



# Capital BlueCross

HAND DELIVERY

November 4, 2004

Sandra L. Ykema, Department Counsel  
Office of Chief Counsel  
Pennsylvania Insurance Department  
Commonwealth of Pennsylvania  
1341 Strawberry Square  
Harrisburg, PA 17120

Re: *Reserves/Surplus Application Process*

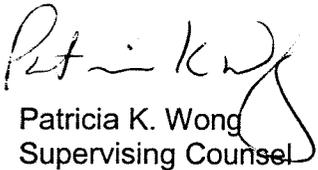
Dear Sandy:

I am writing in response to your letter of October 21, 2004, that sets forth twelve additional questions for Capital BlueCross that have arisen out of the surplus application process.

For ease of reference, and to facilitate your review, we have attached twelve separate tabs to this letter. Each tab repeats your questions in order and includes Capital's response. We are still in the process of compiling the information to question 8 and expect to have the information delivered to the Department on November 5, 2004.

We request confidential treatment of the responses to Questions 2, 4, 7, 8 and 12 pursuant to the Commonwealth Court's Order of July 25, 2004 regarding confidentiality of information provided in the Application process and your September 9, 2004 letter addressed to me. They also contain extremely sensitive proprietary information. Accordingly, the enclosed information is not and should not become publicly available. In our view, its disclosure would be extremely useful to competitors and greatly harmful to Capital BlueCross' continued ability to remain competitive and viable. We ask that all personnel who have access to these materials be reminded of the extremely sensitive nature of this information.

Sincerely,

  
Patricia K. Wong  
Supervising Counsel

PKW/clS

cc: Steven J. Johnson, Deputy Commissioner  
Randolph L. Rohrbaugh, Deputy Commissioner  
Chester Szcepanski, Chief Actuary  
Steven B. Davis, Chief Counsel

RECEIVED CHIEF COUNSEL  
PA INSURANCE DEPT.

2004 NOV 4 PM 4 02

1. **For each year from 1993 to 2003, please specify, separately, the amount of Pennsylvania premium tax, Pennsylvania corporate net income tax and federal income tax paid by each of the following corporations:**
  - a. **Capital BlueCross**
  - b. **Capital Advantage Insurance Company**
  - c. **Keystone Health Plan Central;**

