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Health Insurers Don't Look Immoral to Me

by Graef Crystal

August 12, 2009

At the end of last month, Speaker Nancy Pelosi (D.-CA) leveled her 16-inch naval gun at the health insurance industry. Speaking of her attempts to reform healthcare, she opined: "They [the health insurers] are the villains in this. She went on to add: "It's almost immoral what they are doing".

Mainly, her ire is centered around the resistance to the Democrats' demand that there be a government health insurance option to compete with the companies Speaker Pelosi is vilifying.

Back in the early 1950s, Sen. Joseph McCarthy (R.-WI) was also observed displaying great anger, not over health insurance companies, but over Communists. He made many reckless charges, the bulk of which proved to be untrue. At the end, he was censured by the Senate for his behavior.

Maybe it's a bit over the top to compare Speaker Pelosi to Joe McCarthy, but, in my opinion, they do share in common the making of inflammatory statements that – at least when it comes to the Speaker's comments about health insurance firms -- do not stand up to scrutiny.

Now, let's start by accepting, but for only the moment, that there is villainy among the health insurers, that they are gouging the American public for their own gain.

You would expect to see this gouging show up in one of two ways – or even both ways: First, you would expect top executives of major health insurers to be earning excessive pay. And second, you would expect the shareholders of these companies to be earning excessive returns compared to other stocks.

CEO Pay Among Major Health Insurers

A two-year analysis of five major health insurers shows just the opposite, namely, below-market pay and below-market shareholder returns.

In selecting a study group, I first looked for large health insurers (those with current market caps of $5 billion or more) whose primary SIC Codes were 6324, the title of which is Hospital/Medical Services. I found four companies, including:

- Aetna Inc.
- Humana Inc.
- UnitedHealth Group Inc.
- Wellpoint Inc.

To this group, I added a fifth company, Cigna Corp. Although this company's primary SIC Code is not 6324, it has the same Global Industry Subgroup designation as the other four (namely, Medical-HMO).

I then started with the year 2008 and compared each of these companies with 352 other companies in my pay database, all of which had market caps of $5 billion or more.

Herewith, my estimate of CEO total pay for 2008, as well as the percent by which that pay was above or below a standard (developed through multiple regression) that takes into account the company's size and the riskiness in the CEO's pay package (the ratio of option grant date fair value to total pay):

2008 PAY:		TOTAL PAY (millions)	PCT ABOVE (BELOW) TRENDLINE
COMPANY	CEO		
AETNA	WILLIAMS, RONALD	$21.7	21%
CIGNA	HANWAY, EDWARD	$12.2	-15%
HUMANA	MCCALLISTER, MICHAEL	$5.3	-71%
WELLPOINT	BRALY, ANGELA	$6.1	-73%
UNITEDHEALTH GROUP	HEMSLEY, STEPHEN	$3.3	-81%
	MEDIAN	$6.1	-71%

The median CEO among the five CEOs turned out to earn pay that was 71 percent below the "going rate". Indeed, only one of the five CEOs – Aetna's – earned more than the going rate.

Next, I looked at pay in 2007. The same CEOs were in their jobs in that year or, in the case of the Wellpoint CEO, at least for the majority of the year.

Here's how they stacked up one year earlier:

2007 PAY:		TOTAL PAY (millions)	PCT ABOVE (BELOW) TRENDLINE
COMPANY	CEO		
CIGNA	HANWAY, EDWARD	$15.3	20%
AETNA	WILLIAMS, RONALD	$19.9	14%
HUMANA	MCCALLISTER, MICHAEL	$10.8	-26%
WELLPOINT	BRALY, ANGELA	$14.2	-48%
UNITEDHEALTH GROUP	HEMSLEY, STEPHEN	$4.6	-68%
	MEDIAN	$14.2	-26%

In the case of 2007, the median CEO turned up 26 percent below the "going rate". This time, two of the CEOs earned more than the going rate, but the overage was quite small.

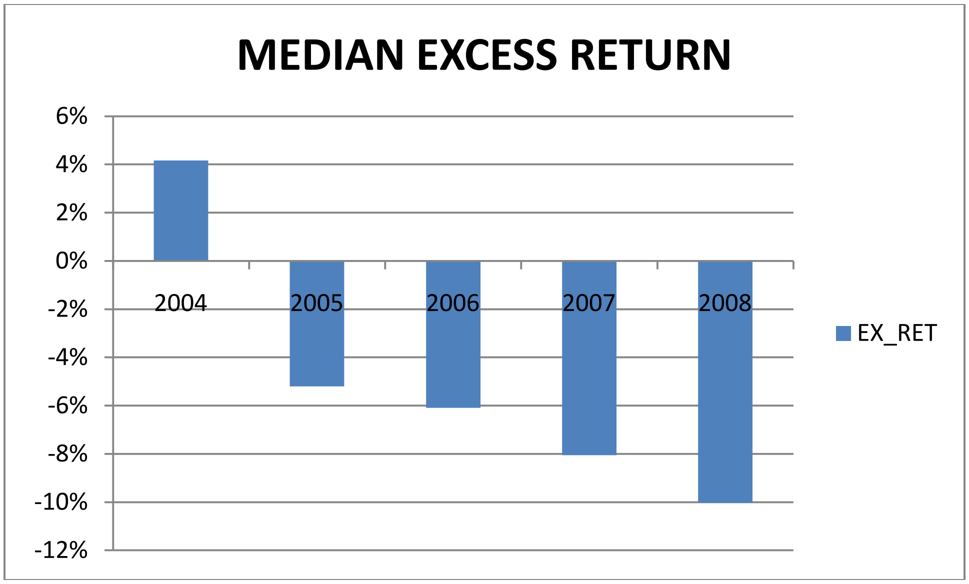
Conclusion: There is no evidence that major health insurers are overpaying their CEOs. Indeed, there is evidence that they are paying too little.

Performance Among Major Health Insurers

I examined total return performance in five time windows covering periods of five years down to one year. The first covered the period Aug. 11, 2004 through Aug. 11, 2009. Each of the four remaining time windows started one year after the preceding time window. But the end point for all time windows was Aug. 11, 2009.

From each company's total return in any given time window, I subtracted the return on the Standard & Poor's 500 Index return for that time window to produce a so-called "Excess Return".

The following chart shows the median excess return for the five companies in each of the five time windows. As can be seen, the excess return was positive only for the very widest five year time window. Thereafter, it turned negative and became more and more negative as the time window narrowed.



So there's no case here for undue enrichment of shareholders.

A question for Speaker Pelosi: If the health insurance CEOs are not pigging out, and if the shareholders are not getting luscious excess returns, then why do you refer to the health insurers as "villains"?

There's no doubt that America's health care system is broken and in need of some serious repair. But there's also no reason to create scapegoats when, on the evidence, there are – at least among these five giant health insurers -- no scapegoats.

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The compensation data used in this article were obtained from Equilar Inc., a leading provider of executive compensation information.

2009 marks Graef Crystal's 50th anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay.