Role of Blue Cross in Michigan’s Health Insurance Market

Commissioned by:

Coalition for Access and affordability in Michigan

Prepared by:

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Executive Summary

REPORT PURPOSE AND OVERVIEW

The Coalition for Access and Affordability in Michigan commissioned Anderson Economic Group to complete an independent analysis of the special role played by Blue Cross in the Michigan health insurance market. In particular, we were commissioned to:

1. review the Michigan health insurance market,
2. identify the specific statutory mission of Blue Cross Blue Shield of Michigan (BCBSM) within that market, and
3. to estimate, where data are available, the benefits and the burdens that result from the company’s activities under the current statutory mission.

As recently-introduced legislation would change the relative burdens of Blue Cross and commercial insurers, it is informative to look at BCBSM’s historic role in the Michigan health insurance market, the original rationale for is unique tax benefit, and the costs and benefits of fulfilling its mission today.

This report is organized as follows:

- In the first section we identify BCBSM’s statutory mission and the other activities the company engages in to further its social commitments.
- In section two we quantify the major benefit the company receives for fulfilling its social mission, a tax exemption.
- In section three we describe BCBSM’s market presence in Michigan and the profitability of Blue Cross’s operations.
- In section four we compare the benefits and burdens of BCBSM’s mission.
- We close this report with a description of Blue Cross conversions from a nonprofit to a for-profit entity in other states in section five.

BCBSM’S MISSION AND BURDENS

Blue Cross Blue Shield (“Blue Cross” or “the Blues”) is a national association with 39 independent, locally-operated, Blue Cross and Blue Shield companies. Blue Cross Blue Shield of Michigan is one of the largest health plans that operates under this association. Initially the Blues were nonprofit companies, created to further the social goal of providing affordable and accessible health insurance for Americans, particularly vulnerable populations.

Original Statutory Burdens and Benefits. Michigan legislation (Public Act 350 of 1980) placed certain burdens on BCBSM in exchange for favorable tax treatment. The intent of Act 350 was to “secure for all people of this state who apply for a certificate, the opportunity for access to health care services at a fair and reasonable price.” The main requirements of the original (1980) statute were that BCBSM must:

- Provide insurance to all who seek coverage regardless of health status. This provision makes BCBSM the “insurer of last resort.”
• Set rates for specific insurance products at the same level for all insureds in a certain group. This type of pricing policy is called “community rating” because the use of underwriting criteria in pricing products is restricted to just the geographic area.

• Develop a provider network in all areas of the state.

**Current Statutory Burdens and Benefits.** At present, BCBSM does not have as many statutory burdens as it once did. However, BCBSM still receives an exemption from most major state and local taxes that it was granted in PA 350 of 1980. BCBSM’s current obligations have changed as follows:

- **BCBSM is the insurer of last resort in only the individual market.**
  Blue Cross now acts as the insurer of last resort for only a subset of individual major medical coverage. Blue Cross no longer acts as the insurer of last resort for groups.

- **BCBSM’s community rating policies have weakened.**
  The restrictions on underwriting criteria in pricing insurance have weakened since 1980. Today, Blue Cross may experience rate groups, use geography in pricing policies for groups with less than 100 employees, and use age to set premiums for individual products where a prescription drug benefit is offered.

**Expanded Non-Statutory Business Activities.** Blue Cross has expanded its non-statutory business activities since 1980. While the general tax exemption BCBSM receives has allowed the company to further its social mission activities, it has also allowed the company to increase its reserves and pursue business activities, such as acquiring other companies (We discuss Blue Cross’s profits and reserves under “Profitability of BCBSM’s Operations” and “Growing Reserves and the Statutory Limit” on page 4.)

**BCBSM’S TAX EXEMPTION IN MICHIGAN**

BCBSM pays the federal corporate income tax. However, in exchange for fulfilling its statutory obligations, Section 102 of PA 350 of 1980 provides a general exemption from state and local taxation: “Each corporation subject to this act is declared to be a charitable and benevolent institution and its funds and property shall be exempt from taxation by this state or any political subdivision of this state.”

We analyzed the effect of this tax exemption on BCBSM using publicly-available data on the firm’s operations. We estimate that BCBSM would pay substantial state and local taxes on their Michigan operations in tax year 2008 if it did not have the unique tax exemption. We estimated the effect of this tax exemption on three of Michigan’s main taxes:

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1. Social-mission activities include providing Medicare Supplement insurance (purchased by seniors who qualify for Medicare, the government sponsored health insurance for senior and disabled citizens) at a lower cost than other carriers; participating in MIChild, the health insurance program for children in low-income families; and providing financial support to clinics that offer free and low-cost health care services throughout the state.

2. For example, Blue Cross acquired M-CARE in 2006 and the Accident Fund Insurance Company of America in 1994.
• **Michigan Business Tax (MBT)**
  BCBSM would be subject to the newly-passed MBT, which includes a gross receipts tax, business income tax, and premiums tax.

• **Property Taxes**
  BCBSM would also pay taxes on its real and personal property located throughout the state. Most of BCBSM’s property is located in Detroit and Southfield.

• **Sales and Use Taxes**
  Under the MBT, insurance companies will no longer be exempt from sales and use taxes. BCBSM would pay tax on its purchases of office supplies and other goods.

We estimate that BCBSM’s tax exemption will be worth approximately $112 million in 2008, assuming the scale and profitability of the company is the same as in 2006, and the selected taxes we considered are not changed. These estimates are based on our understanding of Blue Cross’s financial statements. While we requested a meeting with Blue Cross to discuss its tax exemption, we were not granted our request. See “BCBSM’s Tax Treatment” on page 14 for our complete tax analysis, including the limitations of our analysis, and Table 1 below for a summary of amount exempted by type of tax.

### TABLE 1. BCBSM: Amount Exempted from Select Michigan Taxes, 2008

<table>
<thead>
<tr>
<th>Estimated Tax Liability (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Michigan Business Tax $85.7</td>
</tr>
<tr>
<td>Real and Personal Property Taxes $22.1</td>
</tr>
<tr>
<td>Sales and Use Taxes $4.2</td>
</tr>
<tr>
<td><strong>Total Estimated Tax Liability</strong> $112.0</td>
</tr>
</tbody>
</table>

*Source: Anderson Economic Group, LLC*

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BCBSM is the largest health insurer in Michigan. In 2006, over 70% of residents in Michigan with commercial insurance were insured by BCBSM and its subsidiaries. Blue Cross offers a wide array of group and individual health insurance products as well as administrative service contracts. Most of BCBSM’s business (excluding its subsidiaries) is in the commercial group (fully insured) market. Only 5% of BCBSM’s total insured enrollment and 4% of its premiums in 2006 were for individual insurance products—the sector in which the company has a statutory obligation to be the insurer of last resort and receives a tax exemption for its role in this market. See “Blue Cross’s Market Presence and Profitability in Michigan” on page 24.

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3. In particular, we estimated 2008 taxes using the newly-passed MBT and used 2006 or 2007 tax rates for property, sales, and use taxes. We did not include certain other taxes, such as the gasoline tax; nor did we include the recently adopted “service tax” on many professional services.
Profitability of BCBSM’s Operations. In 2006, BCBSM and its subsidiaries had after- [federal] tax income of $243 million. This is a 0.9% net profit margin on overall revenue. Although Blue Cross is a nonprofit company, it does generate a profit. (“Nonprofit” generally means that profits cannot be distributed as earnings to shareholders.) Undistributed profits in a private company are added to a firm’s retained earnings, and are available to fund capital investment and acquisitions. BCBSM’s profits are added to the company’s subscriber reserves (also referred to as capital and surplus). Of course, both private and nonprofit insurers must be profitable over time, and keep reserves, in order to remain in business.

Growing Reserves and the Statutory Limit. Between 2001 and 2006, BCBSM’s reserves (surplus) increased from $1.3 billion in 2001 to $2.8 billion in 2006 (using generally accepted accounting principles) for an annual compound growth rate of 17%.4 The State of Michigan established a limit on the amount of reserves that BCBSM can legally have. The growth in reserves produced by the company’s profitability has put the company close to exceeding the statutory limit. However, BCBSM has made acquisitions (purchased other companies) and taken other actions to reduce its reserves and remain under the statutory limit.

SUMMARY OF BENEFITS AND BURDENS OF BCBSM’S MISSION

Statutory Benefits and Burdens of Mission. In Table 2 on page 5 we summarize Blue Cross’s statutory benefits and burdens. BCBSM’s statutory role in the Michigan health insurance market results in an annual net benefit to the company of $129.3 million. The key benefits and burdens for which we provide an estimate include:

- A tax exemption that is worth approximately $112 million annually in major state and local taxes.
- A subsidy worth $25 million in 2006 from their profitable product (group insurance) to offset losses from another product (group conversion). No commercial carrier or HMO has similar statutory authority to charge this or other subsidies, but companies can charge more in other product offerings to recover their losses.
- BCBSM’s burden as insurer of last resort, and legal requirement to community rate their products, costs the insurer $7.7 million in underwriting losses and profit. (Our estimate includes a foregone 1% profit margin on premiums.)

Non-Statutory Benefits and Burdens of Mission.

In addition to the statutory burdens and benefits, Blue Cross also makes business decisions, including securing contracts with providers, claims policies, and participation in state contracts, that affect their overall profitability. We separately list in Table 3 on page 6 estimates of the benefit and burden of specific non-statutory activities that reflect, to some extent, the special position of Blue Cross in the Michigan market and the company’s own business plans based on that position.5

Even when including non-statutory burdens the company undertakes to further its social mission, the benefit of large market share and better reimbursement rates with providers is greater than the financial burden of these obligations, as shown in Table 2.

### TABLE 2. Comparison of the Statutory Benefits and Costs of BCBSM’s Mission

<table>
<thead>
<tr>
<th></th>
<th>Benefits</th>
<th>Burdens</th>
<th>Net Benefit (Burden)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Benefits</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michigan Tax Exemption(^a)</td>
<td>$112.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Conversion Subsidy(^b)</td>
<td>$25.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Benefits</strong></td>
<td></td>
<td></td>
<td>$137.0</td>
</tr>
<tr>
<td><strong>Burdens</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurer of last resort; Community Rating(^c)</td>
<td>$7.7</td>
<td></td>
<td>($7.7)</td>
</tr>
<tr>
<td><strong>Total Burdens</strong></td>
<td></td>
<td></td>
<td>($7.7)</td>
</tr>
<tr>
<td><strong>Net Benefit (Burden)</strong></td>
<td></td>
<td></td>
<td>$129.3</td>
</tr>
</tbody>
</table>

Analysis: Anderson Economic Group, LLC

Data Sources: Blue Cross Financial Statements; local and state tax records

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5. This includes lower claims paid per dollar of premium than its competitors in the group insurance market, the losses Blue Cross incurs by offering Medicare Supplement below cost and by participating in MIChild, and the financial support it provides free and low-cost clinics throughout the state.
Table 3 and in “Comparison of the Benefits and Burdens of BCBSM’s Mission” on page 36.

**TABLE 3. Comparison of Non-statutory Benefits and Burdens (2006)**

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Burdens</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower Claims Paid to Providers for Group Coverage&lt;sup&gt;a&lt;/sup&gt;</td>
<td>$138.0</td>
</tr>
<tr>
<td>Medicare Supplement&lt;sup&gt;b&lt;/sup&gt;</td>
<td>$94.8</td>
</tr>
<tr>
<td>MIChild&lt;sup&gt;c&lt;/sup&gt;</td>
<td>$15.5</td>
</tr>
<tr>
<td>Financial Support for Free and Low-Cost Clinics&lt;sup&gt;d&lt;/sup&gt;</td>
<td>$1.0</td>
</tr>
</tbody>
</table>

<sup>a</sup> BCBSM has a lower claims loss ratio for its group commercial products than the remainder of the market. BCBSM’s advantage equates to approximately $138 million in lower payments to providers in 2006. See “BCBSM Pays Lower Average Claims in Group Market” on page 34 for more information.

<sup>b</sup> There is a $94.8 million difference between the loss BCBSM incurred on Medicare Supplement in 2006 and the profit BCBSM would need to earn to recognize a 1% return on premiums. Source: BCBSM Medicare Supplement Rate Filing, dated February 8, 2007, Section VI, Table IB.

<sup>c</sup> BCBSM is limited to a $15.5 million loss on MIChild according to a letter of understanding with the State of Michigan as stated on page 25.14 in BCBSM’s Notes to the Financial Statements in its 2006 annual submission to OFIS.


**PROPOSED LEGISLATION AND BCBSM’S NET BENEFIT**

On October 11, 2007 four bills were introduced in the Michigan House of Representatives that, if enacted, would reduce Blue Cross’s obligations to provide affordable health insurance in Michigan. Specifically the bills (HB 5282-5285) would:

- Eliminate community rating for new individual policies. This will likely result in an increase in rates for older and less healthy residents.
- Allow Blue Cross to increase rates without Commissioner approval. The bills would also no longer require public hearings before allowing BCBSM to increase its rates.
- Reduce its role as insurer of last resort by (1) increasing from 6 months to 12 months the time under which BCBSM does not have to cover treatment for pre-existing conditions, and (2) requiring Blue Cross to offer only four “guaranteed access health benefit plans” to high risk individuals. There are no requirements in the bills as to what services must be covered.
- Reduce Blue Cross’s financial obligations is that the bills require commercial insurers and HMOs to make payments to cover losses in the high-risk segment of the individual market—the only segment in which BCBSM acts as the insurer of last resort.
Additionally, the bills contain no provisions that would require Blue Cross to use its reserves (i.e. surplus) to lower premium rates for its customers or further its social mission. While these bills would reduce the burdens placed on Blue Cross by Michigan law, they would not reduce the benefit of the general tax exemption. Under these bills, Blue Cross would do less for the state and still receive the same benefit while its competitors would face additional burdens. Table 4 summarizes these changes.

