



November 8, 2004

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

**RE: Highmark Inc. response to Department's October 21 Request for
Additional Information Related to Reserves and Surplus**

Dear Ms. Ykema:

We provide the enclosed information in response to your letter of October 21, 2004. Some of the requests in your letter involve information that the company considers to be confidential and commercially sensitive. We have, therefore, included that information in a separate submission that accompanies this response.

Your request:

In your surplus document, you stated that employee volunteerism was part of the satisfaction of your social mission. For those hours/dollars for which you claim credit, identify: (a) the activities performed; (b) which of those hours were during normal business hours, or in lieu of normal business hours; and (c) which of those hours were compensated as regular hours worked.

Our response:

- (a). Highmark promotes and supports employee volunteer activities in a variety of ways. First, Highmark staff plan and conduct numerous corporate driven activities such as blanket and coat drives, food drives, mentoring programs with schools, donations to domestic violence shelters, donations to needy families and children at Christmas, and volunteering on behalf of the United Way campaign. Additionally, Highmark provides employees with information about volunteer opportunities in the community so that interested employees can contact non-profit organizations needing volunteers. Highmark's clear support has created an environment fostering employee volunteerism that, for example, resulted in Highmark employees being number one in employee giving out of all other companies for the United Way of the Capital Region campaign in 2004.
- (b). Highmark supports its employees who volunteer by distributing quarterly 20 employee grants of \$500 to organizations where employees volunteer. Highmark also has

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a matching grants program where it matches employee contributions of \$100 or more (up to a maximum of \$2500) to certain non-profit health, human service and educational organizations. The majority of volunteer hours are not during normal working hours, although Highmark also recognizes employee volunteers in an annual "Volunteer of the Year" luncheon during working hours. Highmark's CEO has encouraged management to serve on the Boards of Directors of non-profit organizations in their communities. This involvement assists these organizations by providing professional expertise and support.

(c). Highmark generally relies on employees to self-report their volunteer hours. Aside from the corporate initiatives, like the United Way "Day of Caring", which are run during business hours, most employees volunteer their time outside of normal business hour. When they volunteer for corporate sponsored charitable initiatives during normal business hours, they are paid as if they are working.

Your request:

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.

Our response:

Highmark's rationale for what is included as charitable or community contributions is reviewed and approved by our Board of Directors and based on Highmark's discussions with the Insurance Department, where the Insurance Department agreed certain contributions could be included in the annual report on charitable and benevolent endeavors that Highmark has provided for years 1997 to 2003. Highmark generally considers programs that increase access and affordability of health care and that improve the health and well being of all individuals in the community – not just our subscribers – as qualifying. Specifically, Highmark identifies the following as qualifying:

- Contributions to programs for low-income, uninsured individuals through programs such as CHIP, adultBasic and Special Care.
- Rate subsidies to our guarantee issue direct pay programs and subsidies to programs that make health care insurance more affordable for senior citizens.
- Support of Highmark programs and contributions to community organizations that improve the health and well being of all individuals in the community.

As requested, this rationale is explained below for each type of activity identified in our response to the Department.

Direct Contributions to Caring Program for Children

These contributions subsidize the rates, thereby assisting with increasing access to and coverage for health care services for uninsured children who become enrolled in the Caring Program for Children. This program is the only insurance plan in Pennsylvania developed specifically for uninsured children without any pre-existing condition limitations, and it offers HMO, dental, vision, hearing, mental health and prescription drug coverage. Since 1985, the Caring Program has provided a viable option for uninsured children in Western Pennsylvania who have not qualified for Medical Assistance or CHIP and have also been deemed to be uninsurable by other companies because of certain health conditions.

CHIP and adultBasic Administrative Expense Contributions

Contributions to CHIP and adultBasic directly support the contractual requirements for the administration of the CHIP and adultBasic programs, which provide health care to low-income, uninsured adults and children. These contributions reflect Highmark's costs which are not covered by the 10% administrative reimbursement provided through the CHIP and adultBasic contracts.

Special Care Rate Subsidy

This is a direct rate subsidy, monies directly from surplus, which is applied to the low-income Special Care program to help keep the program more affordable.

Group Conversion/Subsidy (Direct Pay Rate Subsidies)

This is a direct rate subsidy to our guarantee issue direct pay products, thus making health care insurance more affordable for under 65 individuals and for Pennsylvania senior citizens purchasing Medicare supplemental policies.

Community Contributions

These contributions are either Highmark run programs, or contributions to non-profit community organizations, that improve the health and well being of all individuals in the community.

