WELLPOINT

1 WellPoint Way, CAT202-B005
Thousand Oaks, CA 91362
Tel (805) 557-6020
Fax (805) 557-6823

Brian A. Sassi
President and Chief Executive Officer
Consumer Business Unit

February 11, 2010

The Honorable Kathleen Sebelius
Secretary
U.S. Department of Health and Human Services
Hubert H. Humphrey Building
200 Independence Avenue, SW
Washington, DC 20201

RE: Request for Information Relating to California Individual Market Rate Increases

Dear Secretary Sebelius:

Thank you for your letter of February 8, 2010 requesting Anthem Blue Cross (Anthem) provide information related to individual market rate increases for members in California and to explain the increases being reported in the media. I am the President of the Consumer Businesses Unit, which includes our individual market business in California.

We care deeply about our California customers and community. And we share the concern raised by you and others and appreciate the opportunity to explain why rates—which reflect anticipated medical costs—are increasing substantially for certain individual members. In addition to being the state's largest individual health insurer, we are the largest Medi-Cal provider, are a HIPAA insurer of last resort (for those individuals exhausting COBRA coverage and who do not qualify to be underwritten in the individual market), and we work diligently to improve the health and wellness of all Californians. In fact, our commitment to the state's public programs serving low-income and high-risk Californians is substantially larger than the state's other insurers, including the two largest not-for-profit health plans.

Anthem's profit margin in California is in-line with and below that of many of our competitors, including our two large not-for-profit competitors. For example, Anthem's net income on a per-member-per-month basis was $12.62 during 2008, which compares to $18.45 and $13.22 for our two large not-for-profit competitors.[1]

While the rate increases are significant for certain individuals, it is important to note that the rate increases being reported in the media relate only to the individual insurance market where individuals purchase coverage on their own (not through their employer), which represents approximately 10 percent of our more than eight million members in California. Furthermore, the figure of 39 percent being reported by media represents one of the largest rate increases and includes the impact of aging.

[1] Source: DMHC Financial Filings. All PMPM's have been adjusted to exclude the impact from other-than-temporary impairments of investment securities.

Specifically, the rate changes excluding the impact of age-category changes range from a 20.4 percent decrease to a 34.9 percent increase. Additionally, the rate notices reflect the rate increases for an individual who does not choose to change his or her product, which is an option we offer to members and which many individuals choose to do.

Clearly, we understand that these increases create a challenge for many of our members. However, it is important to know that our members often have a choice of coverage. We help our members understand their options by making available health plan advisors who work with the member to help ensure they understand their coverage options. Further, our products remain very competitively priced when compared with the dozens of other plans competing in the California individual market, including our two largest not-for-profit competitors. Even after these rate changes, a 40-year old woman in Los Angeles can obtain coverage with a $1,500 deductible for as low as $156 per month.

We would also like to emphasize that we have cooperated and are continuing to cooperate with the California Department of Insurance's review of our rates. As part of the review, an independent actuarial firm concluded that our rates are actuarially sound and necessary, reflecting the expected medical costs associated with the membership in these plans, and that they satisfy or exceed the medical loss ratio required by California law. We welcome the scrutiny, and are confident that our rates reflect anticipated medical costs and are established consistent with actuarial principles and state law.

Rate increases reflect the increasing underlying medical costs in the delivery system which are unsustainable. We hope to continue to work with you and others to help mitigate the factors driving these large rate increases, as described below.

Why Individual Market Rates are Increasing Faster than Medical Inflation

Health insurance rates increase year-over-year to reflect general medical inflation and other factors. Medical costs increase each year primarily due to (1) provider prices increasing faster than general inflation, and (2) increases in consumer utilization. Provider price increases above general inflation are driven largely by increased provider cost-shifting to private health insurers due to Medicare and Medicaid not fully covering provider costs, provider consolidation, and higher-priced technologies. Increases in consumer utilization are driven largely by an aging population, lifestyle that results in chronic disease, new treatments, and more intensive diagnostic testing. [2]

However, as noted by observers, the rate increases in California's individual heath insurance market are significantly higher than general medical inflation. This is the case for the following reasons:

