Healthcare
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Profit Margins Converge for Top Health Plans

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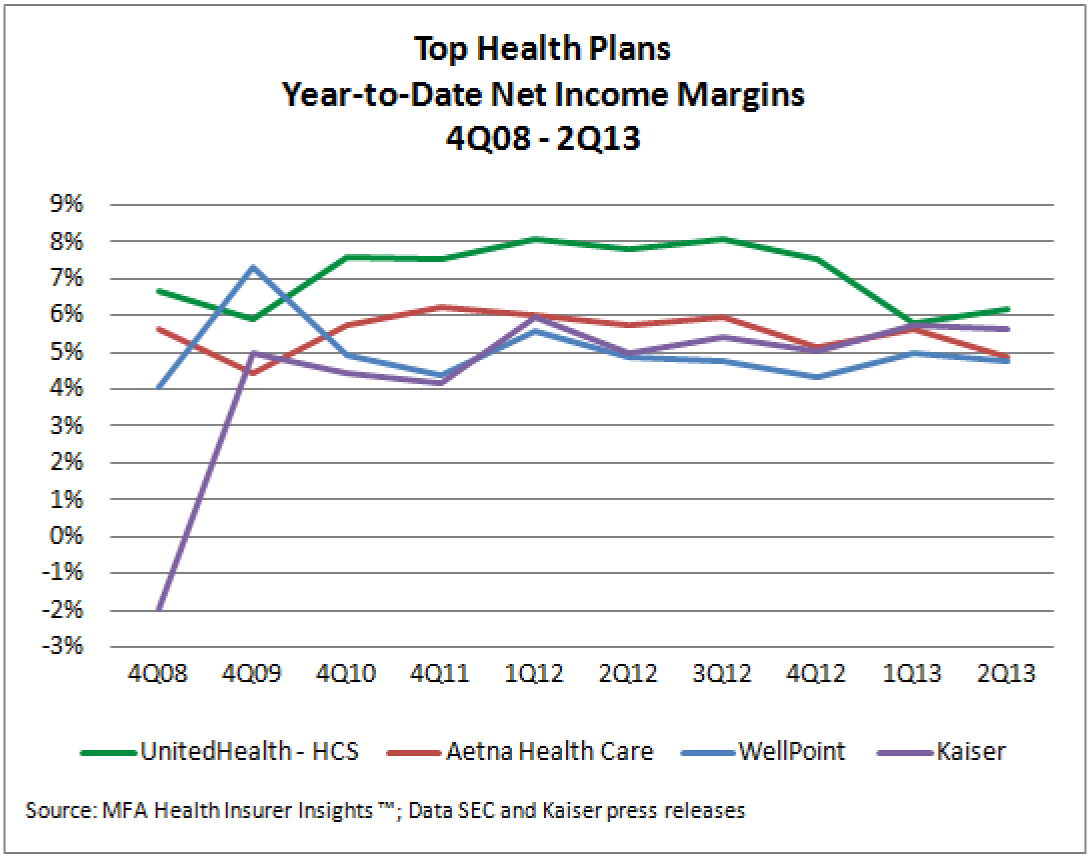
Among the leading health plans in the United States, net income (also referred to as profit) margins converged around an average of 5% for the first six months of 2013. Roughly 2 percentage points separate the most profitable plan from the least profitable plan among the major health insurance carriers through the second quarter of 2013, down from a nearly 9% range in 2008. All of the nation's leading health plans saw enrollment gains between June 2012 and June 2013. Gains were noted in both aggregated fully-insured (risk) business and the administrative services only (ASO) segment, as well as among Medicare, Medicaid and Commercial markets.

This brief presents key findings from Mark Farrah Associates' (MFA's) review of enrollment and financial trends among seven top health insurers: Aetna, Cigna, Health Care Service Corporation (HCSC), Humana, Kaiser Permanente, UnitedHealth Group and WellPoint. It primarily looks at results from the first half of 2012 (ended June 30, 2012) to the first half of 2013 (ended June 30, 2013). Financial and membership data and observations were gleaned from the October 2013 Health Insurer Insights™ series. These seven health plans cover approximately 45% of the total population in the nation.

Profitability Margins Converge

Among the leading health plans in the United States, net income (also referred to as profit) margins* averaged around 5% for the first six months of 2013, approximately the same as the first six months of 2012. It is interesting to note, that first half results for the most profitable plan in 2012 was UnitedHealthcare at 7.78% and the least profitable for the period was Humana at 3.03%. For the first half of 2013 the most profitable plan was Cigna at 6.38% and the least profitable was Humana at 4.29%. Based on Mark Farrah Associates' (MFA's) analysis of profit margin variations among top plans through the second quarter of each year, the difference between the highest and lowest plan was 4.8% for 2012 and 2.1% for 2013. In comparison, profit margins in 2008 for the top seven health plans ranged from Kaiser's -2.0% to UnitedHealthcare's 6.7%, an 8.7% range differential.



