The American Sentimentalist

''Never has any people endured its own tragedy with so little sense of the tragic.''

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Caution: another boring story about corporate abuses and financial chicanery

Do you know where your money goes when you pay your credit card bill? How about your car loan? Or your mortgage? What about your medicals bills?

If you said Wall Street, you're probably right.

While few Americans may realize it, a large portion of all consumer loans made in this country end up in the portfolios of institutional and private money mangers, often with the assistance of big Wall Street brokerage houses. In many cases, a loan signed across the desk of a car dealer or mortgage closer is promised to someone else even before the first payment is due, turning the original loan company into little more than a mailing address or a bill collector.

And now, the bankruptcy today of a company called National Century has shed some light on a part of the financial industry that specializes in selling health-care patients' medical bills, a little-known but financially lucrative practice with potentially disastrous results.

The tools most often used in these transactions are a kind of sophisticated investment known as "asset-backed securities". Asset-backs are a pool of some kind of receivables, like mortgages, car loans, railcar leases, or mutual fund fees, turned into a security like a stock or a bond. The process of turning these promises to pay into investments is known as securitization. In many cases, the owner of the original loans or leases sells the sum total of their expected payments for less than they would be worth if they simply waited until all the loans were paid off. In turn, they get the money up front and reduce the risk of non-payment. The buyer, in turn, gets a set of assets at a discount, which, since they are now tradable securities, he can sell on the open market to someone else, usually a wealthy investor or corporation.

For years, the $1.3 trillion asset-backed market had stayed focused on relatively traditional kinds of receivable pools – mortgages, car loans, and the like. But the need to bring to market ever more esoteric and exciting investments has stretched the industry into some new areas – including tax liens, monthly electric utility bills, and delinquent child support payments. Recently, one of the bright spots in the industry has been health care. Companies like DVI Inc. and Healthcare Business Credit have jumped into this $2 billion segment of the market, buying and selling everything from equipment leases to patients' outstanding bills. The benefits in the securitization of health-care receivables, such as patient bills, on the sellers' part can be attractive for smaller providers, in that they often need to keep an eye on cash flow and have to wait months for reimbursement from Medicare or Medicaid.

The largest player in this market is Dublin, Ohio-based National Century Financial Enterprises Inc. NCFE, often called the health-care industry's "lender of last resort" has been a party to over

$15 billion of health-care receivables since it was created in 1991 and has raised more than $6 billion through creating and selling asset-backs. In 1998 and 1999, National Century created “NPF VI” and “NPF XII”, two sets of asset-backed securities supported by $3.3 billion of expected Medicare and Medicaid payments to health-care providers. National Century sold these securities to some of the biggest investors and traders in the bond world – including industry giant Pimco, New York hedge fund Highland Financial Group, and the State of Arizona, among others. In early November, however, many of those investors sued National Century, alleging mismanagement in the wake of the disclosure that NPF XII was running out of the cash reserves set aside to ensure its financial stability.

The disclosure uncovered a web of insider transactions and financial chicanery which, in turn, led to the resignation of National Century’s chief executive, Lance Paulsen, in November. However, if the troubles at NCFE were simply a story of a Wall Street deal gone bad, the news might not mattered much beyond the ledger sheets of some big bond traders. But the fallout has reached beyond the desks of those players and into the offices and patient rooms of a number of health-care providers as a result of stopped payments to hospitals, physician groups, nursing homes and other health care providers around the country. Shortly after the news of the bond defaults broke, NCFE had amassed over $30 million in missed payments to over 60 different care providers, resulting in cash crunches and bounced checks. In November, the *Chicago Tribune* reported that Michael Reese Hospital in Chicago said it might have problems meeting payroll for its 1,000-plus employees due to stopped payments from NCFE. And at least one physician’s group, PhyAmerica Physician Group, has filed for Chapter 11 bankruptcy protection as a result.

As it turns out, this is not the first time NCFE has been embroiled in controversy over whether its activities have been healthy for patient-care providers. In 2001, the firm was accused of financial mismanagement in relation to its part ownership of Boston Regional Medical Center, which filed for bankruptcy in 1999. In 2001, NCFE, through its part-ownership of another company, Doctors Community Healthcare Corporation, participated in the closing of Washington, DC’s last remaining public hospital, DC General. The company has also been the target of several lawsuits charging fraud and financial mismanagement.

As of yet, there has been little movement afoot to reign in health-care asset-backed investments and their use in funding care providers. That could be due, in part, to the behind-the-scenes nature of these transactions and the companies that operate them. But the troubles at National Century point out the dangers associated with such mechanisms for funding in the industry, and the care providers who operate its front lines. For the vast majority of financial market transactions, it is the role of the market itself to police the legitimacy of its own through such processes such as “risk management” and “over-collateralization”. But implicit in these big-money transactions is the understanding that all of the participants at the table are aware of and can handle the risks. As more and more health-care receivables are securitized for the use of the financial industry, however, it may become more and more difficult to make the same argument for the smaller providers and independent care-givers in the health-care field.

Not to mention the patients who rely on them.

Posted by Mark W. Anderson at November 18, 2002 10:10 AM |