A Report from Families USA
September 1998

Premium Pay II: Corporate Compensation in America's HMOs

INTRODUCTION

The insurance industry has been working very hard to convince the American public that consumer protections in managed care will be too costly for consumers, will reward trial lawyers, and will cause working families to lose health insurance coverage.

In July of this year, the Congressional Budget Office (CBO), in its analysis of the Patients' Bill of Rights Act, found that the industry's projections were significantly inflated. Patient protections would, in fact, cost only pennies per day. The Patients' Bill of Rights Act, the most comprehensive of the managed care proposals before Congress, includes commonsense protections that Americans have said time and again they want in their health plans.

But, even after the CBO came out with its cost estimates, the managed care industry continued to claim consumer protections would be too costly and that trial lawyers would profit at the expense of consumers. The industry failed, however, to disclose another key component of health care costs--executive compensation in managed care companies.

In April of this year, Families USA released Premium Pay: Corporate Compensation in America's HMOs a study of 1996 corporate compensation in managed care. As an update to that report, Premium Pay II reveals the 1997 compensation for high-level HMO executives. As the insurance industry continues to claim it is concerned about the rising costs of health care and as it condemns trial lawyers "who profit at the expense of patients," this new data is especially timely.

During the summer congressional recess, the Health Benefits Coalition, the Business Roundtable, and the American Association of Health Plans (AAHP) all ran advertisements designed to kill patient protection legislation. The Health Benefits Coalition, whose members include Aetna/US Healthcare, CIGNA, United HealthCare, and Humana, ran ads that told consumers "nearly 2 million more Americans could lose their coverage" if the legislation were enacted. The Coalition also claimed that "expanding liability does more to boost trial lawyers' profits than it does to protect patients."1 AAHP held news conferences in a number of major media markets announcing "Local Business, Industry Leaders Cite 'Devastating' Impact of New Health Care Mandates on Families, Workers and Businesses."2 Nowhere in these advertisements about lawyers' profits, or news conferences about increased premiums, did they mention that managed care executives average $2 million per year in compensation.3

Premium Pay II examines 1997 executive compensation for the 15 for-profit, publicly traded companies that owned HMOs with enrollments over 100,000.4 These 15 companies owned 75 of the nation's largest HMOs in 1997. Only publicly traded companies are required to submit compensation-related data to the Securities and Exchange Commission (SEC); nonprofit and private companies are not required to report compensation to the SEC and therefore could not be included in this analysis.

This report is based entirely on each company's public filings with the SEC concerning executive compensation for its highest-paid executives. The information collected from the SEC for this report examines two categories of executive remuneration, namely: (1) total annual compensation in 1997 exclusive of unexercised stock options; and (2) the value of pending, unexercised stock options. These two forms of remuneration are clearly differentiated in the analysis.

Total annual compensation in 1997 exclusive of unexercised options: This first category of self-reported remuneration includes executives' salaries, bonuses, other compensation (including retirement plans, automobile and travel allowances, relocation expenses, value of life insurance), restricted stock awards (the value of stock awards given to executives in 1997), Long Term Incentive Payouts (LTIP) (payments received in cash or stock for reaching specified performance goals) and exercised stock options (stock options that executives cashed in during 1997).

The value of unexercised stock options: This second category of self-reported remuneration involves stock options awarded in 1997 or earlier that have not yet been exercised. The value of these stock options is self-reported by each company based on SEC-approved methodologies. As described more fully in the methodology section, the value reported by companies is designed to indicate the potential value of stock options awarded in 1997 and the current market value of the unexercised options awarded in previous years.

KEY FINDINGS

The 25 highest paid executives in the 15 companies studied made $128.6 million in annual compensation, excluding unexercised stock options, in 1997. The average compensation for these 25 executives was over $5.1 million per executive. The median compensation for these 25 executives was $3.5 million.

