

# Lehman Brothers Healthcare Benefit Brokers Conference Call: 'The Word on the Street'

Transcript from April 2002 Lehman-Sponsored Conference Call

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We compare and contrast recent trends in health insurance product selection and price trends in the Silicon Valley and greater Hartford regions, with our featured speakers, top producing brokers from IBP Insurance Services and the Benefits Group.

We note the following trends and observations:

- The slow economy combined with skyrocketing health insurance premiums are having a devastating effect on small and mid-sized employers in both Silicon Valley and New England.
- The 25% rate hike that CalPERS just announced is apparently not an anomaly in the Northern California market, and may serve as barometer for local rates.
- Both brokers noted that consolidation has dramatically reduced the number of viable competitors in each of their respective markets.
- There is still much work to be done in terms of getting the health plan's technology infrastructure up to speed.

## Companies Mentioned

Aetna, Anthem, CIGNA, Cobalt,  
Coventry, First Health, Health Net,  
Humana, Oxford Health Plans,  
PacifiCare, Trigon Healthcare,  
UnitedHealth Group and  
WellPoint

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## Observations

We are providing some observations from our Lehman Brothers Health Benefits Brokers Conference Call. On Friday April 19, we hosted a conference call for clients in which we held discussions with two health insurance brokers, one from the silicon valley area specializing in the small and mid-sized group markets and one from the greater Hartford region also focusing on the small and mid-sized group markets. ***Our key takeaway from the call is – double-digit rate increases continue unabated and there appears to be no slowdown in pricing for 2003.*** As a reminder, UnitedHealth Group led off the first quarter reporting season on Thursday April 18, with WellPoint releasing their results this Wednesday evening and Aetna reporting on Thursday morning.

Below are some brief observations and insights from the call yesterday with some interesting anecdotes as well:

- **The slow economy combined with skyrocketing health insurance premiums are having a devastating effect on small and mid-sized employers in both Silicon Valley and New England.** Mr. Kuhn noted that technology companies have typically offered rich benefits to attract employees and are now being forced to make difficult decisions with respect to their health plans. In addition, with the number of provider and health plan options having shrunk through consolidation, employers have fewer options to choose from. The situation is similar, but not quite as extreme in Connecticut. Mr. Feen noted that the slowdown on manufacturing, the traditional mainstay of the state's economy, has been buffered to some extent by the emergence of the medical technology industry as a major employer in the state. Nonetheless, small to mid-size employers are facing many of the same issues with respect to price increases and a lack of alternatives.
- **HMO's dominates the Connecticut market while Silicon Valley employers have greater flexibility in their benefit options.** HMO and POS plans control approximately 95% of the small and mid-sized market as the only viable PPO option is offered by Anthem and is "very pricey." Mr. Feen noted that plan designs have not changed much over the years and that the only concessions that the state's Department of Insurance has made to rising healthcare costs are allowing higher co-pays and deductibles. Interestingly, Medical Savings Accounts are not permitted in Connecticut. In California, plan designs are more a function of the demographics of the members. Typically, technology companies are populated by young and educated employees who prioritize choice and flexibility. These companies tend to favor the PPO products. Companies whose employees are at the lower end of the wage spectrum tend to migrate toward the less costly HMO products.
- **The 25% rate hike that CalPERS just announced is apparently not an anomaly in the Northern California market.** Mr. Kuhn noted that he is seeing rate increases in the range of 15-30% and that Kaiser, who has historically been a price leader, is looking for 20-25% increases. The "cost accelerators" driving these hikes are the

aging population, demand for prescription drugs, technology build-outs and wage/real estate pressures. Additionally, Mr. Kuhn noted that contrary to what many have suggested, CalPERS is viewed as a bellwether in the Northern California market and the rates are often referenced in negotiations between employers and health plans throughout the year. Mr. Feen said he has not seen rate increases that high in Connecticut (he is seeing high teens) but was concerned by what he heard Mr. Kuhn mention because typically pricing trends have "moved west to east" historically. He also noted that the pricing increases were larger among the national carriers, such as CIGNA, Aetna and United than they were among the regional plans operated by Anthem Blue Cross Blue Shield of Connecticut, Oxford and ConnectiCare. In fact, Mr. Feen noted that the national carriers were essentially pricing themselves out of the middle market.

- **When asked what draws them to do business with a specific employer, Mr. Feen noted that brand and reliability are large factors.** He noted that the regional players like Anthem, ConnectiCare and Oxford are viewed as "steady eddies" in that their rate increases have been consistent and the service has been reliable. As such, their retention rates, particularly at Anthem have been very high. In California, Mr. Kuhn noted that the network is a large selling point along with pricing and service. Additionally, he noted that WellPoint is "hitting the ball out of the park" in the California market and is consistently taking share from Blue Shield of California, Aetna and many small plans that are being run out of business.
- **In terms of competitive dynamics, both brokers noted that consolidation has dramatically reduced the number of viable competitors in each of their respective markets.** As such, they feel as though there aren't enough competitors in the marketplace and fear that further consolidation will worsen the situation.
- **We asked the brokers if they had seen any interest in defined contribution health plans and they both echoed the sentiment that while there has been much discussion around these options, no one is buying them.** Mr. Feen noted that Aetna has made some noise in the Connecticut market with their defined contribution plan and that it could jump start the company's slowing sales.
- **Since large, public blues plans operate in each of their markets, we wanted to know if the shift from having a non-profit blues plan to a for-profit blues plan changed the way they operated and each noted that the change was for the better.** Mr. Feen noted that BCBS Connecticut has "done everything right" since aligning with Anthem and Mr. Kuhn remarked that since Leonard Schaeffer became the CEO of WellPoint, the company has been more customer focused and has "executed fabulously." Additionally, both noted that in the small and mid-sized market, the BlueCard program has developed into a very real differentiator, particularly in Connecticut where Anthem is the only regional player that offers an option for employers with out-of-state employees.