**TABLE 4. Summary of Changes to BCBSM’s Benefits and Burdens Since 1980 and Proposed Changes***

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Benefits</th>
<th>Burden or Change in Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980 (Original)</td>
<td>State and Local Tax Exemption</td>
<td>Acts as insurer of last resort in individual and group markets;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Community rates policies;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Develops a provider network in all areas of the state.</td>
</tr>
<tr>
<td>2007 (Current)</td>
<td>State and Local Tax Exemption</td>
<td>Weakened burdens as insurer of last resort;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fewer restrictions on pricing policies;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Still maintain statewide provider network.</td>
</tr>
<tr>
<td>2008 (w/ Proposed Bills)</td>
<td>State and Local Tax Exemption</td>
<td>Further reduction of insurer of last resort obligations;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Almost no restrictions on premium rating;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Still responsible for statewide provider network.</td>
</tr>
</tbody>
</table>

*Source: Anderson Economic Group, LLC*

**ABOUT THE AUTHORS**

Anderson Economic Group, LLC (AEG) is a consulting firm with expertise in economics, public policy, financial valuation, market research, and land use economics. AEG has offices in Michigan, Illinois, and Texas.

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University of New York at Buffalo; and a B.A. in French and business from Nazareth College in Rochester, New York.

**Patrick L. Anderson.** Mr. Anderson, principal and CEO, founded the consulting firm Anderson Economic Group in 1996. Since founding the firm, he has successfully directed projects for state governments, cities, counties, nonprofit organizations, and corporations in over half of the United States. Mr. Anderson has written over 100 articles published in periodicals such as *The Wall Street Journal, The Detroit News, The Detroit Free Press, Crain’s Detroit Business*. His book *Business Economics and Finance* was published by CRC Press in August 2004, and his paper on “Pocketbook Issues and the Presidency” was awarded the Edmund Mennis Award for best contributed paper in 2004 by the National Association for Business Economics.

See “Appendix B. About the Authors” for more information about the report’s authors.
I. The Mission of Blue Cross

Blue Cross Blue Shield (Blue Cross) is a national association with independent, locally operated Blue Cross and Blue Shield companies. At present, there are 39 Blue Cross and Blue Shield companies in the United States that provide insurance for almost 100 million Americans—almost one third of the country’s population.6

Blue Cross Blue Shield of Michigan (BCBSM) is one of the largest health plans that operates under the national Blue Cross association. The Michigan legislature created Michigan Blue Cross and Michigan Blue Shield in 1939 to ensure that poor residents received health care and that physicians and hospitals who delivered care were paid. The two companies merged to form what is now known as Blue Cross Blue Shield of Michigan in 1975.

At its creation the Legislature gave BCBSM a specific social welfare mission. Section 102 of Public Act 350 of 1980 sets forth BCBSM’s benefits and obligations as follows: (emphasis added)

(1) It is the purpose of and intent of this act, and the policy of the legislature, to promote an appropriate distribution of health care services for all residents of this state, to promote the progress of the science and art of health care in this state, and to assure for non group and group subscribers, reasonable access to, and reasonable cost and quality of, health care services, in recognition that the health care financing system is an essential part of the general health, safety, and welfare of the people of this state. Each corporation subject to this act is declared to be a charitable and benevolent institution and its funds and property shall be exempt from taxation by this state or any political subdivision of this state.

(2) It is the intention of the legislature that this act shall be construed to provide for the regulation and supervision of nonprofit health care corporations by the commissioner of insurance so as to secure for all of the people of this state who apply for a certificate, the opportunity for access to health care services at a fair and reasonable price.7

In the remainder of this section, we look more closely at the burdens of BCBSM’s mission spelled out in Public Act 350 of 1980—the “original statutory burdens” placed on BCBSM—and the statutory burdens the company has today. In the next section, “BCBSM’s Tax Treatment” on page 14, we quantify the tax benefits Blue Cross receives for fulfilling its statutory obligations.

6. Blue Cross and Blue Shield Association, About the Blue Cross and Blue Shield Association, retrieved on August 23, 2007 from www.bcbs.com/about/.

Public Act 350 of 1980 placed certain burdens on Blue Cross Blue Shield of Michigan. In this section we first describe these original statutory burdens and then discuss how they have changed since 1980.

**Original Statutory Burdens**

Public Act 350 of 1980 required BCBSM to provide health insurance for everyone regardless of health status and to use community rating, defined below, to price their policies. It also required BCBSM to have a provider network that covers all areas of the state.

**Guaranteed Issue.** Section 401 of Public Act 350 of 1980 required BCBSM to provide insurance to any resident seeking coverage or to be the “insurer of last resort” for both individuals and groups.\(^8\) HMOs, which are also nonprofit insurers, are required to offer individual coverage to everyone during an open enrollment period once a year.\(^9\) In 1980, commercial insurers that wrote individual and group policies did not have this obligation and were able to decline coverage to individuals that did not fit within their risk profile. At present, Blue Cross acts as the insurer of last resort for only individuals. We discuss this change in the next section.

**Community Rating.** Section 611 of Act 350 required “uniformity of rates among subscribers to the greatest extent practicable” or what is often called “community rating” (§550.1611 of the Michigan Compiled Laws). The original statute required BCBSM to set rates without regard to an individual’s age, gender, health status or geography, charging the same rate to each member of the community. These policies were intended to make it more likely that aging individuals and individuals with health problems could obtain and afford health insurance. Originally, the inability of Blue Cross to use age, gender, health status, and geography applied to most products and differentiated Blue Cross from commercial carriers that were able to use health status and other factors when developing premium rates. At present, Blue Cross is able to use some of these factors when developing premium rates for their products. We discuss these changes more fully in “Community Rating Policies Have Weakened.” on page 12.

**Provider Networks.** Section 504 of Act 350 required BCBSM to establish an “appropriate number of providers throughout the state to assure the availability of...health care services to each subscriber” (§550.1504 of the Michigan Compiled Laws). This means BCBSM must contract with providers of medical care throughout the state.

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8. §550.1401 of the Michigan Compiled Laws states that “A health care corporation established, maintained, or operating in this state shall offer health care benefits to all residents of the state, and may offer other health care benefits as the corporation specifies with the approval of the commissioner.”

The Mission of Blue Cross

Other Unique Obligations. BCBSM must provide a shorter waiting period on individual coverage when a pre-existing condition exists than is allowed for commercial carriers. BCBSM may limit coverage for six months for conditions whose medical advice, diagnosis, care, or treatment was recommended and received within six months before enrollment. Commercial carriers may limit coverage for twelve months for pre-existing conditions while HMOs may limit coverage for six months.

Regulatory Burdens. BCBSM has several regulatory requirements that are not placed on commercial insurers. For example, BCBSM must obtain prior approval from the state government’s Office of Financial and Insurance Services (OFIS) before changing their rates (MCL 550.1608). Commercial insurers are able to “file and use” rates without prior approval. BCBSM is also subject to public hearings on rate changes if requested by the Attorney General, OFIS, or a subscriber (MCL 550.1612).

Statutory Burdens Today

At present, BCBSM does not have as many statutory burdens as it once did. Since 1980 the following changes have been made to Blue Cross’s obligations.

Guaranteed Issue Applies to Only Some Individual Insurance Coverage. Before 1996, Blue Cross was the insurer of last resort for both individuals and groups. The federal Health Insurance Portability & Accountability Act (HIPAA) of 1996 extended guaranteed issue for small groups to commercial carriers and HMOs. Before HIPAA, this was only BCBSM’s responsibility. The state designated Blue Cross as the alternative mechanism under HIPAA, thus relieving commercial carriers of obligations related to guaranteed issue and pre-existing condition limitations in the individual market.

Today Blue Cross acts as the insurer of last resort for only a subset of individual major medical coverage. Group conversion, which requires insurers to offer coverage to individuals that were previously covered by one of their group policies, is considered individual coverage. However, the burden to offer a group conversion product is placed on all insurers, not just Blue Cross. We discuss this in detail in “BCBSM as Insurer of Last Resort in Individual Insurance Market” on page 36.

10. A similar law applies to HMOs.
11. A small group is defined as an employer with 2-50 employees.
12. Its obligation as insurer of last resort applies to a subset of the individual major medical category, which excludes group-conversion. Offering group conversion is a burden placed on all insurers, not solely on BCBSM. Therefore, when discussing BCBSM’s mission as insurer of last resort, only non-group individual products are relevant. BCBSM Historical Financial Experience Filings with OFIS for 2005, indicate that premiums for the individual line ($221 million in 2005) were roughly evenly divided between group conversion ($115 million) and non-group ($106 million).
Community Rating Policies Have Weakened. Since 1980, the “uniformity of rates among subscribers” obligation placed on Blue Cross has been severely weakened. Blue Cross is able to charge different premium rates to different types of subscribers. Legal changes, such as in 2003, allowed BCBSM to use, for the first time, age and industry to set premiums in the small group market. Blue Cross also received the ability to use age in determining premiums for one product, Individual Care Blue, in exchange for offering a prescription drug benefit product in the individual market. At present, Blue Cross is able to charge different premium rates in the following cases:

- **For groups with over 100 employees** Blue Cross can experience rate the group.
- **For groups with less than 100 employees** BCBSM can “area rate” them, meaning the company can change rates based on geography. As mentioned above, reforms passed in 2003 allow Blue Cross to use age in addition to geography to set rates for small groups (2 to 50 employees). For new groups with 51 to 99 employees, BCBSM can experience rate them.
- **For individuals and groups** Blue Cross can provide a premium discount of up to 10% to encourage wellness programs and healthy behaviors.
- **For individuals** BCBSM can use age to set premiums under one product where a prescription drug benefit is offered.

PROPOSED REDUCTION TO BCBSM’S BURDENS

Blue Cross Blue Shield of Michigan has publicly stated that it remains committed to its original mission. In BCBSM’s 2006 Annual Report, Chairman of the Board Gregory Sudderth stated, “We will remain steadfastly committed to our mission, reinforced by Public Act 350 of 1980, to serve all the people of the state as a nonprofit health insurer.” Nevertheless, House Bills 5282-5285 would eliminate most of the obligations spelled out in Act 350 that differentiate Blue Cross from commercial carriers. This is while maintaining BCBSM’s benefits—state tax exemption, cost advantages in provider rates, and collection of subsidies to off-set losses—which apply to no other insurer.

Reduces Insurer of Last Resort Burden

- **Continues Guaranteed Issue in a Limited Way**
  As the insurer of last resort, BCBSM may not reject applicants based on their health status. Under the proposed bills, BCBSM would be able to limit coverage to a “guaranteed access health benefit plan” (GA plans). BCBSM would be required to establish four GA plans. There is no standard in the bills that identifies who is to be issued a GA plan or what health care services must be covered.

14. Information provided by Joe Aoun of Nuyen, Tomtishen and Aoun, P.C.
16. In preparing this section we had several conversations with Joe Aoun of Nuyen, Tomtishen and Aoun, P.C.
The Mission of Blue Cross

- **Requires Commercial Insurers to Compensate BCBSM for “Excessive” Losses of GA Plans**
  The proposed bills would collect an “assessment” from commercial carriers and HMOs to cover claims above 105% of the GA plan premiums. This would reduce the financial burden placed on BCBSM as insurer of last resort, and spread it to commercial carriers and HMOs that do not enjoy the advantages (tax-exemption, subsidies, better rates) that BCBSM enjoys and would continue to receive.

**Reduces Obligations to Offer Coverage at a “Fair and Reasonable Price”**

- **Eliminates Community Rating on New Policies**
  BCBSM would be allowed to use age, geography, and initial health condition when determining premium rates. The bills also would allow for premiums to vary from the index rate (the average between the highest and lowest premium for a health benefit plan) by up to 80%. This removes the implicit subsidy from the healthy to the sick provided by community rating. It will likely result in less affordable premiums for the riskiest customers and reduced premiums for lower-risk customers.

- **Continues Community Rating on Existing Products**
  Only existing products would remain community rated and they will be closed to new enrollment.

- **Can Increase Rates Without Commissioner Approval**
  The proposed legislation would allow BCBSM to “file and use” any rate increases. BCBSM would no longer have to get Commissioner approval or be subject to a public hearing before increasing its rates.

- **Higher Claims Loss Ratio Will Allow for Higher Premiums**
  Rates would be considered presumptively valid so long as the anticipated claims loss ratio (claims over premiums) was 70% or higher. With a 98% claims loss ratio on its individual non-group product in 2006, BCBSM would be able to increase its premiums on this product by almost 40% and still comply with the proposed regulation.17

Furthermore, the “file and use” change discussed above would allow premium increases without Commissioner approval. Based on BCBSM’s 2006 individual premiums, this could result in BCBSM collecting over $150 million in additional premiums. BCBSM would also be able to raise the rates on many other products.

**Eliminates Other Differences Between BCBSM and For-Profit Insurers**

- **Expands Limit on Coverage for Pre-Existing Conditions**
  The proposed bills would reduce BCBSM’s role as insurer of last resort by increasing from 6 months to 12 months the time under which Blue Cross does not have to cover treatment for pre-existing conditions that were diagnosed six months before enrollment.

