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October 9, 2013

Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Office of Corporate Financial Regulation
Pennsylvania Insurance Department
1335 Strawberry Square
Harrisburg, PA 17120

Dear Deputy Commissioner Johnson:

This is in response to your October 4, 2013 letter to Jack Stover.

Throughout the Form A review and approval process, Highmark and Highmark Health Services provided a large volume of information to the Department and its advisors and consultants. We were fully transparent throughout the process, even providing access to the models used to develop our financial projections. The information we provided included revenue and expense projections assuming UPMC both continuing and not continuing as an in-network provider for Highmark Health Services' health insurance products.

During the process we disclosed that Highmark Health Services would suffer losses of enrollment if there were no ongoing contract with UPMC and that significant administrative costs would need to be eliminated as a result.[1] As we examine ways in which we can control administrative costs in the event UPMC is out of network, we are limited in our ability to reduce certain fixed costs. Thus, administrative cost reductions must focus on variable costs, of which employee costs are the major component. For this reason, Highmark Health Services does not believe the statements made in its recent TV messages are inconsistent with information that was filed with the Department in the Form A process: in the event of declining enrollment, due to UPMC's refusal to continue as an in-network provider, jobs may have to be cut to enable Highmark Health Services to make significant reductions in administrative expenses.

With regard to the operating expense item identified in your letter, we note that the expenses referenced include both claims and operating expenses. An examination of operating expenses

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[1] See, for example, Addendum No. 4 to Amendment No. 2 to Confidential Supplement, filed March 7, 2013, p. 3.

only in a scenario in which UPMC continues as an in network provider for Highmark Health Services' health insurance products and a scenario in which it does not reveals that there is a significant difference in the operating expenses if there is no continuing contract.[2] The difference reflects both an anticipated loss of enrollment and a corollary reduction in administrative costs. The impact to operating expenses is even more significant when taking into consideration that the reductions in operating expenses would relate almost entirely to Highmark Health Services' health insurance business, which accounts for less than half of the Highmark enterprise operating expenses. Detail of the projected operating expenses for Highmark Health Services was shared with the Department's consultants. These same factors also impact the comparison to operating revenue that was cited in your letter.[3]

While, as we state in our messaging, Highmark Health Services would regret the devastating impact to our employees and communities of significant job losses which would be avoided if there were to be a UPMC contract, we also believe, as we said in our filings in conjunction with the Form A, that the ultimate outcome would be to stabilize the company's financial position in a period of declining business volume.

Highmark Health Services continues to work tirelessly towards a new contract with UPMC. This is the central issue that must be confronted. A new contract between Highmark Health Services and UPMC for in-network services is in the best interest of our policyholders, employees and the people of western Pennsylvania.

Sincerely,

Thomas L. VanKirk
Executive Vice President and Chief Legal Officer

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[2] Amendment No. 2 to Confidential Supplement, filed January 18, 2013; Addendum No. 4 to Amendment No. 2 to Confidential Supplement, filed March 7, 2013.

[3] It is disappointing that the Department questions whether it was misled on these issues when Highmark paid the Department's consultants millions of dollars over a one and a quarter year period to probe every aspect of Highmark's form A filing, answering countless questions and supplying all requested information to those consultants.