



THE U. S. HEALTH INSURANCE INDUSTRY:
Year End 2010 Health Insurance Industry Review (May 16, 2011)

Surplus for the U.S. Health Insurance Industry, as reflected by the ALIRT 100 Company Health Composite, continued to strengthen in 2010 and now exceeds that of year end 2007 before the onset of the credit crisis. Earnings were strong on improved underwriting results due in part to lower utilization, a milder flu season, and redundancy of prior year reserves. Premium growth, however, was flat in 2010 as aggregate membership fell, primarily in the commercial market, and employers continued to shift medical offerings to less benefit rich product types.

Comprehensive Healthcare Reform – A Year Later

2010 was a watershed year for the U.S. health insurance marketplace. In March, national healthcare legislation was signed into law after protracted and often acrimonious debate about its relative merits. Almost immediately following passage, legal challenges began which have not yet been fully resolved. Nevertheless, most major stakeholders – including insurers - believe that health reform, in some form or another, is now a permanent fixture and are adjusting to this reality.

2011 can be viewed as another watershed year in that this will be the first in which various health reform elements are in force for the entire year. These elements include those initiated in mid to late 2010: removal of lifetime and annual limits, dependent coverage up to age 26, stricter prohibitions against rescissions, first-dollar coverage for preventative care, and the removal of preexisting conditions for children under 19.

Additional elements came into effect on January 1 of this year, including - importantly - the medical loss ratio (MLR) provision mandating that a certain amount of premium dollars be spent on medical care or rebated the following year. This provision has generated enormous debate and it is still not entirely clear how the MLR formula will be calculated or how many exemptions may ultimately be granted. This calculation will be closely watched by insurers, especially in the individual and smaller group medical markets where product profitability is traditionally higher.

The introduction of additional elements of healthcare reform are slated for 2014, including full guarantee issue and renewable coverage without preexisting condition or health-related rating adjustments, as well as the establishment of state-based insurance exchanges for individuals and small businesses. Excise fees on insurers will also be introduced in that year.

National healthcare reform brings both perils and promises. The perils are somewhat obvious: the potential bureaucratization of healthcare financing and delivery, which could result in operating and/or capital losses for health insurers who are not large/nimble enough to adjust to this new healthcare landscape. Ideological lines have been drawn, to some extent, plotting insurers against providers against insureds in an attempt to curtail the rapid growth of healthcare costs in this country (see Appendix A). Some reform elements seek to curb these costs at the expense of insurer profitability – the latter necessary to maintain stable private markets.

The promise, of course, is the future coverage of most of the approximately 50 million Americans who currently do not have access to health insurance (see Appendix A). Another promise is the improvement of the general health of the American population as well as of the cost and nature of

healthcare delivery and medical outcomes, all born of the necessity of finding creative solutions to the problems we face within our current healthcare system. Insurers who take up this challenge successfully will potentially find themselves with a larger population of insureds, which could result in stronger profitability and growth. Those who avoid this challenge may well find themselves in an increasingly less sanguine financial situation.

The U.S. Health Insurance Composite: Executive Summary

Summary financial results for the ALIRT Health Composite¹ are provided below.

- Statutory surplus for the U.S. Health Insurance Composite rose 11.2% in 2010 to \$61.0 billion, reflecting a second consecutive year of strong surplus growth. Boosting surplus were operating earnings of \$8.2 billion and net capital gains of \$2.5 billion, offset by shareholder dividends (or negative surplus paid in) of over \$3.5 billion and negative other one-time changes to surplus.
- Net premiums rose by just under 1% in 2010 when compared to the prior year period, on continued, though moderating, premium price increases offset by lower membership. Net premium leverage (net premium to surplus) fell to 3.8 times in 2010 versus 4.3 times in 2009, as surplus growth broadly outstripped premium growth.
- Member Months fell by 2% to 804 million in 2010. This continues a trend of membership loss over the last four years, with only 2009 reporting a slight increase. Lower membership reflects continued losses in private plans due to foregone coverage by smaller or mid-sized companies and lower overall employment since the recession of 2008.
- Stronger growth in government programs (Medicare Advantage and Medicaid) also serves as an offset to declining commercial membership. This is evidenced by the continued shift in composite premium away from Comprehensive Hospital & Medical coverage into a number of government programs, including Federal Employee coverage, over the last decade.
- The medical loss ratio for the ALIRT Health Composite fell almost two percentage points to 84.8% in 2010. This improvement marks a reversal from almost steady deterioration since 2006 and likely reflects lower utilization during the recession as members opted not to pay out of pocket costs under high deductible policies. A lighter flu season compared to prior years was also likely helpful, along with gains arising from wellness/disease prevention and other programs.
- Both pretax and after-tax operating earnings rose by 50% or more in 2010 (\$10.8 billion and \$8.2 billion, respectively, in 2010). ***This improvement in operating profitability also snapped a three year losing streak, as underwriting income rose by over 100% in 2010, offsetting lower net investment income.*** After-tax returns on revenues and equity rose 1.1% and 3.7%, respectively, in 2010.
- Net investment yield declined 82 basis points in 2010 to 3.24%, reflecting the impact on portfolio yields of continued very low short and medium term interest rates. The key Federal Funds lending rate has remained at close to zero since the fourth quarter 2008, and the Federal Reserve is vowing to maintain extremely loose monetary policy for an extended period of time. Total return was also lower in 2010, but at 6.16% remains decent, reflecting the benefit of rebounding equity markets and a general improvement in bond credit quality.

¹ The U.S. Health Insurance Composite is comprised of the 100 largest U.S. health insurance companies which file their financials on the NAIC health statement ("orange blank"). Large California health insurers, which do not file on this same statutory convention blank, are excluded.

Surplus & Leverage

The table below highlights composite surplus trends for the U.S. Health Insurance Composite over the last eight years, as well as the major items driving surplus changes.

Composite surplus growth rose 11.2% in 2010, with surplus equaling \$61.0 billion at 12/31/10.

