OFFICE MEMO

TO: BILL AREHART RVP

DATE 11/22/88

FROM: William E. Flaherty AT: President's Office

SUBJECT: Employee Informational Briefing on Corporate Financial Position

Last week, there were misleading news articles about the company's financial status. It is the responsibility of management to assure that employees have an accurate picture of our financial strength and strategic direction.

In their day-to-day encounters at work and in the community, our employees serve as advocates for Blue Cross and Blue Shield of Florida. It is critical to our success, that they understand our financial status and are prepared to answer questions about the company that may arise.

Therefore, I am requesting that you hold informational meetings with your direct reports this week to update them on the company's current financial status and managed care strategies.

Four documents are attached which have been prepared to assist you in that effort. They include: key message, fact sheet, responses to potential questions, and employee communication feedback form. An open dialogue on these issues will ensure that employees all have a good working knowledge of where Blue Cross and Blue Shield of Florida is now and where it is heading.

During these informational meetings, please encourage an open discussion in order that we many reassure our employees and those key publics they interact with on a day-to-day basis. Please list any unanswered questions or concerns on the employee feedback form and forward it to Public Affairs. This feedback will assist us in deciding if a future two-way management meeting would he helpful to gain better understanding of our financial position and strategic direction. If further information is required, please contact Public Affairs at 6268.

While these are indeed challenging times for Blue Cross and Blue Shield of Florida, let me assure you our future is bright. With continuation of the hard work we have all provided this year, I am confident we will be embarking on a very rewarding and exciting period of success in 1989 and beyond.

WEF/tg William E. Flaherty

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EMPLOYEE BRIEFING PAPER ON BLUE CROSS AND BLUE SHIELD OF FLORIDA FINANCIAL POSITION AND STRATEGY FOR 1989

KEY MESSAGE:

Blue Cross and Blue Shield of Florida is both financially sound today and well positioned for the future. Because we have invested over the past few years in innovations such as HMOs, PPOs, new technology and management capabilities, Blue Cross and Blue Shield of Florida has the products and services to meet customers' needs, present and future.

Financial Summary

During the mid-1980s, underwriting gains put Blue Cross and Blue Shield of Florida in solid financial position. Approximately $212 million in reserves were reported at year-end 1986. During the second half of 1986, the national health insurance industry entered the downward portion of what has been a traditional six-year business cycle. Historically, the industry experiences three years of financial gains followed by three years of losses.

Virtually every health insurance organization in the country suffered losses in 1987. Our losses were smaller than many others in the industry. Rapid and unexpected increases in claims costs was the major reason for industry-wide losses. Our investment in HMO development, while necessary for long-term corporate success, also contributed to our losses.

Although industry losses are continuing in 1988, Blue Cross and Blue Shield of Florida has reversed the trend as we approach year-end. Projected 1988 losses are $20 million less than in 1987. Furthermore, each HMO location a. well as both the Local and National Market Segment Teams are in the process of developing and implementing specific plans to guarantee that the company shows a profit in 1989.

Background

Recognizing the market's needs for managed care programs and our unique understanding and experience in Florida's health care industry, we have made a major committment to HMOs. Our investment will reach more than $80 million by the end of 1988.

The Florida Plan entered the HMO market in 1982 with investments in Tallahassee and Miami -- the first steps toward development of Florida's largest HMO network. Our seven operations serve 230,000 members in 28 counties. Health Options, Inc. was formed in 1984. Formation of the wholly owned subsidiary was necessary to gain federal qualification and provided the Florida Plan with financial and tax advantages.

As with any new business, losses were expected initially as we invested in establishing community-based networks. Moreover, as HMO competition exploded in Florida, our efforts focused heavily on building sufficient market share necessary to develop strong and efficient provider networks and to negotiate provider contracts favorable for our members.

National studies had found HMOs needed a minimum of 20,000 members in each area served and four years of operation to reach a break-even point. Our HMOs in Tallahassee and southeast Florida have reached that point and are profitable. Each of the other HMO sites has begun a financial improvement phase of its development program. Having achieved Florida's largest HMO enrollment, we have turned our efforts toward improving financial performance of our HMO operations. Efforts begun in late 1987 will continue into 1989, when we expect positive results will be more apparent in our financial reporting.