**CAPITAL BLUE CROSS  
TAXES PAID-1993 THROUGH 2003**

| Year | A/C #<br>Company   | Pennsylvania                   |                               |                                      |                      | Total              |
|------|--------------------|--------------------------------|-------------------------------|--------------------------------------|----------------------|--------------------|
|      |                    | 90101<br>Federal Income<br>Tax | 90300<br>Capital Stock<br>Tax | 90102<br>Corporate Net<br>Income Tax | 41700<br>Premium Tax |                    |
| 1993 | CBC - Consolidated | 33,441,219                     |                               |                                      |                      | 33,441,219         |
|      | CAIC               |                                |                               |                                      | 1,344                | 1,344              |
|      | KHPC               | 4,112,874                      | 182,938                       | 1,784,971                            |                      | 6,080,783          |
|      | <b>1993 Total</b>  | <b>37,554,093</b>              | <b>182,938</b>                | <b>1,784,971</b>                     | <b>1,344</b>         | <b>39,523,346</b>  |
| 1994 | CBC - Consolidated | 46,987,695                     |                               |                                      |                      | 46,987,695         |
|      | CAIC               |                                |                               |                                      | 3,371                | 3,371              |
|      | KHPC               | 8,233,137                      | 458,676                       | 3,252,855                            |                      | 11,944,668         |
|      | <b>1994 Total</b>  | <b>55,220,832</b>              | <b>458,676</b>                | <b>3,252,855</b>                     | <b>3,371</b>         | <b>58,935,734</b>  |
| 1995 | CBC - Consolidated | 19,829,736                     |                               |                                      |                      | 19,829,736         |
|      | CAIC               |                                |                               |                                      | 4,524                | 4,524              |
|      | KHPC               | 6,964,790                      | 544,142                       | 2,262,589                            |                      | 9,771,521          |
|      | <b>1995 Total</b>  | <b>26,794,526</b>              | <b>544,142</b>                | <b>2,262,589</b>                     | <b>4,524</b>         | <b>29,605,781</b>  |
| 1996 | CBC - Consolidated | 11,895,591                     |                               |                                      |                      | 11,895,591         |
|      | CAIC               |                                |                               |                                      | 3,550                | 3,550              |
|      | KHPC               |                                | 466,860                       |                                      |                      | 466,860            |
|      | <b>1996 Total</b>  | <b>11,895,591</b>              | <b>466,860</b>                | <b>0</b>                             | <b>3,550</b>         | <b>12,366,001</b>  |
| 1997 | CBC - Consolidated | 4,840,217                      |                               |                                      |                      | 4,840,217          |
|      | CAIC               |                                |                               |                                      | 4,752                | 4,752              |
|      | KHPC               |                                | 239,955                       |                                      |                      | 239,955            |
|      | <b>1997 Total</b>  | <b>4,840,217</b>               | <b>239,955</b>                | <b>0</b>                             | <b>4,752</b>         | <b>5,084,924</b>   |
| 1998 | CBC - Consolidated | (3,347,363)                    |                               |                                      |                      | (3,347,363)        |
|      | CAIC               |                                |                               |                                      | 4,390                | 4,390              |
|      | KHPC               | 1,674,886                      | 161,090                       | 50,100                               |                      | 1,886,076          |
|      | <b>1998 Total</b>  | <b>(1,672,477)</b>             | <b>161,090</b>                | <b>50,100</b>                        | <b>4,390</b>         | <b>(1,456,897)</b> |
| 1999 | CBC - Consolidated | 4,781,809                      |                               |                                      |                      | 4,781,809          |
|      | CAIC               |                                |                               |                                      | 5,462                | 5,462              |
|      | KHPC               | 1,668,672                      | 62,466                        | 110,750                              |                      | 1,841,888          |
|      | <b>1999 Total</b>  | <b>6,450,481</b>               | <b>62,466</b>                 | <b>110,750</b>                       | <b>5,462</b>         | <b>6,629,159</b>   |
| 2000 | CBC - Consolidated | 12,920,421                     |                               |                                      |                      | 12,920,421         |
|      | CAIC               |                                |                               |                                      | 5,463                | 5,463              |
|      | KHPC               | 516,307                        | 51,264                        |                                      |                      | 567,571            |
|      | <b>2000 Total</b>  | <b>13,436,728</b>              | <b>51,264</b>                 | <b>0</b>                             | <b>5,463</b>         | <b>13,493,455</b>  |
| 2001 | CBC - Consolidated | 11,867,698                     |                               |                                      |                      | 11,867,698         |
|      | CAIC               |                                |                               |                                      | 6,902                | 6,902              |
|      | KHPC               | 8,825,427                      | 81,670                        | 2,323,913                            |                      | 11,231,010         |
|      | <b>2001 Total</b>  | <b>20,693,125</b>              | <b>81,670</b>                 | <b>2,323,913</b>                     | <b>6,902</b>         | <b>23,105,610</b>  |
| 2002 | CBC - Consolidated | (22,829,090)                   |                               |                                      |                      | (22,829,090)       |
|      | CAIC               |                                |                               |                                      | 4,807,318            | 4,807,318          |
|      | KHPC               | 7,434,380                      | 306,153                       | 2,080,710                            | 2,253                | 9,823,496          |
|      | <b>2002 Total</b>  | <b>(15,394,710)</b>            | <b>306,153</b>                | <b>2,080,710</b>                     | <b>4,809,571</b>     | <b>(8,198,276)</b> |
| 2003 | CBC - Consolidated | (7,761,147)                    |                               |                                      |                      | (7,761,147)        |
|      | CAIC               |                                |                               |                                      | 18,608,418           | 18,608,418         |
|      | KHPC               | 1,437,354                      | 411,789                       | 1,917,386                            |                      | 3,766,529          |
|      | <b>2003 Total</b>  | <b>(6,323,793)</b>             | <b>411,789</b>                | <b>1,917,386</b>                     | <b>18,608,418</b>    | <b>14,613,800</b>  |
|      | <b>Total</b>       | <b>153,494,613</b>             | <b>2,967,003</b>              | <b>13,783,274</b>                    | <b>23,457,747</b>    | <b>193,702,637</b> |

- 3. On page 00076 of your application, you provided a chart of underwriting losses sustained by Capital BlueCross and Capital Advantage Insurance Company. Please provide the same information for Keystone Health Plan Central.**

Keystone Health Plan Central, Inc.