- **There is still much work to be done in terms of getting the health plan's technology infrastructure up to speed.** In Connecticut, Anthem has a lead position in terms of connecting the plan, the member and the provider and that is developing into a point of differentiation. Mr. Feen noted that Aetna also has a very good system but that no other players' systems have met expectations. In Silicon Valley, where expectations for technological capabilities are very high, none of the carriers have met the challenge.
- **Finally, a question was asked specifically about CIGNA's transformation project and whether or not either of the brokers could confirm rumors of the difficulties that customers are having transitioning to the new system.** Interestingly, both mentioned that they could neither confirm nor deny the rumors because CIGNA is not a large player in the middle market in either of their geographies. Mr. Kuhn noted that while CIGNA has often talked about building its share in the middle market, their pricing strategies have not been conducive to meeting that goal. Mr. Feen added that CIGNA's rates are typically 15-20% higher than other proposals for that business.

While we acknowledge that extrapolating trends based on localized, anecdotal evidence can be a risky strategy, the fact that our guests confirmed a majority of the same trends emerging in different regions of the country leads us to even greater confidence in our belief that pricing trends will be strong going throughout 2002 and may continue into 2003. As a result, we continue to suggest that strong earnings reports will continue throughout the quarter.

## Transcript

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**Josh Raskin, Lehman Brothers:** I would like to start off by thanking everybody for calling in as well as our participants. I appreciate everyone taking the time especially as we move through earning season.

We've gotten a lot of good feedback in the past on our broker call series. We do this on a quarterly basis really in an effort to touch base with local brokers in different geographies.

We're fortunate enough to have two independent brokers with us today. I'm going to turn it over to my associate, Gregory Nersessian to introduce our guest speakers.

**Greg Nersessian:** Thank you, Josh. Good morning. Our first guest is Peter Kuhn, founder and principal of IBP Insurance Services. Peter is based out the northern California region where he specializes in the group market with clients ranging in size from 50 to 5,000 employees. After we hear from Peter, we will shift the focus to the Hartford area where we are pleased to be joined by Bob Feen, President of the Benefits Group. In addition to serving his clients in group markets, Bob serves on the market advisory boards of Aetna and Anthem, BlueCross/BlueShield among others.

**Raskin:** Thanks Greg. Basically, the purpose of today's call is to gauge what certain brokers are seeing in their respective markets and how their clients, the employer groups, are reacting to those trends. We are going to touch on a couple of topical areas; obviously including pricing and product selection. We'll also talk a little bit about how the economy is impacting things.

In terms of format, I'm going to turn it over to Peter first for a brief introduction of what his role is at IBP and what he's seeing in the local market. And then I'm going to turn it over to Bob for his take. Next we'll ask some questions and then turn it over to the audience as well. So, without further ado, Peter, the floor is yours.

**Peter Kuhn, IBP Insurance Services, Founder:** Thanks, Josh.

I'm one of the founders at IBP. We started the firm back in 1987. I started the firm because I really saw a need to serve the needs of employers in the small and mid-size market place; again, 50 to a couple of thousand employees. We typically work with them on their medical, their dental, their life, their disability, 401K and Section 125 Plan.

The area of that practice that absolutely requires the most attention is the medical field. This is an area that is constantly presenting employers' challenges. They're challenged by, number one, pricing; number two, plan design; number three, product availability. And all of those issues have really continued to magnify themselves in the past three to five years and we really see no relief coming.

I'm out here in San Jose, California-Silicon Valley. And one of the things that we've seen is, we've see a real slowdown, as many of you are aware, in the tech economy which drives the preponderance of the business out here.

Those employers typically have had to have very rich benefit programs in order to attract employees. They are now being forced to scale back those employees; ask employees to make additional payroll contributions to the plans. And then the employers are frustrated by the lack of flexible plan design and of the shrinking number of carriers as well as the shrinking number of providers in the market.

And those are challenges that we have to address on a day-to-day basis. I can certainly go into some more detail or did you just want an introduction at this point in time, Josh?

**Raskin:** That's helpful Peter. Why don't we turn it over to Bob for a brief introduction as well and then we'll drill down on a lot of those topics that you mentioned.

**Bob Feen, Benefits Group, President:** My introductory comments would not be much different than Peter's and I think that the participants in this call are going to find that you

are going to hear a lot of the same words just from a West Coast point of view and an East Coast point of view.

We're facing a lot of the same problems here. Our slowdown has been in the manufacturing sector. Several of my manufacturing clients post September 11 simply don't have many, in some cases, any, new orders. And that, coupled with the fact that we've been handing them rate increases in the double digits, mostly in the teens, but in the double digits, has been troubling to them.

Our economy here in Connecticut which used to be driven by the defense firms, specifically United Technologies and Electric Boat, at least in my area. My firm is situated between Hartford and New Haven and we're in an alley on Interstate 91 where a lot of medical/technical research is going on; gene mapping and such. And that's kind of helped our economy out here so that we don't have the problems that you're having there, Peter, within the Silicon Valley.