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17. State of Michigan Office of Financial and Insurance Services, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
In 2006, BCBSM had premiums of $122.2 million in the individual non-group product and $119.5 million in claims resulting in a 98% claims loss ratio. Premiums could be increased to $170.7 million to achieve a 70% claims loss ratio. This would be an increase of 39.7% in premiums.
II. BCBSM’s Tax Treatment

FEDERAL AND STATE TAXATION

Like other nonprofit insurers, all Blue Cross and Blue Shield companies in the U.S. were exempt from paying federal taxes for most of the twentieth century. They were exempt under section 501(c)(4) of the Internal Revenue Code because they were “not organized for profit but operated exclusively for the promotion of social welfare.” This changed in 1986 when the U.S. Congress revoked the tax exempt status of most nonprofit insurers. Congress enacted section 501(m) of the Internal Revenue Code, which states that insurers will not be granted a tax exemption when “commercial-type insurance” is a substantial part of its activities. Since a substantial portion of Blue Cross Blue Shield of Michigan’s activities are similar to those of commercial insurers, it lost its federal tax exemption.

Most states grant a state tax exemption to businesses if they are exempt from federal taxes (a “tag-along” provision). Therefore, as a result of losing their federal tax exemption as a nonprofit organization, nonprofit health insurers like Blue Cross Blue Shield also lost state tax exemptions that were based on the federal tax status. Today, most nonprofit health insurers are treated similarly to their for-profit counterparts and pay income tax at both the federal and state levels. Favorable tax treatment is now only available to insurers in the following two scenarios:

1. The insurer is an HMO. Qualifying health maintenance organizations (HMOs) continue to have a federal tax exemption under §501(c)(4). As a result of the federal tax exemption, many states offer HMOs tax exemptions as well.
2. A state government has created a special status for the insurer. Some states have created a special status for one or more insurers. This status gives them exemption from state taxes even though they are not exempt from federal taxes.

BCBSM’S TAX STATUS IN MICHIGAN

For-profit health insurers pay state and/or local taxes in Michigan while Blue Cross Blue Shield of Michigan does not pay most state and local taxes. Section 102 of Public Act 350 of 1980 gave Blue Cross Blue Shield of Michigan this benefit in exchange for certain burdens placed on the insurer: “Each corporation subject to

18. United States Code Title 26 Section 501(c)(4). Exemption from tax for “Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. [The exemption] shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.”

19. United States Code Title 26 Section 501(m)(1), “An organization described in [501(c)(3) or 501(c)(4)] shall be exempt from tax...only if no substantial part of its activities consists of providing commercial-type insurance.”[Emphasis added]

20. The “tag along” state exemption from taxes can be found in each tax statute.

21. For-profit insurers pay taxes on premiums and property taxes, among others. Health maintenance organizations are subject to real and personal property taxes.
this act is declared to be a charitable and benevolent institution and its funds and property shall be exempt from taxation by this state or any political subdivision of this state.”22

BCBSM (the parent company) owns a mix of for-profit and nonprofit insurance subsidiaries in the following categories:

- **HMOs**: Blue Care Network of Michigan, Blue Care of Michigan, Inc., M-Caid/BlueCaid, and M-Care
- **Commercial Insurer**: Michigan Health Insurance Company
- **Property and Casualty Insurance Companies**: Accident Fund Insurance Company of America and its subsidiaries
- **Long-Term Care Insurance Companies**: LifeSecure Insurance Company and Columbia Universal Life Insurance Company23

Table 5 shows the federal and state tax status of BCBSM and each of its subsidiaries. The HMO subsidiaries do not pay federal or Michigan income taxes. The for-profit companies pay both, while BCBSM (the parent company) pays federal taxes but has a general tax exemption from state and local taxes.

### TABLE 5. Tax Status of BCBSM and its Subsidiaries as of December 31, 2006

<table>
<thead>
<tr>
<th>Parent and Subsidiary Structure</th>
<th>Type of Health Insurance</th>
<th>Subject to Federal/Michigan Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blue Cross and Blue Shield of Michigan (Parent)</td>
<td>Nonprofit Health Care Corp.</td>
<td>Yes/No</td>
</tr>
<tr>
<td>Blue Care Network of Michigan</td>
<td>HMO</td>
<td>No/No</td>
</tr>
<tr>
<td>M-Care</td>
<td>HMO</td>
<td>No/No</td>
</tr>
<tr>
<td>M-Caid (BlueCaid)</td>
<td>HMO</td>
<td>No/No</td>
</tr>
<tr>
<td>Blue Care of Michigan, Inc.</td>
<td>HMO</td>
<td>No/No</td>
</tr>
<tr>
<td>Michigan Health Insurance Company</td>
<td>For Profit</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>LifeSecure Insurance Company</td>
<td>For Profit</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>Columbia Universal Life Insurance Company</td>
<td>For Profit</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>Accident Fund Insurance Company of America</td>
<td>For Profit - Non Health</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>Accident Fund General Insurance Company</td>
<td>For Profit - Non Health</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>Accident Fund National Insurance Company</td>
<td>For Profit - Non Health</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>United Wisconsin Insurance Company</td>
<td>For Profit - Non Health</td>
<td>Yes/Yes</td>
</tr>
</tbody>
</table>


Analysis: Anderson Economic Group, LLC.

22. A general tax exemption is also given in Section 201 of Public Act 350 of 1980.
Our analysis in this section is limited to BCBSM (the parent company) and does not include its subsidiaries. BCBSM would pay several different taxes if not tax-exempt. We quantify BCBSM’s potential tax burden by applying the 2008 tax rates under current law to the 2006 tax base. The newly passed Michigan Business Tax (MBT) includes several components—a gross receipts tax, a business income tax, and a premiums tax on insurance companies. BCBSM would also pay property, sales and use taxes if it were not tax-exempt. See Table 6 below and Table A-1 on page A-2 at the end of this report.

### TABLE 6. Amount Exempted from Select Michigan Taxes for BCBSM

<table>
<thead>
<tr>
<th>Source: Anderson Economic Group, LLC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data: BCBSM 2006 Annual Report to OFIS, Assessors Offices in Southfield and Detroit.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax Category</th>
<th>2006 Tax Base ($)</th>
<th>2008 Tax Rate</th>
<th>Estimated Liability ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Michigan Business Tax</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM Gross Direct Premiums</td>
<td>5,865,134,213</td>
<td>1.25%</td>
<td>73,314,178</td>
</tr>
<tr>
<td>Gross Receipts&lt;sup&gt;a&lt;/sup&gt;</td>
<td>700,971,000</td>
<td>0.8%</td>
<td>5,607,768</td>
</tr>
<tr>
<td>Business Income&lt;sup&gt;b&lt;/sup&gt;</td>
<td>189,069,000</td>
<td>4.95%</td>
<td>9,358,916</td>
</tr>
<tr>
<td>Examination Fee Credit to MBT</td>
<td>963,375</td>
<td>-50.00%</td>
<td>(481,688)</td>
</tr>
<tr>
<td>Compensation Credit to MBT</td>
<td>343,818,074</td>
<td>-0.37%</td>
<td>(1,272,127)</td>
</tr>
<tr>
<td><strong>Total MBT Liability</strong></td>
<td></td>
<td></td>
<td><strong>85,665,499</strong></td>
</tr>
</tbody>
</table>

| **Property Taxes**                  |                   |               |                         |
| Real Property                       | 445,847,991       | 3.8%<sup>c</sup> | 16,939,236             |
| Personal Property                   | 128,934,235       | 5.2%          | 6,690,397              |
| 12 Mil Exemption                    | 128,934,235       | -1.2%         | (1,547,211)            |
| **Total Property Tax Liability**    |                   |               | **22,082,423**         |

| **Sales and Use Taxes<sup>d</sup>** |                   |               |                         |
| Purchases of Goods                  | 69,985,885        | 6%            | 4,199,153              |

| **Total Estimated Tax Liability**   |                   |               | **$111,947,075**       |

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<sup>a</sup> Actual gross receipts for BCBSM exceed $8 billion on ASC services, but the MBT Act excludes gross receipts that are received by a business acting solely as an agent and providing a service for a third party.

<sup>b</sup> Includes $27.3 million of business income on ASC services and $161.8 million of investment earnings.

<sup>c</sup> This reflects different millage rates in Southfield, Detroit, and the rest of the state.

<sup>d</sup> We do not include estimates for the newly-passed use tax on services.

As shown in Table 6, above, using BCBSM’s 2006 financial information and the newly-passed Michigan Business Tax, we estimate BCBSM’s tax liability would be approximately $112 million. This includes $85.7 million in MBT liability, $22.1 million in property taxes, and $4.2 million in sales and use taxes.
BCBSM's Tax Treatment

million in property (real and personal) tax liability, and $4.2 million in sales and use taxes.

MICHIGAN BUSINESS TAX

The Michigan Business Tax Act (MBT) was passed as Public Act 36 of 2007. It takes effect January 1, 2008. There are several taxes that are imposed by the MBT including a gross receipts tax, a business income tax, and a gross premiums tax for insurance companies. Insurance companies that pay the gross premium tax do not also pay gross receipts and business income taxes on the same revenue. Section 235(3) of the MBT Act contains an “in lieu of” clause that states:

The tax calculated under this chapter is in lieu of all other privilege or franchise fees or taxes imposed by this act or any other law of this state, except taxes on real and personal property, taxes collected under the general sales tax act, 1933 PA 167, MCL 205.1 to 205.78, and taxes collected under the use tax act, 1937 PA 94, MCL 205.91 to 205.111, and except as otherwise provided in the insurance code of 1956, 1956 PA 218, MCL 500.100 to 500.8302.

The gross receipts and business income taxes only apply to other non-insurance earnings by BCBSM.

Gross Direct Premiums Tax

Section 235 of the MBT defines the gross direct premiums tax for insurance companies and states: “The tax imposed by this chapter on each insurance company shall be a tax equal to 1.25% of gross direct premiums written on property or risk located or residing in this state.” In 2006, BCBSM had gross direct premiums of $5.86 billion. The resulting MBT liability is $73.3 million. See Table 6 on page 16.

Gross Receipts Tax

Section 203 of the MBT contains the gross receipts tax and states:

Except as otherwise provided in this act, there is levied and imposed a modified gross receipts tax on every taxpayer with nexus as determined under section 200. The modified gross receipts tax is imposed on the modified gross receipts tax base, after allocation or apportionment to this state at a rate of 0.80%.

As a result of the “in lieu of” clause of section 235, this tax does not apply to the receipts from insurance premiums. It does, however, apply to any other business activity of BCBSM not covered by the gross direct premiums tax. Particularly, section 235 includes administrative service contracts (ASCs), or third party administrator businesses. ASCs are a significant portion of BCBSM’s business.

Gross receipts are defined in section 111 of the MBT as “the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or

to others.” Under this definition, it would appear at first that the entire ASC premiums of $8.3 billion are subject to the 0.8% tax. However, the ASC business, defined above, would most likely fall under section 111(1)(b)(i) which excludes:

Amounts received by the taxpayer as an agent solely on behalf of the principal that are expended by the taxpayer for...the performance of a service by a third party for the benefit of the principal that is required by law to be performed by a licensed person.

Under this exclusion, the ASC revenue, less claims paid on behalf of the principal, would be subject to the tax. In 2006, the 0.8% tax on $701 million gross receipts would result in $5.6 million.

**Business Income Tax**

Section 201 of the MBT contains the business income tax and states that:

Except as otherwise provided in this act, there is levied and imposed a business income tax on every taxpayer with business activity within this state unless prohibited by 15 USC 381 to 384. The business income tax is imposed on the business income tax base, after allocation or apportionment to this state, at the rate of 4.95%.

BCBSM would pay a business income tax on the ASC business described above. In 2006, BCBSM’s business income was $27.3 million before any cross-product subsidies. This would result in a tax of $1.4 million.

In addition, BCBSM has significant investment earnings. The business income tax includes most income from investments. If subject to income tax on all of its $161 million of investment income in 2006, BCBSM would pay $8 million.

**MBT Credits**

The MBT Act has several credits applicable to insurance companies, which are outlined in sections 237 and 239 of the Act. Section 237 provides credits for payments to the following:

- Michigan worker's compensation placement facility
- Michigan basic property insurance association
- Michigan automobile insurance placement facility
- Property and casualty guaranty association
- Michigan life and health guaranty association

Furthermore, section 239(1) of the MBT provides “a credit against the tax imposed under this chapter in an amount equal to 50% of the examination fees paid by the

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26. Ibid.
27. Ibid.
BCBSM’s Tax Treatment

insurance company during the tax year pursuant to section 224 of the insurance code of 1956, 1956 PA 218, MCL 500.224.” It does not appear that BCBSM made any payments pursuant to section 237. According to BCBSM’s annual filing with OFIS, BCBSM paid approximately $1 million for regulatory licenses and fees. We assume all of these qualify under section 239(1) and result in a credit of $481,688.

Section 239(2) of the MBT states that:

An insurance company that does not make any of the payments described under section 237... may claim a credit against the tax imposed under this act as provided under section 403(2), not to exceed 65% of the insurance company's tax liability for the tax year after claiming the other credits allowed by this chapter.

Section 403(2) defines the compensation credit provided by the MBT. The 0.37% credit is applied to wages, salaries, fees, and other payments made on the behalf of employees. Applied to BCBSM’s 2006 compensation of $577 million, BCBSM would receive a $2.1 million credit.

PROPERTY TAXES

Section three of the Michigan State Constitution states that “The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property.” BCBSM owns real and personal property throughout the state of Michigan. If BCBSM did not have the tax exempt status under PA 350 of 1980, it would pay tax on all of its property.

BCBSM provides the Office of Financial and Insurance Services with the cost, book value, and fair value of the real estate it owns. For property tax purposes, the fair value is the most relevant measure of value so long as it does not exceed the


29. MCL 208.1403(2) [Sec. 403 (2)]: Subject to the limitation in subsection (1), a taxpayer may claim a credit against the tax imposed by this act equal to 0.370% of the taxpayer's compensation in this state. For purposes of this subsection, a taxpayer includes a person described in section 239(2) and subject to the tax imposed under chapter 2A. A professional employer organization shall not include payments by the professional employer organization to the officers and employees of a client of the professional employer organization whose employment operations are managed by the professional employer organization. A client may include payments by the professional employer organization to the officers and employees of the client whose employment operations are managed by the professional employer organization.