Statutory Underwriting Results

|                              | <u>1997</u>            | <u>1998</u>           | <u>1999</u>           | <u>2000</u>           | <u>2001</u>          | <u>2002</u>          | <u>2003</u>          | <u>2004 (A)</u>     |
|------------------------------|------------------------|-----------------------|-----------------------|-----------------------|----------------------|----------------------|----------------------|---------------------|
| Premium revenue              | \$ 276,031,810         | \$ 329,151,566        | \$ 328,744,089        | \$ 380,021,485        | \$ 416,413,713       | \$ 429,594,539       | \$ 448,997,823       | \$ 244,756,466      |
| Medical expenses             | 271,846,963            | 297,656,880           | 294,776,201           | 346,732,056           | 356,428,555          | 367,651,763          | 374,805,972          | 217,660,555         |
| Administrative expenses      | 37,857,192             | 33,288,801            | 35,491,704            | 37,759,521            | 42,286,972           | 46,530,582           | 46,017,943           | 25,023,274          |
| Net underwriting gain (loss) | <u>\$ (33,672,345)</u> | <u>\$ (1,794,115)</u> | <u>\$ (1,523,816)</u> | <u>\$ (4,470,092)</u> | <u>\$ 17,698,186</u> | <u>\$ 15,412,194</u> | <u>\$ 28,173,908</u> | <u>\$ 2,072,637</u> |
| Capital BlueCross Share      | (16,836,173)           | (897,058)             | (761,908)             | (2,235,046)           | 8,849,093            | 7,706,097            | 20,067,578           | 2,072,637           |

(A) For the period ended June 30, 2004

**5. For each type of “social mission activity” or charitable or community contributions you identified in your response to the Department’s January 5, 2004 letter subparagraph (d), explain your rationale for considering that type of activity or contribution as part of your social mission and/or your statutory designation as a charitable and benevolent institution.**

As a threshold matter, Capital BlueCross is proud of its record of service to the residents of Central Pennsylvania and the Lehigh Valley. We described in both our March 22, 2004 submission and in our Application the many activities we have traditionally and voluntarily engaged in for the benefit of the residents and communities in our service area. That commitment is, in a very real sense, part of the fiber of our organization and it contributed, in no small measure, to our decision to remain an independent health plan focused on the needs of the region we serve.

It is important to keep this background in mind, because there is a central, but incorrect, theme which underlies the Department question here, namely that Capital BlueCross is a public charity that has a social mission, and therefore *Capital BlueCross has some mandatory obligation to fund social or charitable programs outside of its operation of a nonprofit hospital plan*. As we have pointed out in both our responses to public comments and in our Application, our sole corporate and statutory purpose is to operate a nonprofit hospital plan for the benefit of our members, not to run a public charity for the benefit of the general public. Moreover, as we have noted on numerous occasions, the term “social mission” is statutorily meaningless, does not appear anywhere in the insurance laws, and, therefore, has no application to Capital BlueCross.

While we do not have an obligatory social or charitable mission, what we do have is an unwavering, but completely voluntary, commitment to support worthy community, health-related, and civic endeavors in our service area. In addition to incurring the expenses of operating a nonprofit hospital plan with significant underwriting losses, all as detailed in our Application, we give millions of dollars every year to charitable and Commonwealth health programs:

- By giving members the means to pay for hospital expenses and by serving as a vehicle to help hospitals and subscribers finance the cost of care – that is, by operating a Nonprofit Hospital Plan;
- By administering such programs as CHIP, adultBasic, Special Care and the Health Care Tax Credit Program; and,
- By undertaking voluntary activities intended for the benefit of the residents of our 21 county service area.

All of these activities are described in detail in our Application and March 22 submission. We do not believe further elaboration is necessary. Our point is, however, that we do not undertake these activities because we think we have to as part of a mandatory “social mission” or in fulfillment of some obligatory charitable role. We undertake these activities because, as any good corporate citizen, we have a vested interest in making our community a better place. In short, we do it because we want to, not because we

have to. Moreover, as stated in our Application we have every intention of continuing to undertake our voluntary commitment to our community and these programs regardless of the outcome of the Application process.