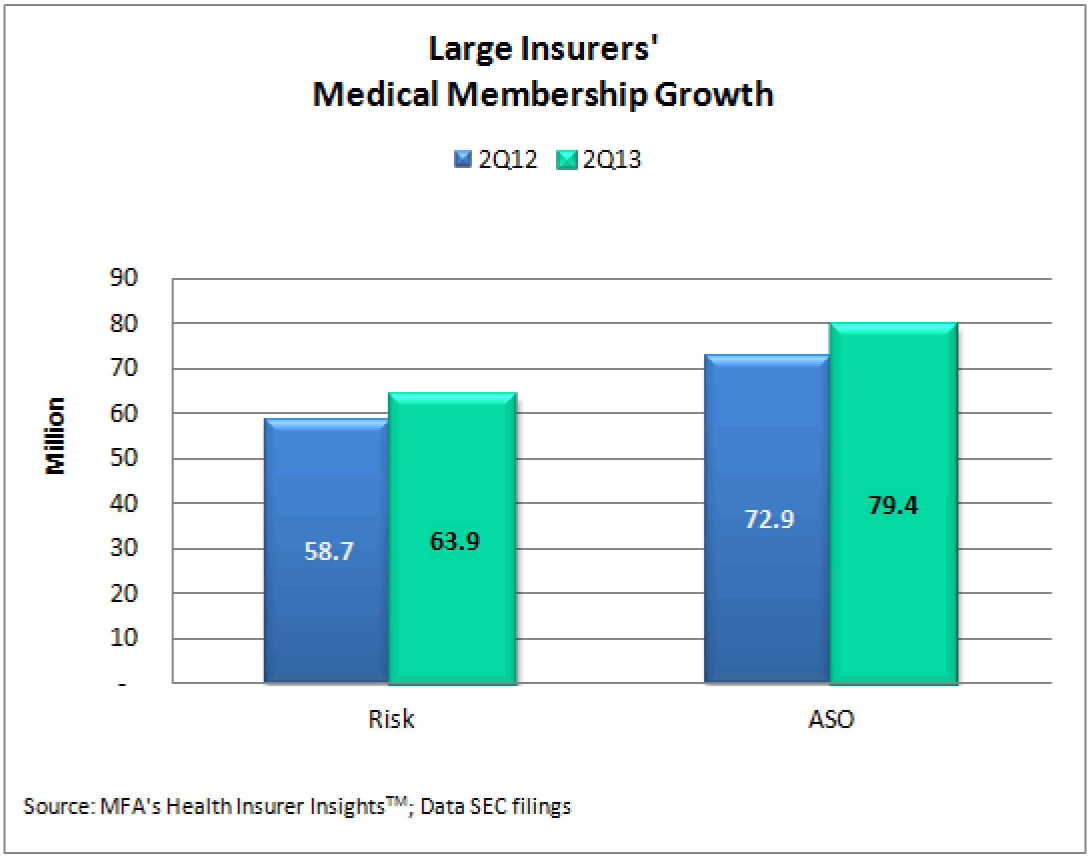
**Net Income (profit) margin is net income (loss) divided by total revenues.*

Four of the seven health plans saw modest downturns in year-over-year profitability for the first half of 2013, when compared to the similar period in 2012. Profit margins decreased slightly from a combined average of 5.41% for the first six months of 2012, to 5.36% for first six months of 2013. UnitedHealthcare reported the largest percent decline year-over-year among the seven leading plans. UnitedHealthcare generated $56.6 billion in revenue and reported earnings from operations of $3.5 billion (6.2%) year-to-date through June 30, 2013. This compares to revenue of $51.0 billion and reported earnings from operations of $4.0 billion (7.8%) year-to-date through June 2012. Humana, Cigna and Kaiser were the only plans out of the seven leading companies to see profit margins increase between the first half of 2012 and the first half of 2013.

The reasons for the narrowing of profit margins among the top plans are many. The primary cause of the convergence is the medical loss ratio requirements, due to health insurance reform. Historically, health plans that managed costs below the medical loss ratio requirements set by the government (80% - 85% depending on the segment) could reap those benefits in the form of higher profit margins. Now, they must give back those savings to the customer in the form of rebates. The Commercial enrollment shift from fully insured policies to low margin administrative services only business may also be influencing overall profits. Low returns on health plans' invested capital may be another contributing factor. Typically the leading plans that primarily focused on government programs had lower profit margins, while those that focused on the Commercial segment had higher margins. As leading health plans add Medicare and Medicaid market segments to their portfolios, this too, is contributing to the narrowing of profit margin differentials.