Medicare Advantage (previously Medicare Choice) Rate Subsidy

This is a direct rate subsidy to help make health care insurance more affordable to Pennsylvania senior citizens.

CHIP and adultBasic Claim Losses

These represent a direct contribution to these programs, which is necessitated by the contractual rates established by the Insurance Department. As rates for the programs are regulated by the Insurance Department, and particularly for the adultBasic program, these losses reflect reductions in rates from what was requested and actuarially justifiable. Additionally, for the CHIP program, these losses reflect Highmark's and its subsidiary KHPW's subsidies to the low-cost CHIP program where Highmark reduces the amount of money the family must contribute each month in order to help more families afford this coverage.

Your request:

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 do the foundation(s) play in handling claims arising from CHIP, adultBasic or any other state or government funded program.

Our response:

The following responds to the specifics of your request:

- a. Other than as described in the following paragraph, the Caring Foundation did not pay any expenses related to the CHIP, adultBasic, or any other state or government funded program during the time period from 1997-2003. In 2004, the Caring Foundation began paying for a new initiative, which provides individuals on the adultBasic waiting list \$100 to obtain basic health services through federally qualified health centers and rural health clinics. In preparing any reports on Highmark's social mission contributions, Highmark has not taken credit for this or any other initiative being paid for by the Caring Foundation.
- b. The Caring Foundation receives administrative reimbursement to perform outreach, education, eligibility determinations, enrollment functions, customer service and member billing, but does not process claims for CHIP, adultBasic, or any other state or government funded program. The costs that the Caring Foundation incurs in conducting these functions are covered through the 10% administrative reimbursement Highmark receives from the Commonwealth for these programs. However, because of the costs related to these functions, there is very little administrative reimbursement left to cover Highmarks' or its subsidiary KHPW's administrative costs to process and pay claims, to conduct medical management, and to answer inquiries related to claims for these programs. Thus, all

administrative and underwriting losses are born by either Highmark or KHPW for these programs.

Your request:

Specify what, if any, arrangements have been made for the protection of policyholders or members in the event that the corporation becomes insolvent:

Our response:

As an independent licensee of BCBSA, Highmark must either participate in a state guaranty fund, establish an alternative method which assures payment of claims liabilities and continuation of coverage in the event of an insolvency, or have 800% or greater of the Authorized Control Level RBC. Through this standard BCBSA ensures that customers of a plan with an RBC ratio below 800% are protected by a state guaranty association or some other means.

Because the Pennsylvania Blue Plans are not permitted to participate in the state guaranty association, Highmark established, in consultation with the Department, a Custodial Trust Account to assure that sufficient funds are available to discharge obligations to subscribers, and has entered into reciprocal agreements with other Pennsylvania Blue Plans for continuation of coverage in the event of an insolvency.

Your request:

Specify what, if any arrangements have been made with any other Pennsylvania Blue Plan for the payment of claims submitted by policyholders or members.

Our response:

Blue Card

Highmark, like the other Pennsylvania Blue Plans, participates in the BCBSA Blue Card system for payment of claims. The BlueCard Program enables members to obtain inpatient, outpatient and professional services from a network of health care providers when traveling or living outside Highmark's service area.

The BlueCard Program links participating health care providers and independent Blue Cross Blue Shield Plans across the country through a single electronic network of claims processing and reimbursement. The BlueCard program allows Plans to share their participating provider discounts with other Plans.

Under the BlueCard program, the Host Plan is the Plan in the same geographic area as the provider who performed the service to the Highmark member. The provider bills the Host Plan for a Highmark member. The Host Plan sends the appropriate claims information to

Highmark. Highmark adjudicates the claim, passes the appropriate information back to the Host Plan who pays the provider.

Administrative Service Arrangements

Other arrangements exist for the payment of claims submitted by policyholders or members. These are the administrative service agreements that Highmark has with two of the partner Blue Plans that serve as its agent in their respective service areas, which are Independence blue Cross and Blue Cross of Northeastern Pennsylvania.

Highmark Inc., through an administrative service agreement, processes Independence Blue Cross's QCC Personal Choice PPO claims on the Highmark (OSCAR) claims system, as well as some of the jointly underwritten Major Medical claims.

Also through an administrative service agreement, Highmark claims processing staff process jointly underwritten Major Medical claims on the Independence Blue Cross (PlanMate) system.

Through an administrative services agreement with Blue Cross of Northeastern Pennsylvania, Highmark provides the initial claims entry services for Medical, CMM and PPO products on the Highmark (OSCAR) claims system, and Blue Cross of Northeastern Pennsylvania processing staff utilize the Highmark (OSCAR) claims system to process and finalize the CMM and PPO claims.