The 25 Highest Paid HMO Executives
1997 Annual Compensation (Exclusive of Unexercised Stock Options)

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1. Stephen Wiggins, Chairman and CEO, Oxford Health Plans, Inc.- $30,735,093

2. Wilson Taylor, Chairman and CEO, CIGNA Corporation- $12,456,169

3. William McGuire, CEO, United HealthCare Corporation - $8,607,743

4. James Stewart, Executive Vice President and CFO, CIGNA Corporation- $ 7,306,921

5. Robert Smoler, Executive Vice President, Oxford Health Plans, Inc.- $ 6,918,509

6. Gerald Isom, President, Property and Casualty, CIGNA Corporation - $5,737,691

7. Ronald Compton, Former Chairman and CEO, Aetna - $5,383,148

8. H. Edward Hanway, President, CIGNA HealthCare, CIGNA Corporation- $5,282,734

9. Donald Levinson, Executive Vice President, CIGNA Corporation - $5,177,026

10. Eugene Froelich, Executive Vice President, Maxicare Health Plans, Inc.- $ 4,720,483

11. David Jones, Chairman of the Board and former CEO, Humana, Inc.- $ 4,495,798

12. George Jochum, Chairman of the Board, President and CEO, Mid-Atlantic Medical Services, Inc.- $ 3,779,358

13. Travers Wills, COO, United HealthCare Corporation - $3,461,096

14. Gregory Wolf, President and CEO, Humana, Inc. - $2,954,430

15. David Snow, Jr., Executive Vice President, Oxford Health Plans, Inc. - $2,835,477

16. Peter Ratican, Chairman of the Board, President and CEO, Maxicare Health Plans, Inc. - $2,620,483

17. Jeffrey Folick, Executive Vice President, PacifiCare Health Systems, Inc. - $2,184,470

18. Jeffrey Elder, Senior Vice President, Foundation Health Systems, Inc. - $2,129,008

19. Andrew Cassidy, Executive Vice President, Oxford Health Plans, Inc. - $2,004,509

20. Allen Wise, President and CEO, Coventry Corporation - $1,974,171

21. Alan Hoops, President and CEO, PacifiCare Health Systems, Inc. - $1,745,788

22. Leonard Schaeffer, Chairman and CEO, WellPoint Health Networks, Inc. - $1,596,097

23. Anthony Marlon, Chairman and CEO, Sierra Health Services, Inc. - $1,555,184

24. Erin MacDonald, President and COO, Sierra Health Services, Inc. - $1,540,315

25. Norwood Davis, Jr., Chairman, Trigon Healthcare, Inc. - $1,437,744

The 25 executives with the largest unexercised stock option packages in 1997 had stock options valued at $290.4 million. The average value of unexercised stock options for these 25 executives was $11.6 million. The median unexercised stock option package for these executives was $7.3 million.

The 25 Executives with the Largest
Unexercised Stock Option Packages in 1997

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1. William McGuire, CEO, United HealthCare Corporation -$61,178,652

2. Alan Hoops, President and CEO, PacifiCare Health Systems, Inc. -$32,777,354

3. Wilson Taylor, Chairman and CEO, CIGNA Corporation -$19,959,470

4. Jeffrey Folick, Executive Vice President, PacifiCare Health Systems, Inc. - $19,076,327

5. Malik Hasan, Chairman and CEO, Foundation Health Systems, Inc. -$17,778,014

6. Wayne Lowell, Executive Vice President, PacifiCare Health Systems, Inc. - $13,224,331

7. Jay Gellert, President and COO, Foundation Health Systems, Inc. -$12,263,445

8. Travers Wills, COO, United HealthCare Corporation -$11,431,203

9. Eric Sipf, Regional Vice President, PacifiCare Health Systems, Inc. -$10,313,347

10. James Stewart, Executive Vice President and CFO, CIGNA Corporation -$9,800,057

11. Gerald Isom, President, CIGNA Property and Casualty, CIGNA Corporation - $9,062,053

12. Stephen Wiggins, Chairman and CEO, Oxford Health Plans, Inc. -$8,654,000

13. H. Edward Hanway, President, CIGNA HealthCare, CIGNA Corporation -$7,295,973

14. Donald Levinson, Executive Vice President, CIGNA Corporation -$6,631,215

15. Gregory Wolf, President and CEO, Humana, Inc. -$5,821,274

16. Richard Huber, Chairman, CEO and President, Aetna, Inc. -$5,755,562

17. Leonard Schaeffer, Chairman and CEO, WellPoint Health Networks, Inc. -$5,724,912

18. James Carlson, President, Health Plans, United HealthCare Corporation -$4,867,000

19. William Sullivan, President and CEO, Oxford Health Plans, Inc. -$4,617,000

20. Norwood Davis, Jr., Chairman, Trigon Healthcare, Inc. -$4,478,573

21. Karen Coughlin, Senior Vice President, Humana, Inc. -$4,195,934

22. David Koppe, CFO, United HealthCare Corporation -$4,012,708

23. David Snow, Jr., Executive Vice President, Oxford Health Plans, Inc. -$3,952,780

24. Thomas McDonough, CEO, Strategic Business Services, United HealthCare Corporation -$3,801,120

25. Dale Berkbigler, Executive Vice President, Foundation Health Systems, Inc. -$3,687,463

The highest paid executive in each of the 15 companies received average compensation, exclusive of unexercised stock options, of $5.5 million in 1997. The median compensation for these 15 executives was $2.2 million. Taken together, these executives received a total of $83.2 million in compensation in 1997.