30. MCL 208.110 (2)[Sec. 107]: “Compensation” means all wages, salaries, fees, bonuses, commissions, other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayers, and any earnings that are net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer.

maximum taxable value increases set forth in the Constitution (the lesser of the increase in the immediately preceding year in the general price level, or 5 percent). However, the fair market values provided by BCBSM in 2006 for several significant parcels were based on appraisals from 1998. Therefore, for Detroit and Southfield (which is where the majority of BCBSM’s real estate is located) we collected actual information from the assessor’s offices in each city and estimated a cash value for those properties.

**Real Property**

**Southfield.** BCBSM has a “Metro Service Center” in Southfield. In the tax records, this consists of four parcels located at 27300 W. Eleven Mile Road. The tax records provide a cash value for the land as well as the square footage of the buildings. The commercial assessor provided an estimate that cash value in that area of Southfield ranges between $94 and $133 per square foot. BCBSM states that the cost of the property was $96 million. This is consistent with a per-square-foot value of $125, which would yield a value of $88 million. Rounding to the nearest $10 million, we used $90 million in our tax estimate. With a 2008 millage rate of 54.42, the property tax for the Southfield property would be $2.5 million.\(^{34}\)

**Detroit.** BCBSM has several pieces of real property in Detroit: the Tower Service Center and parking garage, the Jefferson facility and parking garage, and the Bricktown Customer Service Center and parking garage. In the tax records, this consists of seven parcels. The tax records provide a cash value for the land as well as the square footage of the buildings. We were not able to obtain an average per square

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32. Section 3 of the Michigan State Constitution of 1963: The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law except for taxes levied for school operating purposes. The legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 percent; and for a system of equalization of assessments. For taxes levied in 1995 and each year thereafter, the legislature shall provide that the taxable value of each parcel of property adjusted for additions and losses, shall not increase each year by more than the increase in the immediately preceding year in the general price level, as defined in section 33 of this article, or 5 percent, whichever is less until ownership of the parcel of property is transferred. When ownership of the parcel of property is transferred as defined by law, the parcel shall be assessed at the applicable proportion of current true cash value. The legislature may provide for alternative means of taxation of designated real and tangible personal property in lieu of general ad valorem taxation. Every tax other than the general ad valorem property tax shall be uniform upon the class or classes on which it operates. A law that increases the statutory limits in effect as of February 1, 1994 on the maximum amount of ad valorem property taxes that may be levied for school district operating purposes requires the approval of 3/4 of the members elected to and serving in the Senate and in the House of Representatives.


34. Millage rates obtained from the Michigan Department of Treasury at https://treas-secure.state.mi.us/ptestimator/PTEstimator.asp.

Calculation of the tax is as follows: \([\text{estimated cash value} \times 50\%] / 1000 \times \text{millage rate}\).
foot value from the assessor’s office. We estimated a value of $146 per square foot using the rate for the Southfield properties and rental rate comparisons for Southfield and Detroit.\textsuperscript{35}

Using $146 per square foot, the estimated total cash value for the property is $312 million. To be conservative, we used $300 million in our tax estimate. With a millage rate of 83.96, the property tax for the Detroit property would be $13 million.

**Other Properties.** The properties owned by BCBSM in other locations have all combined for purposes of the tax calculation. The fair value of these properties provided by BCBSM is $56 million.\textsuperscript{36} If subject to the statewide average millage of 51.89, the property tax on these properties would be $1.5 million.\textsuperscript{37}

See Table 1, "Amount Exempted from Select Michigan Taxes for BCBSM," and "Property Analysis for Blue Cross Blue Shield of Michigan, 2006" in Appendix A for our detailed analysis.

**Personal Property**

**BCBSM Owned Personal Property.** BCBSM reports ownership of $14 million of furniture and equipment which would be subject to the commercial personal property tax.\textsuperscript{38} If subject to the statewide average millage of 51.89, the property tax on this property would be slightly less than $1 million.

**Leased Personal Property.** In 2003, BCBSM transacted two sale and leaseback agreements for computer hardware and software. The remaining lease obligation at December, 31, 2006 was $115 million.\textsuperscript{39} Leasehold interests are included in taxable property.\textsuperscript{40} If subject to the statewide average millage of 51.89, the property tax on this property would be $6 million.

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\textsuperscript{35} According to Grubb & Ellis *Office Market Snapshot for Detroit Third Quarter 2007*, the rental rate for Class A property in Southfield is $22.52 and in the Central Business District of Detroit it is $26.29. We used the rental rate ratio to estimate the owned property value of Blue Cross’s property in Detroit. We calculated the cash value per square foot of Blue Cross’s property in Detroit by multiplying the Southfield owned rate per square foot ($125) by the rental ratio for the two cities (26.29/22.52).


BCBSM's Tax Treatment

12 Mill Exemption for Personal Property Passed with MBT

When the Legislature passed the MBT it also amended the School Code (MCL 380.1211) to exempt commercial personal property from 12 of the 18 school operating mills. This 12 mill reduction has been applied to BCBSM’s personal property of $129 million and results in a $1.5 million exemption.41

SALES AND USE TAXES

Prior to the passage of the MBT, insurance companies were not subject to sales and use taxes under the Single Business Tax. However, the “in lieu of” clause in the MBT excludes sales and use taxes, and therefore, if BCBSM were not tax exempt, it would pay sales tax.42

We estimate the value of products subject to the sales tax purchased by BCBSM by adding the following actual 2006 expenditures by BCBSM: $8.7 million in printing and office supplies and $61 million for EDP equipment and software.43 We estimate the annual cost of the equipment and software using the annual depreciation amount. Other services and goods are likely to be included in the taxable basis for sales tax, but have been excluded from our analysis. At a 6% sales tax rate, the liability for BCBSM would be $4 million.

DATA SOURCES

We used 2006 financial information to create our estimated tax liability for BCBSM. The primary sources of information were BCBSM’s Annual Statement submitted to OFIS, BCBSM Annual Report, and property tax data provided by Detroit and Southfield Assessors. Relevant tax rate information was obtained from the Michigan Compiled Laws, and relevant state agencies. See Table A-1 on page A-2 in the appendix for specific source notes.

LIMITATIONS OF THIS ANALYSIS

We completed this analysis using reasonably conservative assumptions and actual financial data where available. Even using these methods, we recognize certain limitations on the accuracy of our estimates, including:

- We base our market share and tax base estimates on reported past activities. Future activities will be different, but we consider past actions to be representative.
- Tax laws, and tax rates, change over time. Our analysis does not account for possible future state and local tax rate changes.
- In general, we relied on the company’s own practices for recording revenues and allocation costs. These practices reflect the company’s own business decisions, as well as applicable accounting rules.

41. Calculation is as follows: [$129 million/1000) * 12.
42. Section 235(3) of the MBT states “The tax calculated under this chapter is in lieu of all other privilege or franchise fees or taxes imposed by this act or any other law of this state, except taxes on real and personal property, taxes collected under the general sales tax act...”
BCBSM's Tax Treatment

- We did not base our tax estimate on Blue Cross’s actual tax records. We did not have access to the company’s federal income tax return.
- Although we requested several times a meeting with Blue Cross in October to review the tax analysis, as of the date of this report the company has not scheduled such a meeting with us.
III. Blue Cross’s Market Presence and Profitability in Michigan

Most Michigan residents have health insurance. In 2006, over six million residents in Michigan (61% of the total population) had private health insurance. Another 2.8 million (28%) received health insurance through a government-sponsored program (mostly Medicaid and Medicare) while 10% of the population was uninsured.44 The health insurance market in Michigan consists of the following types of insurance:

- **Commercial Group (fully insured)**
  Purchased by employers for, or on behalf of, their employees.45

- **Commercial Group (partially insured/stop loss)**
  Purchased by employers for, or on behalf of, their employees. Employer assumes risk of claims up to a predetermined level.

- **Commercial Individual**
  Purchased by individuals who are self-employed or unemployed, or whose employers do not offer group insurance, or who cannot afford or do not qualify for the coverage. Often purchased through an association. This includes both individual insurance plans and group conversion.

- **Ancillary Commercial Products**
  Dental, Vision, Short Term, and Health Savings Accounts.

- **Government Sponsored Products**
  Medicare Supplement, Medicare Part D, Medicaid, MiChild, and Medicare Advantage.46

- **Other Products**
  Long Term Care and Disability Income.47

Blue Cross offers products in these categories and offers administrative service contracts (ASC) to groups. ASCs place the risk of loss from claims on the group, not the administrator. The group benefits from using the administrator’s provider network and claims cost structure; the administrator earns revenue while taking no insurance risk.

In 2006 health insurers wrote approximately $18 billion of premiums in Michigan. Of this total, 61% ($10.9 billion) of premiums was for commercial group coverage (fully insured), 1% ($260 million) of premiums was for commercial group coverage (partially insured), 4% ($713 million) was for commercial individual coverage, 5%...
Blue Cross’s Market Presence and Profitability in Michigan

($897 million) was for ancillary commercial products, 24% ($4.3 billion) was in government sponsored programs, and 5% ($905 million) was in other products.\(^{48}\) Figure 1 summarizes market share by premiums.

**FIGURE 1. Michigan Health Insurance Premiums Written by Insurance Type (2006)**

While there are over 400 insurers in the Michigan market, market share is very concentrated among the top insurers. Of the $18 billion in health insurance premiums written in Michigan in 2006, $12.5 billion (almost 70%) were written by ten insurers. These insurers include health maintenance organizations, nonprofit and commercial insurers.\(^{49}\)

\(^{49}\) Ibid.
Table 7 illustrates the premiums written and market share of the top ten health insurers in Michigan. BCBSM and two of its HMO subsidiaries are in the top ten; the three have a combined market share of 44% of the insured market. Specifically:

- **BCBSM (the parent company)** had the greatest market share with 33% of the total health market—almost $6 billion of premiums written in 2006. In addition to the insurance premiums written, BCBSM also acted as an administrator of self-funded plans for an additional $8.3 billion of premium-equivalents.

- **Blue Care Network of Michigan**, an HMO owned by BCBSM, was the third largest with 9% market share, trailing only slightly behind Health Alliance Plan of Michigan, which was second largest with $1.59 billion premiums.

- **M-Care**, another HMO owned by BCBSM, was also in the top ten with a 3% share of the market ($500 million in premiums).

**TABLE 7. Top Ten Health Insurance Providers in Michigan by all Premiums Written (2006)**

<table>
<thead>
<tr>
<th>Provider</th>
<th>Type of Insurer</th>
<th>Premiums Written (in millions)</th>
<th>Percent of Total</th>
<th>BCBSM Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blue Cross Blue Shield of Michigan a</td>
<td>HMDI b</td>
<td>$5,865</td>
<td>33%</td>
<td>*</td>
</tr>
<tr>
<td>Health Alliance Plan of Michigan</td>
<td>HMO c</td>
<td>1,587</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Blue Care Network of Michigan</td>
<td>HMO</td>
<td>1,572</td>
<td>9%</td>
<td>*</td>
</tr>
<tr>
<td>Priority Health</td>
<td>HMO</td>
<td>1,084</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>Molina Healthcare of Michigan, Inc.</td>
<td>HMO</td>
<td>499</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>M-Care</td>
<td>HMO</td>
<td>468</td>
<td>3%</td>
<td>*</td>
</tr>
<tr>
<td>Healthplus of Michigan, Inc.</td>
<td>HMO</td>
<td>403</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Delta Dental Plan of Michigan, Inc.</td>
<td>HMDI</td>
<td>395</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Humana Insurance Company</td>
<td>INS d</td>
<td>333</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Care Choices HMO e</td>
<td>HMO</td>
<td>301</td>
<td>2%</td>
<td></td>
</tr>
</tbody>
</table>

**Total Ten Top Insurers by Market Share**

$12,507 69%

**Memo:**

- **Three BCBSM Companies in the Top Ten**
  - Health Alliance Plan of Michigan
  - Blue Care Network of Michigan
  - M-Care

- **Michigan Total (Over 400 Insurers)**
  - $18,056 100%

**Source:** State of Michigan Office of Financial & Insurance Services, Compilation of Forms 0322 (Michigan Health Insurance Enrollment, Premiums & Losses) for 2006.

**Analysis:** Anderson Economic Group, LLC

a. Does not include BCBSM non-funded (self-insured plans) where it acts as the administrator for ASCs. Equivalent “premiums” for ASCs exceed BCBSM’s premiums for funded plans.

b. Health, Medical, Dental Indemnity (HMDI) are insurer-like entities formed under specific enabling authority. In Michigan, the only entities under the HMDI designation are Delta Dental Plan of Michigan, Michigan Dental Plan, and Blue Cross Blue Shield of Michigan.

c. Health Maintenance Organizations (HMOs) deliver health care services that are defined under the terms of the contract. They operate directly through contracts with affiliated providers, in exchange for a fixed prepaid sum or per capita prepayment, without regard to the frequency, extent, or kind of health services.

d. Commercial insurer.

e. Care Choices recently merged into Priority Health.
Commercial insurers have only 20% of the insured commercial market with the largest commercial insurer, Humana, having only 2%. The remaining 30% of the premiums not written by the top ten are written by over 400 insurers. See Table 7 on page 26.

**BCBSM’S MARKET SHARE**

BCBSM has significant market share in the insured commercial market (groups and individuals). In 2006, BCBSM wrote $4.8 billion (44%) of the commercial group (fully insured) premiums. With its subsidiaries, BCBSM wrote $6.7 billion premiums or 61% of the market. BCBSM writes the majority of commercial group (partially insured) premiums (52%) and has over a third (35%) of the individual market premiums. BCBSM has over 10% of the market in each ancillary commercial products and government-sponsored insurance. Table 8 summarizes BCBSM’s market share in the various markets.

