0862

Bybee, Cressinda

From: Samuel R. Marshall <smarshall@ifpenn.org>
Sent: Monday, February 02, 2015 5:16 PM
To: Bybee, Cressinda
Cc: Jonathan Greer
Subject: Highmark/NEPA proposed merger
Attachments: highmarknepaltr.doc

Attached is our comment letter.

Thanks,

Sam Marshall

04

The Insurance Federation of Pennsylvania, Inc.

1600 Market Street
Suite 1720
Philadelphia, PA 17101
Tel: (215) 665-0500 Fax: (215) 665-0540
E-mail: mailbox@ifpenn.org

Samuel R. Marshall
President & CEO

February 2, 2015

Cressinda Bybee
Senior Insurance Company Licensing Specialist
Company Licensing Division
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: The proposed merger of Highmark and NEPA

Dear Ms. Bybee:

We offer the following comments on behalf of the members of the Insurance Federation of Pennsylvania.

By way of introduction, the Federation is a non-profit trade association representing all lines of insurers doing business in this Commonwealth. Our members include a number of health insurers, although not the Blues, and our members compete with each other.

As an association, the Federation is committed to regulatory and legislative policies that foster, not control or limit, competition, on the belief that a properly regulated competitive market, in any line of insurance, best serves consumers in promoting accessible and affordable insurance. We are also committed to regulatory oversight that best ensures fiscal stability of insurers even as they innovate to meet changes in the market and the needs of consumers.

We recommend the proposed merger be stayed pending further analysis of the merger's impact on other insurers' competitive abilities, and the viability of the merger based on Highmark's 2014 year-end results – including the results of its hospital operations as well as its insurance operations.

Further, we recommend that if the Insurance Department approves the proposed merger, it does so with conditions to promote competition and sound fiscal oversight of two insurers proposing to merge even as each of them faces marketplace and financial difficulties.

1. The competitive impact of the proposed merger

Sections 1402 and 1403 of the Insurance Holding Companies Act make preserving competition a primary standard in the review of this proposed consolidation: Generally, a merger that would "substantially lessen" competition in the relevant market is not to be approved absent exceptional needs or benefits.

Compass Lexecon, the Insurance Department's consultant on competition, accepted Highmark's analysis that the proposed merger of Highmark and NEPA would not substantially lessen competition because the two entities are already largely merged, and there are already other insurers in the relevant market, which it sets as the NEPA service area.

The Department's consultant, however, failed to consider the proposed merger's impact on the competitive abilities of those other insurers. The Department should not make the same mistake: It should expressly evaluate the proposed merger's impact on actual and potential competition from other insurers in this market, both those already there and those who might enter it.

The proposed merger would allow the Commonwealth's largest insurer to take over an insurer that already has a sizable market share in this region – a market share it enjoys despite being, in the words of the Department's consultant, "neither a maverick nor an especially strong or low cost competitor."

Highmark promises to bring new ideas and new efficiencies that it presumably believes will address those deficiencies at NEPA. That highlights the need to consider the competitive impact, actual and potential, on other insurers if this merger is approved – a consideration thus far missing.

It also highlights the need to establish terms and conditions to ensure such competition will not be lessened. That is especially true in the event Highmark extends its integrated delivery system model into the NEPA service area. That consideration was missing in the Compass Lexicon report, but again, the Department should not make the same mistake.

2. The fiscal soundness of the proposed merger

This is not a proposed merger of two insurers enjoying stable growth and sound finances. To the contrary: For NEPA, it is needed to survive. For Highmark, it comes in the midst of major changes in management and direction, as it attempts to become an Integrated Delivery System in its own service area, as it transitions from its long-term network relation with UPMC, as it adjusts to several rapid changes in its leadership, and as it confronts less-than-encouraging reports from rating agencies.

Blackstone, the Insurance Department's other consultant, noted this, but not with sufficient study (or at least disclosure), and without looking at the latest results for Highmark, or looking at all of Highmark. We understand Blackstone's conclusion that the proposed merger doesn't present much risk to NEPA, given its current financial problems. We are more concerned with its analysis of the risk to Highmark, which can be summarized as this being so small that it won't impact Highmark policyholders and finances either way.

We doubt that. Highmark hasn't engineered a turn-around of NEPA even as it has been an equity partner, so it may be part of the problem, not part of the solution. Even with NEPA, the anticipated efficiencies are questionable given that Highmark has already been involved in its operations.

And for Highmark, this hardly seems a small undertaking or expense, given its other commitments and rating concerns: Taking over a struggling hospital system and seeking to become an Integrated Delivery System while dealing with changes in the law (the ACA is its own challenge) and with new competition is a Herculean task in itself, as already noted by various rating agencies. Whether Highmark is prepared to (or should be allowed to) add the turn-around of NEPA to its list of projects is questionable at best.