But we are facing the fact that our manufacturers have seen a great slowdown but because we have this relatively new bunch of businesses over the last 10 years in the alley between New Haven and Hartford, that our economy has not been all that bad.

We serve the same size clients as Peter's firm does. I am the President of the Benefits Group. We have approximately 400 clients and most of those clients - about three quarters of them - are sized 50 employees to about 2,000 employees. In Connecticut we have a lot, a lot of small business.

**Raskin:** As a follow-up to your background, on your bio it mentions that you're on the advisory board for Aetna and Anthem. I assume those are broker committees and it is a sounding board for the companies in the market?

**Feen:** Yes, it's a sounding board for the companies. We meet regularly, they ask us a lot of questions. Different carriers listen to us to varying degrees. Anthem listens to us very carefully.

**Raskin:** I'm going to start asking just a couple questions. Bob, maybe we can start with you. If you could talk a little bit about the products that you're selling most in your region and then compare and contrast that to what we've seen historically, be it five years ago or 10 years ago, even.

**Feen:** There was an article in the New York Times a couple of months ago which even surprised me because, according to the Times, they said that this Interstate 91 alley between New Haven and Hartford had the heaviest percentage of HMO coverage anywhere in the nation. So we are really dominated here in Connecticut with HMOs and Point of Service Plans which are, as we all know, HMO plans with an out of network option.

Very few carriers have PPOs. That is terribly hard to find here in Connecticut. Anthem has one that is quite pricey. United Health Care, who really hasn't been a player here in Connecticut for the past several years, has one as well.

Indemnity plans don't exist. And we are HMO'd and POS'd here probably to 95-96%.

**Raskin:** And it sounds like that's probably what has been the major trend over the past few years as well?

**Feen:** Yeah, when it happened, it happened very quickly. We went from an Indemnity PPO/HMO environment from about 1988 to 1992. It happened very quickly. Plan designs have not changed since then. The only plan design changes that we've been seeing amongst the HMOs is that our department of insurance has finally allowed them to come up with plans that have higher co-pays and some deductibles.

That is the only trend we're seeing here right now in Connecticut. A lot of talk about consumer-driven health plans but nothing coming of that and we are one of the only states in the union, if not the only state, where medical savings accounts aren't allowed on either an individual or a group basis.

**Raskin:** Interesting.

**Feen:** That could change with this legislative session.

**Raskin:** And Peter, can you contrast that to what you're seeing on the other coast in terms of product selections currently and how that compares to what you've seen in the past.

**Kuhn:** I would say that our product selection really is determined or driven by the demographics of the group. Let's get a typical group. Maybe a group of bio-tech engineers or a group of software programmers where the average wage may approximate \$105-\$110,000.

And those groups we typically see very low HMO participation. Those folks are very particular about where they obtain their care; typically very educated with advanced degrees and have strong opinions about how, who and what should be providing them with coverage.

So if the average age of the group is younger and their average wage is higher, they'll primarily be a PPO group, maybe 10-20% in the HMO.

In contrast, if we have, say, a manufacturing organization or a food service organization, something that has employees at the lower end of the wage spectrum,

we'll see 80-90% of the group migrate into the HMO. So it really does make a difference on the demographics of the group.

Product shift: We've probably seen a little more interest in the HMOs just because of the affordability, although there has been some backlash in select pockets because we've had some provider disruption, particularly some of the Sutter medical groups and Sutter hospitals that have caused people to leave HMO but, again, we're talking about a single digit shift in enrollments.

**Raskin:** Next, I want to shift to the topic that's on everybody's mind ... pricing. If we could start with Bob up in the Northeast. What are you seeing in terms of rate increases currently? What are your expectations for 2003 and then just for a frame of reference, if you could tell us what you saw last year as well that would be extremely helpful.

**Feen:** Most of the rate increases that we have seen so far this year have been in the double digits but under 20%.

The rate increases that we are seeing in what I'll call, "the middle market," which I'm going to say is employers with under 1,000 employees, we've been saying 15 to 18% rate increases and we've made some plan design changes. We've had some negotiations and maybe we can get those increases down a point or two. That's part of what our role is as brokers.

We have seen, and I can't say that this is a carriers' trend, but for our own clients, those clients who have been covered by, say, Cigna and Aetna and to a lesser degree, United Health Care, the national carriers if you will, have had higher rate increases than what I'm going to characterize as the local carriers. The local carriers being Anthem, a very local carrier, ConnectiCare; local carrier, Oxford Health Plans. Those have been the carriers, along with Health Net who seem to be in that 15 to 18% range.

Talking to Peter this morning and talking about California rate increases, along with what I've been reading in the Wall Street Journal, et cetera, the last several days and in the trades, I am very scared that the kind of rate increases that Peter's talking about occurring out West are going to bring themselves over to the East Coast. That is always the direction medical trends seem to go.

**Raskin:** I agree. Before we jump over to Peter, Bob, if you're seeing a 15 to 18% range this year, what's your expectation for 2003?

**Feen:** Locally my expectation is that it's going to be the same next year and none of the carriers are leading me to believe anything different than that. Quite frankly the news over the last week or so and this CalPERS situation in California is scaring the heck out of me.

**Raskin:** So you think there is actually potential for further rate increases at even higher magnitudes?

**Feen:** Yeah, I do and, I'm just an insurance broker. Before this conference call we talked about the fact that, with the pharmaceutical companies' stock values going down, one wonders what that means because, at least here in the East, it's really been the cost of pharmaceuticals that's been driving these rate increases.