**TABLE 8. BCBSM Market Share (With and Without Subsidiaries) for Major Medical and Other (2006)**

<table>
<thead>
<tr>
<th></th>
<th>Total Premiums (in millions)</th>
<th>BCBSM Only Premiums (in millions)</th>
<th>Market Share</th>
<th>BCBSM and Subsidiaries Premiums (in millions)</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Group (fully insured)</td>
<td>$10,943</td>
<td>$4,767</td>
<td>44%</td>
<td>$6,711</td>
<td>61%</td>
</tr>
<tr>
<td>Commercial Group (partially insured)</td>
<td>$260</td>
<td>$135</td>
<td>52%</td>
<td>$135</td>
<td>52%</td>
</tr>
<tr>
<td>Commercial Individual</td>
<td>$713</td>
<td>$250</td>
<td>35%</td>
<td>$272</td>
<td>39%</td>
</tr>
<tr>
<td>Ancillary Commercial Products</td>
<td>$897</td>
<td>$94</td>
<td>11%</td>
<td>$94</td>
<td>11%</td>
</tr>
<tr>
<td>Government-Sponsored</td>
<td>$4,339</td>
<td>$620</td>
<td>14%</td>
<td>$778</td>
<td>18%</td>
</tr>
<tr>
<td>Other</td>
<td>$905</td>
<td>$0</td>
<td>0%</td>
<td>$0</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$18,056</strong></td>
<td><strong>$5,865</strong></td>
<td><strong>33%</strong></td>
<td><strong>$7,990</strong></td>
<td><strong>44%</strong></td>
</tr>
</tbody>
</table>

*Memo: BCBSM’s ASC “Premiums” $8,345*


While BCBSM’s premiums market share is large, the percentage of persons Blue Cross insures is even larger. In 2006 over 70% of residents in Michigan with commercial insurance were insured by Blue Cross. Due to the large number of self-funded employers in the state, the commercial market share of BCBSM should be reviewed in terms of not only insured business, as the previous discussion has done, but also in terms of the self-funded business. To measure that, we examined total lives covered by BCBSM and its subsidiaries in the commercial market, whether on an insured, self-funded or partially insured basis. As shown in Table 9 on page 28, the number of persons covered by Blue Cross and its subsidiaries is over 4.2 million or 70% of the commercially insured population in Michigan.
BCBSM’S PRODUCT MIX

In the previous section we examined BCBSM and its subsidiaries’ market share by insurance product. In this section we look only at BCBSM (no subsidiaries) and examine the internal product mix of the company.

BCBSM offers a wide array of group and individual health insurance products as well as administrative service contracts. In 2006, commercial group (fully insured) products accounted for 48% of BCBSM’s total insured enrollment and 83% of the company’s premiums. Commercial individual products accounted for 5% of total insured enrollment and 4% of premiums. Government-sponsored products accounted for 10% of total insured enrollment and 8% of premiums. Table 10 on page 29 shows BCBSM’s enrollment and premiums collected in 2006 for each of its product lines.

---

TABLE 9. BCBSM’S 2006 Commercial Market Share in Michigan

<table>
<thead>
<tr>
<th>Category</th>
<th>Figure</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCBSM, BCN and M-Care Enrollment&lt;sup&gt;a&lt;/sup&gt;</td>
<td>4,955,231</td>
</tr>
<tr>
<td>Less: Medicare Supplement and Medicare Adv Enrollment</td>
<td>(269,199)</td>
</tr>
<tr>
<td>Less: Out-of-State Enrollment&lt;sup&gt;b&lt;/sup&gt;</td>
<td>(413,439)</td>
</tr>
<tr>
<td>Total: Net Blue Cross Commercial Enrollment in Michigan</td>
<td>4,272,593</td>
</tr>
</tbody>
</table>

Memo:

- Estimated Commercial Insured Population in Michigan<sup>c</sup> 6,091,526

**BCBSM Commercial Market Share** 70.1%


- <sup>a</sup> Data from BCBSM’s 2006 Management Discussion and Analysis filed with OFIS. BCN and M-Care reported total membership in 2006 Annual Statements.
- <sup>b</sup> Difference between total membership reported in the 2006 Management Discussion and Analysis and in-state membership reported in the 2007 Fact Book.
- <sup>c</sup> State’s population less Medicare and Medicaid recipients, plus dual eligibles, less the uninsured.

---

Blue Cross’s Market Presence and Profitability in Michigan

TABLE 10. Blue Cross Blue Shield of Michigana Enrollment and Premiums by Product Type (December 31, 2006)

<table>
<thead>
<tr>
<th>Product Type</th>
<th>Insured Enrollment</th>
<th>Percent of Total Insured Enrollment</th>
<th>Premiums (millions)</th>
<th>Percent of Total Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Group (fully insured)</td>
<td>1,234,074</td>
<td>48%</td>
<td>$4,858</td>
<td>83%</td>
</tr>
<tr>
<td>Commercial Group (partially insured)</td>
<td>880,138</td>
<td>34%</td>
<td>$135</td>
<td>2%</td>
</tr>
<tr>
<td>Commercial Individual</td>
<td>124,071</td>
<td>5%</td>
<td>$261</td>
<td>4%</td>
</tr>
<tr>
<td>Ancillary Commercial Products</td>
<td>24,309</td>
<td>1%</td>
<td>$93</td>
<td>2%</td>
</tr>
<tr>
<td>Government-Sponsored</td>
<td>245,364</td>
<td>10%</td>
<td>$449</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>61,492</td>
<td>2%</td>
<td>$68</td>
<td>1%</td>
</tr>
<tr>
<td><strong>BCBSM Total</strong></td>
<td><strong>2,569,448</strong></td>
<td><strong>100%</strong></td>
<td><strong>$5,865</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

**Memo:**

**Administrative Service Contracts**

<table>
<thead>
<tr>
<th></th>
<th>Insured Enrollment</th>
<th>Percent of Total Insured Enrollment</th>
<th>Premiums (millions)</th>
<th>Percent of Total Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1,739,084</td>
<td>100%</td>
<td>$8,345</td>
<td></td>
</tr>
</tbody>
</table>


Analysis: Anderson Economic Group, LLC.

*a. Includes Nonprofit Health Care Corporation only, not BCBSM subsidiaries.

b. ASC members are the difference between total membership as reported in the MD&A and membership in Exhibit (a). ASC premiums (premiums fees and reimbursement) as reported on page 25.12 of the Notes to the Financial Statements.*

**BCBSM’s OPERATIONS**

In 2006, BCBSM and its subsidiaries had after-tax income of $243 million (see Table 11 on page 30). The Company had $8 billion of earned premiums and $700 million of net administrative service contract fees. BCBSM paid claims (benefits provided) of approximately $7 billion and had net operating expenses of $1.7 billion. BCBSM’s revenue and expenses resulted in a $14.1 million operating loss in 2006. However, BCBSM also had $260 million of net investment income and $32.9 million in other gains. After expensing $36.6 million for federal income tax, BCBSM had positive income of $243 million.51 Table 11 on page 30 summarizes BCBSM’s Statement of Operations (income statement) for 2004-2006.

TABLE 11. Consolidated Statements of Operations for BCBSM and Subsidiaries, 2004-2006\textsuperscript{a}

<table>
<thead>
<tr>
<th>Income Statement (in millions)</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underwritten Premiums Earned</td>
<td>$7,394.8</td>
<td>$7,465.5</td>
<td>$7,985.6</td>
</tr>
<tr>
<td>ASC Revenue (Net of claims)</td>
<td>649.4</td>
<td>685.1</td>
<td>700.9</td>
</tr>
<tr>
<td><strong>Total Premium and Fee Revenue</strong></td>
<td>8,044.2</td>
<td>8,150.6</td>
<td>8,686.5</td>
</tr>
<tr>
<td>Benefits Provided</td>
<td>(6,184.4)</td>
<td>(6,257.7)</td>
<td>(7,014.2)</td>
</tr>
<tr>
<td>Change in Deficiency Reserve</td>
<td>(127.5)</td>
<td>(109.4)</td>
<td>26.5</td>
</tr>
<tr>
<td>Net Operating Expenses</td>
<td>(1,462.6)</td>
<td>(1,594.4)</td>
<td>(1,712.9)</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>(7,774.5)</td>
<td>(7,961.5)</td>
<td>(8,700.6)</td>
</tr>
<tr>
<td>Operating (Loss) Gain</td>
<td>269.7</td>
<td>189.1</td>
<td>(14.1)</td>
</tr>
<tr>
<td>Investment and Other Income (Net)</td>
<td>204.3</td>
<td>190.2</td>
<td>260.8</td>
</tr>
<tr>
<td>Provision for Federal Income Tax</td>
<td>(86.5)</td>
<td>(42.4)</td>
<td>(36.6)</td>
</tr>
<tr>
<td>Other Gain (Loss)</td>
<td>23.5</td>
<td>(42.0)</td>
<td>32.9</td>
</tr>
<tr>
<td><strong>Comprehensive Income</strong></td>
<td>$411.0</td>
<td>$294.9</td>
<td>$243.0</td>
</tr>
</tbody>
</table>

Memo: Subscriber Reserve Level $2,302.3 $2,597.2 $2,840.2


\textsuperscript{a} BCBSM’s Consolidated Financial Statements are prepared in accordance with Generally Accepted Accounting Principles (GAAP). Information provided to the Office of Financial and Insurance Services (OFIS) of Michigan are prepared in accordance with Statutory Accounting Rules. Difference in balance sheet items and income statements exist.

BCBSM had an operating gain in 2004 and 2005, but an operating loss in 2006. According to BCBSM, the decline in income from 2005 to 2006 was:

in part anticipated and deliberate, as profit margins were pulled back in 2006 [for] premium rates and fees charged to self-insured group customers. The margin reductions were in response to increased competitive pressures and a weak Michigan economy, as well as a desire to maintain subscriber reserves at levels appropriate for a not-for-profit company. Also restraining operating results were underwriting losses in the Company’s Medicare Supplemental and individual markets, as medical inflation continues to outpace premium rates for these products. In total, these factors contributed to a small operating loss of $14.1 million, compared to a $189.1 million gain in 2005.\textsuperscript{52}

\textsuperscript{52} Blue Cross Blue Shield of Michigan, Consolidated Financial Statements for Years Ended December 31, 2006 and 2005.
BCBSM RESERVE LEVEL

Comprehensive income gains and losses affect the subscriber reserve level, also called the total adjusted capital. The subscriber reserve level is similar to retained earnings for a private company, and officially comprise the company’s cushion against future hard times. Contrary to popular belief, nonprofit companies can earn profits. They are, however, restricted in the distribution of the profits. In the case of BCBSM, income gains or “profits” are added to the subscriber reserve level (also referred to as capital and surplus). BCBSM’s reserve level has increased from $1.3 billion in 2001 to $2.8 billion in 2006 (using GAAP) for an annual compound growth rate of 17%.\(^5\) See Figure 2 for the reserve level (surplus) the past five years.

**FIGURE 2. BCBSM Reserve Level, 2001-2006**

![BCBSM Reserve Level, 2001-2006](image)

Data Source: 2001-2006 BCBSM Annual Statements; BCBSM Management Discussion and Analyses Analysis: Anderson Economic Group, LLC
Note: Subscriber reserve level calculated using GAAP.

Although BCBSM’s reserve level is growing significantly, it is still within the reserve parameters established by law. Section 204(a) of Public Act 350 states that BCBSM “shall not maintain a surplus [reserve level] in an amount that equals or is greater than 200% of the authorized control level under risk-based capital requirements multiplied by 5.”\(^5\) In other words, BCBSM cannot have a surplus that is greater than 10 times (1000%) of its authorized control level based on risk-based capital. Risk-based capital is a measure of the reserves allowed for a given level of

\(^{53}\)State of Michigan Office of Financial and Insurance Services, Blue Cross Blue Shield of Michigan Annual Statement for 2006: Five Year Historical Data. The 2006 total subscribers’ reserves using SAP were $2.5 billion.
financial risk. Risk-based capital is calculated using a complex formula that accounts for BCBSM’s underwriting, business, investment, credit, and subsidiary risk. Table 12 summarizes BCBSM’s reserve level using Statutory Accounting Principles (SAP), authorized control level based on risk-based capital, and reserve ratio for 2002-2006.


<table>
<thead>
<tr>
<th>Year</th>
<th>Reserve Level (surplus in millions)(^\text{b})</th>
<th>Authorized Control Level (in millions) (based on risk-based capital)</th>
<th>Reserves to Risk-Based Capital Ratio</th>
<th>Memo: GAAP Reserve Level (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$1,532</td>
<td>$268</td>
<td>572%</td>
<td>$1,532</td>
</tr>
<tr>
<td>2003</td>
<td>$1,898</td>
<td>$300</td>
<td>633%</td>
<td>$1,891</td>
</tr>
<tr>
<td>2004</td>
<td>$2,244</td>
<td>$283</td>
<td>793%</td>
<td>$2,302</td>
</tr>
<tr>
<td>2005</td>
<td>$2,461</td>
<td>$276</td>
<td>892%</td>
<td>$2,597</td>
</tr>
<tr>
<td>2006</td>
<td>$2,501</td>
<td>$318</td>
<td>786%</td>
<td>$2,840</td>
</tr>
</tbody>
</table>


Analysis: Anderson Economic Group, LLC

\(^\text{a}\) Information provided to the Office of Financial and Insurance Services of Michigan are prepared in accordance with Statutory Accounting Rules, and do not exactly match financial statement prepared by BCBSM in accordance with GAAP.