Claims Submitted by Policyholder or Member

The great majority of claims are submitted by providers on behalf of members. However, if members seek to submit claims, claim forms are made available to members to submit such claims. Members send the claims to the Post Office Box number on the back of their ID cards.

Your request:

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. Include specific comment with regard to advantages engendered by your investment in other than health insurers and also in for-profit entities.

Our response:

Highmark is organized as a non-profit hospital plan and professional health service plan that views as its core mission the obligation to provide access to affordable, quality health care to individuals so that they can live longer, healthier lives. It does so by remaining financially viable and by offering its local and national customers a wide range of competitively-priced health insurance and ancillary products that are underwritten, marketed and administered either directly through the parent corporation or through its

for-profit subsidiaries and affiliates, as well as through joint programs with other Pennsylvania hospital plan corporations. Highmark is able to meet its mission, in large measure, because it is a licensee of the Blue Cross Blue Shield Association, which, among other things, maintains a national network of providers, and sets standards to promote the long-term financial stability of its member plans.

The health insurance market in Pennsylvania and nationally has become increasingly competitive. Larger for-profits entities, both Blue and non-Blue, are combining nationally and entering new markets, including Pennsylvania. These entities have ready access to capital and freedom from many of the statutory and regulatory constraints that apply only to non-profit health plan corporations or HMOs. In fact, Highmark is presently advocating changes to the regulation of premium rates of small groups in Pennsylvania, so that its programs for its small group customers can remain viable and affordable.

Highmark's subsidiaries are a vital component in helping the company meet its corporate mission and its commitment to the communities in which its thousands of employees live and work. Highmark's subsidiaries support the company's mission in several ways. For example, KHPW provides managed care benefits to 450,000 people in the 29 counties of western Pennsylvania. KHPW also administers the SecurityBlue HMO program, one of the largest Medicare Advantage HMO programs in the country. To help its members live longer, healthier lives, KHPW has undertaken a broad range of clinical quality activities, including those relating to the management of diabetes, asthma, and congestive heart failure. In addition to making managed health insurance available to young and old alike, KHPW helps Highmark fulfill its mission by administering programs that cover vulnerable segments of the community, such as low-income families and uninsured children. KHPW is organized as a subsidiary company because the Insurance Department has required such an entity for the issuance of a certificate of authority under the Pennsylvania Health Maintenance Organization Act.

Highmark's other insurance subsidiaries, such as UCCI, and Highmark Life and Casualty, also support Highmark's corporate mission, by offering a line of ancillary insurance products – dental, vision, stop-loss - enabling the parent company to compete with diversified companies that offer comprehensive portfolios of insurance products. In other words, they help the parent company meet marketplace expectations. These for-profit subsidiaries help Highmark compete for mid-sized and larger customers – Pennsylvania-based companies and those with operations in multiple states. As A.M. Best noted in its 2002 report, "Highmark's product and geographic diversification strengthen its existing customer relationships and the quality of its earnings stream."

As noted in one of our previous submissions, Highmark's subsidiaries also help diversify the company's sources of income in the event of weak operating performance by the core health insurance business. Health insurance is subject to significant underwriting cycles. In 2003, for example, Highmark posted negative operating results on its health insurance business, while Highmark's dental and vision subsidiaries, produced positive operating

Reserve Surplus Request

S. Ykema

November 8, 2004

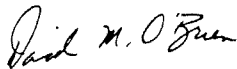
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results that offset such losses, thereby helping the company maintain a positive net income.

Some of Highmark's subsidiaries, such as Highmark Life and Casualty Group, provide administrative services to the parent company, thereby promoting operating efficiencies. Subsidiaries, such as Alliance Ventures and Insurer Physician Services Organization, have performed strategic functions to enable Highmark to continue to offer its products in the marketplace at a time when provider consolidations threatened subscribers' access to affordable networks.

As you know, we are anxious to resolve any questions regarding reserves and surplus. If you have questions or wish to discuss the material herein, please do not hesitate to contact me at (412) 544-5250, or by contacting Candy Gallaher at (717) 302-3982.

Sincerely,

A handwritten signature in cursive script, appearing to read "David M. O'Brien".

David M. O'Brien
Executive Vice President,
Government Services

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Cc: Stephen J. Johnson, Deputy Commissioner
Randolph L. Rohrbaugh, Deputy Commissioner
Chester Szczepanski, Chief Actuary
Steven B. Davis, Chief Counsel