

MAIL AND ELECTRONIC MAIL

October 4, 2004

Blues Reserve/Surplus Application
Pennsylvania Insurance Department
Office of Insurance Product Regulation and Market Enforcement
1311 Strawberry Square
Harrisburg, PA 17120

Re: Response to Public Comments

This letter is Capital BlueCross' response to the second through last sets of public comments filed in response to the Pennsylvania Insurance Department's ("Department") invitation for public input on the surplus applications filed by the Pennsylvania Blue Plans¹ pursuant to Notice 2004-1. As with our initial response, this letter responds to general "categories" of issues raised in the recent sets of comments, especially where those comments are directly related to Capital BlueCross and its Application. To the extent the new public comments relate to issues previously discussed in our first letter, we refer readers to our initial letter dated August 31, 2004.² We also plan to file one additional response to some of the more extensive comments that we received on September 24 and 28. Capital BlueCross previously filed a response to the first set of comments.

A. Why Health Insurance Premiums Have Risen

There is a common concern expressed by a majority of the recent comment letters and it is simply this – subscribers throughout the Commonwealth are unhappy with increases to their health insurance premiums. Given the high rate of increase in premiums over the last few years, Capital BlueCross certainly understands this concerns and recognizes the difficulties it can cause. However, we need to explain that the cost increases are driven by the underlying trend in medical costs and utilization not by any artificial factors added by Capital BlueCross. We do not set the underlying medical costs, but serve as a conduit by which these costs, and increases in the costs, are passed on to consumers. A number of the letters suggest that forcing the Pennsylvania Blue Plans to reduce their surplus is the solution to this problem and that such an action will have a significant and sustained impact on the cost of their health insurance. This is unfortunately not accurate, and would only exacerbate the problem over the long term.

¹ "Pennsylvania Blue Plans" refers collectively to Capital BlueCross, Highmark, Independence Blue Cross, and Blue Cross of Northeastern Pennsylvania.

² Our response is available on the Department's website at the following address:
http://www.ins.state.pa.us/ins/lib/ins/whats_new/2004bc/Capito_Blue_Cross_261-271.pdf

We are very much aware of the increasing cost of health insurance in our communities. As an employer we also shoulder the burden of increased health care premiums for our employees. We are also acutely aware of the financial impact these escalating costs are having on individuals, the elderly, families and businesses. In fact, over the last years we have used over a portion of our surplus **to mitigate premium increases** for our subscribers.

It is important to recognize that the rising cost of health care is primarily due to a combination of factors that are in large measure outside our control. First and foremost, it is important to remember that the Pennsylvania Blue Plans do not administer health care – we are simply the buffer between the provider community (hospitals, physicians, etc.) and the patient population. Our role, in part, is to ensure that our subscribers have access to providers and that claims and providers are paid. Approximately 90 cents of every \$1 dollar in health insurance premiums gets paid out directly in the form of benefits provided to our subscribers. Accordingly, the overwhelming portion of the premiums we charge are calculated to cover the cost of benefits being provided by hospitals, doctors, and others – not services being supplied by us. The rising cost of health care (*i.e.*, hospital costs, pharmaceutical costs, etc) is one of the principal driving factors that has led to the significant increases in health insurance premiums these last few years.

Other factors that are increasing the costs of health care, include:

- *Demographics*—Pennsylvanians are getting older and in turn require more health care.
- *Lifestyle*—The level of obesity in our society is almost at epidemic proportions. This has led to a huge increase in the number of people with chronic conditions such as diabetes and heart disease.
- *Technology*—Unlike most other aspects of our economy, technological improvements in health care do not necessarily bring costs down. In fact, in many cases technological improvements result in increased cost, although it has the beneficial impact of offering medical outcomes that were previously unavailable.

Many of the public comments suggest that the Pennsylvania Blue Plans use their surpluses to decrease premiums. We have in fact done exactly that with a portion of our surplus, as a response to the high levels of competition in our market. But even the complete reduction of our surplus would not begin to address the underlying causes of the rise in health care premiums or even meaningful relief to our subscribers. If all of our surplus were allocated for premium reduction, it would only amount to a one-time reduction of \$548.00 per member (based on our July 2004 financials) and we would then no longer be able to serve our subscribers and community.

Moreover, any reduction in our surplus would cause Capital BlueCross to dramatically cut back on our plans with respect to product development and administrative cost reductions. Such a reduction would also impact our ability to remain competitive and to respond to unforeseen contingencies in our community. As an example, Capital BlueCross offers qualified products to eligible individuals who have lost coverage due to failure of their pension plan or loss of jobs to foreign competition under the Health Coverage Tax Credit program. Using our surplus to reduce premiums would only produce a minimal one-time benefit which would also impair our ability to mitigate future rate increases in response to competition, to offer new products, and to develop new services to mitigate costs (such as services aimed at reducing costs for individuals with chronic conditions).