Overall Membership Gains

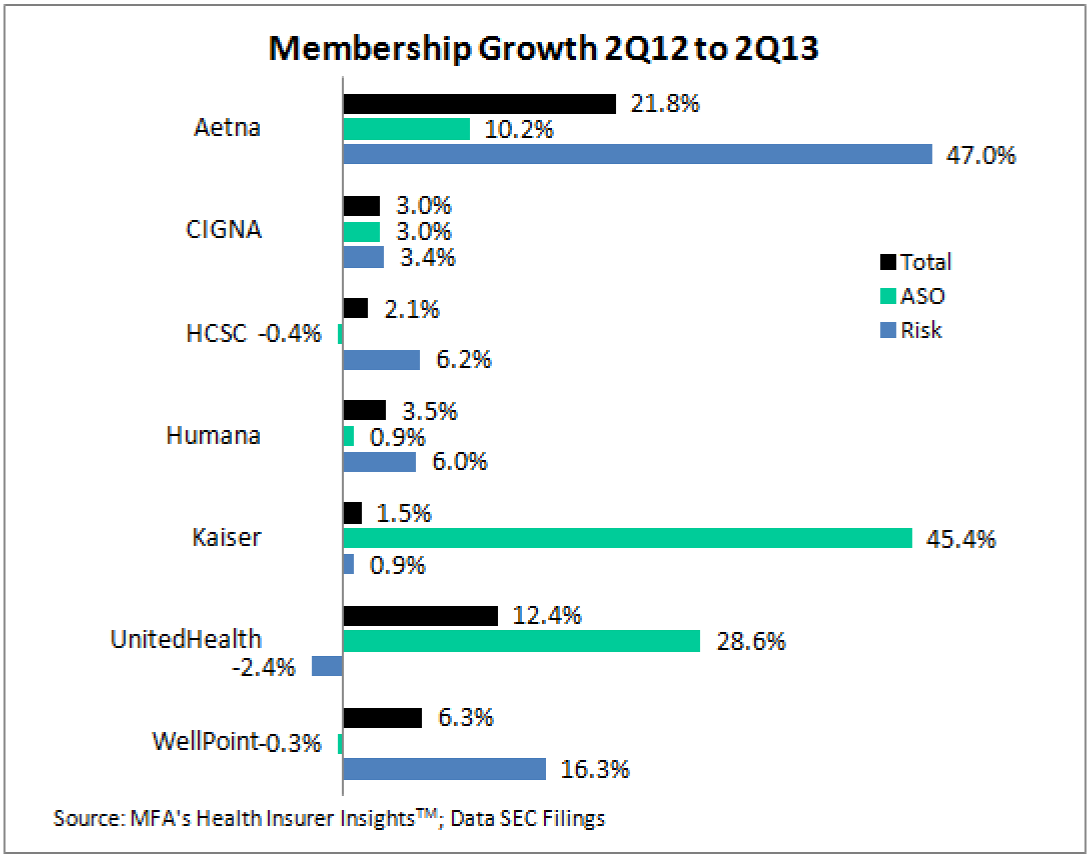
Year-over-year, total membership for the seven leading plans increased by nearly 11.6 million (8.8%), from 131.6 million as of June 2012 to 143.3 million as of June 2013. UnitedHealthcare's addition of nearly 3 million TRICARE members contributed to the large gain in 2Q13. Another 3.7 million of the increase is attributed to Aetna's acquisition of Coventry, and WellPoint's acquisition of Amerigroup added 2.7 million covered lives.



A shift from the uncertain profitability margins for fully-insured (Risk) business to the more stable, but lower margin, administrative services only (ASO, also known as self-insured) segment is one of the contributing factors for the narrowing of the profit margins among health plans. From June 2012 to June 2013, the ASO segment gained nearly 6.5 million covered lives, ending 2Q13 with approximately 79.4 million members. Risk enrollment increased by 5.2 million members in the same period. Aggregate risk enrollment for the top plans totaled 63.9 million at June 2013. Gains in managed Medicare and Medicaid enrollment are driving risk enrollment up. Commercial Risk enrollment increased slightly from 2Q12 to 2Q13.