**Raskin:** Fair enough. Peter, let turn to the much anticipated West Coast pricing discussion. Maybe you could talk a little bit about what you're seeing in the market and any comments you have around the recent CalPERS negotiations. Should we read into that as a real indication of market trends or is that a separate situation?

**Kuhn:** Let's talk about what we're seeing in our block of business. Again; for block of business, customers 50 to 1,000 employees type of situation. We're seeing rate increases on the low end at about 15% and out on the high end pushing 30%. We're typically seeing from Kaiser, 20 to 25% and they've been considered a cost leader.

I attended a recent Kaiser conference. Basically, the words they used were "cost accelerators." The cost accelerators that they see out there are absolutely frightening to them. Cost accelerators would be such things as the baby boomers; that group of folks 40 to 55, that bulge of a population that's going through and has high demands and high expectations as, basically, they're body parts and systems wear out.

Prescription drugs and the demand for them. Other technological demands, investments, earthquake retrofits that they need to make as well as wages, real estate pressures, facility pressures, et cetera, that they have to face.

So we're seeing rate increases a little higher than you've seen on the East Coast. And I think the other thing is the CalPERS situation certainly has gotten a lot of press. It is something that needs to be paid attention to. That risk pool's a little different because it's primarily public sector. There is a little adverse selection that takes place in that risk pool but with 1.2 million members, you have to pay some level of credibility because it does have some actuarial validity.

One of the things that they're looking at doing is kicking out Health Net and PacifiCare. I think that that's Health Net and PacifiCare's respectively largest customer. That could have material impacts on their financial results, et cetera.

**Raskin:** Do other large groups out there look at CalPERS as a reasonable negotiation and is that a starting point for some of the following negotiations?

**Kuhn:** Absolutely, CalPERS will be referenced for the rest of season; from now to December 31st everybody will reference what happened with the CalPERS renewal.

There's another big purchasing group out here, Pacific Business Group on Health, PBGH, probably one of the five or 10 biggest coalitions in the country. Again, they've had a lot of challenges recently because of adverse selection. What we've seen happen is the people with the good risk that could go get pricing on a better basis elsewhere have left PBGH so they've really had some challenges and frustration.

Some of you may recall Pat Powers was there and she was kind of the PR maven of that organization but we think they're past their hey day.

**Raskin:** I'm sure we'll touch on this later in the Q&A but let's shift gears a little bit. A question that I like to ask every quarter is, what draws individual brokers to specific insurers? Is it price or is it product selection, brand name, service levels? Maybe if we could start with Bob and then move to Peter.

**Feen:** I'd like to add a word to that, Josh, all those words are correct but I think that we've added one to that, safety. And a lot of what our clients are looking for if they can put them into the right value pricing equation is that our clients would prefer to be with the brand name. They would prefer to be regional not national except for those clients who have a national presence, of course. And we're finding that Anthem - Anthem Blue Cross here in Connecticut - has been the "Steady Eddie" which has been able to really hold onto small and medium size business and renew it and renew it and renew it. It doesn't hurt that Anthem's average rate increase where their small and middle-sized books of business have been about 12% last year and this year.

**Raskin:** OK. Meaning it doesn't hurt, i.e. their competitors are even higher?

**Feen:** Their competitors are even higher or their competitors might have had a lower price but their rate increases have been more herky jerky if you will. We're finding that Oxford Health Plan's, a very popular health plan here in the Northeast and in New York, less in Connecticut, has become kind of a safe harbor, safe haven plan as well as a local plan called ConnectiCare. Those have been kind of considered "Steady Eddie" plans.

What's odd to us is that the rock solid plans of five and 10 years ago - that being the Aetna, the CIGNA, the United HealthCare - they're kind of having the more troublesome rate increases. They're the ones who have more California style rate increases. Maybe that is because of their national presence. And it seems to us that they are trying their best to exit the small market most certainly, but also the medium size market, which we find very troubling here.

There's a lot less choice here in Connecticut that I'm hearing that Peter is able to offer his clients in Northern California.

**Raskin:** And, Peter, in terms of what attracts you to a specific insurer?

**Kuhn:** What really attracts us to a carrier is their network, their pricing and then the level of service that we get from them as an organization and our customers get.

If we sell a case with a carrier that's got challenges or difficulties, we end up losing money on it and we're just really not in that business to be honest with you.

The guys that have really, absolutely hit the ball out of the park, and continue to do so, is Blue Cross/Well Point. Absolutely gaining market share like its going out of style. They are eating all their competitors lunches, particularly in the under 250 marketplace where they, in essence, own that market.

**Raskin:** And the reason for that is just service and product?

**Kuhn:** They've got a good pool of business. They've been able to write the right cases. They've been able to write them profitably and now they have the thing under control. Their rate increases are averaging about 16% on that block of business, which, again is far more favorable than what their competitors are. Plan designs are stable, their management team is stable. And more importantly, they have the right doctors in their networks. They have all the must-have, go-to docs, go-to hospitals. They've locked them all up on long-term contracts, they've settled their Sutter situation. They re-negotiated their Sutter for 2003. So those are all favorable things.

But, absolutely, Blue Cross is taking market share away from Blue Shield. They're taking market share away from Aetna. Their taking market share away from the local HMOs; or the HMOs that have really gone broke-the Maxicares, the Interplans, those type of plans, they're running all out of business. They're absolutely hitting the ball out of the park.