The current healthcare crisis has been caused by a number of complex and interrelated factors. To suggest that giving away all of the surplus of Capital BlueCross will act as a universal remedy is simply not realistic – to the contrary, it may even lead to greater problems. While we share the public’s concern with the rising costs of health care, we are equally concerned that the Application process maybe viewed as a way to solve this problem – it does not.

B. The Hospital and Healthsystem Association of Pennsylvania (“HAP”) Letter

We have had a long and excellent working relationship with HAP and the hospitals in our service-area. It is also evident that HAP took considerable time in looking at this important issue and drafting its comments. As much as we appreciate HAP’s observations, however, we do not agree with some of them.

We would first like to note those areas where we are in agreement with HAP, including:

- HAP’s distinction between Blue Cross plans, which are to be “benevolent and charitable,” and Blue Shield Plans, which are mandated to have a “social mission.” As discussed in more detail below, Capital BlueCross has no statutorily mandated social mission and its only obligation is to fulfill its nonprofit role operating a hospital plan.
- HAP’s statement that, “[i]t is important in assuring security to the subscribers of the Blue Cross and Blue Shield plans and the health care providers delivering care to the individuals covered by the plans that these plans be financially strong.” We agree with this statement, and our concern with the Department’s Application process is that it will undermine the long-standing confidence that our subscribers have in us.

- With respect to Capital BlueCross and its operating area that, “it must be acknowledged that the market served by this plan has greater health insurer competition than do other geographic areas.” Again, we are in agreement with HAP. The competitive environment in Capital BlueCross’ service area is unique as compared to the rest of the Commonwealth. As stated in our Application, we believe that this competitive environment must be taken into consideration in determining an appropriate maximum level of surplus for Capital BlueCross. **Simply put, without our surplus the ability of Capital BlueCross, which is the plan of choice in our service area and the plan trusted by our subscribers, to remain competitive will be weakened.**

While we are in agreement with HAP on the above points, there are two substantive points that HAP makes with which we disagree.

First, even though HAP acknowledges that Blue Cross plans have no statutory “social mission,” it nevertheless concludes that “given the ‘benevolent’ not-for-profit nature of these health plans, more support in the health care arena in regard to uninsured and hard to insure appears to be an appropriate use of surplus.”

As discussed in our Application, Capital BlueCross’ statutory obligation is to act as a “not-for-profit engaged in the business of maintaining and operating a nonprofit hospital plan.”³ This is entirely consistent with Pennsylvania’s Nonprofit Corporations Law which provides that one purpose for which a nonprofit can be formed is “health.”⁴ Our nonprofit purpose is therefore limited solely to the operation of a nonprofit hospital plan. We also have **voluntarily undertaken activities intended to benefit the residents of our service area**. For example, we serve as an “insurer” of last resort, and we provide an **individual program that is not medically underwritten**, in a market where few others are even willing to enter. HAP is simply incorrect when it states that Capital BlueCross, as a nonprofit hospital plan, has a statutory obligation to use its surplus for any other purpose than to operate a nonprofit hospital plan is simply not supported by the law.

Part of our concern with the Department’s Application process is that it starts with the faulty premise that Capital BlueCross has “social mission” obligations other than to act as a nonprofit hospital plan. Initially, we would note that the term “social mission” does not have any statutory basis with respect to nonprofit hospital plans. Moreover, we believe this creates a dangerous precedent that, if left unchecked, could be applied to **any nonprofit entity, including hospitals, or to other types of insurance companies, such as mutual insurers and HMOs**. This specific concern was made in comments filed by the Pennsylvania Association of Mutual Insurance Companies (“PAMIC”):

³ 40 Pa.C.S.A. §6101.

⁴ 15 P.S. §5301.

Our concern, however, is that [the] concept of government appropriation of private sector assets might gain credibility by this action and might serve as a precedent for further government activity involving other entities. In the insurance industry, the concept of “excessive” surplus is meaningless. Growth in surplus is usually considered an indication of successful management.

Second, with respect to Capital BlueCross’ Application, HAP claims that we failed to provide documentation or evidence to support our argument that the competitive nature of our particular market gives rise to the need for more surplus than some of the other Pennsylvania Blue Plans. We disagree. In addition to the data provided in its Application, Capital BlueCross retained the services of a qualified independent economist to support this very point.⁵ Capital BlueCross took considerable time and effort to complete the Application to the fullest extent possible. This process was made more difficult by the fact that because there is no precedent for this process, Capital BlueCross and the other Pennsylvania Blue Plans simply had no “blueprint” to follow in completing the Application. Capital BlueCross believes that it provided more than ample support for all of the positions it has taken in its Application.