\(^\text{b}\) Beginning January 1, 2004 BCBSM began a transition from GAAP accounting to SAP accounting. Figures presented for 2004-06 reflect transition accounting; figures presented for 2002-03 reflect GAAP.

The ratio neared 900% (or 9 times) the authorized control level in 2005. The ratio decreased to 800% in 2006 due, in part, to the $257 million acquisition of M-Care by BCBSM. Statutory accounting does not recognize a portion of the amounts paid for goodwill, which is the excess of purchase price over book value when a company is acquired. In this way, the purchase of subsidiaries allows BCBSM to permanently lower its offered reserve level while acquiring assets like M-Care.

When the risk-based reserve requirements were originally established, insurers were less certain if they would be able to collect outstanding premiums quickly.

54. Michigan Compiled Laws, Section 550.1204(a) (Public Act 350 of 1980): “Subject to this subsection, a health care corporation shall not maintain surplus in an amount that equals or is greater than 200% of the authorized control level under risk-based capital requirements multiplied by 5. If a health care corporation files a risk-based capital report that indicates that its surplus is more than the allowable maximum surplus permitted under this subsection for 2 successive calendar years, the health care corporation shall file a plan for approval by the commissioner to adjust its surplus to a level below the allowable maximum surplus.”

55. Risk-based capital is a complex formula based on underwriting risk (risk that the premiums collected will not be sufficient to cover the claims), administrative and business risk (risk that administrative and business costs will be higher than anticipated), investment risk (risk that investments will not pay out as expected if liquidated), subsidiary risk (risk that a subsidiary will have a loss), and credit risk for ASC business (risk that company will not be able to reimburse BCBSM for claims paid on its behalf).
With more modern collection mechanisms and real-time reporting, a 1000% RBC ratio is considered by some within the industry to be excessive since a company can react today more timely to changes within the market.

**PROFITABILITY BY PRODUCT**

In 2006, BCBSM had an overall profit margin of 1%. Profitability varies greatly across products. Table 13 summarizes the profitability for BCBSM’s products for group insurance, individual insurance, Medicare Supplement and Medicare Advantage, and Administrative Service Contracts.\(^{56}\) Group coverage was Blue Cross’s most profitable product with a 6.8% profit margin and an operating gain of $314 million while Medicare Supplement/Medicare Advantage was its least profitable product with a profit margin of -40.5% and an operating loss of $139 million.

The premiums for some products include cross product subsidies. ASC and group products collected subsidies (as part of the customer premiums) in the amount of $137 million, and transferred them to the individual and Medicare Supplement/Medicare products. This reduced the operating loss that these products would have otherwise had.

**TABLE 13. Profitability of BCBSM’s Segments for 2005**

<table>
<thead>
<tr>
<th></th>
<th>Revenue</th>
<th>Cross Product Subsidies</th>
<th>Benefits Provided</th>
<th>Admin. Expenses</th>
<th>Operating Gain (Loss)</th>
<th>Profit Margin(^b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative Service Contracts(^c)</td>
<td>$8,314</td>
<td>($55)</td>
<td>($7,566)</td>
<td>($671)</td>
<td>$22</td>
<td>0.3%</td>
</tr>
<tr>
<td>Group(^d)</td>
<td>4,719</td>
<td>(82)</td>
<td>(3,827)</td>
<td>(496)</td>
<td>314</td>
<td>6.8%</td>
</tr>
<tr>
<td>Individual - Non-Group</td>
<td>107</td>
<td>(1)</td>
<td>(118)</td>
<td>(7)</td>
<td>(20)</td>
<td>-19.3%</td>
</tr>
<tr>
<td>Individual - Group Conversion</td>
<td>116</td>
<td>25</td>
<td>(178)</td>
<td>(11)</td>
<td>(49)</td>
<td>-34.6%</td>
</tr>
<tr>
<td>Medicare Supplement/Medicare Advantage</td>
<td>231</td>
<td>112</td>
<td>(432)</td>
<td>(50)</td>
<td>(139)</td>
<td>-40.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$13,486</td>
<td>$0</td>
<td>($12,122)</td>
<td>($1,236)</td>
<td>$128</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

*Note: May be slight differences in totals due to rounding.*

*Source: State of Michigan Office of Financial & Insurance Services, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.*

*Analysis: Anderson Economic Group, LLC*

\(^a\) ASC, group, and individual markets are estimates based on aggregates of BCBSM segments reported to OFIS.

\(^b\) Calculated as Operating Gain/(Loss) / (Revenue plus Cross Product Subsidaries).

\(^c\) Includes the following BCBSM segments: ASC & Other, Auto, and National Non-Auto. These are the type of customers.

\(^d\) Includes the following BCBSM segments: Experience Rated, Area, and Industry.

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\(^{56}\) State of Michigan Office of Financial & Insurance Services, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
BCBSM has a higher gross profit margin (percentage of premiums remaining after the payment of claims) than the remaining insurers in the commercial group market. To quantify this advantage, we compared BCBSM’s premiums and claims for its commercial group product (fully insured) to the remainder of the market (excluding BCBSM subsidiaries). The market for commercial group products has many insurers competing for business.

In the group market in 2006, BCBSM collected average premiums of $252 per-insured-per-month. The remainder of the market, excluding BCBSM subsidiaries, on average collected the same amount ($252). However, BCBSM paid average claims of $212 per-insured-per-month, while the remainder of the market paid average claims of $222 per-insured-per-month. This resulted in BCBSM having a gross profit per-insured-per-month (to apply toward administrative costs and profit) that was $10 higher than the other competitors in the market.

These premium and claim amounts result in a claims loss ratio (the ratio of claims paid out by the company to premiums received) of 84.2% for BCBSM and 87.9% for the remainder of the market. This means that for every dollar of premiums BCBSM collected, it had 15.8 cents left for administrative expenses and profit. The remainder of the market had 12.1 cents for every dollar of premiums collected.

Table 14 summarizes the comparison of commercial group profitability for BCBSM and the remainder of the market in 2006.

### TABLE 14. Comparison to Market for Gross Profitability of Commercial Group (Fully Insured), 2006

<table>
<thead>
<tr>
<th>Per Insured Per Month</th>
<th>BCBSM</th>
<th>Remainder of Market</th>
<th>BCBSM Advantage/Disadvantage to Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>$251.6</td>
<td>$252.2</td>
<td>$(0.6)</td>
</tr>
<tr>
<td>Claims</td>
<td>$(211.8)</td>
<td>$(221.8)</td>
<td>$10.0</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$39.8</td>
<td>$30.5</td>
<td>$9.4</td>
</tr>
<tr>
<td>Claims Loss Ratio</td>
<td>84.2%</td>
<td>87.9%</td>
<td>3.7 Percentage Points</td>
</tr>
</tbody>
</table>


Analysis: Anderson Economic Group, LLC.

a. Remainder of market excluding BCBSM subsidiaries. A small number of insurers were removed from the data set due to incomplete data submissions.

b. BCBSM’s premiums include a reduction of an $85 million subsidy payment, based on subsidy from 2005.

A 3.7 percentage point gross profit advantage means BCBSM profits are $138 million higher (on $3.7 billion of commercial group product) than they would be without the advantage. This advantage may come from several factors: lower reimbursement rates with service providers, lower benefit levels per dollar of pre-

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57. Total premiums collected by BCBSM have been reduced by $85 million to reflect a subsidy cost transfer. The total group subsidy transfer in 2005 was $85 million. Without the subsidy, the amount of premiums collected per-insured-per-month would be $257.
mium (e.g. higher co-pays or deductibles for similarly priced plans), or lower claims level per insured (more healthy individuals). Significantly higher claim levels for the remainder of the market are not likely, however, since BCBSM and the remainder of the market each have over one million insured individuals in the commercial group products.

Most likely a significant portion of BCBSM’s higher gross profit margin results from lower reimbursement rates it pays medical care providers. This results from Blue Cross and its subsidiaries using its market share to negotiate better rates with providers. 58 This lowers costs for its subsidiaries and gives BCBSM an advantage in obtaining market share in the ASC business.

**CONCLUSION: BCBSM’S FINANCIAL POSITION**

BCBSM is the largest insurer in Michigan. Blue Cross and its subsidiaries currently insure 70% of Michigan residents that have commercial insurance and write almost half (44%) of all health insurance premiums in Michigan. Its size has helped Blue Cross be profitable and competitive. Specifically:

- BCBSM had after-tax income of $243 million in 2006.
- BCBSM had $2.8 billion in reserves in 2006.
- BCBSM had a gross profit per-insured-per-month that was $10 higher than other competitors in the market in 2006. This means BCBSM received an additional $138 million in gross profit than its competitors on commercial group product.

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58 In many small rural hospitals where BCBSM’s market share is smaller, BCBSM requires a “most favored nation” clause in its contracts with the providers. The providers agree to the terms because they can’t afford to exclude BCBSM. This clause prevents the provider from offering other insurance companies more favorable rates than BCBSM receives. The following clause is included in BCBSM “Participating Hospital Agreement” dated July 1, 2007: “Hospital will attest and commit that the payment rates which it has provided to BCBSM under this Agreement for non-Medicare members are at least as favorable as the rates it has established with all other non-governmental PPOs, non-governmental commercial insurers.”
IV. Comparison of the Benefits and Burdens of BCBSM’s Mission

BURDENS OF BCBSM’S MISSION

As discussed in “The Mission of Blue Cross” on page 9, the primary burdens placed on BCBSM include Blue Cross acting as the insurer of last resort and a limitation on what factors Blue Cross can use to price its policies. At present, these burdens apply only to the individual major medical market. This section takes a closer look at these burdens placed on BCBSM.

BCBSM as Insurer of Last Resort in Individual Insurance Market

There are two segments within the individual major medical market: group conversion, and non-group. Group conversion is a product for individuals who were covered by a group policy but no longer qualify for coverage, usually due to a change in employment status. In Michigan, all insurers, not just BCBSM, are required to offer group conversion coverage for individuals who were covered by one of their employer’s group policies. Since only consumers that really need coverage purchase this insurance, insurance companies lose money on this product. Unlike commercial insurers, BCBSM is allowed to collect subsidies by increasing other product premiums to help defer the losses from group conversion products. At present, Blue Cross collects a 0.5% subsidy from groups to help fund its group conversion product.

Individual non-group is a product purchased by individuals that are self-employed, or employed but not offered an employer-sponsored group plan. For this market, BCBSM is the insurer of last resort. This requires BCBSM to provide insurance to any individual, regardless of medical condition, so long as the person can afford the premiums established by BCBSM and approved by OFIS.

59. For purposes of this discussion we are not including Medicare supplement or Medigap which are not commercial-type insurances.

60. If the employer was subject to COBRA, the individual would go to COBRA continuation, and once that was exhausted, they would go to group conversion. If the employer is not subject to COBRA, the individual would go directly to group conversion. Consolidated Omnibus Reconciliation Act (COBRA) was passed by Congress in 1986. [Pub.L. 99-272, 100 Stat. 82] As described by the U.S. Department of Labor, “COBRA provides certain former employees, retirees, spouses, former spouses, and dependent children the right to temporary continuation of health coverage at group rates. This coverage, however, is only available when coverage is lost due to certain specific events. Group health coverage for COBRA participants is usually more expensive than health coverage for active employees, since usually the employer pays a part of the premium for active employees while COBRA participants generally pay the entire premium themselves. It is ordinarily less expensive, though, than individual health coverage.” Retrieved from http://www.dol.gov/ebsa/faqs/faq_consumer_cobra.html on October, 19, 2007.

61. The requirement to offer this product is MCL 550.1410a for BCBSM and MCL 500.3612b for commercial insurers and HMOs.
Comparison of the Benefits and Burdens of BCBSM’s Mission

Table 15 compares the group conversion and non-group individual business of BCBSM from 2000 to 2006. From 2000 to 2006, both products generated roughly the same amount in premiums. Although group conversion had a higher annual claims expense than non-group, this was largely offset by an annual subsidy from the commercial group product. Including the subsidy for group conversion, both products roughly broke even from 2000 to 2006, prior to applying administrative expenses. Non-group, which is the subject of BCBSM’s mission, had sufficient premiums to cover claims in three of the seven years between 2000 and 2006. There are no cross product subsidies for the non-group individual product.

