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Samuel R. Marshall
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Stephen Johnson
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
Strawberry Square
Harrisburg, PA 17120

Re: Highmark's March 9, 2015 Request for Approval of a Transaction

Dear Deputy Commissioner Johnson:

The Insurance Federation, on behalf of its member companies, writes in opposition to Highmark's request to provide a grant of $175 million to Allegheny Health Network.

We are concerned with the timing of this. The request was submitted to the Department on March 9 but not posted until late yesterday, with a proposed effective date for approval of this Sunday, March 15. Highmark doesn't explain the short time frame, which suggests this is an emergency. If so, that should be explained – and if an emergency, this should be subject to more thorough review and public comment than Highmark's proposed timing allows.

Beyond the troublesome immediacy of this request, we note numerous other problems and questions in it, all of which show the request to be improvident and ill-explained. Highmark hasn't made a case for approving this $175 million grant. It has, however, made a strong case for the Department to conduct an updated review of the Highmark/AHN merger as it approaches its two-year anniversary, and to require Highmark to promptly file a Corrective Action Plan that addresses increasingly obvious changes.

As to specific areas of concern:

Capital investment expenditures

Highmark suggests the requested $175 million grant will go exclusively to capital improvements at AHN: "The Financial Commitment will be used to fund additional capital investments at AHN...." It intimates it has already spent considerable sums on capital improvements at AHN, as it talks of spending "approximately $1 billion to build the IDN" and then lists a series of capital-related projects, and then talks of "a need for additional capital investments." It explains that "AHN has increased its capital investment plan in comparison to the original capital investment plan filed with the Department," but that "AHN is not able to make all these critical investments without additional funding from Highmark."

The Department should require that Highmark give a detailed analysis of where the $175 million is going, with an outline of how much will go to capital improvements (and which ones) as opposed to operational costs. Highmark should also make public, without redaction, the original capital investment plan filed by AHN and the increases it now proposes so the Department and the public can gauge what portion of Highmark's grants to AHN have gone to capital improvements versus operational costs.

Highmark's January 30, 2015 financial filing with the Department highlights the uncertainties here: That filing listed a total of only $61 million in paid capital in 2014 for "building and building improvements" and "equipment/software". Perhaps Highmark has made other major contributions to AHN capital improvements, but this requested grant – if primarily for capital improvements previously unanticipated – needs to be evaluated in the context of grants and expenditures made to date. Is it to fill gaps that have come about on the capital investment side, or is it an investment of an entirely new project and scale that dwarfs or matches previous investments?

The Department should also examine whether this will be the first of many requests for grants for capital expenditures (or operating costs) at AHN. That requires a thorough examination of the capital expenditures made thus far and those being proposed, now and in the future, as well as their impact on the overall revenues of AHN: Will this grant result in capital improvements that enable AHN to meet the patient volume it has said is necessary for it to thrive?

Operating costs

The Department should require that Highmark specify how much of this requested grant is to go to AHN's operating costs, directly or indirectly. It says it needs this funding to "maintain the desired days' cash on hand." Highmark should supply a detailed analysis of the AHN "days cash on hand" numbers and any trends that go with it – has it been steady, and how much of this cash has come from its revenues versus loans and grants? Have movements in it been tied to holding off or restructuring any payments of its own obligations?

This grant seems to match the $175 million in grants that Highmark gave to AHN as part of the original approval of this merger. If that is the case, this is a doubling of the grants AHN needs, and in less than two years' time. That suggests serious problems on the operational side of AHN, problems that may be better understood through deeper analysis of AHN's "days cash on hand" numbers and projections.

Patient volume

Highmark is inconsistent in this request: It says "recent utilization trends in the region have led to lower volumes than previously anticipated." But in the next sentence, it says "AHN and WPAHS are performing in anticipated ranges…" The Department needs to figure out this inconsistency.

More to the point, the Department needs to determine whether the requested $175 million is to compensate for a lack of needed patient volume and revenue at AHN, or to make the expenditures needed to improve that volume and revenue on a sustainable basis. When the Department approved the Highmark/AHN merger in April, 2013, it and its consultants did so based on projections of patient volume at AHN. It appears those projections aren't being met, which is why Highmark needs to give another $175 million to AHN. But nothing in Highmark's request outlines how this will get AHN's patient volume to the numbers it needs to be self-sustaining.

Risk-Based Capital

Highmark claims it "has the financial stability to provide the additional $175 million of finding and maintain risk-based capital ('RBC') through 2017 well within a range deemed to be appropriate by the Department."

The Department should require that Highmark provide a detailed analysis of this. It should also require that Highmark include in any RBC calculations its total financial picture, meaning its risks associated with loans and other commitments to AHN, and with Jefferson Health Systems. Much of Highmark's policyholder surplus – perhaps as much as 38% - is either invested in AHN or exposed to any failures at AHN; an example would be the May, 2014 $700 million loan to AHN from PNC, for which Highmark's surplus serves as collateral..

The Department needs to examine this request, and the financial ramifications for Highmark, not only by looking at Highmark's insurance side, but its hospital side, and by looking at this on an ongoing basis, not just a "snapshot" approach. That is what being "integrated" means. Highmark and AHN are truly joined, not just in delivering care but in their financial strengths and weaknesses: They will rise or fall together. Whether with this request, or Highmark's request to modify the original AHN merger order, or its request to merge with NEPA, the Department should look at Highmark's aggregate financial picture, with appropriate scrutiny on how it is evolving when compared with the projections it made in seeking this merger.

Corrective Action Plan

Section 15 of the Department's April, 2013 merger order requires that Highmark file a Corrective Action Plan under certain conditions, all set as of June 30.

This request for a quick approval of a $175 million grant shows the danger of waiting. Highmark's merger with AHN, and its hopes for reviving AHN, are clearly not going as planned: AHN wouldn't need a quick $175 million grant if its turn-around were on schedule, or progressing as projected but on a slower time-frame.

To the contrary, this request sets off every conceivable alarm for regulatory intervention, and the best place to start is by requiring that Highmark immediately file with the Department a Corrective Action Plan to address the financial stresses AHN is under, those that Highmark is under in light of its lost market share on the insurance side, and where the Highmark/AHN plan is falling short of the projections in the reports prepared for the Department two years ago.

Most important, Highmark should set forth the corrections it proposes to solve those problems. Based on this request, its solution is to move another $175 million to AHN without questions or conditions. That isn't a true solution for AHN, its patients and those – like our members who contract with AHN – who hope to see AHN remain a viable system. And it isn't a solution for Highmark's policyholders or the consumers of western Pennsylvania.

We understand complicated mergers don't always go as planned, and quick Department approval addressing changing circumstances is sometimes needed. But the Department also needs far greater information than Highmark has given here, and it needs to address the obvious: The Highmark/AHN merger isn't just complicated, it is troubled. The time has come not for more money, but for full disclosure of the changing conditions and a Corrective Action Plan that addresses those changes.

Sincerely,

Samuel R. Marshall