Surplus is now 11% higher than the pre-crisis level of year-end 2007 as capital growth accelerated for a second consecutive year. Contributing to the improved industry surplus were strong earnings (the third strongest earnings in the last 8 years) and net capital gains, the latter largely on stock holdings, corporate bonds, and U.S. Treasuries. These were offset by shareholder dividends and negative paid-in surplus of \$3.5 billion, though these levels were lower than those of 2008 and 2009, perhaps reflecting a more defensive stance on the part of insurers as they brace for the impact of health care reform elements which took effect in late 2010/early 2011.

Surplus Development – U.S. Health Insurance Composite (\$ Mns.)								
	2003	2004	2005	2006	2007	2008	2009	2010
Surplus Beginning of Period	23,022	31,515	37,852	44,417	51,015	55,104	50,981	54,894
Operating Earnings	6,556	7,165	8,292	8,944	8,081	8,009	5,207	8,159
Net Capital Gains or (Losses)	1,944	1,488	635	1,512	968	(5,497)	4,186	2,452
Surplus Paid-In	(54)	20	243	119	(33)	309	(33)	(515)
Shareholder Dividends	(1,602)	(2,146)	(2,488)	(3,106)	(3,533)	(4,613)	(6,448)	(3,023)
Changes in Acctg. Principles	51	(100)	25	0	(18)	0	66	0
All Other Changes to Surplus	1,598	(68)	(141)	(871)	(1,376)	(2,331)	935	(925)
Surplus End of Period	31,515	37,852	44,417	51,015	55,104	50,981	54,894	61,042
Change in Surplus	36.9%	20.1%	17.3%	14.2%	8.0%	-7.5%	7.7%	11.2%

Surplus Development/Underwriting Leverage – Individual Companies

Surplus rose for 76 composite companies in 2010, in most cases due to operating earnings being supplemented by net capital gains. Twelve composite companies reported surplus growth exceeding 30%, led by Ohio Medicaid specialist Caresource (62.8%), Humana Health Plan, Inc. (59.9%, helped by other miscellaneous gains to surplus), QCC Insurance Company (53.3%), United Healthcare of Florida, Inc. (51.5%), Group Health Inc. (45.6%, helped by a \$115 million surplus note), and Presbyterian Health Plan, Inc. (41.7%).

Only three composite insurers reported surplus declines exceeding 20% in 2010 (versus 10 companies in 2009), largely due to shareholder dividends paid to parent companies. The largest surplus declines were reported by United Healthcare of NC, Inc. (-31.0%), BCBS of Florida subsidiary Health Options, Inc. (-28.1%), and Health Net of CT, Inc. (-23.4%; company currently in run-off after acquisition by UnitedHealth Group in late 2009).

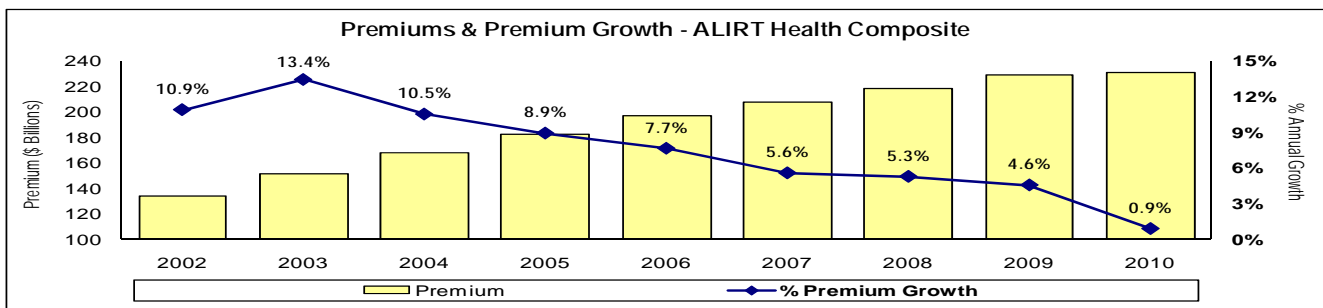
Composite net premium leverage (net premium divided by surplus) declined 45 basis points to 3.8 times surplus in 2010, as surplus growth outstripped anemic net premium growth. Higher premium leverage exposes surplus to potentially more rapid erosion in the case of mispriced business, so this development is a credit positive.

Eleven composite companies reported net premium leverage of over 10 times surplus at year end 2010, with the highest leverage reported by Emblem Health subsidiary Group Health, Inc. (17.1 times), an improvement from the 2009 figure as surplus improved on one-time gains. The second and third highest leverage figures were reported by Florida-only insurers: Medicaid specialist Vista Health Plan, Inc. (16.4 times) and Wellcare of FL, Inc. (16.1 times). Interestingly, six of the seven companies with the highest premium leverage specialize in servicing the Medicaid or Medicare markets.

Composite companies reporting the lowest (= most conservative) net premium leverage are traditionally dominated by Blue Cross Blue Shield licensees and include BCBS of South Carolina (1.1 times), Highmark, Inc. (1.7 times), BCBS of Kansas City (1.8 times), BCBS of Arizona (1.9 times), and Medical Mutual of Ohio (2.0 times). In fact, of the 20 composite companies with the lowest net premium leverage, seventeen were BCBS carriers (or subsidiaries of BCBS licensees), contributing to the overall stronger risk-adjusted capitalization of these organizations.

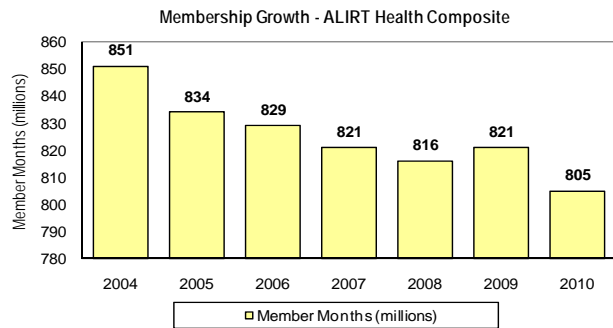
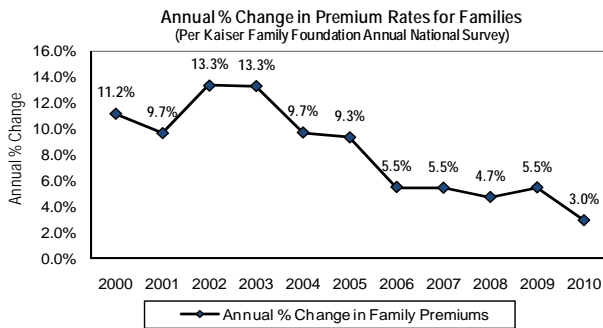
Premium Growth/Membership

After having peaked in 2003 at 13%, premium growth rates for the ALIRT Health Composite are at their lowest levels in the past nine years at just 0.9%. Premium is the expression of the price of coverage as well as the units of that coverage being written (membership). While premium rates continue to rise – though at a much lower annual level (see graph below²), the sharp downtick in membership has pressured overall revenue for insurers.