Blackstone noted the broader financial challenges facing Highmark, and it apparently attempted to run different scenarios and forecasts in evaluating the soundness of this proposed merger from Highmark's perspective.

That's the right approach, but it seems done at the wrong time, as it apparently was done last fall and therefore without considering 2014 developments and results at Highmark. It also seems done without looking at all of Highmark, meaning its results as an IDS. To consider the finances of Highmark without looking at its hospital operations – inextricably interwoven with its insurance

operations – would thwart the Holding Company Law's requirement of a comprehensive examination of its financial ability to take on the proposed merger.

It is hard to offer specific comments on the proposed merger or the reports from the Department's consultants in this area, because so much of the critical numbers are redacted as confidential, and because it is unclear of the time period considered by the consultants. Still, even with the limited disclosures in those reports, the need for more exploration and explanation, especially as to where things stand at year-end 2014 for Highmark as an IDS, is obvious: The year, particularly the second half of 2014, was too transformational and tumultuous for Highmark to rely on anything but the latest numbers.

Consider all that has happened since Highmark made this filing on February 18, itself less than a year after the Insurance Department approved Highmark's radical plan to become an IDS, albeit with numerous conditions recognizing the ongoing scope and risk of the transformation: In late May, it made a sudden and unexpected change in leadership with the appointment of a new CEO; then came the June 27 Consent Decrees with UPMC; then Highmark filed a still-pending August 27 request for major modifications to the terms of its acquisition of its hospital system; then came litigation on proper interpretations of those Consent Decrees; then came some possibly significant market shifts as consumers faced year-end renewal decisions; and most recently, Highmark settled litigation from several competitors about anti-competitive practices.

To decide on this proposed merger without considering all that would be irresponsible. As with the competitive impact, some of this can be dealt with through the conditions that would attach to any approval. But the more prudent course is for the Department to evaluate this proposed merger based on where things stand for Highmark as of year-end 2014. The Department's consultants may not have had the latest data in making their recommendations, but that's the data the Department needs to make a final determination of this magnitude.

Further, as noted above, any evaluation should consider the finances and results of Allegheny Health Network. The Blackstone report doesn't seem to have considered that, but the Department should. Highmark's becoming an IDS is its biggest challenge, both in the market and financially. The Department recognized this in reviewing its filing to become an IDS in April, 2013. That change having been approved, the Department should review all further merger proposals – including this one - from the perspective of Highmark as an IDS.

Accordingly, we recommend any decision be stayed to consider 2014 year-end and IDS results. Since Highmark and NEPA are already in a number of joint ownership agreements, the Department can do this without unduly prejudicing either entity. And this will enable the Department, its consultants, the impacted public, providers and competitors to have the best and current information on which to decide.

3. Recommended conditions for the proposed merger

Even if the Insurance Department declines to consider 2014 year-end data in deciding on this proposed merger, it should make any approval a conditional one, with the conditions promoting fair competition and allowing the Department the ongoing ability to evaluate the merged entity and its promised public benefits. As to possible conditions, we offer some tied to recent changes at Highmark and some going back to our recommendations on the 2008 merger Highmark proposed with IBC.

Ongoing Highmark orders, decrees and settlements

- The orders, decrees and settlements Highmark has accepted and entered into over the past two years should be expressly made part of any order approving the proposed merger, and applicable to the merged entity and all subsidiaries and affiliates. This would start with the April 29, 2013 order approving Highmark's merger with West Penn and include recent clarifications and settlements tied to the firewall conditions in that order. It would extend to the June 27, 2014 Consent Decrees Highmark entered into with UPMC and include subsequent clarifications and settlements on these terms.

- The Insurance Department should first decide Highmark's August 27, 2014 Request for Modification of the Department's April 29, 2013 order. That Request seeks material changes in the terms and transparency of that order, on finances and on provider contracting. Neither of the Department's consultants made reference to it, possibly because it was filed after they had their documents for analysis. But it needs to be considered in any decision on the proposed merger, certainly by the Department and also by the consultants.

- The Insurance Federation recommended on October 3, 2014 that Highmark's Request for Modification be denied based on the information supplied, or held open for public hearing. Given the added risk connected with this proposed merger and the expansion of operations it envisions – including with provider contracts – we recommend, based on the information made public, that Highmark' Request be denied as a condition to any approval of this proposed merger. The two are incompatible.

Provider contracting

- Clarify that the terms in the April 29, 2013 Highmark order apply to all its provider contracts. Highmark is seeking to overturn this in the above-mentioned Request for Modification. It should be denied as to the merged entity.