- **Less healthy risk pool in a challenging economy.** One dynamic in this challenging economy is that individuals are far more likely to keep their coverage if they are less healthy and require ongoing medical services, and a higher proportion of individuals who do not need services disenroll or choose not to enroll. The result is an insured pool that utilizes significantly more services per individual than under better economic times. This in turn leads to higher costs in the pool and to rate increases higher than general medical inflation. For example, if an insurance pool

[2]/ Drivers for rising health care costs are detailed in the 2008 PricewaterhouseCoopers report *The Factors Fueling Rising Health Care Costs 2008.*

consists of 100 individuals that incur medical costs of $10,000 per month, the cost per individual is $100 per month. However, if 10 individuals leave the pool who incur little or no costs because of the challenging economic times, the $10,000 now must be spread over 90 individuals. The per-individual cost is now $111 per month, an increase of 11 percent. This means a health insurer must increase rates 11 percent in order to cover the increase in costs per individual and this is before reflecting general medical inflation. While this dynamic always exists, in a challenging economy it becomes more prevalent as individuals who are paying for coverage without a government or employer subsidy must choose to continue coverage or use the money for other necessities. As described in more detail below, an effective personal coverage requirement can mitigate this dynamic and help stabilize the market.

- **Individuals moving to lower-cost options in a challenging economy.** Another dynamic in our current challenging economy is that a higher proportion of individuals move to lower-cost coverage, such as coverage with a higher deductible, than under good economic times. Our experience also shows that new, healthy enrollees are more likely to enroll in similar high-deductible plans. For example, in 2009, affordability concerns led a high proportion of Anthem individual members to switch from higher-cost products to lower cost-products, resulting in an average 2009 premium increase after product migration of 2 percent, considerably lower than the average rate increase of 13.8 percent initially reported in 2009. Meanwhile in 2009, the average claims per member increased by 8 percent, dramatically more than our premium increase of 2 percent. The fact that the weak economy caused more people to move to lower-cost options in 2009 contributed to the fact that Anthem's individual business in California operated at a loss during 2009.

- **Individuals aging into a higher age category.** The reported rate increases include demographic changes, such as individuals aging into higher age segments. Since rates increase by age, a renewing customer will often face higher rates. These age rate increases occur before reflecting general medical inflation and reflect higher utilization associated with aging.

- **"Deductible leveraging."** Benefit costs for members are typically divided between the premium paid by a member and the member cost sharing (e.g., deductibles and co-payments). If a member does not change plans, deductibles and co-payments typically remain unchanged at renewal. When the deductible and co-payments do not increase with medical inflation, there is a "leveraging" effect where the medical cost increases disproportionately fall on the premium component of benefit costs (as opposed to the member cost-sharing share of benefit costs, which is fixed). This results in premiums for fixed deductible products increasing faster than general medical inflation.

These rating dynamics are part of necessary, actuarially-sound rating practices and each of these factors contributed to the individual market rate increases in California in addition to general medical inflation. Other individual market health insurers are facing the same dynamics and are being forced to take similar actions.

Policy Changes to Mitigate Volatile Individual Market Rate Increases

Several factors contribute to the volatility in the individual health insurance market, including the fact that the individual market is the "market of last resort" for individuals who do not have access to the employer market or government-subsidized public programs, and participation in the individual market is voluntary (i.e., individuals can forgo coverage). The market exhibits a high "churn" rate, with the average individual or family participating in the market for only about three years. This means that while overall enrollment may remain relatively constant, with 1/3 of the risk pool leaving each year, the overall risk of the members can increase quickly. This can lead to wide swings in rates—even if the dynamics seem to shift only slightly.