The lower premium figures reflect a number of factors, including: a secular trend of higher deductible/higher co-pay insurance policies, which are cheaper (i.e. employers passing costs through to the employees), more intense competition for commercial insureds as membership trends lower, a growing number of larger employers opting to self-insure, and a spike in unemployment given poor economic conditions over the last three years.

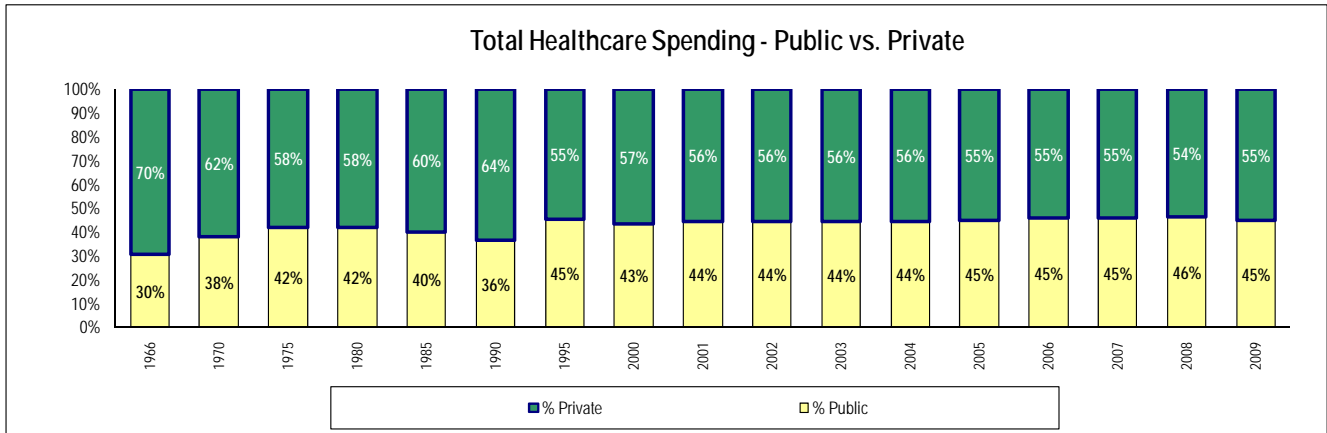
Contributing to these trends going forward will likely be pressure on pricing from regulators as new national healthcare regulation seeks to “bend the cost curve” (including requirements to prove rate reasonableness).



² Kaiser Family Foundation and Health Research & Educational Trust: Employer Health Benefits, 2010 Summary of Findings.

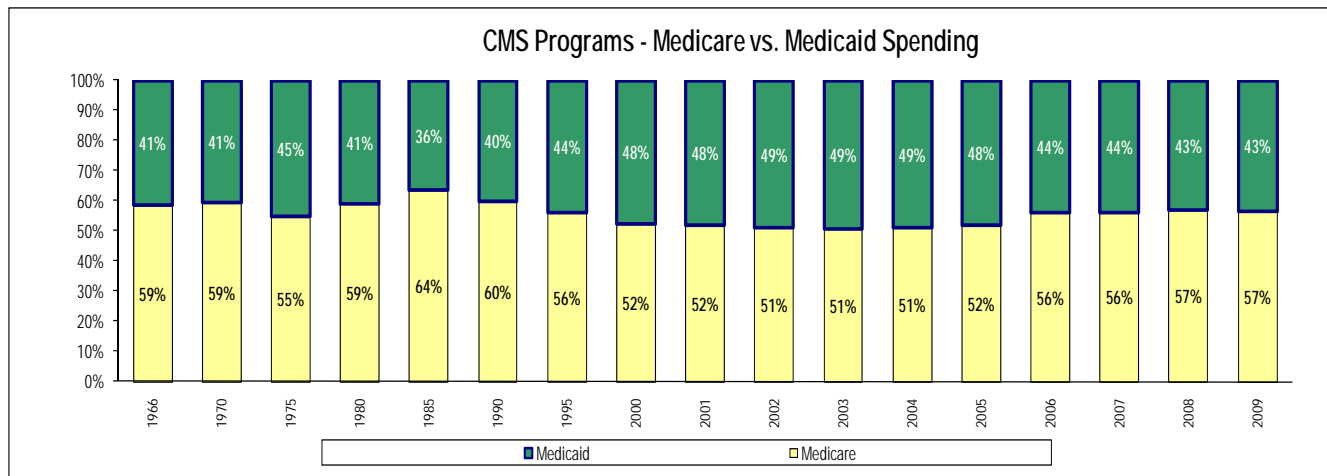
Stronger growth in government plans, and especially in Medicare Part D and Medicare Advantage Plans, has partially offset growth/membership declines on the commercial side, providing additional sources of revenue for private insurers. This trend could accelerate as baby boomers begin to enter the Medicare program in larger numbers and as national healthcare reform (2010) makes increasing subsidies available for lower income families, which may boost Medicaid rolls.

The graph below shows a breakdown of health care spending between public and private funding sources since 1966³. The share of government spending for healthcare grew rapidly in the late 1960s and early 1970s due to the introduction of the Medicare and Medicaid programs. In 2009, the latest year for which this data is available, government spending ticked downward – unexpected given the recessionary environment of that year - but the longer term trend will likely continue to push government participation toward the 50% mark.



