could leave the nonprofits at the end of 2004 with reserves that are still too high in the eyes of regulators. And if pressure on prices intensifies in the next several months, it will be even harder for for-profit companies to preserve their profit margins.

"The impact on premiums and the industry could be more than many people have anticipated," says Matthew Borsch, an analyst at Goldman Sachs.

Increased competition already is giving employers more clout in negotiating prices. In Buffalo, N.Y., where three nonprofit Blues compete, premiums on average are climbing between

6% and 8%, compared with increases of between 12% and 22% a year ago, according to the Niagara Insurance Group, an employee-benefits consultant in that area.

Hebeler Corp., a Buffalo-based maker of custom-fabricated piping systems, says that when it initially was negotiating rates for this year, its Blue health plan, Univera, asked for a 15% boost. After quick negotiations, the plan agreed to 10%, says Jim Breyer, Hebeler's vice president of finance. "They knew we were shopping around," he says.

So far, most insurers still are pricing premiums to maintain healthy profit margins to guard against underwriting losses. But as competition heats up, "we've seen a few cases of pricing that's not only aggressive, but quite possibly irresponsible," says Steve Lewis, vice president of sales and marketing at FitzMaurice Cos., a New York-based employee-benefits consultancy.

A recent one, he says, involved a midsize Texas-based employer, which over the past two years has experienced higher medical claims and layoffs while losing some of its healthier employees. While those factors pointed toward much higher premiums for the company this year, a nonprofit Blue plan offered a premium cut that was "so far below the rest of the market, we advised them

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they should take it," Mr. Lewis says.

A number of for-profit insurers, including UnitedHealth, Cigna Corp. and Humana Inc., have loudly declared in recent months that they won't sacrifice profitability for the sake of buying business by

cutting premiums. But many are finding it tough to increase health-plan membership amid lackluster job growth and cutbacks in employee health benefits.

Not including Cigna, which has been losing members as it restructures operations, the 10 major public managed-care companies have set the ambitious goal of collectively adding 3.2 million members this year, adding to the roughly 67 million members they claim now. That will be difficult to achieve without lower prices, says Goldman's Mr. Borsch.

It's especially tough for for-profit insurers exposed to heavy nonprofit Blues competition, such as Humana, based in Louisville, Ky. Last month, the company lowered its projections for second-quarter earnings, citing more-heated competition and, in some areas, irrational pricing, both by

publicly traded rivals and nonprofits.

"It's clear there are some companies who are now clearly pricing for market share," said Mike McCallister, Humana's chief executive, in a recent conference call with analysts.

With health-care costs soaring, along with the number of uninsured, some lawmakers and regulators are arguing for caps on the Blues' reserves and seeking greater control over rate increases. A wave of such legislation could have a longer-lasting impact on premium prices.

In Pennsylvania, for instance, a series of class-action lawsuits alleges that the four large Blue Cross and Blue Shield insurers there have violated their nonprofit charters by stockpiling combined cash reserves of more than \$3.5 billion while boosting premiums an average of 10% to 15% a year.

In North Carolina, regulators have floated a bill to limit how much Blue Cross and Blue Shield can build up reserves and when it would have to issue rebates. After a series of public flaps over corporate excesses at Blue Cross and Blue Shield of Rhode Island, state

legislators have introduced a package of bills that would give regulators more control over its profits and pricing.

Blue plans argue that they've reaped robust profits from offering competitive insurance products and that unlike publicly traded commercial insurers, their reserves in good years are all they have to protect their viability in the lean ones, or in a catastrophic event. "These things tend to even out," says Bob Greczyn, chief executive of Blue Cross and Blue Shield of North Carolina. Though the North Carolina Blue's reserves rose 52% to \$743 million in 2003, he says they were just enough to cover 3.7 months of estimated claims and operating expenses. By state law, he adds, the carrier is required to hold reserves of between three and six months. In 2002, after a string of weaker profits, its reserves had actually fallen below the three-month level. "We've just gotten past that," he says.

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