- 6. If you identified one or more foundations in your response to the Department's January 5, 2004 letter subparagraph (d), specify:**
- a. any and all expenses that the foundation(s) pay for CHIP adultBasic or any other state or government funded program;**
  - b. what role, if any, the foundation(s) play in handling claims arising from CHIP, adultBasic or any other state or government funded program.**

Not Applicable

**9. Specify what, if any, arrangements your corporation has made for the protection of its policyholders or members in the event that your corporation becomes insolvent.**

As you are aware, Capital BlueCross is not eligible to participate in any state established guarantee fund. Given this situation, Capital BlueCross is required to look only to its own financial assets to protect its members.

In October 2002 each Pennsylvania Blue Plan agreed with the Blue Cross Blue Shield Association to establish its own mechanism to provide members with such protection. Capital BlueCross' obligations are triggered if its RBC falls below 800% or if its liquidity falls below 2.0 months. Following such a triggering event, Capital BlueCross must file an action plan with the Blue Cross Blue Shield Association within 30 days outlining how it will provide subscriber protections within 6 months from the end of the applicable reporting period. One method for complying is to place an appropriate amount of funds, as certified by an actuary, into a trust account. Funds placed in the account are available only for the payment of claims liabilities in the event of an insolvency or for return to Capital BlueCross after certification that the trigger events are no longer applicable

Capital Advantage Insurance Company participates in the Pennsylvania Life and Health Insurance Guaranty Association.

Pursuant to statute, Keystone Health Plan Central's provider contracts provide that the subscriber is to be held harmless by the provider.

In addition, both Capital Advantage Insurance Company and Keystone Health Plan Central have the benefit of a parental guarantee in which Capital BlueCross guarantees the respective contractual and financial obligations of Capital Advantage Insurance Company and Keystone Health Plan Central to their members.

- 10. Specify what, if any, arrangements your corporation has made with other Pennsylvania Blue Plans for the payment of claims submitted by its policyholders or members.**

None.

11. **Explain the reasons you believe your corporate structure is advantageous to your statutory mission as a health insurer. Stated differently, what is the advantage, if any, to your policyholders of the corporate structure you have created. Your discussion should include specific comment with regard to advantages engendered by your investment in other than health insurers and also in for-profit entities.**

In answering this question, we think it is important to first start with our public mission statement (which is available to anyone on our website):

**The mission of Capital BlueCross is to provide its customers with the best value in health care coverage and complementary services through:**

- Leading in the development and delivery of best value health care services.
- Partnering with our members, our providers and community.
- Caring by being a responsible corporate member of our community.

**Our goals:**

- We strive to be the leading regional health services company, with a focus on quality and the management of health care resources.
- We continue to lead the market by offering a full spectrum of products and programs to meet the needs of employers, large and small, and their employees.
- We focus on our customers and customer service standards.
- We work to maintain the financial soundness of our corporation, which is currently one of the most financially strong members of the Blue Cross Blue Shield Association.
- We strive to remain a responsible corporate member of our community.<sup>1</sup>

As discussed in more detail below, our corporate structure is critical in allowing us to meet our public mission statement. Absent our subsidiaries, we would not be able to meet the total health care needs of our subscribers by providing “a full spectrum of products and programs.” Also, our subsidiaries allow us to “maintain the financial soundness of our corporation” by allowing us to generate additional revenue – which is important given our inability to raise capital through public stock offerings. Finally, our subsidiaries give us additional ways in which to support our community as a “responsible corporate member of our community.”

**A. Our Subsidiaries Let Us Offer a Total Spectrum of Products and Services Demanded by our Subscribers and Customers.**

As the Department is well aware, Capital BlueCross is organized as a hospital plan corporation. Our subsidiaries supplement our mission in several important respects. First and foremost, some of our subsidiaries, including Capital Advantage Insurance Company (“CAIC”) and Keystone Health Plan Central (“KHPC”) allow us to

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<sup>1</sup> <https://www.capbluecross.com/About+CBC/Mission+and+Goals/>

provide our subscribers with a full spectrum of innovative and cost-effective insurance products and services, including HMO, PPO, POS and other products. Our subscribers demand “one-stop shopping” for their health insurance needs. Through our subsidiaries we can offer new and pioneering products that could not be offered directly through Capital BlueCross. Absent our subsidiaries we would not be able to compete in our service area.

Likewise, some of our subsidiaries provide related insurance services to our subscribers and customers. For example, Capital Administrative Services (d/b/a NCAS Pennsylvania) is a for-profit wholly owned subsidiary which operates as a third-party administrator for self-funded customers, offering various benefits administration services. Similarly, Consolidated Benefits, Inc. is a for-profit insurance agency offering life, short and long-term disability and accidental death and dismemberment coverages. Again, we offer these services because they complement our programs and allow us to fulfill our mission as a provider of total healthcare products and services.