Source: Centers for Medicare and Medicaid Services (CMS); U.S. Census Bureau

Of the two principal government programs, the share of Medicare spending rose rapidly over the past four years – and especially in 2006 – due to the introduction the Medicare Part D (pharmacy) and liberalization of the Medicare Advantage plans within the Medicare Modernization Act of 2003. As mentioned, we may see Medicaid programs gain a greater share of government business post-health care reform, as that program is slated to expand while reimbursements to providers under Medicare will likely come under pressure.



Source: Centers for Medicare and Medicaid Services (CMS)

³ Total U.S. Healthcare expenditures were \$2.49 trillion in 2009 (the latest data available), according to the CMS. This was a 4% increase from the previous year, the lowest annual increase in overall healthcare expenditures in the past 10 years.

Besides Medicare and Medicaid, the Federal Employees health program has also shown strong growth over the past eight years, and especially between 2004 and 2005 and again in 2010. Below we show the premium mix for the ALIRT Health Composite over the past nine years. It is interesting to note that, taken together, government programs in 2010 represented 37% of total private insurer premiums, up from 26% in 2002. The mix of private insurer group and individual health business (non-government), on the other hand, has fallen steadily since 2003 with sharp downward acceleration over the past two years⁴.

Again, given the presumed growth of Medicaid under new healthcare legislation, combined with potential large growth in Medicare Advantage/Medicare Part D business as baby boomers begin turning 65, one could expect the share of government-sourced business to grow. That said, it is possible that the planned cut-backs in Medicare Advantage reimbursements may force more retirees into the traditional government Medicare programs (Parts A & B) – as private insurers leave the program - and therefore decrease the public market’s premium flow. Additionally, as national healthcare legislation pushes more Americans into insured programs (and especially come 2014), we may see the share of “privately-sourced” premiums grow at the expense of government programs.

Premium Mix By Line of Business ALIRT Health Composite 2002-2010								
	Hosp.& Medical	Medicare Suppl.	Dental	Vision	Federal Employee	Medi- Care	Medi- caid	Other
2002	66.9%	3.7%	1.1%	0.1%	6.9%	14.4%	5.1%	1.8%
2003	68.9%	3.5%	1.0%	0.1%	7.3%	13.1%	5.1%	1.0%
2004	68.6%	3.3%	0.9%	0.1%	7.6%	13.5%	5.5%	0.5%
2005	67.5%	3.8%	0.8%	0.1%	9.5%	12.8%	5.1%	0.4%
2006	64.8%	3.4%	0.7%	0.1%	9.1%	14.8%	5.1%	2.0%
2007	63.9%	3.1%	0.7%	0.1%	9.3%	15.5%	5.4%	2.0%
2008	62.5%	3.0%	0.7%	0.0%	9.6%	17.3%	5.5%	1.4%
2009	59.8%	2.9%	0.7%	0.0%	9.8%	18.7%	6.6%	1.5%
2010	57.4%	2.8%	0.6%	0.0%	10.6%	19.7%	7.2%	1.7%

Premium Growth/Membership – Individual Companies

Twelve companies reported annual net premium growth exceeding 10% in 2010. Premium growth exceeded 20% for only three companies, including Michigan insurer Priority Health (25%) and Minnesota insurer Medica Health Plans (25%). Both companies reported strong growth in Medicare and/or Medicaid programs. Other companies reporting large gains in net premiums written include HealthAssurance Pennsylvania (20%), Medicaid specialist Health Partners of Philadelphia (20%), Florida insurer Avmed Inc. (17%), and Group Health Inc. (15%).

⁴ We note that the ALIRT Health Composite does not include the large, predominantly group medical health writers that issue their financials on a life insurance blank (e.g. Aetna Life, Connecticut General Life, United Healthcare Insurance Company, etc.). These necessary exclusions likely serve to distort downward somewhat the commercial medical health premium as a growing amount of PPO business – especially in programs tied to high-deductible health plans – is written out of these large “life” insurers. These insurers likewise house the majority of Administrative Services Only/Administrative Services Contract (ASO/ASC) business produced within their respective groups, representing an important source of fee income.

Forty companies reported annual declines in net premium in 2010 (up from 31 last year), with four companies reporting declines of greater than 20%. These include UnitedHealth HMO Optimum Choice, Inc. (-29%), BCBS of Florida subsidiary Health Options Inc. (-28%), Regence BCBS of Oregon (-22%), and Coventry subsidiary Health America Pennsylvania Inc. (-21%).

Member months fell 2.2% in 2010, continuing a general trend over the past six years (see page 4). As with premiums, the steady decline in private individual and group health business membership over the past five years has been offset by growth in the government lines (Medicare Advantage and Part D programs, Medicaid, and Federal Employees). The Other category also grew steadily over the past two years and represents a number of lines, but is likely distorted by the introduction of a stop loss program by Health Care Service Corp. in 2009.

Member Months By Line of Business ALIRT Health Composite 2005-2010								
	Hosp.& Medical	Medicare Suppl.	Dental	Vision	Federal Employee	Medi- Care	Medi- caid	Other
2005	63.2%	5.5%	5.6%	2.4%	6.9%	3.7%	5.9%	6.8%
2006	62.9%	5.3%	5.5%	2.3%	6.9%	4.1%	6.1%	6.8%
2007	62.8%	5.1%	6.0%	1.4%	7.0%	4.4%	6.2%	7.1%
2008	62.6%	5.0%	6.1%	1.0%	7.2%	5.1%	6.6%	6.6%
2009	59.0%	4.8%	6.5%	1.1%	7.2%	5.5%	7.2%	8.7%
2010	55.5%	4.7%	6.3%	1.9%	7.6%	6.0%	8.0%	10.0%

Unlike in prior years, the majority of the 15 insurers with the largest gain in member months in 2010 had the majority of their premium volume in non-governmental plans. In fact, among that group there were only three companies exclusively dedicated to either Medicare or Medicaid business. The companies with the largest annual gains in membership, measured by member months, were Avmed Inc. (20%), Priority Health (15%), Medicaid specialist Caresource (14%), Medica Health Plans (14%), and Anthem Health Plans of Maine, Inc. (13%). It is interesting to note that three of the four companies with the strongest membership growth are relatively small, HMO-predominant, single-state insurers.

