

**SENT VIA E-MAIL, FACSIMILE, AND FIRST CLASS MAIL**

December 21, 2011

Brent A. Barnhart, Director  
California Department of Managed Health Care  
980 9th Street, Suite 500  
Sacramento, CA 95814

Re: Kaiser Foundation Health Plan's Proposed Rate Increases Effective January 1, 2012

Dear Mr. Barnhart,

On January 1, 2012, more than 660,000 Californians enrolled in Kaiser Foundation Health Plan's individual and small group HMO plans are facing premium hikes averaging 9.0% and 8.2%, respectively,<sup>1</sup> with increases for some subscribers as high as 18.3%.

We ask that you direct the Department of Managed Health Care (DMHC) to exercise its full statutory authority to investigate these planned rate increases to determine their reasonableness and whether they are justified. We also ask the DMHC to make its findings widely known to Kaiser plan participants and the general public if it ultimately determines, as we think it should, that such rate hikes are excessive and unnecessary.

Kaiser's rate review filings, submitted to the DMHC in late October, demonstrate significant deficiencies. For example, the filings fail to provide sufficient information for six (6) of the fourteen (14) factors that are required by the DMHC as part of its review process.<sup>2</sup> These missing data include Kaiser's rate of return, its surplus condition, its executive compensation and the cumulative impact of its past rate hikes on consumers, among other factors. Meanwhile, publicly available records raise questions about the financial necessity of Kaiser's rate hikes. For example, Kaiser has reported profits of \$5.6 billion since 2009 and currently holds excess financial reserves of approximately \$12.8 billion. Given the ongoing economic recession affecting California's residents, it is difficult to understand Kaiser's rationale for imposing rate hikes that are nearly triple the rate of medical inflation on 660,000 California consumers.

On July 1, 2011, Kaiser implemented a substantial rate hike on more than 300,000 Californians enrolled in Kaiser's small group HMO plan. As in the current rate review filing, Kaiser's earlier filing<sup>3</sup> similarly failed to disclose required data and failed to offer adequate justification for its rate increase. These failures were highlighted in a letter from Edward Heidig (the DMHC's Interim Director) to Jerry Fleming (Kaiser's National Health Plan Manager), which stated in part:

As you know, the Department has voiced our concerns about the rate increase and asked that Kaiser reduce its rate increase. The Department is extremely disappointed that Kaiser has refused to do so. This refusal on Kaiser's part, leaves the Department very concerned that more than 300,000 of our enrollees will be receiving a rate increase of over 10%, during these difficult economic times...

As we discussed, the Department has identified several factors that are troubling regarding Kaiser's rate filing, including, but not limited to, the lack of substantial evidence to support Kaiser's assumptions regarding its rate increase, and the fact that Kaiser's rate filing lacked all required documentation and detail upon which the Department could determine the reasonableness of the rate increase.

In addition to lacking data, Kaiser's financial capital raises questions about the necessity of this rate increase... Kaiser, a nonprofit health plan, has about \$12 billion in excess TNE, about \$20 billion in short-term and long-term investments, \$42 billion in revenue, and yet is targeting billions more in increases for more than 300,000 of its customers. The Department expresses its deep disappointment that Kaiser is raising rates for California consumers and small businesses during a time when we are seeking to make health insurance more affordable.<sup>4</sup>

In September, Kaiser officials agreed to a partial rollback of its rate hike by 1.2 percentage points. This episode provides important context for Kaiser's current rate hike filings, which have nearly identical deficiencies. We believe that these significant data deficiencies, along with the company's strong financial position, make it difficult to conclude that Kaiser's proposed rate hikes for January 1, 2012 are justified. These deficiencies include, but are not limited to, the following items.

**1. Rate of Return.** Kaiser's filings are conspicuously silent on the company's rate of return and its overall profitability. According to the DMHC's "Guidance Related to Premium Rate Filings," Kaiser is required to provide its rate of return for the prior three years as well as its anticipated rate of return for the following year.<sup>5</sup> Instead, Kaiser's "Actuarial Certifications" state the following: "This information was not explicitly considered in the rate development process; therefore I could not offer an opinion on this."