California's individual health insurance market is particularly challenging. As opposed to most states that use high risk pools and broad-based funding sources to subsidize HIPAA guaranteed issue products (for those individuals exhausting COBRA coverage and who do not qualify to be underwritten in the individual market), California requires the individual market to absorb the very high costs associated with these individuals without additional funding support. In 2009, Anthem alone experienced an approximate $58 million loss on these HIPAA members in California. Additionally, as a result of being the only PPO and the only statewide option in the state's high risk pool (MRMIP), in 2009 Anthem experienced an additional loss of more than $10 million in the MRMIP "graduate" program.[3]

In November 2008, our industry came forward with an interdependent framework of policy proposals that would help control costs and improve health insurance markets for consumers. Included in this framework was an effective, enforceable, personal coverage requirement that would expand and stabilize the individual health insurance market, even when combined with requirements on insurers to accept all applicants with no pre-existing condition exclusions and limit rate variation between higher risk and lower risk individuals. In the proposal, we emphasized that the entire framework rested on the personal coverage requirement being very successful and ensuring that virtually everyone maintains continuous coverage. As shown in some of the examples above, even if a small fraction of healthy individuals choose to forgo coverage, it can lead to substantial rate increases and an environment where individuals purchase coverage only when services are needed. Ultimately, an effective personal coverage requirement must (1) be deployed with sufficient subsidies to ensure no one is exempted, (2) include sufficient "checkpoints" to make sure everyone is brought into coverage, and (3) exhibit sufficient penalties to ensure healthy individuals enroll in coverage and do not choose to pay the penalty.

Unfortunately, the proposed personal coverage requirements in the health care reform legislation passed by both houses of Congress failed all three requirements by (1) exempting tens of millions of Americans from the requirement, (2) using the tax filing process as the only checkpoint which misses tens of millions of Americans who do not file taxes, and (3) including penalties that are a small fraction of the cost of coverage. Under this framework, it is only logical that many individuals—primarily those who are healthy—would have not been captured by the mandate or would have made the logical choice to pay the penalty unless services were needed. The result will be a national health insurance market that is similar to New York, where the average individual market premium is over

[3] For a period of time until 2008, members in California's high risk pool (MRMIP) were limited to being MRMIP members for three years. After three years, individual market carriers were required to accept these members on a guaranteed issue basis and split the losses with the state.

twice the average individual premium in California.[4] And this is a finding borne out by analyses completed by our senior actuaries. In fact, these analyses showed that the legislation considered by Congress would increase California individual market premiums for the young and healthy by as much as 106 percent (before premium subsidies for certain eligible individuals).[5] The personal coverage requirement must be substantially improved for reform to be successful.

Additionally, we firmly believe that the primary focus of responsible health care reform must be improving quality and controlling the underlying medical costs, which is what is driving the high cost of coverage. For 2010, we expect hospital inpatient and outpatient costs in California to grow by over 10 percent, driven primarily by hospital reimbursement rates. Additionally, we expect pharmacy costs in California to grow by over 13 percent. These cost increases that continuously drive premium increases are unsustainable and must be addressed.

And while we believe that the government must take action in this area to facilitate higher levels of quality and efficiency, we take our commitment to advancing quality very seriously and are continuing to implement a variety of initiatives to help achieve these goals. For example, Anthem recently sponsored a patient safety collaborative in California, committing $6 million to a partnership with the state's three regional hospital associations to share data, resources, and proven, successful safety practices to reduce the incidence of pre-term births, and to reduce the incidence of sepsis and other hospital acquired infections (ventilator associated pneumonia, central line blood stream infections and catheter associated urinary tract infections). We are aggressively taking these actions because focusing on the quality and cost of care is the only path to creating a sustainable health care system.

We are committed to driving quality in the health care system and improving the lives of not only the Californians we serve, but also the health of communities all across California. As the state's largest health benefits company with more than 8 million members, and the state's largest partner serving more than 1 million low-income Californians under the Medicaid and CHIP programs and more high-risk individuals than any other plan, we are committed and well positioned to help transform health care in the state.

Thank you for this opportunity to explain the factors behind our rate increases in California's individual health insurance market. These rate increases are unfortunate but necessary to reflect the costs of paying for the medical services for our members in the current challenging environment.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Brian A. Sassi

Cc: Members of the California Congressional Delegation

[4] AHIP Individual Market Survey. October 2009.
http://www.ahipresearch.org/pdfs/2009IndividualMarketSurveyFinalReport.pdf
[5] WellPoint premium impact analysis: http://www.wellpoint.com/newsroom/stats_facts.asp