Programs for Improved Financial Results

We are working to reduce administrative expenses and manage health care costs. An extensive audit has been conducted to identify what improvements can contribute to lower administrative expense. Plans underway include greater integration of Health Options administrative functions with those of Blue Cross and Blue Shield of Florida. Savings will be achieved by reducing duplication and taking greater advantage of economies of scale. For example, a single corporate provider contracting team not only improves efficiency, it potentially can gain greater leverage in contract negotiations by representing our combined membership of all lines of business.

State-of-the-art technology and expanded databases will enable us to better track utilization of our HMO members, identify trends and work with providers whose practices are outside utilization norms. We are continuously reviewing our provider networks to ensure their composition includes those high quality providers with appropriate utilization patterns whose practices support cost effective quality health care. Reducing inappropriate utilization will help contain premiums for our customers as well as reduce Health Options expenses.

We are making business decisions to improve our HMO product lines and benefit designs. A recent decision to discontinue offering the Medicare & More product in the Jacksonville market will result in a $4 million savings for 1989. Changes in co-payments and deductibles are also being made which will encourage members to be more efficient consumers of health care services.

Rate adjustments are being made to more accurately reflect the costs of providing health care coverage to members. Since a large number of HMO accounts renews in January, the result of these adjustments will be best recognized in early 1989. Health Options' continued growth and retention of customers indicate these rate increases reflect industry prices and our customers believe we are continuing to provide them with a value for their health care dollars.

EMPLOYEE FACTSHEET ON
BCBSF FINANCIAL POSITION AND STRATEGY FOR 1989

FINANCIAL SUMMARY

- BCBSF ended 1986 with $212 million in policyholders' surplus
- Reasons for losses: underwriting cycle, HMO development expenses, a highly competitive market, high utilization of health care (particularly outpatient), new medical technologies and covered procedures, inflation rate for medical care twice that of the general consumer price index.
- Health Options losses: $30.9 million for 1987; $28 million expected for 1988; trend toward profitability in 1989.
- BCBSF retains $114 million in policyholders' equity (Sept. 30, 1988).
- BCBSF losses: $66 million for 1987; $45 million expected for 1988; trend toward profitability in 1989 (consolidated losses, includes Health Options).
- BCBSF corporate assets through September 1988 are $410 million.

BACKGROUND

- We are making HMOs the centerpieces of our product line, in response to needs and expectations of the marketplace; we see evidence our competitors are moving in the same strategic direction.
- Began HMO involvement in 1982 with HMO investments in Tallahassee and Miami.
- Health Options, Inc. formed in 1984.
- HMO subsidiary necessary for federal qualification, tax and financial advantages.
- Studies showed HMOs needed a minimum of 20,000 members and four years operation to break even.
- Rapid change and extensive competition in HMO market forced us to implement strategies quickly; in such situations, more mistakes are likely than in a mature industry.
- Health Options growth -- 11,000 members in six counties during 1984; 230,000 members in 28 counties in 1988.
- Health Options represents more than $80 million investment.
- Waxman Bill recently passed by Congress would allow us to remain federally qualified without separate legal entity and to experience-rate; haven't made corporate decision to make changes but currently evaluating.

PROGRAMS FOR FINANCIAL IMPROVEMENT

- HMO rate adjustments will vary HMO by HMO but generally range 20-40 percent.
- Discontinuation of Medicare & More in Jacksonville market only; effective 1-1-89; projected savings of $5 million for 1989.
- Benefit design changes include increases in co-payments and deductibles.
- Implementing tighter utilization management programs, also integrating Health Options with BCBSF programs.
- Renegotiating provider contracts, combining forces of HMO and PPO enrollment.
- Continuing to work with public policy decision-makers toward effective and appropriate legislation and regulation.
- National/special and Local Group Market Segment Teams developing improvement programs for profitability in 1989.
- Report our progress to DOI routinely and receive feedback they are pleased with our results and projections for 1989.