The executive with the largest valued unexercised stock options in each of the 15 companies had stock options worth, on average, $11.6 million in 1997. The median value of unexercised stock options was $5.7 million. Taken together, these executives held total stock options valued at $174 million.

NOTE:
(The original report contains a table here which reflects the following information: Company Name, Highest 1997 Compensation By Company (Exclusive of Unexercised Stock Options) Largest Valued Unexercised Stock Option Packages By Company)

The 79 executives from the 15 publicly traded for-profit companies received, exclusive of unexercised stock options, $161.6 million for 1997, an average compensation of $2.0 million per executive.

The value of the unexercised stock options for these 79 executives exceeded $358.6 million and averaged over $4.5 million per executive.

The average annual compensation for the top executives, exclusive of unexercised stock options, in each company in 1997 was as follows:

Company Name	Average Compensation for Highest Paid Executives (1997)
CIGNA Corporation	$7,192,198
United HealthCare Corporation	2,852,423
Aetna Inc.	1,730,621
Humana Inc.	1,624,780
PacifiCare Health Systems, Inc.	1,417,612
Maxicare Health Plans, Inc.	1,376,938
Mid-Atlantic Medical Services, Inc.	1,184,452
Sierra Health Services, Inc.	1,062,889
WellPoint Health Networks, Inc.	1,045,360
Foundation Health Systems, Inc.	929,837
Coventry Corporation	730,631
Trigon Healthcare, Inc.	690,330
United Wisconsin Services, Inc.	484,245
RightCHOICE Managed Care, Inc.	387,104

*The average value of unexercised stock options packages for the top executives in each company in 1997 was as follows:

Company Name	Average Value of Stock Options
United HealthCare Corporation	$17,058,137
PacifiCare Health Systems, Inc.	13,455,753
CIGNA Corporation	$10,549,754
Foundation Health Systems, Inc.	7,523,228
Oxford Health Plans, Inc.	5,231,540
WellPoint Health Networks, Inc.	5,224,084
Humana, Inc.	5,112,741
Trigon Healthcare, Inc.	1,944,149
Maxicare Health Plans, Inc.	1,376,938
Aetna Inc.	1,935,024
Coventry Corporation	1,722,562
Sierra Health Services, Inc.	1,469,185
United Wisconsin Services, Inc.	1,034,075
Maxicare Health Plans, Inc.	764,545
Mid-Atlantic Medical Services, Inc.	534,904
RightCHOICE Managed Care, Inc.	87,897

CONCLUSION

Throughout the debate on consumer protections, the managed care industry has used misleading numbers and spent millions of dollars to convince the public and Congress that patient protections would be too costly. In their efforts to kill legislation that would protect patients from managed care abuses, they have focused on two key themes--that premiums would go up and that trial lawyers would profit at the expense of consumers.

But a key component of cost continues to be left out of the discussion. For publicly traded managed care companies, remuneration in annual compensation and unexercised stock options for top executives routinely reaches millions of dollars. Indeed for some companies, such remuneration reaches tens of millions of dollars. When those same HMO executives complain about the costs of consumer protections and express concern about lawyers' incomes, it is apparent that their cost-consciousness is inconsistent and self-serving.

NOTE: The original version of this report includes a section of tables which include the following information:

-Publicly Traded For-Profit HMO's: Enrollment and Parent Companies
-Specif data on each of the above-mentioned HMO's

ENDNOTES

1 Health Benefits Coalition News Release, Coalition Launches Ad Blitz on Health Care Liability, May 27, 1998

2 American Association of Health Plans News Releases, March-May 1998.

3 Premium Pay: Corporation Compensation in America's HMOs, Families USA, April 1998, p.6.

4 Although HMO enrollment in one John Deere Health Care product was over 100,000, the report does not include John Deere Healthcare because its primary business is not health care or insurance.