Sixty-one composite companies reported a decline in member months in 2010, with 10 companies reporting declines exceeding 20%. The largest declines in member months were reported by Health America Pennsylvania Inc. (-41%), Optimum Choice Inc. (-37%), Health Options, Inc. (-27%), Empire Healthchoice Assurance Inc. (-27%), Regence BCBS of Oregon (-24%), Pacificare of Colorado, Inc. (-23%), and MVP Health Plan Inc. (-23%). The first three of these organizations write predominantly commercial/individual health coverage in non-government markets; Regence has an equal mix of private vs. government business; while Pacificare of Colorado and MVP write predominantly Medicare business. The point is that declines in membership are impacting various lines in business.

When viewed by product type, composite membership has stabilized in the HMO lines (after a couple of years of deterioration), while membership has trended down in all of the other business types. The growth in the "Other" category reflects in part the aforementioned sharp growth of Health Care Service Corp's stop loss business since 2009. Medicare Part D business is also included in this category for some insurers.

Member Months By Product Type ALIRT Health Composite 2005-2010						
	HMO	PSO	PPO	POS	Indemnity	Other
2005	30.9%	1.5%	41.1%	8.0%	9.1%	9.4%
2006	29.2%	1.5%	42.3%	7.9%	8.1%	11.0%
2007	30.2%	1.5%	44.4%	6.4%	7.7%	9.7%
2008	28.1%	1.5%	47.8%	5.9%	7.1%	9.5%
2009	27.5%	1.4%	46.7%	5.3%	6.5%	12.5%
2010	27.8%	1.2%	46.1%	4.7%	6.1%	14.1%

Profitability & Earnings

Profitability metrics improved nicely for the ALIRT Health Composite in 2010, *as underwriting earnings rose by over 110% and overall pretax operating earnings rose by over 50%, when compared to the prior year results.* The tables that follow provide an overview of business line loss and expense ratios for the composite over the past nine years.

Medical Loss Ratio By Line of Business ALIRT Health Insurer Composite 2002-2010								
	Total	Hosp.& Medical	Medicare Suppl.	Dental	Vision	Federal Employee	Medicare	Medicaid
2002	86.2%	85.3%	81.9%	80.4%	71.0%	91.7%	87.6%	89.6%
2003	85.1%	84.1%	80.3%	79.8%	68.3%	92.6%	86.6%	88.3%
2004	85.3%	84.0%	88.7%	80.5%	72.9%	91.9%	87.3%	87.7%
2005	84.4%	82.5%	83.7%	78.9%	62.7%	93.3%	86.9%	88.1%
2006	84.2%	83.3%	81.6%	77.9%	63.5%	93.1%	85.2%	87.9%
2007	86.2%	85.1%	83.9%	77.9%	62.6%	95.3%	85.2%	88.6%
2008	86.1%	85.3%	81.4%	77.9%	65.4%	92.5%	86.0%	89.5%
2009	86.7%	86.8%	85.2%	78.9%	66.5%	91.7%	85.8%	88.7%
2010	84.8%	83.6%	81.1%	79.6%	74.8%	90.9%	85.1%	86.7%

The loss ratio for the Hospital & Medical business (group and individual non-government medical health business) improved by almost three percentage points in 2010. Insurer managements cite lower utilization, a milder flu season, and favorable prior year reserve development. There is some speculation that the lower utilization was tied to insureds opting not to spend funds within their deductible limits given difficult economic conditions. Some insurers also cited the beneficial impact of wellness/preventative care/disease management programs, which have gained in popularity among employers.

Loss ratios for the three governmental lines also improved, with Medicare showing the third best medical loss ratio among product types. The Medicaid line improved by a strong two percentage points as well and we note that profitability among government-sourced business has now improved for the second consecutive year. Only the Vision line of business, quite a bit smaller than the other lines, showed sharp deterioration in 2010.

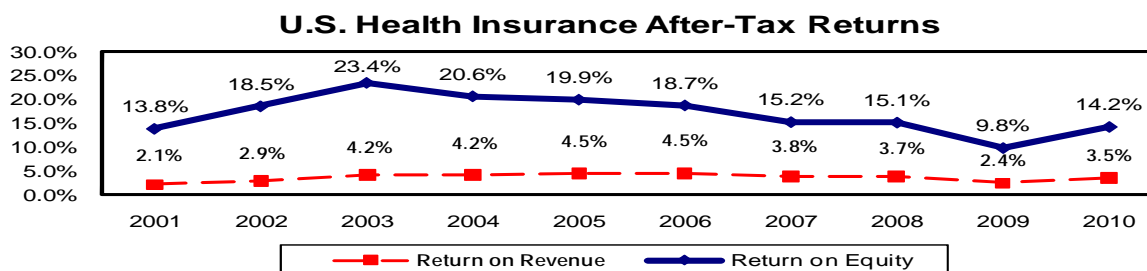
As shown below, the composite expense ratio was flat in 2010, with expense loads much improved for the two smallest lines of business (Dental & Vision). These lines, together with Medicare Supplement business, have the highest expense ratios among the various market types. Both of the major governmental programs, Medicare & Medicaid, showed deterioration in their expense ratios in 2010, while the expense ratio for non-governmental commercial and individual medical health business remained steady at 12.8%. Various insurer managements spoke of the beneficial impact of administrative expense initiatives in 2010, but as an industry the expense ratios have remained remarkably consistent.

Expense ratios will be given greater scrutiny going forward as minimum loss ratio rules come into effect starting this year. As rules stand now, no more than 15% / 20% of premium can be spent on non-medical expenses for large group medical and small group/individual medical insurance, respectively, in any calendar year. This has already put pressure on commission practices and may have a significant impact on distribution strategies going forward in certain lines of business.

