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Brackbill, Robert

From: Samuel R. Marshall [smarshall@ifpenn.org]
Sent: Friday, June 01, 2012 12:21 PM
To: Brackbill, Robert
Cc: Jonathan Greer
Subject: Highmark/West Penn acquisition - supplemental comments
Attachments: brackbillltr.doc

Attached is the June 1 letter of the Insurance Federation, on behalf of its member insurers competing with Highmark (or at least trying and hoping to), to supplement our April 12 letter and our testimony at the April 17 hearing.

Thanks,

Sam Marshall

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Samuel R. Marshall
President & CEO

June 1, 2012

Robert Brackbill, Chief
Company Licensing Division
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: Highmark's proposed affiliation with West Penn Allegheny Health System

Dear Mr. Brackbill:

This is to supplement the comments and recommendations we submitted on April 12, as well as the testimony we provided on April 17, on Highmark's proposed acquisition of West Penn.

At the outset, we emphasize the need for the Insurance Department to hold true to the standard set forth in Sections 1402 and 1403 of the Insurance Holding Company Law, 40 P.S. Sections 991.1402 and 991.1403 – whether the merger or acquisition "would be to substantially lessen competition in insurance in this Commonwealth or tend to create a monopoly therein" – with the possible offset that the acquisition "will yield substantial economies of scale" or "substantially increase the availability of insurance" more than would happen if insurance competition were not lessened.

Many of the comments to date, and certainly those in the April 17 hearing, have advocated prompt approval of the acquisition – but their arguments are based on either saving jobs in the region or providing competition to UPMC as a health care provider. Those are both good objectives, although whether the acquisition achieves either of them in a sustainable way is dubious at best from the public record to date.

Even if those objectives were attainable – again, highly speculative based on the record – they could not be the standard of review. The only standard is that in the Insurance Holding Company Law – the impact on insurance competition and the ongoing solvency of the insurer. Those elements, not possible job savings at or possible provider competition from an ailing hospital system, are within the expertise and regulatory oversight of the Department, and they must be the exclusive basis for the Department's decision.

The Department should also be mindful of the finding it reached a few years ago when considering the Highmark/IBC merger application – that Highmark already has a monopoly. At that time, we faced Highmark's argument (really, a contortion) that veritably nothing it could do would lessen competition because there isn't much now. As we countered then, the proper focus is on potential as well as existing competition.

That potential has been heightened by recent developments, namely the likelihood of Highmark and UPMC discontinuing their long-standing contract that served as an entry barrier for insurer competitors. We realize those parties have agreed to continue that contract until January 1, 2015, not the January 1, 2014 date we had recommended – we'll have more on that below. But even with that one-year extension, the end of the relation between Highmark and UPMC raises the potential for insurance competition, and any terms and conditions applied to the Highmark/West Penn merger will have a significant impact on that.

<u>As to recommendations in addition to those in our April 12 letter and our April 17 testimony:</u>

First, we endorse the recommendations submitted by Health America in its May 24 letter. Health America is a member of the Insurance Federation and knows in practical terms the challenge of competing in Highmark's region. Its recommendations reflect those practical experiences and are shared by others trying to compete.

As to others:

1. **Highmark and/or UPE must allow West Penn to remain open to other insurers, and remain open on terms competitive with those it provides to Highmark.**

We recommended this in our April 12 letter and testified about it on April 17, and it bears emphasis here: The Insurance Department has to ensure that Highmark's acquisition of West Penn (that's what this really is) not enable it to limit West Penn from contracting with other insurers at rates and terms competitive with its terms with Highmark.

That's easily stated in broad terms, but we realize is more difficult to put into specifics. Again, we recommend both the terms in Health America's letter and those in the May 25, 2007 Final Oder referenced in **Commonwealth v. UPMC et al**, attached to our April 12 letter, as practical means for achieving this goal.

Further, we recommend the Department establish an ongoing review process to ascertain whether this recommendation of open competition by West Penn is being fulfilled.