**Raskin:** Bob, I think you had mentioned, when speaking with Greg in a prior conversation – that some plans are doing some things differently to incent the local brokers for better or worse.

**Feen:** Doing things differently in what fashion?

**Raskin:** Changing compensation rates or anything like that; introducing new products for the smaller groups.

**Feen:** We wish that new products would be introduced. There seems to be as vacuum here in our market and with less carriers doing business we have less choices both carrier-wise and product-wise.

This is different from the California market. All of our HMOs have the entire medical community as their providers; all the hospitals, all the physicians. So carrier picks aren't

usually made based on network: a Health Net, an Oxford, an Anthem Blue Cross or a ConnectiCare would, by definition, have all providers in the Connecticut marketplace.

One thing that Aetna did which really is not going to make a great deal of difference in the small market is they increased broker compensation which was a good thing because they had decreased it a few years ago, much to we brokers' objection.

But when they decreased it years ago they weren't really a factor in the small and medium sized marketplaces. Now that they have increased compensation they still continue not to be a factor. They are not priced well to the competition in the small market most certainly but in the medium market as well. So that's the only thing that we have seen.

One thing that Anthem Blue Cross has done here to our broker compensation, and I don't want to make my comments all about our compensation, but it's really about the first misstep I have seen Anthem make in the last four or five years here in Connecticut, is that they cut down our bonus compensation; compensation that we get from meeting certain marks with them and retaining a greater portion of our books of business.

And I'm wondering if somewhere in the future that's going to have some kind of impact on their operation. I say that, telling you that Anthem Blue Cross is the carrier who, here in Connecticut has, so far, for the last several years, been running on all cylinders. And like Peter was describing WellPoint, they've been just eating up market share in the small and medium marketplaces. In the small marketplace, I believe the last two years they've increased their book of business by 100%.

**Raskin:** That's helpful. Peter, how has the competitive landscape changed over the last 10 years or so? It sounds like WellPoint's doing real well but were they not the leader back then? Have there been any changes, any consolidations, et cetera?

**Kuhn:** There's been huge consolidation in the carrier base or the number of plans that are offered out here. And that presents us frustrations, it presents employers' frustrations.

The perception among the employers there's really no difference between Health Plan A, B, or C. Ten years ago I may have had 30 or 40 offerings that I could have gone to market and obtained proposals for. Now I'm really down to about six. So, through the results of attrition, the people that are left are obviously going to continue to get market share and then those that execute will even get more.

But we've seen a lot of the traditional companies: the Guardians, the New York Lifes, the Prudentials; particularly Prudential and New York Life, they were bought by Aetna. Guardian has really exited the group market for all intents and purposes except for select situations. Principle's the same way.

United Health Care won't write business in California under about 2,000 lives. CIGNA really is not a player for anything less than 500 lives out here. So we've seen a lot of our viable markets disappear and get acquired and we could go down the list and see.

**Raskin:** And back in Connecticut, Bob?

**Feen:** We're seeing the same trends. It's very troubling to us that we don't have a lot of plan choices but we also don't have a lot of carrier choices for those reasons which Peter just described. We are wondering if there are, indeed, going to be even less plan choices as some carriers could be bought over the next couple of years.

We wonder if Oxford is not a candidate at some point in the future to be bought. We wonder if ConnectiCare is not a buying target as well. And we're wondering here in Connecticut where we have California's Health Net. If you recall, Health Net bought PHS which has, subsequently bought MD Health Plan two regional/local carriers. We're wondering if there comes a point when Health Net throws in the towel and says that they don't want to really be in the Northeast.

**Raskin:** Shifting topics a little bit. One thing we hear a lot about are defined contribution health plans and I was wondering, maybe we'll start with Peter, are you seeing any real movement towards those plans or is it all just talk at this point?

**Kuhn:** Everybody loves to talk about defined contribution health plans. The problem is defined contribution health plans present a number of challenges and issues that nobody's really been able to address. I think, probably the most well publicized defined contribution health plan is Definity out of Minneapolis.

The challenge, from an underwriting perspective, that we face with a defined contribution plan, is it sounds real good. You put a \$2,000 deductible in. Maybe the employer funds some of it. And then the employer's got exposure for \$1,000 more. Anybody who's got any ongoing conditions: asthma, diabetes, other chronic health conditions, is not going to sign up for the plan because they know they're going to be out of \$1,000.

So what you have is you end up creaming off the good-at-risk. Then the traditional health plans are left with those people that continue to have the high ailments, diseases, that type of stuff and really get into a death spiral.

If someone could come out with a comprehensive plan that would encompass a traditional PPO, an HMO, and maybe a defined contribution, that may have some chance of success. But these niche players that just want to carve off the defined contribution strategy are really not going to work and we really haven't seen anybody bring any viable product to any share of the market under 2,000 employees. Although

we continue to pressure our carriers for it. They say they're working on it but I think they're scared of it.

**Raskin:** That is doubtful. Bob, your sense?

**Feen:** I think that Peter's answer was absolutely complete and right on the mark. The only thing that I'd add to that is that Aetna, which is housed here in Hartford, has made a lot of noise nationally that they want to bring these plans to the Fortune 1000. We've been on record with Aetna saying that we think that this would be a terrific way that if they could right-price what they've been doing into the small and medium-size marketplace that it would be a great way for them to jump-start their sales which have been either somewhere between slow and non-existent here in Connecticut.

**Kuhn:** Same in California. Aetna's really been on hold, for all intents and purposes, hasn't renewed any business in the last six months. They're just trying to tend to their store, I think, through the whole Ron Williams house cleaning, et cetera.