Expense Ratio By Line of Business ALIRT Health Insurer Composite 2002-2010								
	Total	Hosp.& Medical	Medicare Suppl.	Dental	Vision	Federal Employee	Medicare	Medicaid
2002	11.6%	12.5%	13.2%	12.7%	26.9%	7.5%	9.1%	9.6%
2003	11.5%	12.5%	13.1%	15.6%	21.0%	6.9%	9.3%	10.4%
2004	11.5%	12.3%	12.9%	13.9%	31.4%	6.8%	9.0%	11.2%
2005	11.3%	12.3%	12.2%	16.9%	19.5%	6.1%	9.3%	11.4%
2006	11.3%	13.0%	13.5%	18.6%	23.4%	5.8%	8.8%	12.0%
2007	11.2%	12.8%	14.4%	19.0%	17.6%	5.9%	8.9%	11.1%
2008	11.1%	12.6%	14.1%	19.5%	17.1%	5.8%	8.9%	10.4%
2009	11.4%	12.8%	15.9%	18.2%	19.3%	6.0%	8.8%	11.1%
2010	11.4%	12.8%	15.2%	16.5%	16.9%	5.6%	9.2%	11.7%

As for operating profitability, after-tax profit margins for almost all lines of business improved in 2010 when compared to the three prior years, reflecting the rebound in industry underwriting results (net investment income, discussed later, actually fell 14%). After-tax returns on equity and revenue for the composite were 14.2% and 3.5%, respectively, with the rebound in ROE arresting a six year trend of deteriorating profitability.

We note, however, that 2009 may well have been an anomalous year – with higher flu losses and the well documented mispricing of some business – and that the general profitability trend over the last eight years is still decidedly lower. As discussed in our opening comments, the more complete introduction of healthcare reform elements (including, likely, more stingy government payments) in 2011 may adversely impact profitability this year as carriers seek to “right price” their product offerings.



On a business line basis, pretax returns on premium in 2010 were strongest, once again, in the vision market, though profitability there continues to trend lower. Of the largest lines of business, the profit margin for Medical and Hospital (57% of total composite premium) rose almost 300 basis points to 3.6%, the best result in four years. The Medicare Supplement and Medicaid lines also reported stronger profitability metrics in 2010, while Medicare margins (20% of total composite premium) were essentially flat.

Pretax Return on Premium (Profit Margin) ALIRT Health Insurer Composite 2002-2010								
	Total	Hosp.& Medical	Medicare Suppl.	Dental	Vision	Federal Employee	Medi- Care	Medi- caid
2002	2.5%	2.4%	4.7%	7.4%	1.6%	0.2%	4.1%	0.9%
2003	3.8%	3.8%	6.5%	5.0%	10.6%	0.4%	4.5%	1.3%
2004	3.6%	4.0%	-1.6%	6.2%	-4.5%	1.0%	4.4%	1.1%
2005	4.7%	5.4%	4.8%	4.8%	17.0%	0.6%	4.7%	0.4%
2006	4.5%	4.1%	4.9%	4.0%	14.1%	0.8%	5.6%	1.1%
2007	3.1%	2.6%	1.7%	3.0%	20.5%	0.5%	5.8%	0.3%
2008	2.8%	2.1%	4.6%	2.7%	17.7%	0.3%	5.2%	0.1%
2009	2.4%	0.7%	-1.1%	3.5%	15.0%	0.1%	5.6%	0.2%
2010	3.5%	3.6%	3.4%	3.6%	13.9%	0.8%	5.7%	1.5%

Profitability & Earnings – Individual Company Results

Eight composite insurers reported combined ratios lower than 90% in 2010 (up from 3 in 2009). These include two UnitedHealth subsidiaries: Optimum Choice, Inc. (80.4%) and Pacificare of Colorado, Inc. (86.2%), four Wellpoint subsidiaries: Anthem Health Plans of Virginia, Inc. (87.0%), Empire Healthchoice HMO Inc. (88.1%), Community Insurance Company (88.4%), and Anthem Health Plans Inc. (88.6%), as well as Health Options Inc. (89.2%) and Health America Pennsylvania (89.8%).

It is interesting to note that of the 20 composite companies with the strongest combined ratios in 2011, sixteen are owned by large, publicly-traded holding companies (Aetna, Coventry, Humana, UnitedHealth Group, and Wellpoint). Wellpoint owns eight of these subsidiaries, while UnitedHealth owns five. These remaining four are relatively large Blue Cross/Blue Shield licensees. It is likely that the industry will continue to be dominated by these types of organizations, which have the scale and resources to compete effectively in a healthcare landscape challenged by new healthcare mandates.

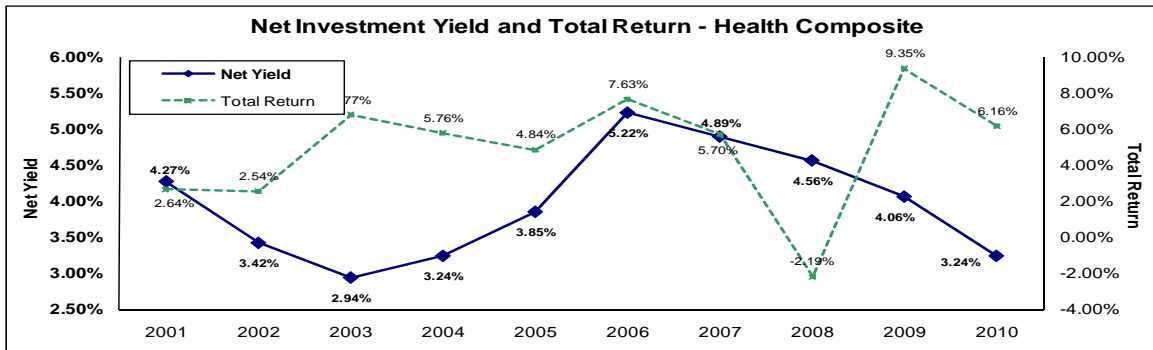
Twenty-two composite insurers reported combined ratios of over 100%, indicating underwriting losses. The weakest combined ratios were reported by two Kaiser Permanente subsidiaries: Kaiser Foundation Health Plan Midatlantic and Kaiser Foundation Health Plan Inc. (both at 103.8%), followed by BCBS of Rhode Island (103.7%), Medicare/Medicaid specialist Lovelace Sandia Health Systems Inc. (103.6%), Medical Mutual of Ohio (102.8%), and Health Net of CT, Inc. (102.3%).