Finally, HAP raises a number of Application specific questions in its letter. We would like to address some of the CBC-related issues:

- HAP questions whether Keystone Health Plan Central’s underwriting losses are included in the chart we filed with the Department. Prior to April 1, 2003, Keystone Health Plan Central was not a wholly owned subsidiary of Capital BlueCross. We felt it would be inappropriate to include the underwriting gains or losses in the chart of an entity not controlled by Capital BlueCross. However, even if Capital BlueCross’ share of the Keystone Health Plan Central’s underwriting gains or losses are included in the chart, the conclusion drawn from the chart remains valid.
- HAP questions whether HIPAA-eligible coverage is the same as COBRA. Our HIPAA-eligible individual program is not COBRA coverage. It is a direct-pay individual account program under which any individual presenting a certificate of creditable coverage may obtain individual insurance coverage with us without any pre-existing condition waiting period. HIPAA required that each state develop a plan for providing such coverage and in Pennsylvania, this role was assigned to the Blue plans by the General Assembly. As noted in our Application we incur losses for all of our direct-pay business (CHIP, Adult-basic, etc.) of over

⁵ See report of Douglas B. Sherlock, CFA, attached as Exhibit (d)-1 to Capital BlueCross’ Application. Capital BlueCross’ Application, including Exhibits, and other surplus related documents are available on Capital BlueCross’ website at: <https://www.capbluecross.com/Press+Room/News+Releases/Surplus+Message.htm>.

\$1,000,000 per month. Until the Department grants rate relief, we anticipate these losses will grow in 2005.

- HAP expresses disappointment that our community contributions were not more detailed in our Application. Our community contributions were, indeed, quantified in the confidential portions of our filing with the Department. We believe that this is competitively sensitive matter as the information concerning the amount of our subsidies could be used by our competitors for pricing purposes for similar products.

HAP asks what are “net contributed services” to the Caring Foundation. These consist of administrative services (accounting, customer services, printing, mailing, IT, legal and other services), the costs of which exceed the administrative reimbursement cap. These are not allocated as expenses but simply **absorbed by Capital BlueCross as part of its contribution to this worthy program.**

C. Capital BlueCross’ Role as a Nonprofit Hospital Plan

In addition to HAP, a number of public comments evidence a misunderstanding about Capital BlueCross’ role as a nonprofit hospital plan corporation. We would like to dispel some of those misconceptions:

- Capital BlueCross is not a 501(c)(3) nonprofit corporation under the Internal Revenue Code. While we are organized as a not-for-profit Pennsylvania hospital corporation, we are not a charitable organization under Section 501(c)(3) of the Code.
- We do pay taxes and make voluntary payments in lieu of taxes. Unlike many nonprofit companies, Capital BlueCross pays federal income taxes. In addition, CAIC pays state premium tax and Capital BlueCross voluntarily pays property taxes.
- We do not use our surplus as a source of funds to pay executive salaries, bonuses, or other “perks.” As discussed in our Application, we use our surplus to fund enhancements in our services and new product offerings and infrastructure improvements. Our surplus is also our only protection against unanticipated increases in utilization of health services arising out of such events as epidemics, terrorist activities and other catastrophes.

As discussed above, our only nonprofit mission is to operate a nonprofit hospital plan corporation. We do not believe it appropriate for the Department to attempt to use our surplus for any other purpose.

D. Using Surplus to Benefit Non-Subscribers

Several public comments raise concerns over the Department’s plan that any “excess” surplus be used to benefit non-subscribers. Most of these comments suggest that any “excess” surplus should be used only to lower premiums and not for any other

purpose. Conversely, a number of comments have been filed saying just the opposite – surplus should be used on to fund programs such as AdultBasic and to create and fund new programs for the uninsured and underinsured.

Another one of our concerns about this Application process was that it would lead to these types of disputes between subscribers and non-subscribers over best how to use our surplus. As we have said in the past, the purpose of surplus is to protect our operations to ensure **that we are here for our members in the long-run** – not to provide lump sums of cash for the state government to use to fund governmental programs, no matter how worthy. We think the confusion among the public is due in large measure to the manner in which the Department has cobbled together this Application process without any statutory mandate or guidance. The legislative, or even regulatory, process would have allowed all parties to carefully considered these types of issues and avoided this very kind of confusion.

Again, we appreciate the opportunity to respond to the public statements filed with the Department on this important issue.

Very truly yours,

Patricia K. Wong
Supervising Counsel