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President and CEO Dan Loepp says the Blues need protection from increased losses on individual policies.

Photo credit: Nathan Skid/Crain's Detroit Business

Bills raise Blues debate: An unfair edge or level playing field?

By [Sherri Begin](#)

By pushing for changes in state law on how it can sell health insurance to individuals, **Blue Cross Blue Shield of Michigan** may have inadvertently unleashed a debate about its status as a state-created nonprofit insurer.

To avoid losses on policies for individuals, Blue Cross introduced a package of bills in 2007 that it said would "level the playing field" with its competitors. The bills were passed by the House of Representatives in October and now face action in the Senate.

But critics are saying that Blue Cross is trying to keep its tax-exempt status while gaining a competitive edge against for-profit insurers and nonprofit HMOs.

"The Blues are a charitable and benevolent organization whose job is to make health care affordable to the citizens of Michigan," said Frances Wallace, chief deputy commissioner of the **Michigan Office of Financial and Insurance Service**.

Wallace testified at a House hearing on the bills and offered a list of concerns. "Whatever reform happens, it needs to move toward the goals of greater affordability and availability of individual health care."

Business is lining up both for and against Blue Cross, with supporters primarily business groups that also sell Blue Cross insurance to members.

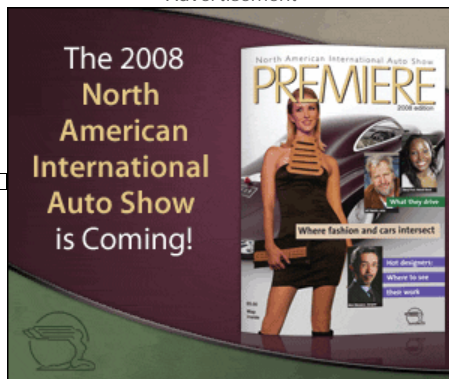
The Michigan licensee of the Blue Cross and Blue Shield name was created by doctors and hospitals as a nonprofit organization in 1939. Public Act 350 of 1980 continued the tax exemptions the Blues enjoyed in Michigan, in exchange for the Blues serving as the insurance carrier of last resort. As such, the Blues cannot deny coverage to anyone based on health.

But Blue Cross organizations nationwide lost their tax-exempt status at the federal level in the 1980s because Congress determined most of their business did not differ much from commercial business, said Nancy Baerwaldt, former Michigan insurance commissioner from 1980 to 1985, when Michigan's tax-exempt protection in 1980 was reinforced.

The nonprofit benefit

On Friday, a coalition fighting the Blue Cross individual market reform legislation released a

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report it commissioned. **Anderson Consulting Group** estimates that the Blues are exempted from \$112 million in state taxes — \$85.7 million for the Michigan business tax, \$22.1 million for real and personal property taxes and \$4.2 million in sales and use taxes.

The Anderson report was commissioned by the for-profit insurance carriers' **Coalition for Access and Affordability in Michigan**.

The figures differ from the Blues' own numbers. In a meeting with *Crain's* last week, Blue Cross President and CEO Dan Loepp estimated that prior to the recent Michigan Business Tax changes, his nonprofit was exempt from \$78 million in taxes typically levied on commercial insurance carriers.

Additionally, the Blues received \$25 million in subsidies from a 1-percent charge or tax of sorts on customers of its profitable group plan to help cover losses on policies sold to individuals converting from group coverage, the report said. The Blues are allowed by law to assess the charge, while no other carriers in Michigan are.

But the Blues lose an estimated \$7.7 million in underwriting revenue because they are required, as insurer of last resort, to only community-rate members instead of grouping them by age, health or other factors. So, the Blues receive an annual net benefit of about \$129.3 million, according to the report.

The Blues said they provided \$458 million worth of subsidies and grants for uncompensated care, charitable giving and research in 2006, far beyond the tax -exempt benefit.

The Anderson report disagreed, saying even including non-statutory burdens such as subsidies for Medicare supplemental and MI Child and financial support for free and low-cost clinics, the benefits of the Blues' exemption still outweighed the burdens.