Meanwhile, financial statements, tax returns and other records indicate that Kaiser is highly profitable. Since 2009, nonprofit Kaiser has earned profits of more than \$5.6 billion, according to its financial statements.<sup>6</sup> On a comparative basis, Kaiser's profit margin for the first nine months of 2011 is the second highest among the ten largest HMOs under DMHC's regulation and exceeded the margins of many for-profit HMOs, such as Blue Cross, Aetna and Cigna.<sup>7</sup> During this nine-month period, Kaiser recorded \$1.5 billion in profits.

If implemented, Kaiser's proposed rate increases would produce additional revenues of \$574 million in 2012 as compared to 2011, according to Kaiser's filings.<sup>8</sup>

**2. Surplus Condition.** Kaiser's filings are also silent on the company's surplus condition. The independent "Actuarial Certifications" submitted as part of Kaiser's rate review filings state the following regarding Kaiser's surplus condition: "This information was not explicitly considered in the rate development process; therefore I could not offer an opinion on this."

Meanwhile, publicly available financial records indicate that Kaiser enjoys a significant surplus. On September 30, 2011, Kaiser's excess financial reserves ("excess tangible net equity" or "excess TNE") stood at \$12.8 billion, according to data available from the DMHC.<sup>9</sup> Kaiser's TNE levels exceeded statutorily required levels by 1,162% – more than eleven-and-a-half times the necessary amount. Kaiser's financial strength is further reflected in its \$20 billion investment portfolio.

**3. Executive Compensation.** Kaiser's filings also fail to adequately disclose the company's executive-compensation practices. According to the DMHC's guidelines, Kaiser is required to provide "the annual compensation of each of the ten most highly paid officers, executives, and employees..." Kaiser's "Actuarial Certifications" state the following: "I did not review the compensation levels of the staff or executives and offer no opinion on the appropriateness of the compensation levels, as this is not my area of expertise."

Meanwhile, tax returns and other data indicate that Kaiser's executives enjoy high levels of compensation and have received substantial compensation increases in recent years.

**Compensation of Kaiser's ten most highly  
paid officers & executives, 2010<sup>10</sup>  
(in millions)**

1.	\$8.98
2.	\$2.37
3.	\$2.30
4.	\$2.06
5.	\$1.94
6.	\$1.85
7.	\$1.64
8.	\$1.60
9.	\$1.50
10.	\$1.50
<b>TOTAL</b>	<b>\$25.8 million</b>

Source: Kaiser Foundation Health Plan & Kaiser  
Foundation Hospitals, 2010 IRS Form 990

According to its tax returns, Kaiser's executive compensation practices continue to be among the highest in the industry.

- In 2010, 20 of Kaiser's executives received individual annual compensation of more than \$1 million while the combined compensation of Kaiser's top 40 executives totaled more than \$55 million.
- In 2010, Kaiser's CEO received \$8.98 million in compensation, including multiple bonuses totaling \$ 5,155,125.<sup>11</sup> This represents a 13.6% increase from the prior year and places Kaiser's CEO at the top of the compensation ladder among all non-profit HMOs in California.
- Kaiser's top executives currently receive at least eight separate pension, retirement and deferred compensation plans, as well as at least four bonus plans.
- Kaiser provides its executives with forgivable loans of as much as \$500,000 for home purchases and relocation, according to disclosures filed with the Internal Revenue Service and the DMHC.

**4. Medical Cost Inflation.** Kaiser's proposed rate increases of 9.0% and 8.2% are more than twice as high as the rate of medical cost inflation reported by the U.S. Bureau of Labor Statistics. In fact, both the "CPI-U for U.S. Medical Care" and the "CPI-U for U.S. Medical Care Services" showed an average yearly increase of only 3.1% from October 2010 to October 2011.<sup>12</sup>

Kaiser's contracted actuaries, despite asserting that measures of past increases in actual costs are not relevant to projecting future cost increases, do not adequately describe the drivers for expected future spending.<sup>13</sup>

**5. Prior Rate Increases.** Kaiser's filing does not adequately consider whether the cumulative impact of the proposed rate increases, combined with previous increases, would cause the rates to be unreasonable. For example, Kaiser fails to provide information about the rate increases paid by these same plan enrollees in January of 2011 and during prior years. Without such data, it is impossible to evaluate the cumulative impact of rate hikes on enrollees.