- Prohibit the merged entity from using exclusive contracts and "most favored nation" or "prudent buyer" requirements. This should include prohibiting restrictions on or otherwise interfering with providers from contracting with or joining networks of other insurers. This has been a concern in Highmark's conduct under the April 29, 2013 order and was recently the subject of litigation between Highmark and Aetna. Any order approving the proposed merger should expressly address this as to the merged entity.

- Prohibit loans, investments or any contributions to providers on the board(s) of the merged entity or its subsidiaries, or to any providers or facilities in the network, except as otherwise allowed for providers that are part of Highmark as an IDS. We recognize that other exceptions may be appropriate; we recommend any exception be subject to Department approval to ascertain that such loans, investments or contributions not be tied to rates or other contractual relations.

- Prohibit employees, officers or directors of the merged entity and all subsidiaries from having a position in any participating network or facility, except as otherwise allowed for providers that are part of Highmark as an IDS.

- Require transparency in provider contracts. The merged entity and all subsidiaries should disclose all provider reimbursements and other financial incentives, with that information available on-line.

Marketing practices

- Prohibit the merged entity and all subsidiaries from not allowing a group policyholder to offer coverage from other insurers.

- Require that the merged entity and all subsidiaries share a group's claims and renewal information with the group and, upon request, with other insurers or producers. The information should go back three years (assuming they had the business that long) and be made available within 30 days of a request.

- Require restrictions on producer compensation. This should include a prohibition on excessive incentives tied to membership retention, with "excessive" being deemed more than 10% of standard compensation rates.

- Prohibit exclusivity requirements with producers or, in the alternative, prohibit compensation variations based on exclusivity (possibly with a 10% variation cap as with membership retention).

- Prohibit the merged entity from entering into any non-compete covenants with other Blue plans or their subsidiaries, or any other health insurer or ASO. Such covenants seem a presumptive violation of Section 5(a)(5) of the Unfair Insurance Practices Act and its prohibition of agreements "tending to result in unreasonable restraint of, or monopoly in, the business of insurance."

Social mission conditions

- Require annual accounting of social mission expenditures, with public notice and regulatory approval.

- Require a set amount for annual social mission expenditures by the merged entity in an amount equal to what premium taxes would be, as was done in the 1997 order creating Highmark and in the 2005 CHRA for all Blues. Spending of those funds may change depending on health care needs in Pennsylvania – but in no event should such spending be used to gain market share through temporary price cuts or shifts that will only erode market competition.

- Specify the appropriate social mission, and clarify that it not be allowed for general promotional activities.

Surplus and financial conditions

- Require that "excess" surplus be disgorged and distributed to state health initiatives, not Highmark's market enhancement, with a reexamination of what constitutes "excess" surplus under the Insurance Commissioner's 2005 order. As the Commissioner noted in that order, "excess" surplus is determined based on the size of the Blue – and the size of this Blue may be substantially different than contemplated in that order, based on both this proposed merger and 2014 changes at Highmark.

- Impose limitations on investments. Limit investment in health insurance subsidiaries, both in-state and out-of-state, and both for-profit and non-profit, to the investment caps in Section 405.2(c) of the Insurance Company Law, 40 P.S. Section 505.2, but with the exceptions in Section 405.2(c)(2) not applicable. This will ensure that investments benefit the policyholders of Highmark, not its business ventures in other states.

Conditions on subsidiaries and affiliates

- Require that all subsidiaries and affiliates be subject to the same conditions as the merged entity.

Future transactions

- Clarify whether the merged entity intends to expand Highmark's current operations as an Integrated Delivery System into the NEPA service area.

- Prohibit the merged entity from converting to for-profit status absent specific statutory authority.

- Require prior approval of any shift of funds, business or internal allocation from the merged entity's non-profit operations to its for-profit operations, both in-state and out-of-state. This should include annual reporting on the balance of non-profit and for-profit business, as well as in-state and out-of-state business.

BCBSA conditions

- Prohibit participation in territorial allocation agreements among BCBSA members, in-state or out-of-state. This should include, as part of the review of the proposed consolidation, an examination of the terms and conditions in being part of the BCBSA. This association seems a largely unregulated and unaccountable body that is able to reduce, control or eliminate not only competition among Blue plans, but competition to Blue plans from other insurers. Such arrangements run afoul of the Unfair Insurance Practices Act and the goal of Sections 1402 and 1403 to preserve, not lessen, competition.

We look forward to discussing these comments and recommendations with the Department and other parties, and we look forward to refining them as further specifics and updated information come in.

Sincerely,

Samuel R. Marshall

C: Honorable Donald C. White, Chairman
Honorable Matt Smith, Minority Chairman
Senate Banking and Insurance Committee

Honorable Tina Pickett, Chairman
Honorable Anthony M. DeLuca, Minority Chairman
House Insurance Committee

Honorable Kathleen Kane
Attorney General