**B. Our Subsidiaries Provide Us With An Additional Source of Income to Support our Mission.**

Our corporate structure and our subsidiaries also provide us with a means of raising additional capital. We must maintain our financial strength to carry out our statutory mission of operating a nonprofit hospital plan and also to stay competitive in this region. Unlike many for-profit health insurance companies, we do not have the ability to raise capital through public stock offerings. Consequently, we must fulfill our corporate mission and fulfill our other financial obligations from the revenue we generate through other means, including from income from our subsidiaries. Any revenue we receive from our for-profit subsidiaries is consolidated with our surplus. Accordingly, these revenues ultimately benefit Capital BlueCross and our subscribers. Over the next several years, we anticipate the need for substantial capital in order to make infrastructure improvements and to provide enhanced product offerings in order to stay competitive in this region. Our subsidiaries will play a vital role in helping us compete in this ever changing and highly competitive environment.

Our investment in our subsidiaries also allows us to diversify our sources of income in the event of weak operating performance by our core health insurance business. As we indicated in our Application, Capital BlueCross and CAIC have not generated a profit on any underwritten business in the last seven years. Accordingly, our for-profit subsidiaries provide us with a means of offsetting at least some of these losses through any revenue that they may generate. Moreover, several credit rating agencies, including A.M. Best, Moody’s Investors Service and Standard & Poor’s view our subsidiaries as a positive factor in considering the overall financial strength of our company.

**C. Our Subsidiaries Allow Us to Better Fulfill Our Role As A Good Corporate Citizen.**

Our subsidiaries also allow us to greater maximize our contributions to our communities in our role as a responsible corporate citizen. Our subsidiaries employ hundreds of Pennsylvanians in this region. Our subsidiaries have further increased the tax revenues in the communities in which they operate. Our insurance subsidiaries, including CAIC and KHPC, pay premium taxes that contribute to the Commonwealth’s

general fund. Through our subsidiaries we sponsor numerous activities for the benefit of the residents and communities in our service area. In short, through our subsidiaries we are able to extend our reach into the community for maximum impact to those we serve.

**D. Our Corporate Form Is Completely in Keeping with Pennsylvania Law.**

Finally, we would also like to respond to the tone of the Department's question and the inference it seems to have been fostering throughout this Application process that *there is something wrong with our corporate form*. This is simply not the case. We have operated for-profit subsidiaries since 1981. In all that time the Department has never once, until now, raised issue with our corporate form or asked us to justify the role of our subsidiaries. In 2001, when Pennsylvania Blue Shield terminated our Joint Operating Agreement and we were compelled to utilize our subsidiaries, including CAIC, to compete against Highmark, the Department review our business plan and the role all of our subsidiaries would play in this new competitive environment. Again, at no time during that period did the Department express any issue or concern about the existence or role of our subsidiaries.

Additionally, the insurance laws enforced by the Department clearly provide for our investment in our subsidiaries. Hospital plan corporations and health service plan corporations are both authorized to invest in the same types of investments authorized for life insurers. See 40 Pa.C.S.A. §§6123; 6330. Under these investment rules, insurers are limited to investing 10% of their total admitted assets in their own subsidiaries. 40 P.S. §505.2(c)(1). However, in 1995, the General Assembly removed any limitation on the amount that an insurer, including the Blues, may invest in a subsidiary which is either an insurer or an HMO, so long as the insurer's surplus remains "reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs". 40 P.S. §505.2(c)(2)(iv). Moreover, Pennsylvania's Business Corporation Law ("BCL"), 15 Pa.C.S.A. §1101, *et seq.*, does not restrict a nonprofit's ability to own for-profit subsidiaries and specifically allows the nonprofit to realize incidental profits from these other activities. 15 Pa.C.S.A. §5545.

After operating under our current form for many years with Department approval, we believe that the Department is legally estopped from now challenging strategic decisions we made years ago, most of which required Department approval. Moreover, we take exception to the inference raised by the Department's question that our corporate form is some way not in keeping in our corporate mission or Pennsylvania law. As discussed above, our organization is specifically designed to help us meet our public mission statement and is in complete accord with Pennsylvania law.