Health Plan Observations

All of the leading health plans saw total enrollment growth year-over-year. Aetna reported the largest percentage increase in enrollment from 2Q12 to 2Q13, reflecting a 3.7 million gain in risk enrollment from its acquisition of Coventry Health Care and additional growth in Medicare enrollment, as well as gains in Commercial ASO business. UnitedHealth's enrollment topped 40 million in 2Q13, with a gain of 12.4% from 2Q12 to 2Q13. UnitedHealth gained more than 2.9 million covered lives from its new ASO TRICARE West Region contract and added nearly 2 million more covered lives to its Commercial ASO business during the period. The only UnitedHealth segment to decline from June 2012 to June 2013 was the Commercial Risk line. UnitedHealthcare reported converting a large commercial client, with over 1 million members, from Risk to ASO in first quarter 2013.



Cigna's total enrollment, which includes international ASO business but not international risk membership, dropped slightly behind HCSC's total enrollment through second quarter 2013. HCSC's acquisition of Blue Cross Blue Shield of Montana, with 244,000 members during the third quarter of 2013, may move it solidly in front of Cigna by year end. Kaiser's ASO enrollment remains insignificant in terms of its total enrollment. The sale of Kaiser Foundation Health Plan of Ohio to Cincinnati-based Catholic Health Partners' nonreligious, not-for-profit auxiliary organization, HealthSpan Partners, in October 2013, will be reflected in yearend numbers and is not expected to have a material impact.

Membership Mix Shifts

The shift from Commercial to Government (Medicare, Medicaid and State-subsidized marketplace or exchange) business also impacts profitability. Government business tends to have higher premiums due to the serious health issues for many enrollees; however the profitability margins tend to be much smaller. Addressing the health needs of previously uninsured or underinsured non-group populations also has atypical start-up and educational costs. These populations can drive up health plan administrative costs and medical expenses, once enrollees begin receiving coverage, leading to lower profitability as health plans expand into these new segments. Margins may worsen as the health insurance exchanges ramp up over the coming year and health plans try to maintain Medicare Advantage enrollment despite cuts to Medicare premium rates for 2013 and 2014. On the other hand, it may be hard to tell what the true impact of membership mix shifts will be as most of the leading plans are mitigating or sharing the insurance risk through provider contracting and accountable care initiatives.

Commercial, Senior and Medicaid segments all saw enrollment growth year-over-year, with five of the top companies citing enrollment gains across all three major business lines. WellPoint was the only plan to report declines in the Commercial and Senior sectors year-over-year.

Large Insurers' Medical Membership Growth			
Segment	**2Q12**	**2Q13**	**Change**

Senior[1]	12,069,708	13,629,372	1,559,664
Medicaid[2]	7,918,073	11,507,619	3,589,546
Commercial[3]	111,642,187	118,118,249	6,476,062
Total	131,629,968	143,255,240	11,625,272

(1) May include both Med Supp and Medicare Advantage but not PDP
(2) Includes ASO and Risk-based arrangements
(3) Includes TRICARE and FEHBP enrollment, and ASO and Risk-based arrangement
Source: MFA's Health Insurer Insights™; Data SEC filings

Aggregate total Commercial enrollment for the leading plans increased by 5.8% from 2Q12 to 2Q13, all commercial growth came from the ASO segment and includes UnitedHealth's new TRICARE business. Senior (also referred to as Medicare) and Medicaid enrollment increased 12.9% and 45.3%, respectively during the same period. WellPoint's acquisition of Amerigroup and Aetna's acquisition of Coventry Health Care drove much of the Medicaid increase.

While the majority of enrollment is currently under ASO arrangements, this is shifting as more of the leading plans explore opportunities in the Medicaid, Medicare and non-group markets. Six of the seven top plans saw gains in Medicaid; Kaiser reported a small decline in Medicaid enrollment from June 2012 to June 2013. Most of the top plans have expressed interest and many will be participating in The Centers for Medicare & Medicaid Services (CMS) dual eligible integration pilot projects in the coming year. Four of the seven plans, HCSC, Humana, Kaiser and WellPoint also expect to play a large role in the state-based and federal health insurance marketplaces or exchanges in 2014. Aetna, Cigna and UnitedHealth have all taken a more watchful or selective approach to where and when they are likely to participate in the exchanges. The impact to profitability for all these changes remains uncertain.

The seven leading health plans cover 45% of the people in the United States, so the financial health of these plans is important. As long as these plans continue to maintain the 5% to 5.5% average profit margin since 2010, there is nothing disconcerting about the margin convergence. This margin allows for a sufficient contribution to reserve levels, returns on invested capital and further investments in programs that support new health and wellness initiatives, reduce medical costs, technological development and health plan innovation. The concern will be if that average starts to drop.

As the differences between the leading health plans' profitability margins change and the industry transforms from a business-to-business sales paradigm to a much more consumer-driven and retail-based business model, staying current on the latest business strategies and financial health of the competition is critically important. Mark Farrah Associates' many products can help simplify your analysis of health insurance business.

About Health Insurer Insights™

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