**6. Transactions between Kaiser and affiliates.** Kaiser's filings are also silent about the company's transactions with its affiliates. The DMHC's guidelines require HMOs to disclose "the nature and amount of transactions between the health plan and any affiliates." Kaiser's "Actuarial Certifications" state the following regarding these transactions: "This information was not explicitly considered in the rate development process; therefore I could not offer an opinion on this."

Meanwhile, Kaiser's financial records indicate that Kaiser conducts billions of dollars of transactions with more than two dozen affiliates, including eight for-profit independent medical groups, five health plans operated in other states, and a venture capital fund.<sup>14</sup> These transactions include loans, distributions, contributions, equity transfers and service contracts.<sup>15</sup> In October of 2011, a senior Kaiser executive filed a civil suit against Kaiser in which she alleges that Kaiser has been involved in "funneling funds to related for-profit Kaiser entities (Mid-Atlantic Permanente Medical Group and The Permanente Medical Group, Inc.)."<sup>16</sup>

In consideration of all the issues raised above, it is clear that Kaiser's planned rate hikes demand DMHC's full scrutiny. California consumers need DMHC's full protection and advocacy in this matter.

We request that the DMHC act with all deliberate speed to thoroughly investigate these issues and intervene with Kaiser to protect consumers' interest before the planned January 1, 2012 rate hikes, with a level of focus to actuarial merit similar to that shown by the California Department of Insurance regarding many of the rate hikes over which it exercises jurisdiction.

Kaiser has claimed it cannot provide adequate details regarding its rate-development process, as required by the DMHC, because Kaiser does not collect detailed data on its expenditures due to Kaiser's integrated model and delivery system. For example, last summer Kaiser stated that it was unable to provide data on inpatient, outpatient, physician and other expenses as part of its filing for its July 1 rate hike that affected more than 300,000 consumers.<sup>17</sup> We urge the DMHC to interrogate Kaiser's claims on this matter. First, it strains credibility that the nation's largest nonprofit HMO does not collect and monitor basic patient-utilization and expenditure data, especially given Kaiser's multi-billion-dollar system of electronic records. Furthermore, for nearly five years Kaiser has enrolled thousands of Californians in high-deductible indemnity insurance products for which patients are billed for each appointment, diagnostic procedure and other service provided by Kaiser. If Kaiser's information systems are sufficiently robust so as to enable it to operate indemnity insurance products, then these same systems are likely capable of capturing data on expenditures needed by the DMHC.

Lastly, we would like to offer our assistance to the DMHC in interrogating Kaiser's claims regarding its community benefit expense and the deductibility of these expenses from Kaiser's profit margin for its product lines. We have substantial concerns regarding Kaiser's claims and calculations on these matters.

We and California's consumers thank you in advance for your prompt attention to this matter.