Of the 20 composite companies with the weakest underwriting results, 11 are privately-held, 7 are BCBS affiliates, while only two are subsidiaries of publicly traded managed care organizations.

On a return on revenue basis, only one composite company reported an after-tax ROR exceeding 10% in 2010: Optimum Choice Inc. (14.5%). Fourteen composite companies reported operating losses (down from 20 in 2009), with the largest losses reported by Group Health Cooperative (-2.8%), Kaiser Foundation Health Plan Midatlantic (-1.9%), BCBS of Rhode Island (-1.7%), Medical Mutual of Ohio (-1.5%), and Health Net of CT, Inc. (-1.4%). We note that these operating losses are substantially smaller than those reported by composite companies in 2009.

Investment Results

The graph below shows Net Investment Yield and Total Return on invested assets for the ALIRT Health Composite over the past decade (2001-2010).

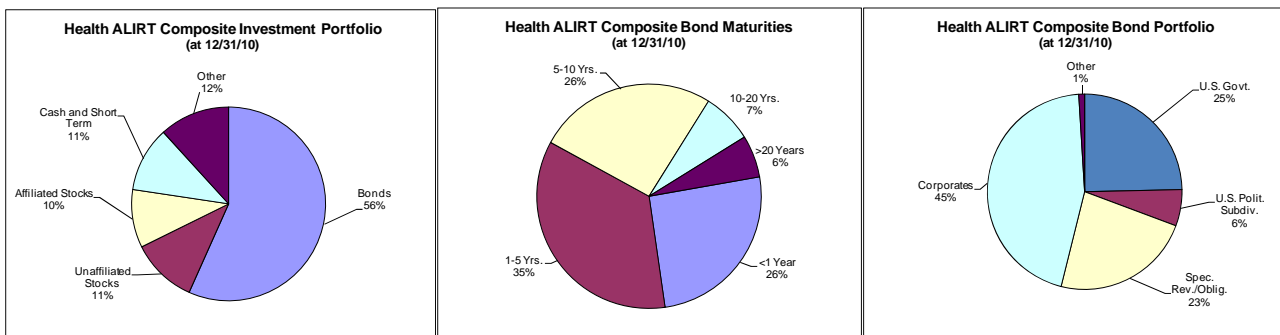


Net Investment Yield

Net investment yield for the composite improved sequentially in the three years 2003 to 2006, before trending down almost 200 basis points to a low 3.24% in 2010. This lower yield reflects the impact of the continued very low interest rate environment as the Federal Reserve cut its key Federal Funds rate by 425 basis points since mid-2007 (to 0.25% currently), in an attempt to combat the impact of the financial crisis of 2008 and subsequent economic recession. The Fed has publicly stated that it will maintain these low rates for an extended period of time, even as it promises to end its current quantitative easing policies mid-year.

As shown below, the Health Composite holds 56% of its invested assets in bonds. Of these holdings, approximately 60% have maturities in the 0-5 year range, where yields have been most adversely impacted. Additionally, the Health Composite holds just over 50% of its bonds in U.S. government instruments, including U.S. Treasuries, Agencies, and State and Municipal bonds, where yields have also tended to be lower given the perceived stronger credit quality of these instruments.

The low portfolio yield contributed to a 14% drop in net investment income in 2010.



Total Return

Composite **total return** improved sharply in 2009 and 2010, largely reflecting the rebound in equity markets after the capital market collapse of 2008/early 2009. As the Health Composite holds 21% of invested assets in equities - split evenly between affiliates and unaffiliates - this improvement contributed to the strong total returns of 9.35% and 6.16% in 2009 and 2010, respectively.

As shown below, equity markets have trended higher thus far in 2011, which could result in additional improvement to net capital gains as of the 1Q2011 reporting period. However, capital markets have proved somewhat skittish in recent weeks and there always exists the possibility that the U.S. economy could stall again if the Federal Reserve seeks to wean it off of current easy money policies later this year.

	2004	2005	2006	2007	2008	2009	2010	1Q11	2Q11*
DJIA	+3.1%	-0.6%	+16.3%	+6.4%	-33.8%	+17.9%	+11.0%	+6.4%	+2.2%
S&P 500	+9.0%	+3.0%	+13.6%	+3.5%	-38.5%	+21.3%	+12.8%	+5.4%	+0.9%
NASDAQ	+8.6%	+1.4%	+9.5%	+9.8%	-40.5%	+36.0%	+16.9%	+4.8%	+1.7%