**Feen:** Yes, it was characterized to me by a former Aetnoid yesterday as that they're burning down the forest so that they can plant seedlings.

**Raskin:** That's the story they're telling. I want to talk a little bit about Blues conversion because you are both in states where we've seen some conversions over the last 10 years. Bob, with Anthem's conversion last Fall to a for-profit, publicly traded company, have you noticed any difference in their behavior and has that impacted the entire landscape competitively.

**Feen:** Did you see their stock price this morning? My Lord. They went up a lot yesterday. The Anthem Larry Glasscock/Marjorie Dorr team, Marjorie Dorr is the president of Anthem East, and has done a great job of re-energizing Blue Cross/Blue Shield here in Connecticut. They've been doing everything right.

I am worried, though, that as they grow they might not be keeping their eye on their core marketplaces. For example, Anthem East has been very successful because they've been so successful in Connecticut. Now that they've bought the Maine and New Hampshire Blue Cross systems, one has to wonder if some of their best people won't have their attentions on those states and we might lose some of the attention of the folks who got us here.

**Raskin:** Have you seen any signs of that or is that just speculation at this point?

**Feen:** I haven't yet seen signs of that but I have given them my opinion that that is something that they really have to be aware of and watch out for. They also have to make sure that they're picking their next generation of operation management very carefully.

**Raskin:** Peter, I know it's been a little while since Well Point converted, but was there a change when they came to the market and do you think that they operate any differently as a publicly traded company than some of their competitors, maybe Blue Shield or Kaiser?

**Kuhn:** I don't necessarily know if we saw any change exactly when the conversion took place. I can't remember, did Leonard Schaeffer join them before or after - I believe it was before the conversion?

**Raskin:** It was before the conversion.

**Kuhn:** I would put it more under the Schaeffer regime. Since Schaeffer really came on board and shook the place up, they have become more customer focused.

Really, Blue Cross is broken up into a couple of silos. There's large group operations and small group operations. The small group operation still has challenges but the small group anywhere is tough to do. Their large group team really has executed fabulously over the past seven or eight years. Maybe that was concurrent with the for-profit conversion. But they have really done a very good job and I think it has some positive impacts on them because it has allowed them to go out and buy those other health plans across the country - buy Unicare and has made them a stronger organization overall.

**Raskin:** That's been very helpful. At this point, why don't we turn it over to the audience and see if there are any questions from the callers.

### **Question and Answer**

**Question:** Josh, thank you very much for doing the call today.

A lot of discussion among some of the larger national plans and even some of the more regionals on enhancing their IT capabilities and I say that broadly whether their capabilities are focused on the physician, focused on the employers and customers, and definitely also focused on the brokers. How do you see the plans in your areas differentiating themselves and is it something that comes into play in the sales or, I guess, retention process in your minds? Thank you.

**Feen:** I'll be happy to comment on that. This is Bob Feen. Here's what we're seeing in Connecticut.

Back to Anthem Blue Cross. We are finding that they have taken a lead position in offering IT capability both to the broker and to the client, HR financial software. And it's been very well received by the marketplace. They're using a system called "Sympata" that it is putting us in touch, computer-wise; broker-to-client-to-Anthem, broker-to-client-to-Anthem. It's new technology. They've really just rolled it out over the last six months. But, from all the feedback I'm getting from my staff and my clients, it's good and it does

give them a value differentiator, if you will, something else that they have in their toolbox that no one else really has. The only other carrier who has some of those capabilities is Aetna. And Aetna has a very good system which they have been using for the last two or three years but Aetna has had other challenges.

**Kuhn:** This is Peter Kuhn. I'm in Silicon Valley and our customers have very high expectations what technology can do.

My favorite story is: I can go to the gas station, swipe my credit card and make that \$20 or \$30, or these days, \$40 purchase of gasoline very quickly, very easily, very efficiently. We have people ask, and I've certainly asked, Why can't I go to the doctor, swipe my card and they can tell me, OK, "my co-pay is \$10" or "you haven't met your deductible, your co-insurance." That level of technology would like to be delivered out here. Unfortunately, nobody has executed on it. It may be more complicated than we think.

From a carrier perspective on an administrative basis, we have clients that continue to have some level of frustration. People do ask about the capabilities of the carrier but nobody has the fail-safe, fool-proof system. I think the carriers are going to need to invest some more money in IT and come up with solutions to try and streamline the process to eke a little bit of administrative and retention savings out of their programs.

**Question:** Thank you both very much.

**Question:** Hello, yes. Thanks for having the call. I just wanted to get further clarification on Bob's comment where you had indicated that there are some steady Eddie plans that are having more modest increases, and then some of the larger carriers are having more problematic rate increases. Could you quantify what those increases were? And then as an extension of that question, what allows them to do that? Is it their regional focus? Is there something in their network? And then finally, what would you expect next year?

**Feen:** That's a lot of question. I'll do my best to answer it.

We have been seeing – and this is amongst our own clientele and some stories I hear from my broker colleagues. The trends that we've been seeing are that our regional carriers – Anthem Blue Cross, Oxford Health Plan, I'm going to call Health Net a regional carrier here in Connecticut, and ConnectiCare have really been able to deliver their rates for small and medium-sized customers in the 12% to 15%, 18% – let's call it 15% area, which has been very, very good. And those clients have all been renewing their coverage with those carriers. And what we're seeing is those carriers have been able to keep those customers on the books year-in, year-out.