2. **Highmark must accept only reasonable rates from West Penn, not the hospital equivalent of predatory pricing, but rather the equivalent of actuarially justified rates.**

This is a corollary to the above recommendation and may help in determining and ensuring competitive rates by West Penn to all insurers.

Highmark's filing acknowledges that the key to West Penn remaining viable is not just an infusion of money from Highmark (and whether its pledged amount is adequate is highly suspect). Even more critical, Highmark acknowledges West Penn needs a substantial increase in patient volume – presumably coming from its own policyholder base leaving UPMC and other surrounding hospitals.

The danger, certainly to insurance competition and ultimately to the solvency of both Highmark and West Penn, is that Highmark attempts to achieve this either by reducing its own insurance rates below what is actuarially justified, or by requiring that West Penn give it rates that are not financially sound for West Penn (and therefore Highmark, as its own fiscal strength will be determined by that of West Penn).

The Insurance Department needs to protect against either of these temptations. As such, we recommend it establish an ongoing review process of the rates West Penn provides to Highmark to ensure they are financially sound for West Penn, not artificially reduced to allow Highmark to steer patients to West Penn or cut its own insurance rates (temporarily) low.

These first two recommendations go to an underlying concern with the proposed acquisition: This is not "just" Highmark investing in West Penn to keep it as a viable competitor to UPMC so that Highmark can control its insurance rates. That'd be challenging enough.

The proposed acquisition is much more than that: It is the cornerstone of Highmark's plan to convert to an Integrated Delivery System, a far more complicated task. Granted, Highmark will have the advantage of its monopoly status on the insurance side; but its plan hinges on its ability to move its policyholders from UPMC to its own system. That will be difficult: As competitors to Highmark, we understand the power of a monopoly and "brand loyalty" in Western Pennsylvania. It likely exists as much (or more) on the provider end as on the insurance end.

The Department needs to ensure that Highmark's efforts to move policyholders to its own IDS not be done by manipulating the rates it gets from its IDS or the rates its providers charge other insurers. That will either be bad for insurance competition or for the solvency of Highmark and its UPE.

3. **All terms and conditions between Highmark and West Penn should extend to all other providers, provider practices and medical facilities Highmark purchases.**

As noted above, Highmark's proposed affiliation with West Penn is part of its broader plan to become an IDS and therefore part of its broader purchase and establishment of provider groups and facilities under the same ownership.

As such, any conditions ensuring access by other insurers to West Penn should extend to all other Highmark-affiliated provider groups and facilities. Again, Highmark is not investing in West Penn – it is establishing a controlling affiliation with it under common ownership by UPE as part of an IDS. Therefore, its impact on insurance competition has to be considered in the totality of Highmark's other provider acquisitions, existing or planned.

Further, extending these terms and conditions to other Highmark-owned provider groups and facilities will ensure the integrity of the Insurance Department's review of the Highmark/West Penn agreements, if only as a point of comparison.

4. **The financial viability of this acquisition needs to be thoroughly examined and documented, both for the immediate future and the longer-term.**

Supporters of the affiliation argue it is the best/only chance of saving West Penn and its 11,000 jobs.

Highmark's own filings concede West Penn can survive only through a significant increase in patient volume, presumably coming from Highmark. The Insurance Department needs to ascertain the likelihood of that increase, particularly if done without unfair pressures or short-term shell games, as prohibited under our earlier recommendations. It also needs to examine the ramifications if this patient increase doesn't happen within certain volumes or times, or with certain revenues, and what contingency plans Highmark has. And, of course, it needs ongoing reporting on progress toward those milestones.

Highmark also claims it intends to invest no more than the $450 million it has already committed to West Penn. That needs to be examined both as a realistic investment and as unduly limiting given the likelihood of changing conditions and demands. Would it mean Highmark cannot invest more – or that the Department could not require it to do so? At the least, the Department should have prior approval, with public notice, of any future investments in West Penn – and maybe to require and structure them.

Highmark's monopoly status can give a false sense of fiscal calm, and the hype of saving a hospital and jobs is a genuine allure to approve the acquisition. The Department, however, needs to remember that no other insurer – Blues or commercial – has successfully converted to an IDS (as opposed to a hospital system taking on an insurer).