TABLE 15. BCBSM’s Individual Major Medical Market, 2000-2006

<table>
<thead>
<tr>
<th></th>
<th>Premiums</th>
<th>Subsidy Cost Transfer</th>
<th>Claimsa</th>
<th>Claims Loss Ratio b</th>
<th>Admin. Expenses</th>
<th>Gain/(Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group Conversion</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>$42.0</td>
<td>$19.7</td>
<td>($52.0)</td>
<td>84%</td>
<td>($4.6)</td>
<td>$5.2</td>
</tr>
<tr>
<td>2001</td>
<td>45.9</td>
<td>25.6</td>
<td>(60.3)</td>
<td>84%</td>
<td>(5.1)</td>
<td>6.1</td>
</tr>
<tr>
<td>2002</td>
<td>57.3</td>
<td>25.1</td>
<td>(80.6)</td>
<td>98%</td>
<td>(5.8)</td>
<td>(4.0)</td>
</tr>
<tr>
<td>2003</td>
<td>74.7</td>
<td>27.5</td>
<td>(100.0)</td>
<td>98%</td>
<td>(7.0)</td>
<td>(4.7)</td>
</tr>
<tr>
<td>2004</td>
<td>101.4</td>
<td>25.9</td>
<td>(132.8)</td>
<td>104%</td>
<td>(9.5)</td>
<td>(15)</td>
</tr>
<tr>
<td>2005</td>
<td>115.8</td>
<td>25</td>
<td>(154.0)</td>
<td>109%</td>
<td>(11.1)</td>
<td>(24.4)</td>
</tr>
<tr>
<td>2006 (estimate)</td>
<td>125.5</td>
<td>25.5</td>
<td>(163.5)</td>
<td>108%</td>
<td>(11.3)</td>
<td>(23.8)</td>
</tr>
<tr>
<td><strong>2000-2006 Total</strong></td>
<td>$562.6</td>
<td>$174.3</td>
<td>($743.2)</td>
<td>101%</td>
<td>($54.5)</td>
<td>($60.6)</td>
</tr>
</tbody>
</table>

**Non-Group Individual**

<table>
<thead>
<tr>
<th></th>
<th>Premiums</th>
<th>Subsidy Cost Transfer</th>
<th>Claimsa</th>
<th>Claims Loss Ratio b</th>
<th>Admin. Expenses</th>
<th>Gain/(Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$39.9</td>
<td>(37.7)</td>
<td>94%</td>
<td>(2.6)</td>
<td>($0.4)</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>41.6</td>
<td>(42.7)</td>
<td>103%</td>
<td>(2.8)</td>
<td>(3.9)</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>49.5</td>
<td>(55.7)</td>
<td>113%</td>
<td>(2.6)</td>
<td>(8.9)</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>68.2</td>
<td>(67.2)</td>
<td>99%</td>
<td>(3.4)</td>
<td>(2.4)</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>83.7</td>
<td>(88.8)</td>
<td>106%</td>
<td>(4.8)</td>
<td>(9.9)</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>106.5</td>
<td>(109.6)</td>
<td>103%</td>
<td>(7.4)</td>
<td>(10.5)</td>
<td></td>
</tr>
<tr>
<td>2006 (estimate)</td>
<td>122.2</td>
<td>(119.5)</td>
<td>98%</td>
<td>(9.1)</td>
<td>(6.5)</td>
<td></td>
</tr>
<tr>
<td><strong>2000-2006 Total</strong></td>
<td>$511.6</td>
<td>($521.2)</td>
<td>102%</td>
<td>($32.70)</td>
<td>($42.5)</td>
<td></td>
</tr>
</tbody>
</table>

Source: State of Michigan Office of Financial and Insurance Services, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
Analysis: Anderson Economic Group, LLC

b. Calculation of claims loss ratio includes premiums plus subsidies in the denominator.

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62. State of Michigan Office of Financial and Insurance Services, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
From 2000 to 2006, BCBSM had total losses of $42.5 million for non-group, and $60.6 million for group conversion, after a total subsidy of $174 million.\(^{63}\) These figures do not account for investment income or income from subsidiaries, which would reduce Blue Cross’s losses. According to BCBSM’s rate filings, in 2006 it will likely lose $23.8 million in underwriting losses for its group conversion coverage, but only $6.5 million in underwriting losses for its non-group individual product. Therefore, approximately 25% of the underwriting losses in the commercial individual products in 2006 are due to BCBSM’s unique burdens under PA 350. The remaining 75% is due to the requirement of all insurers to provide group conversion policies. BCBSM’s large number of group conversion policies is a direct result of its large market share in the group market.

**Government Sponsored Insurance**

As shown in Table 8, “BCBSM Market Share (With and Without Subsidiaries) for Major Medical and Other (2006),” on page 27, Blue Cross and its subsidiaries have an 18% share of the government-sponsored insurance market (in terms of premiums). BCBSM considers providing supplemental Medicare insurance as part of its social mission and it offers this products below cost. In 2005, it had a $139 million operating loss on Medicare Supplement and Medicare Advantage.

BCBSM also insures poor children through the MIChild program. In 2006, BCBSM insured 91% of the children in the program. The State of Michigan pays premiums to BCBSM to cover claims. Currently, BCBSM does not receive enough in premiums to cover all the claims filed by MIChild participants. However, the State of Michigan limits Blue Cross’s losses on MIChild to $15.5 million.\(^{64}\)

Most of the other health plans that participate in MIChild do not lose money on this program. These plans cover fewer people, which theoretically creates more volatility and a greater likelihood of having losses. One explanation for why Blue Cross loses money and other insurers do not is that Blue Cross pays health care providers at Blue Cross rates while other insurers pay providers at Medicaid rates, which are significantly lower.\(^{65}\)

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63. Unlike its commercial competitors, BCBSM is allowed to “subsidize” its losses in the group conversion products by adding a charge to its other products. In 2005, the subsidy collected from other products for group conversion was approximately $25 million (BCBSM Historical Financial Experience). MCL 550.1609(6), which applies only to BCBSM, states “Except for identified cost transfers, each line of business, over time, shall be self-sustaining. However, there may be cost transfers for the benefit of senior citizens and group conversion subscribers.”

64. BCBSM is limited to a $15.5 million loss on MIChild according to a letter of understanding with the State of Michigan as stated on page 25.14 in BCBSM’s Notes to the Financial Statements in its 2006 annual submission to OFIS.

65. Information based on OFIS 0322 (2006) and a conversation with Joe Aoun at Nuyen, Tomtishen and Aoun, P.C.
Comparison of the Benefits and Burdens of BCBSM’s Mission

Exemption From State Taxes
As discussed in “BCBSM’s Tax Treatment” on page 14, BCBSM receives a general tax exemption. We estimate that the amount BCBSM is exempt from in major state and local taxes is $112 million. This includes exemptions from the newly-passed Michigan Business Tax, real and personal property taxes, and sales and use taxes.

Better Reimbursement Rates with Providers of Medical Care
BCBSM has an advantage over most of its competitors due to its ability to use its size in negotiating reimbursement rates with providers of medical care. This advantage is described in “BCBSM Pays Lower Average Claims in Group Market” on page 34. In 2006, BCBSM paid $138 million less in claims for the same amount of premiums than the rest of the insurers in the group market. Most likely much of this difference can be explained by BCBSM’s better reimbursement rates with providers.

Statutory Benefits and Burdens of Mission. As shown in Table 16, BCBSM’s statutory role in the Michigan health insurance market results in an annual net benefit for the company of $129.3 million. The key benefits and burdens for which we provide an estimate include the following:

- A state and local tax exemption that is worth approximately $112 million annually.
- A subsidy worth $25 million in 2006 from their profitable product (group insurance) to offset losses from another product (group conversion). No commercial carrier or HMO has similar statutory authority to charge this or other subsidies, but companies can charge more in other product offerings to recover their losses.
- BCBSM’s burden as insurer of last resort and requirement to provide uniform rates among subscribers costs the insurer $7.7 million in underwriting losses and profit. (Our estimate includes a foregone 1% profit margin on premiums.)
Comparison of the Benefits and Burdens of BCBSM’s Mission

Non-Statutory Benefits and Burdens of Mission. In addition to its statutory burdens and benefits, Blue Cross also makes business decisions, including contracts with providers, claims policies, and participation in state contracts, that affect its overall profitability. We separately list estimates of the benefit and burden of specific non-statutory activities that reflect, to some extent, the special position of Blue Cross in the Michigan market and the company’s own business plans based on that position. This includes lower claims paid per dollar of premium than its competitors in the group insurance market, the losses Blue Cross incurs by offering Medicare Supplement below cost and by participating in MIChild, and the financial support it provides free and low-cost clinics throughout the state.

Even when including non-statutory burdens the company undertakes to further its social mission, the benefit of large market share and better reimbursement rates with providers is greater than the financial burden of these obligations. See Table 17 on page 41.

TABLE 16. Comparison of the Statutory Benefits and Costs of BCBSM’s Mission

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>Benefits</th>
<th>Burdens</th>
<th>Net Benefit (Burden)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michigan Tax Exemption(a)</td>
<td>$112.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Conversion Subsidy(b)</td>
<td>$25.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Benefits</strong></td>
<td><strong>$137.0</strong></td>
<td><strong>$7.7</strong></td>
<td><strong>($7.7)</strong></td>
</tr>
<tr>
<td>Burdens</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurer of last resort; Community Rating(c)</td>
<td>$7.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Burdens</strong></td>
<td><strong>($7.7)</strong></td>
<td><strong>$129.3</strong></td>
<td><strong>$129.3</strong></td>
</tr>
</tbody>
</table>

Analysis: Anderson Economic Group, LLC
Data Sources: Blue Cross Financial Statements; Michigan tax laws; local and state tax records

a. For AEG’s calculation see “Amount Exempted From Taxes” on page 16.
b. BCBSM is allowed by law to collect a group conversion subsidy from their group customers to reduce the cost of their group conversion product. No other commercial carrier or HMO has similar statutory authority to charge this or other subsidies. Source: State of Michigan OFIS, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
c. Non-group individual losses for 2006 were estimated at $6.5 million. On premiums of $122 million, $1.2 million of profit is necessary to achieve a 1% return on premiums. Source: State of Michigan OFIS, BCBSM Nongroup and Group Conversion Rate Filings, dated October 24, 2006, Section VI, Table 1B-1.
As shown above, the benefits Blue Cross receives for fulfilling its social mission is greater than the cost of both its statutory and non-statutory obligations. The recently-introduced legislation (House Bills 5282-5285) would allow Blue Cross to continue receiving these benefits while greatly reducing the company’s burdens in the following ways:

- The bills would eliminate the remaining community rating requirements on BCBSM. Only the plans grandfathered in (Option A through G) will continue to be priced without the use of age, geography, and initial health condition.
- The bills would allow Blue Cross to increases rates without Commission approval and would remove some of the public’s ability to challenge rate increases.
- The bills would reduce its role as insurer of last resort by (1) increasing from 6 months to 12 months the time under which BCBSM does not have to cover treatment for pre-existing conditions, and (2) requiring Blue Cross to offer only four “guaranteed access health benefit plans” to high risk individuals. There are no requirements in the bills as to what services must be covered by the plans.

**TABLE 17. Comparison of Non-statutory Benefits and Burdens of BCBSM’s Mission (2006)**

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Burdens</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower Claims Paid to Providers for Group Coverage&lt;sup&gt;a&lt;/sup&gt;</td>
<td>$138.0</td>
</tr>
<tr>
<td>Medicare Supplement&lt;sup&gt;b&lt;/sup&gt;</td>
<td>$94.8</td>
</tr>
<tr>
<td>MIChild&lt;sup&gt;c&lt;/sup&gt;</td>
<td>$15.5</td>
</tr>
<tr>
<td>Financial Support for Free and Low-Cost Clinics&lt;sup&gt;d&lt;/sup&gt;</td>
<td>$1.0</td>
</tr>
</tbody>
</table>

*Analysis: Anderson Economic Group, LLC*

*Data Sources: Blue Cross Financial Statements*

<sup>a</sup> BCBSM has a lower claims loss ratio for its group commercial products than the remainder of the market. BCBSM’s advantage equates to approximately $138 million in lower payments to providers in 2006. See “BCBSM Pays Lower Average Claims in Group Market” on page 34 for more information.

<sup>b</sup> There is a $94.8 million difference between the loss BCBSM incurred on Medicare Supplement in 2006 and the profit BCBSM would need to earn to recognize a 1% return on premiums. Source: BCBSM Medicare Supplement Rate Filing, dated February 8, 2007, Section VI, Table IB.

<sup>c</sup> BCBSM is limited to a $15.5 million loss on MIChild according to a letter of understanding with the State of Michigan as stated on page 25.14 in BCBSM’s Notes to the Financial Statements in its 2006 annual submission to OFIS.

Comparison of the Benefits and Burdens of BCBSM’s Mission

• The bills would reduce the relative financial burden of Blue Cross’s competitors by requiring commercial carriers and HMOs to make payments to offset BCBSM’s loses in its individual health market.

The bills contain no provisions that would require Blue Cross to use its reserves (i.e. surplus) to lower premium rates for its customers or further its social mission. Blue Cross has increased its premium rates for individual coverage by double digit percentage points four times in the past five years. While it was the Michigan Legislature’s intent for Blue Cross to provide affordable health insurance, the bills would reduce the financial burden on Blue Cross while not reducing BCBSM’s net benefit and not alleviating the cost of health insurance for many of BCBSM’s customers.

V. For-Profit Conversions of BCBS in Other States

Initially the Blues were nonprofit companies, created to further the social goal of providing affordable and accessible health insurance for Americans, particularly vulnerable populations. In the past two decades, many Blue Cross Blue Shield (BCBS) companies have converted away from their nonprofit status and become for-profit companies. There are several factors that led to many of the for-profit conversions of BCBS, including:

**Market Pressures.** In response to competitors offering experience-rated coverage (charging more to heavier users of medical care, thereby making their products less expensive for more profitable, less sick patients), BCBS plans became interested in regional and national consolidation, including consolidation as for-profit entities.

**Tax Laws.** The federal government removed the BCBS plans’ federal tax exemption in 1986, reducing the benefit of remaining a nonprofit. Nevertheless, the tax treatment by individual states has sometimes remained a benefit of nonprofit status.

**Business Climate.** During the early 1990’s, many BCBS plans faced an unusually harsh downturn in the insurance cycle, prompting some to look to the private capital markets as a source of the investment necessary to weather the storm.67

The proposed legislation discussed in this report would not make Blue Cross Blue Shield of Michigan a for-profit company. However, since the State of Michigan would treat BCBSM more like a for-profit insurer in its obligations and burdens to the state, it may be informative to review for-profit conversions in other states. The remainder of this section provides a few examples of how the Blues converted in other states and what was paid to the state for the loss of their social mission.