METHODOLOGY & DEFINITIONS

For this report, Families USA analyzed 1997 compensation for the top executives at the 15 publicly traded companies that own 74 of the country's largest for-profit HMOs. Each of the HMOs included in the study was owned by a publicly traded health care company in 1997. While it would have been useful to track the salaries of nonprofit HMO executives and executives in private companies, these companies are not required to file executive compensation reports with the Securities and Exchange Commission (SEC). Only the publicly traded parent companies of for-profit HMOs with enrollments over 100,000 at the end of 1997 were included in the study.

The data used in this study were taken from the Electronic Data Gathering Analysis and Retrieval (EDGAR) Database. EDGAR is available online at the SEC's website and includes all public companies' filings to the SEC. These companies are required to submit proxy statements reporting the compensation--including salaries, bonuses, stock options, and other compensation--of their top five executive positions.

Families USA downloaded the 1997 SEC filings pertaining to executive compensation and computed two values for remuneration: (1) total annual compensation exclusive of unexercised stock options, and (2) the value of unexercised stock options.

How Remuneration Was Computed

Total Annual Compensation Exclusive of Unexercised Stock Options

This amount was computed for each executive by adding together the following information from the SEC filings:

Salary: annual wages paid to the executive for the fiscal year.

Bonus: bonuses paid to the executive for the fiscal year.

Other Annual Compensation and All Other Annual Compensation: additional compensation given to the executive, which could include the company's contributions to a savings plan, tax reimbursements, transportation, relocation fees, a signing bonus, life insurance plans, and retirement plans.

Restricted Stock Awards: the value of shares given to the executive by the company during the year 1997. These shares are usually subject to restrictions; for example, the executive may not be able to sell them for a specified period of time. The dollar value is as reported in the proxy statements for the fiscal year and is not adjusted to reflect any of the stock restrictions.

Long Term Incentive Payouts: taxable payments in cash or stock to the executive for reaching a specified performance goal over a period longer than a year.

Value of Shares Acquired on Exercise: the value of stock options the executive exercised during 1997. The company computes this value by multiplying the number of shares acquired by the difference between the market price and the "exercise price" (see below).

The Value of Unexercised Stock Options

This amount was computed by adding together information from the SEC filings regarding stock option grants awarded to each executive. Stock option grants give these executives the right--but not the obligation--to buy or sell a specific amount of the company's stock at a specified price (the "strike price" or "exercise price") during some specified time period in the future. The IRS allows companies to deduct the transaction from taxable income.

Stock options are only valuable when the market price of the company's stock exceeds the "exercise price" of the option. For example, if an executive is awarded 100 stock options at an exercise price of $10 a share, and the market price is $30 a share, then the executive could buy 100 shares at $10 a share, reaping the $20 difference between the exercise price and market price for each share--or a total of $2,000. However, if the market price of the share is less than the exercise price, the stock options have no value. The value of unexercised stock options was computed for each executive by adding together the following:

Grant Date Present Value/Potential Realizable Value: the company's estimate of the potential value of the stock options awarded to executives in 1997. Companies are permitted by the SEC to choose between two methods for reporting grant date present value for stock option grants awarded during the year. The company can report the stock option grants by either the Black-Scholes option pricing model or the potential realizable value method.

- Black-Scholes option pricing model: a model used by market professionals to calculate the value of an option. It includes such variables as the stock price, the exercise price, and the expiration date.

- Potential Realizable Value: the potential value of the stock option grants, calculated at hypothetical annual growth rates of 5 percent and 10 percent for the stock price over the term of the option--usually five or ten years. The company reports potential realizable value at both 5 percent and 10 percent in its proxy statements. For purposes of this study, the more conservative value of 5 percent was reported.

Other Compensation from Stock Options: the current market value of stock options that were awarded to the executives prior to 1997. This includes:

- Value of Unexercised In-The-Money Options/SARS (Exercisable): value of the "in-the-money" stock option grants the executive has been awarded in the past that are fully vested and thus can be exercised at the time of the report. This value is the difference between the current market price and the exercise price.
- Value of Unexercised In-The-Money Options/SARS (Unexercisable): the value of the "in-the-money" stock option grants that are not yet vested and that the executive can choose to exercise in the future. This value is the difference between the current market price and the "exercise" price for stock options that have not yet vested. For example, this would include options that a CEO has held for two years but whose terms require three years to pass before the options are available.

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1 Although HMO enrollment in one John Deere Health Care product was over 100,000 we did not include John Deere Healthcare in this study because its primary business is neither health care nor insurance.

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