In this case, the Department is faced with an application from an insurer that has recently been downgraded and is undergoing significant management change, and it is trying an unprecedented conversion built on acquiring a hospital system struggling with both its revenue stream and patient volume. Even a monopoly can make financial blunders or quixotic business plans.

5. **The Insurance Department should revisit the RBC ranges to which Highmark is subject under the Department's February, 2005 order.**

The Insurance Department's February, 2005 Order determined that Highmark's Risk-Based Capital percentages to measure appropriate surplus operating ranges are as follows: below 550% - efficient; between 550% and 750% - sufficient; above 750% - inefficient.

The Department needs to re-examine those percentages as Highmark becomes an IDS and embarks on the proposed acquisition as the cornerstone to that transformation. It is proposing to be something quite different from what it was in February, 2005, with a far greater degree of risk, so its RBC percentages should be revised to reflect that.

Further, the Department needs to consider whether and how it should limit Highmark's ongoing investments in West Penn and other provider groups or facilities in terms of its impact on Highmark's RBC – e.g., no investment or expansion that would drop it below a certain percentage.

6. **The Insurance Department needs to ensure ongoing regulatory review of efficiency standards and quality of care issues.**

Highmark touted the acquisition of West Penn and its becoming an IDS as allowing it to revolutionize health care delivery and financing, with a move toward results-oriented provider reimbursement that will promote both better and more affordable care. That, as much as the promise of saving jobs and providing provider competition to UPMC, is the professed public benefit in this.

That promise should be subject to initial scrutiny – how and when will it be achieved; it also merits ongoing monitoring to determine if the reality meets the promise, with provisions for corrective action. It is a laudable goal, but whether it is realized is a different matter.

That means looking past the promise and into the pragmatic prospect of achieving it. That will require added and ongoing scrutiny of Highmark, West Penn and UPE, in each of their financial capabilities. It will also require scrutiny of Highmark's management: Running a hospital, let alone one with the problems of West Penn where the future promise is built on dramatic reversal in patient admissions and a unique reimbursement system, is no easy task.

As part of this, the Insurance Department needs to give close attention to the abilities of whatever new management team emerges, as well as the structure of Highmark's relation with UPE and West Penn, in assuring coordinated, not controlling, relations among them.

To that end, the Department needs to examine, at the outset and on an ongoing basis, the non-insurance related aspects of the UPE, and the finances of West Penn, not just oversight of Highmark. That is essential given that the fate and finances of West Penn will be interwoven with the fate and finances of Highmark.

7. **Penalties and remedies for non-compliance, as well as ongoing audits and reports, should be provided in any approval.**

Given the novelty of the proposed acquisition – not just Highmark's attempt to reinvent itself as an IDS, but its attempt to do so through the acquisition of a struggling hospital system – any approval will have to come with extensive ongoing audits and reports, not just the standard financial filings required of all insurers.

Just as important, the Insurance Department should ensure that penalties and remedies for non-compliance are in any order of approval and are self-executing, so as to avoid needless procedural delays.

A final comment tied to the recommendations in our April 12 letter and in our April 17 testimony:

- **We still recommend that any approval of Highmark's acquisition be conditioned on an orderly and prompt ending of its contracts with UPMC, and we still believe the appropriate date is January 1, 2014.**

We recognize Highmark and UPMC have entered into an agreement to extend the contracts for an additional year, to January 1, 2015. That agreement, however, was not made to satisfy the Holding Company Law standards applicable to this proposed acquisition.

As we said in our earlier letter and at the hearing, Highmark's promptly and permanently ending those contracts is essential to allowing insurance competition. Highmark and UPMC may have reached an agreement and may even consider doing so again – but Highmark, at least, should be barred from doing so for the reasons we set forth before: Allowing an insurer with a monopoly share to own one of the two major health systems while contracting with the other is a major barrier to insurance competition and should not be allowed.

Again, thank you for the opportunity to comment. We are happy to answer any questions.

Sincerely,

Samuel R. Marshall