**NEW YORK**

Empire Blue Cross (EBC) proposed a partial for-profit conversion in 1995 as a way to raise capital. The proposal would have left EBC as a nonprofit holding company controlling several for-profit subsidiaries, which would have been free to court investors. Faced with opposition (on the grounds that the for-profit subsidiaries would benefit from decades of tax breaks enjoyed by EBC), Empire then proposed a full conversion from nonprofit to for-profit status, transferring its assets to a charitable foundation. After years of argument, lobbying, and litigation, EBC was finally able to raise private capital: stock worth 20% of the company was floated in a public offering in 2002 and sold for $440 million. As part of the agreement allowing this action, Empire agreed to use 5% of the proceeds of the sale ($22 million) to endow two foundations that would fund health initiatives otherwise paid for by the state, one controlled by community organizations, the other dedicated to funding

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hospitals. The foundations financed programs that were funded by tax revenue before, essentially amounting to public appropriation of the funds.68

**WISCONSIN**

In 1999 Wisconsin Blue Cross Blue Shield (WBCBS) converted to a for-profit company called Cobalt Corporation. To compensate the state residents for tax breaks that WBCBS received while it was a nonprofit corporation, Cobalt gave 77% of its shares, valued at around $250 million at the time, to the Wisconsin United for Health Foundation.69 The foundation endowed public health grant-making entities at the University of Wisconsin Medical School and the Medical College of Wisconsin, which began making grants in 2004—by which time the endowment was worth $680 million.70

**CALIFORNIA**

In 1992 Blue Cross of California (BCC) proposed a restructuring that included the creation of a for-profit subsidiary, called WellPoint Health Networks. The proposal also guaranteed that no assets of the nonprofit would be appropriated by any private actor and included other elements which were meant to enhance BCC’s efficiency while maintaining its nonprofit status. WellPoint’s initial public offering of stock in 1993 garnered $517 million. The next three years saw much argument over the arrangement, with difficulty over separating BCC and WellPoint’s nonprofit and for-profit activities, and the value and ownership of BCC’s assets. Finally, in 1996, BCC settled the matter by converting to for-profit status, transferring the assets it had built up under its tax-exempt status, $3 billion, to two endowments, which are now managed independently of WellPoint.71 One, the California Endowment, has a mission to “expand access to affordable, quality health care for underserved individuals and communities, and to promote fundamental improvements in the health status of all Californians.”72

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Appendix A. Tax Liability Analysis

Included in this appendix are the following tables:

1. Table A-1: Amount Exempted from Select Michigan Taxes for BCBSM

2. Table A-2: Property Analysis for Blue Cross Blue Shield of Michigan, 2006
Table A-1. Amount Exempted from Select Michigan Taxes for BCBSM

<table>
<thead>
<tr>
<th>Michigan Business Tax</th>
<th>1/ 2006 Tax Base</th>
<th>2008 Tax Rate</th>
<th>Tax Liability</th>
<th>Source Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Gross Direct Premiums Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM Gross Premiums</td>
<td>$ 5,865,134,213</td>
<td>1.25%</td>
<td>$ 73,314,178</td>
<td>BCBSM 2006 Annual Report to OFIS - Statement of Revenue and Expenses (Excludes revenue from ASC business)</td>
</tr>
<tr>
<td>(b) Gross Receipts--Taxable Service Revenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM ASC Services</td>
<td>2/ $ 700,971,000</td>
<td>0.80%</td>
<td>$ 5,607,768</td>
<td>BCBSM 2006 Annual Report to OFIS - Notes to Financial Stmts. (25.12)</td>
</tr>
<tr>
<td>(c) Business Income Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM ASC Services</td>
<td>$ 27,269,000</td>
<td>4.95%</td>
<td>$ 1,349,816</td>
<td>BCBSM 2006 Annual Report to OFIS - Notes to Financial Stmts. (25.12)</td>
</tr>
<tr>
<td>Investment Earnings</td>
<td>$ 161,800,000</td>
<td>4.95%</td>
<td>$ 8,009,100</td>
<td>BCBSM 2006 Annual Report to OFIS - Mgt. Discussion and Analysis</td>
</tr>
<tr>
<td>(d) Examination Fee Credit to MBT</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM Examination Fees</td>
<td>$ 963,375</td>
<td>-50.00%</td>
<td>$ (481,688)</td>
<td>BCBSM 2006 Annual Report to OFIS - Part 3 Analysis of Expenses</td>
</tr>
<tr>
<td>(e) Compensation Credit to MBT</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BCBSM Compensation</td>
<td>3/ $ 576,668,755</td>
<td>-0.37%</td>
<td>$ (2,133,674)</td>
<td>BCBSM 2006 Annual Report to OFIS - Part 3 Analysis of Expenses</td>
</tr>
<tr>
<td><strong>Total MBT Liability</strong></td>
<td></td>
<td></td>
<td>$ 85,665,499</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Property Taxes</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Real Property</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Detroit</td>
<td>$ 300,000,000</td>
<td>4.35%</td>
<td>$ 13,041,000</td>
<td>AEG calculation of Actual Cash Value Based on Property Tax Records from Assessors Ofc.</td>
</tr>
<tr>
<td>Southfield</td>
<td>$ 90,000,000</td>
<td>2.72%</td>
<td>$ 2,449,260</td>
<td>AEG calculation of Actual Cash Value Based on Property Tax Records from Assessors Ofc.</td>
</tr>
<tr>
<td>Other</td>
<td>$ 55,847,991</td>
<td>2.59%</td>
<td>$ 1,448,976</td>
<td>BCBSM 2006 Annual Report to OFIS - Schedule A Part 1 (Fair Value)</td>
</tr>
<tr>
<td>(b) Personal Property</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Property - Furniture and Equipment</td>
<td>$ 13,934,235</td>
<td>5.2%</td>
<td>$ 723,047</td>
<td>BCBSM 2006 Annual Report to OFIS - Assets</td>
</tr>
<tr>
<td>Personal Property - EDP Leased Equipment and Software</td>
<td>$ 115,000,000</td>
<td>5.2%</td>
<td>$ 5,967,350</td>
<td>BCBSM 2006 Annual Report to OFIS - Mgt. Discussion and Analysis</td>
</tr>
<tr>
<td>12 mil. Exemption</td>
<td>$ 128,934,235</td>
<td>-1.2%</td>
<td>$ (1,547,211)</td>
<td>Based on Personal Property</td>
</tr>
<tr>
<td><strong>Total Property Tax Liability</strong></td>
<td></td>
<td></td>
<td>$ 22,082,423</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales Taxes</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchases of Goods</td>
<td>(Printing, office supplies, EDP equipment and software)</td>
<td>4/ $ 69,985,885</td>
<td>6%</td>
<td>$ 4,199,153</td>
</tr>
<tr>
<td><strong>Total Estimated Tax Liability</strong></td>
<td></td>
<td></td>
<td></td>
<td>$ 111,947,075</td>
</tr>
</tbody>
</table>

Notes:
1/ Tax rate that is applicable to private businesses under the newly-adopted Michigan Business Tax.
2/ Gross receipts for ASC services exceeded $8 billion. Under Section 111 (1)(b)(i) of the MBT Act, ASC revenue less claims would be subject to tax.
3/ Negative rate indicates likely reduction in tax liability due to credit.
4/ Excludes the newly passed use tax on select services.
# Table A-2. Property Analysis for Blue Cross Blue Shield of Michigan, 2006

## Southfield

<table>
<thead>
<tr>
<th>Parcel Number</th>
<th>Location</th>
<th>Floor Space</th>
<th>Current Land TCV</th>
<th>Est. TCV / Sq. Ft.</th>
<th>Est. TCV of building</th>
<th>Est TCV</th>
</tr>
</thead>
<tbody>
<tr>
<td>76-24-18-351-007</td>
<td>11 mile Road</td>
<td>162,460</td>
<td>$3,940,002</td>
<td>$125</td>
<td>$20,307,500</td>
<td>$24,247,502</td>
</tr>
<tr>
<td>76-24-18-351-011</td>
<td>11 mile Road</td>
<td>-</td>
<td>$16,497,043</td>
<td>$125</td>
<td>-</td>
<td>$16,497,043</td>
</tr>
<tr>
<td>76-24-18-351-012</td>
<td>11 mile Road</td>
<td>114,254</td>
<td>$3,152,870</td>
<td>$125</td>
<td>$14,281,750</td>
<td>$17,434,620</td>
</tr>
<tr>
<td>76-24-18-351-014</td>
<td>11 mile Road</td>
<td>195,864</td>
<td>$5,582,650</td>
<td>$125</td>
<td>$24,483,000</td>
<td>$30,065,650</td>
</tr>
</tbody>
</table>

### Total Southfield

|                  | $472,578          | $29,172,565 | $125          | $59,072,250        | $88,244,815 |

**Memo:**

"Cost" for Property in Southfield (Schedule A - Part 1 OFIS) $96,168,367

Estimated Actual Cash Value as a % of OFIS "Cost" 92%

## Detroit

<table>
<thead>
<tr>
<th>Parcel Number</th>
<th>Location</th>
<th>Floor Space</th>
<th>Current Land TCV</th>
<th>Est. TCV / Sq. Ft.</th>
<th>Est. TCV of building</th>
<th>Est TCV</th>
</tr>
</thead>
<tbody>
<tr>
<td>03000100-32</td>
<td>600 E. Lafayette - Office</td>
<td>182,121</td>
<td>$3,829,760</td>
<td>$146</td>
<td>$26,576,161</td>
<td>$30,405,921</td>
</tr>
<tr>
<td>03000135-64</td>
<td>500 E. Lafayette - Office</td>
<td>214,000</td>
<td>-</td>
<td>$146</td>
<td>$31,228,131</td>
<td>$31,228,131</td>
</tr>
<tr>
<td>03000100-32</td>
<td>600 E. Lafayette - Parking Garage</td>
<td>160,969</td>
<td>$6,305,220</td>
<td>$146</td>
<td>$23,489,537</td>
<td>$29,794,757</td>
</tr>
<tr>
<td>03000135-64</td>
<td>500 E. Lafayette - Parking Garage</td>
<td>211,000</td>
<td>-</td>
<td>$146</td>
<td>$30,790,353</td>
<td>$30,790,353</td>
</tr>
<tr>
<td>01000088-109</td>
<td>415 E. Jefferson - Office</td>
<td>177,449</td>
<td>-</td>
<td>$146</td>
<td>$25,894,395</td>
<td>$25,894,395</td>
</tr>
<tr>
<td>01000088-109</td>
<td>415 E. Jefferson - Parking Garage</td>
<td>452,600</td>
<td>-</td>
<td>$146</td>
<td>$66,046,037</td>
<td>$66,046,037</td>
</tr>
</tbody>
</table>

### Total Detroit

|                  | $1,935,022         | $30,326,660 | $146          | $282,369,718       | $312,696,378 |

**Memo:**

"Cost" for Property in Detroit (Schedule A - Part 1 OFIS) $200,781,353

Estimated Actual Cash Value as a % of OFIS "Cost" 156%

Appendix B. About the Authors

CAROLINE M. SALLEE

Ms. Sallee is a consultant at Anderson Economic Group, working in the Public Policy, Fiscal, and Economic Analysis practice area. Ms. Sallee’s background is in applied economics and public finance.

Ms. Sallee’s recent work includes an economic impact study for Michigan’s University Research Corridor, fiscal and economic impact studies for Michigan State University, and the benchmarking of Michigan’s business taxes with other states in a project for the Michigan House of Representatives. She has also completed several technology industry reviews, estimating the wages and employment of technology workers in Southeast Michigan and North-central West Virginia.

Prior to joining Anderson Economic Group, Ms. Sallee worked for the U.S. Government Accountability Office (GAO) as a member of the Education, Workforce and Income Security team. She also has worked as a market analyst for Hábitus, a market research firm in Quito, Ecuador and as a legislative assistant for two U.S. Representatives.

Ms. Sallee holds a master’s degree in public policy from the Gerald R. Ford School of Public Policy at the University of Michigan and a Bachelor of Arts degree in economics and history from Augustana College.

DARCI R. KEYES

Ms. Keyes is a senior consultant at Anderson Economic Group, with expertise in finance and law. She works primarily in the Finance and Business Valuation, and Public Policy, Fiscal and Economic Analysis areas.

Prior to joining Anderson Economic Group, Ms. Keyes worked as a financial analyst for Ford Motor Company where she held positions in manufacturing, internal audit, marketing and sales, accounting policy and transactional accounting. Prior to joining Ford, Ms. Keyes worked as an attorney in Pittsburgh, Pennsylvania, where she served as a consultant in such areas as tax reporting and planning, estate planning and administration, real property acquisitions and dispositions, and other general business law.

Ms. Keyes holds an M.B.A from the Katz School of Business at the University of Pittsburgh; a Juris Doctorate, with a concentration in taxation and real property, from the State University of New York at Buffalo; and a B.A. in French and business from Nazareth College in Rochester, New York. Ms. Keyes is a licensed attorney in the states of Pennsylvania, New York, and Michigan. She is also a Certified Internal Auditor.

PATRICK L. ANDERSON

Mr. Anderson, principal and CEO, founded the consulting firm of Anderson Economic Group in 1996. Since founding the firm, he has successfully directed projects
for state governments, cities, counties, nonprofit organizations, and corporations in over half of the United States.

Prior to founding Anderson Economic Group, Mr. Anderson served as the chief of staff of the Michigan Department of State and as a deputy director of the Michigan Department of Management and Budget, where he was involved in the largest state privatization project in U.S. history and the landmark 1994 school finance reform constitutional amendment. Prior to his involvement in state government, Mr. Anderson was an assistant vice president of Alexander Hamilton Life Insurance, an economist for Manufacturers National Bank of Detroit, and a graduate fellow with the Central Intelligence Agency.

Mr. Anderson has written over 100 articles published in periodicals such as The Wall Street Journal, The Detroit News, The Detroit Free Press, Crain’s Detroit Business. His book Business Economics and Finance was published by CRC Press in August 2004, and his paper on “Pocketbook Issues and the Presidency” was awarded the Edmund Mennis Award for best contributed paper in 2004 by the National Association for Business Economics. He is a graduate of the University of Michigan, where he earned a master’s degree in public policy and a bachelor’s degree in political science.