The Blues say they already operate on a narrow margin on health insurance of just 0.1 percent in 2006, while the Anderson Economic Group report pegged it at about \$223 million or about 0.9 percent net profit margin. Even small erosions in employer-sponsored coverage can lead to significant increases in the individual market, said Mark Cook, vice president, government affairs at Blue Cross Blue Shield. The Blues lost about \$126 million in the individual market in 2006 and expect to lose \$150 million this year, Loepp said. The bulk of those losses came in the Blues' Medicare supplemental products, something the state does not count in its market share assessments of the individual market.

According to rate filings, the Blues were projected to lose about \$93 million in 2006 on Medicare supplemental products vs. \$24 million in converting individuals from group employer plans to individual plans and \$6.5 million on classic, comprehensive individual policies.

Those losses could be compounded if that market grows from the current 5 percent to represent 15 percent to 20 percent of the entire insurance market as the Blues project it will, Loepp said.

According to the state, the Blues held 54 percent of the individual market in 2006; the only insurer to have market share in double digits.

Critics of the Blues legislation say it is using individual market reforms as a way to increase profits and is seeking to be treated like a for-profit while maintaining the tax exemption.

Among other things, the reforms the Blues are seeking would allow them to rate members on the basis of sex, age and geography and to push the pre-existing conditions waiting period to 12 months from six months.

Those changes would be "tantamount to ending (the Blues') nonprofit mission," said Dennis Schornack, who was senior adviser to Gov. John Engler.

Critics also say that collecting reserves to make acquisitions rather than using those reserves to make individual coverage more affordable does not fall in step with the Blues' mission.

"When you say nonprofit, sometimes that gets a little lost," Loepp said. "Really what (the Blues are) is a not-for-profit, which is anything in excess of premiums goes in reserves."

The Blues reserves

The Blues reserves have increased from \$1.3 billion in 2001 to \$2.8 billion in 2006. Loepp said they have grown about 9.5 percent each year since 2003, keeping pace with revenue. The Blues' reported consolidated revenue of about \$19.9 million last year, up from \$13.8 billion in 2003.

The reserves fall under the state cap of 1000 percent of risk-based capital, which is a measure

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of how much capital a carrier has relative to their risk, Cook said.

Those reserves would cover the Blues' operating costs for two months, in the event of some unforeseen emergency, Loepp said, adding that when Hurricane Katrina hit Louisiana, the Blues plan there could not collect premiums for two months, but thanks to reserves, it continued to pay claims.

The Blues have only kept their reserves below the state cap by acquiring companies, the Anderson report contends.

The Blues paid \$275 million to acquire the Accident Fund. Since 2005, Blue Cross and its affiliates have spent more than \$365 million acquiring other companies, said Attorney General Mike Cox in a report written to prove his view that the Blues are putting profits over their historic mission.

But the Blues counter that investing in other companies has increased the amount of money coming back to the Blues' reserves. Had they not made those acquisitions, that money would have earned a 6.3-percent return, Loepp said. Instead, the acquisitions have yielded a 14.9-percent rate of return.

Business group support

Members of a coalition of business associations supporting the bills last week agreed they had an interested position in supporting the Blues legislation, given that they profit from marketing Blues policies to their members.

But they said their involvement in the insurance market gives them a better understanding of why the reforms deserve support.

"I'm not pitching for Blue Cross; I'm pitching for the same set of rules for the individual market," said Rob Fowler, president and CEO of the **Small Business Association of Michigan**, a member of the coalition.

Because an increasing number of SBAM members and their employees are buying individual policies, "there needs to be a fair and predictable set of rating rules."

The Detroit Regional Chamber said the status quo will result in "extreme instability to the Blue Cross system."

"The reforms will stabilize Blue Cross as the provider of last resort, while preserving robust competition among the commercial insurers," said Sarah Hubbard, vice president of government relations.

Hubbard said she expects the Senate to make changes to the legislation that would address concerns that it benefits the Blues over other carriers.

"I believe by the time this legislation gets to the governor, there will be far more support around it," said Hubbard.

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