*As of end of day May 13, 2011

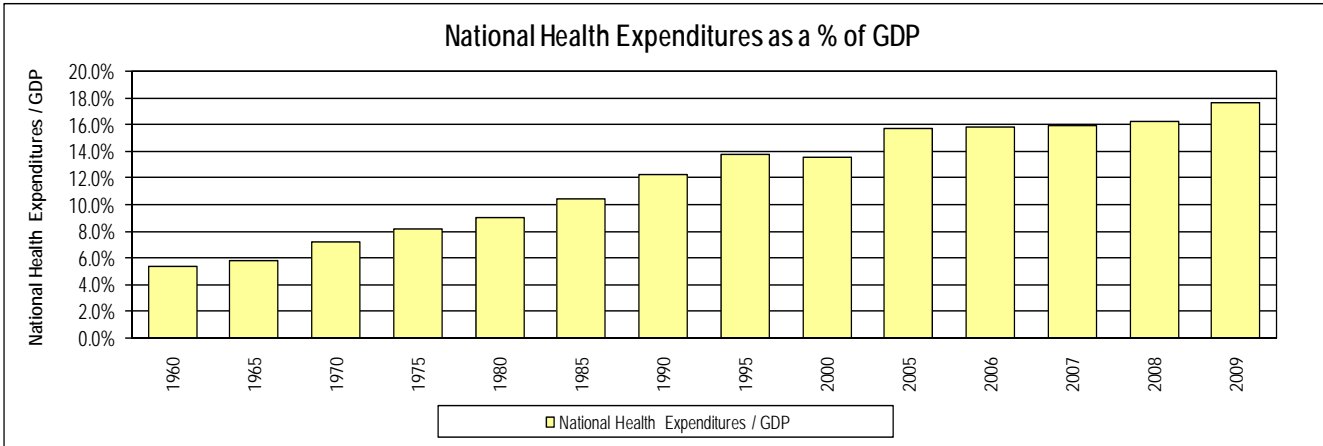
Conclusion

The U.S. healthcare insurance industry moves into its first full year under the new national healthcare regime with improved underwriting and operating profitability and a refortified balance sheet after the economic and capital market challenges of 2008-2009. That said, top-line growth remains challenged due to continued lower (though improving) national employment and the shifting of health care costs from employers to employees in the form of less benefit rich policies. As the cost of health care rises faster than inflation, employers will likely continue to pursue strategies to mitigate their cost burden while providing this valuable benefit. The insurance industry remains an important partner in this challenge, helping to redesign policies as well as aiding in preventative/wellness and disease management initiatives.

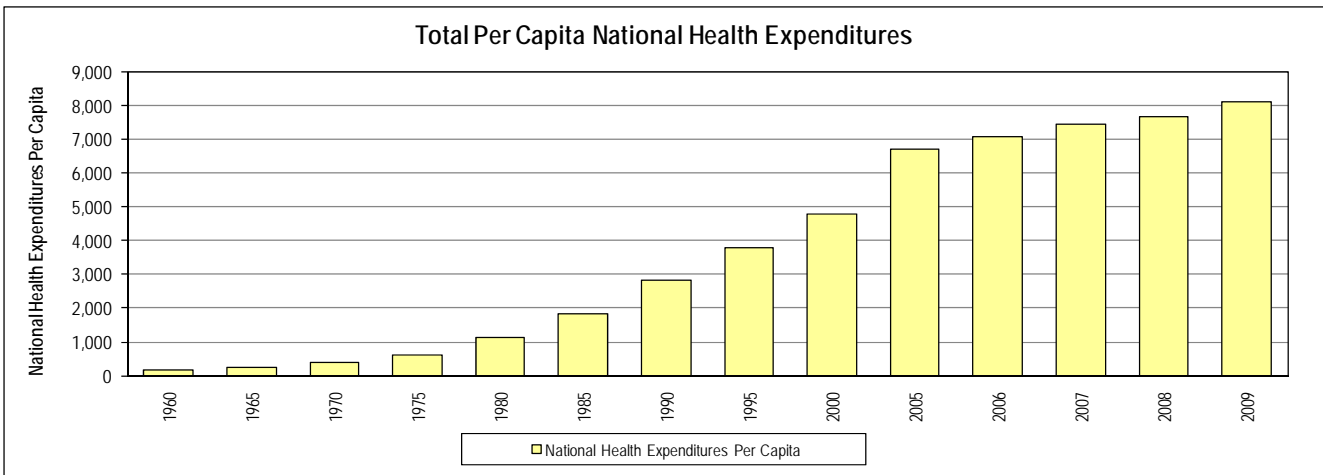
Government programs continue to grow their membership and demographics indicate that Medicare will see robust growth in the coming years. Medicaid could also see continued growth should the economy continue to languish. That said, membership growth will likely be tied to attempts to rein in cost. These attempts are already taking the form of lower reimbursements to insurers/providers, which could compromise the availability and quality of medical care for seniors and the poor. New initiatives, such as accountable care organizations, will hopefully provide creative ways to improve care at a lower cost – the healthcare holy grail.

In the meantime, political elements unhappy with the character of healthcare reform continue to fight a rear-guard action against the legislation, with some success overturning small, unpopular measures. However, full repeal seems a very distant possibility. National healthcare reform is now with us and successful adaptation on the part of insurers will be the key going forward.

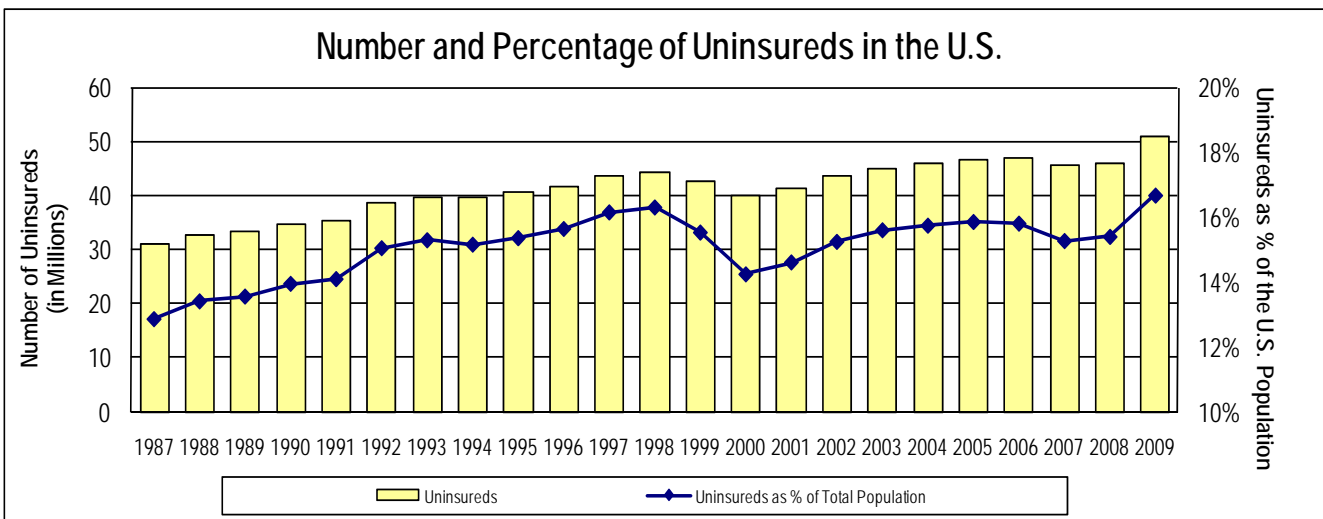
APPENDIX A



Source: Health & Human Services; U.S. Department of Commerce



Source: Health & Human Services; U.S. Census



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