It would not be uncommon here in Connecticut for a small or medium-sized business to change carriers every couple of years. But these carriers have been able to keep their customers.

What we've been seeing, though, from the national carriers – and here in Connecticut those would be Aetna, CIGNA and United Healthcare – is in the medium-sized marketplace – those carriers had lost the small group marketplace three, four and five years ago. But in the medium-sized marketplace, where they tell us they want to continue to play, their rate increases are not validating that.

And we have seen lately with United and CIGNA, we've been seeing increases that look more like what Peter is talking about in Northern California. We're seeing over 20%, and some cases around 30%.

With Aetna, we're seeing rate increases of 30%, 40%, sometimes 50%. That's bothering us just because that's telling us that the right messages aren't being sent to the marketplace and even with the difficulties that some of those carriers have had in small and medium-size business risk, I can't see those types of rate increases.

**Question:** OK, and then, finally, next year – why do you think that larger carriers are producing such higher rate increases? And then what would you expect next year?

**Kuhn:** Looks to me, and this strictly my perspective that they are exiting the small and medium-sized marketplaces. And they are leaving those to – what I'll characterize as – the regional carriers. And I think that that's business strategy that they can take a larger risk and do a better job with it.

And the small and medium-size group markets they're maybe not as predictable and maybe their handled better on a regional basis but that's bringing us problems because a lot of Connecticut businesses, especially newer businesses, will have national offices, national sales forces and then we've got to cover employees on a nationwide basis.

So it can be very hard for us to be able to use a "Steady Eddie" health plan like that ConnectiCare plan or that Oxford plan where our client has a regional office in Chicago, in Los Angeles, et cetera. All of a sudden we've got another set of problems on how do we cover those people?

The only carrier on a regional basis who can help us there is Anthem Blue Cross because their PPO plan travels nationally to any other Blue Cross/Blue Shield plan. That's helped Blue Cross increasing their market share, like I said, in small and medium-size business 100% over the last two years.

**Question:** And then next year, you expect this trend to continue?

**Feen:** Yes, we are thinking that those carriers will have about the same increases this year and we are thinking that CIGNA, Aetna, and United, for all intents and purposes, will be out of the medium-size marketplace like they have exited the small marketplace here in Connecticut.

**Question:** Thank you.

**Question:** Hi. I'd like to ask a couple of questions relating to CIGNA. First of all, if either of you gentlemen have clients that have gone through this transformation process, I'd be interested in your views on how it's been going and what the reaction of the customers is once it's all done.

And the second part of my question is about CIGNA and the small and medium-size group markets.

I met with the company recently and they expressed quite an ambition to increase their presence in that sector, so what you're telling me about they're actually feeding share to the regional carrier seems to be at odds with that. So I'd like to have your thoughts on that as well.

**Kuhn:** This is Peter, I'll start first. CIGNA, for all intents and purposes, has been a non-existent player in California in the under 500 marketplace for the last 15 years. They have certainly talked every two or three years that, "Yes, we want to get in. We want to make a commitment. We want to make a push" but we just don't see that execution in rates. They will issue proposals but, typically, the proposals are not competitive in comparison to a proposal, say, from Aetna. A proposal from Blue Cross. A proposal from Blue Shield. A proposal from LifeGuard, Pacific Care Health Net. So we just don't see them really executing.

They talk about it every now and then and our rep comes down and sees us and says, "We want to be in the market" but we don't do it. I'm sorry I missed the first part of the question you were talking about ...

**Question:** Oh, the transformation, they're migrating customers onto new IT platforms and there have been some horror stories out there about people getting issued wrong I.D. cards and the wrong benefit booklets and all sorts of things and I was wondering if any of your customers had had this process take place while they were doing business with CIGNA. How would you comment on their service, basically?

**Kuhn:** I think their service is spotty, to be perfectly honest with you, as it is with almost any carrier. Some customers have a very good episode of care and some have a horrible episode of care so it really depends on how your system was implemented. It depends on the lead-time that you took. It depends on the people in your organization

that were applied to it. Sometimes people don't take it seriously and there are miscues that take place.

So every case needs to be drilled down into a little deeper. I think as a whole, CIGNA has decent systems but, again, I think they're committed to, let's call it "the jumbo marketplace" which would be cases with 1,000 - 2,000 and more. I don't really think their heart and soul is in the small group market. At least I haven't seen anything from a financial perspective. Let them put their money where their mouth is.

**Question:** Well, it might interest you to hear that they were going to go direct to the clients and tell the prospect rather than waiting for RFP. Have you heard any reports that this is going on out in the field?

**Kuhn:** I have not heard any reports that they were going to do that. I know that Aetna did that several years ago and it was a complete and total failure. I encouraged them to go to do it and they'll realize how tough the business is and how we earn our money.

**Feen:** Peter, I'll add some comments to that. It failed miserably for Aetna a couple years ago. They're still recovering from that. And there was a great cartoon in the New Yorker last issue where around a corporate board table - they're looking at sales that have gone down, down, down and someone is saying, "Gee, I didn't think that would happen when we dismissed our sales force!"

When the carriers try to do things like that, they fail miserably because they don't really know how to end-market to small and medium size risk and those carriers are already handling the Fortune 1000 and the big institutions.

**Kuhn:** The other challenge is to face is that they don't have the complete suite of products. The employer's not only looking for a solution to their medical plan but they need solutions to their dental, life, disability, 401K, Section 125, Employee Communication, Regulatory Compliance with ERISA and, typically, the carrier's just not set up to do that so that's why they need a distribution partner.