Respectfully,



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cc: Governor Jerry Brown

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- <sup>1</sup> Kaiser Foundation Health Plan, DMHC Rate Filings for “Individual HMO” (SERFF Tracking No: KHPI-127757071) and “Group HMO” (SERFF Tracking No: KHPI-127718991) effective January 1, 2012. In each filing, the proposed annual rate increase is discussed in Exhibit E-1, Part III.
- <sup>2</sup> Edward Heidig, Interim Director of the DMHC, “Guidance Related to Premium Rate Filings” (Letter No. 8-K), May 24, 2011; Edward Heidig, Interim Director of the DMHC, Letter to Jerry Fleming, Senior VP of Kaiser Foundation Health Plan, July 1, 2011, Footnote 2.
- <sup>3</sup> Kaiser Foundation Health Plan, DMHC Rate Filing for “Small Group HMO” (SERFF Tracking No: KHPI-127146900) effective July 1, 2011.
- <sup>4</sup> Edward Heidig, Interim Director of the DMHC, Letter to Jerry Fleming, Senior VP of Kaiser Foundation Health Plan, July 1, 2011.
- <sup>5</sup> Edward Heidig, DMHC, “Guidance Related to Premium Rate Filings,” 2011, p. 3.
- <sup>6</sup> Annual figures are taken from the audited financial statements of Kaiser Foundation Health Plan & Hospitals. The year-to-date figure for 2011 is taken from Kaiser’s press releases for Q1, Q2, and Q3. All three press releases are published on Kaiser’s website.
- <sup>7</sup> DMHC, “Health Plan Financial Summary Report” for “Full-Service Health Plans” for the Reporting Period of January 1 through September 30, 2011. The ten “largest” full-service plans were selected according to “Total Enrollees.” The plans’ profit margins were calculated by using figures provided by DMHC and according to the following formula: Profit Margin = (“Net Income-Loss”) ÷ (“Total Revenue”). Data captured in 11-21-11 from <http://wps0.dmhc.ca.gov/flash>
- <sup>8</sup> Figures are taken from Kaiser’s DMHC Rate Filings for January 1, 2012 (SERFF Tracking Nos: KHPI-127757071 and KHPI-127718991) in the section entitled “Rate Review Details,” which discloses “earned premiums” for “Prior Rate” and “Requested Rate.”
- <sup>9</sup> DMHC, “Health Plan Financial Summary Report” for Kaiser Foundation Health Plan for the Reporting Period of July 1 through September 30, 2011. The figures were taken from the data field labeled, “Excess TNE” and “% TNE to Required.” Data captured on 11-21-11 from <http://wps0.dmhc.ca.gov/flash>
- <sup>10</sup> The compensation figures are the sum of figures disclosed in the following portions of KFHP’s IRS Form 990 for 2010: (1) Schedule J Part II (Compensation) and (2) Schedule J Part III (“Supplemental Nonqualified Retirement Plan Payments”).
- <sup>11</sup> Kaiser Foundation Health Plan, IRS Form 990 for 2010, Schedule J Part II and Part III. Part II indicates that, in 2010, CEO George Halvorson received \$7,743,427 in various forms of compensation, including \$5,155,125 in “Bonus & Incentive Compensation.” Part III (Schedule J, Part I, Line 4-B) indicates that Halvorson received an additional \$1,237,500 in “supplemental nonqualified retirement plan payments” in 2010.
- <sup>12</sup> U.S. Bureau of Labor Statistics, “Consumer Price Index for All Urban Consumers, U.S. Medical Care Cost Inflation Index” for October 2010 to October 2011 (1984 = 100), captured on 12-12-11 at <http://data.bls.gov/cgi-bin/surveymost?cu>
- <sup>13</sup> Milliman, Inc, “Actuarial Certifications” for Kaiser’s DMHC Rate Filings for January 1, 2012 (SERFF Tracking Nos: KHPI-127757071 and KHPI-127718991), Exhibit E-1, Attachment 6 entitled, “Actuarial Certification,” p. 5.
- <sup>14</sup> Kaiser Permanente, Official Bond Statement for Series 2009E-1 and 2009E-2, California Statewide Communities Development Authority, April 20, 2011, p. 1 (“Kaiser Permanente”).
- <sup>15</sup> Kaiser Permanente, Official Bond Statement for Series 2009E-1 and 2009E-2, p. 14.
- <sup>16</sup> Carrie Harris-Muller v. Kaiser Foundation Health Plan, Civil Complaint, Superior Court for the County of Alameda, Case No. RG11599464, October 11, 2011.
- <sup>17</sup> Amendment 4, Exhibit E-1, Kaiser Foundation Health Plan, DMHC Rate Filing for “Small Group HMO” (SERFF Tracking No: KHPI-127146900) effective July 1, 2011, submitted August 24, 2011.