POTENTIAL QUESTIONS

AND RECOMMENDED RESPONSES FOR EMPLOYEES

You may encounter these types of questions in your contacts with customers, prospects, brokers, consultants, friends and acquaintances. By denying inaccurate or false information and clarifying appropriate background, you are serving as the company's most important spokesperson. If you are faced with additional questions you cannot answer, please contact Marjorie Moe in Public Affairs at 904/791-6123.

Q: Will BCBSF continue to be able to pay our claims?

A: Absolutely. Although we have had significant losses over the past two years, we retain approximately $114 million in policyholders' equity. Last year's losses, compared to revenues, represent only about 6 percent of our total revenues. As they have in the last seven of eight years, our revenues have continued to grow in 1988 and will be more than $1 billion for the year.

Q: Are there plans to liquidate or sell Health Options?

A. No. Management at BCBSF has never even contemplated abandoning our HMO development plans. The only objective is to improve the financial performance of our HMOs. BCBSF has made our HMOs the centerpiece of our product line, recognizing that our customers need and want multiple options in today's marketplace. The financial position of Health Options is no different than that of most of the HMO industry. And, like any new business, the first years' of operation require HMOs to reinvest in the long-term success of the business. Two of our HMO sites -- Tallahassee and southeast Florida --have already reached the break-even point. We have begun our financial improvement plans at each of the other HMO sites and are beginning to see the rewards of our efforts. Liquidation or sale of Health Options at this time, with our break-even point clearly in sight for 1989, would not be a prudent business strategy.

Q: How is Health Options doing compared with other HMOs?

A: National studies indicated that each HMO needed about 20,000 members and four years of operation before breaking even. And, like any new business, the first years' of operation require HMOs to reinvest in the long-term success of the business. Two of our HMO sites -- Tallahassee and southeast Florida -- have already reached the break-even point. We have begun our financial improvement plans at each of the other HMO sites and are beginning to see the rewards of our efforts. With approximately $114 million in reserves, BCBSF clearly has the financial strength to remain committed to the long-term success of our HMOs.

Q: Are BCBSF losses getting worse? (What do you anticipate for 1989?)

A: No. The financial picture is improving. We anticipate that losses for 1988 will be $20 million less than they were last year and we expect to be profitable in 1989. As a result of implementing our HMO financial improvement programs, HMO losses have been declining each month since August and our plans call for reaching the break-even point in 1989. Although we have had to revise our previous forecasts periodically, we are confident in achieving our target for profitability in 1989. Also, the traditional underwriting cycle in health insurance is moving into a period where profits can be expected. Achieving and maintaining profitability is always a priority objective at BCBSF and management feels strongly that every employee can and must contribute to our financial performance.

Q: Will premiums for other products be increased to make up for HMO losses?

A: No. We establish premiums based on the anticipated costs of paying for customers' health care during the rating period, including the prices we'll pay and the amount of care that will be needed. Large employer groups are rated based on their experience; small groups and individuals are rated on anticipated costs of covering all those with that type of coverage, with some variation to reflect factors such as geographic and demographic differences in health care use.

Q: Will the financial losses jeopardize BCBSF's contract to administer the Medicare contract?

A: With $114 million in reserves and corporate assets of $410 million as of Sept. 30, 1988, BCBSF is financially strong. Our Medicare operations are very separate from our private business, as the Medicare budgets and funding are negotiated with the federal government. Our retention of the Medicare contract is based on our operational performance, as measured by criteria established by the federal government. As a highly competent performer, BCBSF is in no jeopardy of losing its contract to administer Medicare.

Q: Is the Department of Insurance concerned about BCBSF's financial position?

A: With its oversight responsibilities to monitor and regulate the insurance industry, the DOI is charged with reviewing the financial results of each insurance company. The DOI routinely works with all Florida insurers to protect the insurance policyholders' interests.

In BCBSF's routine dealings with them, the DOI has not expressed any special or significant concern about our financial position. The DOI has not directed us to alter our business practices in any way, and in fact, a DOI official was recently quoted in a newspaper as stating "We're not alarmed at anything that's going on there."

Employee Communication
Feedback Form
on Corporate Financial Position

Comments about topics covered in today's meeting:

New questions on topics covered:

Concerns:

Suggestions:

Return to Public Affairs, 3C.