**Question:** CIGNA thinks they have all those products.

**Feen:** Well, they think they do and, maybe, in one of 1,000 cases they'll have the right mix. But, typically, when we go into a prospect, let's say we go into a prospect of 200 people. CIGNA may be the right medical solution but they may not be the right dental solution. They may not be the right life solution. They may not be the right disability solution. They may not even want to do 125 on a case of that size.

So, again, I don't discourage them from doing it. In most instances, what happens is the customer will say I use A or B or C as my broker and CIGNA will end up working through them and say, "Hey, can we put together a proposal on that case?"

**Kuhn:** Yes, we've just heard a lot of positioning and posturing from CIGNA over the years and I would absolutely love to see them – and I will underline the word “love” to see them get in the small group marketplace, mid-size marketplace, and be competitive to provide an alternative with a carrier that's got some name brands, some recognition, some networks and some delivery system. We absolutely support them. But I'm also tired of hearing them say, “We're going to do it” and then they don't execute.

**Feen:** When we do get a proposal from them here in Connecticut, it'll typically be anywhere from 15% to 25% higher than other proposals. So it's almost a “why bother” situation. But they do have some talent here in Connecticut in their group home office and maybe things will be changing.

**Question:** What's your take on the service side of Cigna?

**Feen:** I just had to handle a big service problem with them yesterday. Amongst my 400 clients who are a broad sampling of Connecticut businesses, we currently have no CIGNA clients on the books, nor have we had for the last two or three years. And I was asked by a fellow broker to help with a service issue and I was just lucky enough to be able to make a couple of phone calls in the CIGNA management to get the situation helped. They're not a factor here in Connecticut. I'm sure they are with the Fortune 1,000 and some large institutions but they're not a factor with brokers here in Connecticut.

**Question:** Thank you. I believe one of you gentlemen had mentioned, maybe Anthem and some of their national capabilities, or possibly it could have been Well Point, and it brings up the issue of their use of the Blues network across the country. I'm not sure whether or not your customers, typically, are large enough to be interested in multi-state coverage. Do you have any thoughts on the BlueCard program and how it's become more or less of a sales potential for you over the last couple of years? Thank you.

**Feen:** This is Bob Feen and I was talking about the fact that our Anthem Blue Cross here in Connecticut has a plan that they call Century Preferred, an old PPO that they have had on the books for the last 15 years, and the special feature of that is that it does have this out-of-state capability to bring someone who is a non-Connecticut resident into their local Blue Cross system. So Anthem Blue Cross has been getting all of the small and medium-size risk here in Connecticut that has employees out of state. That's a market that they have come to own here in Connecticut.

The BlueCard capability is a good thing here in Connecticut. Anthem is using it on the basis of when there are longer stay employees who leave Connecticut and might have a three-month, six-month project in another area, they can go into that area's local Blue Cross program under the Blue Cross HMO, BlueCard plans. And they're covered in that area for the length of their stay. I think Anthem Blue Cross in our small marketplace is probably the only carrier who is doing that and has that capability.

**Kuhn:** Out here in California, the BlueCard plan for both Blue Cross and Blue Shield is an essential part of their business philosophy and operation.

Typically what we have is a company that has headquarters operation say, here in Silicon Valley, they they'll have a sales and service organization throughout the country. It's got to be able to provide some level of network to those employees. BlueCard is really a very good solution. I'd say they probably contract with 70% to 80% of the doctors nationwide so it does present a viable solution, and works out very well and it's essential to their business and it seems to have gotten better particularly with Blue Cross. Blue Shield has a few challenges every now and then with it but they can both access it. It seems to be working well actually, for all the Blues across the country.

**Question:** Has this always been as it is now for the last couple years or has this improved?

**Kuhn:** I think there's a group called the Consortium Health Plans, which I believe, is 17 or 19 of the largest Blues that control probably 85% of the members. They've all worked real hard to make sure that the BlueCard system works. They had an experiment with HMO USA and that failed miserably, really because the HMOs are regulated by the individual states' departments of insurance, or in California, as we have the Department of Managed Care.

PPO plans are more at risk or are federally regulated so it's a little easier to work through those and I think that the demise of the HMO USA was the individual state regulations versus the BlueCard plan which can float at a federal level and doesn't need to be quite as concerned about the state regulations.

**Raskin:** I want to thank everyone for dialing in and then, of course, Peter and Bob for all of their help. If anyone has any follow-up, feel free to give me a call in the office here and I can try and patch you through or get you phone numbers or follow-up questions. And with that I think we'll conclude the call. Thanks again.

## **Biographies**

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### **Robert Feen, The Benefits Group**

Robert Feen, CLU, has been president of The Benefits Group, a regional health insurance agency serving over 400 northeast businesses, since 1992. Mr. Feen is well-known speaker in the northeast on employee benefit issues and healthcare trends and has served on the market advisory boards of Aetna, Anthem Blue Cross Blue Shield and MedSpan Health Options among others. Finally, Bob is the only two-time chairman of the Connecticut Benefit Brokers Association.

### **Peter Kuhn, IBP Insurance Services**

Peter Kuhn is the Founder and Principal of IBP Insurance Services, a health benefits agency that designs, develops, implements and services state of the art employee benefit programs for employers with 50 - 5000 employees. Prior to founding IBP, Mr. Kuhn was an account executive at CIGNA where he worked with small and mid size employers on their employee benefits programs and financial services needs.

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