

Pennsylvania Insurance Department

Public Informational

Hearing

Proposed Transaction Between Highmark Inc.

and Independence Blue Cross

Comments of Kenneth R. Melani, M.D.

President and Chief Executive Officer

Highmark Inc.

and

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President and Chief Executive Officer

Independence Blue Cross

We welcome this opportunity to talk about why bringing together Highmark and Independence Blue Cross (IBC) and their subsidiaries into a new company will be good for Pennsylvania – how it will benefit our subscribers, the communities in which the two companies operate and, most of all, the people of Pennsylvania.

We are personally very proud to have reached this time of public hearings and look forward to open discussion and dialogue. We recognize that the Department must review the applications we have filed based on very specific criteria under state law. We believe that our presentation today, combined with the large volume of information we have already submitted to the Department, will show that the proposed transaction satisfies these criteria and should be approved.

Today, we will cover several topics, focusing on how the proposed transaction will benefit Pennsylvania. We will discuss our companies, their history and mission. We will also discuss why we believe it is important for our companies to come together at this time and the benefits from coming together to the citizens of the Commonwealth. Moreover, we will address some of the concerns about the transaction that have been raised by others, especially the issue of competition.

And we look forward to hearing from many others, including those from Pennsylvania businesses, civic and community organizations, and health care providers who will share their experiences with our companies.

With Joe and me today are two experts. Dr. Barry Harris is a respected economist and a principal and chairman at Economists Incorporated, a leading economics consulting firm based in Washington, D.C. He is intimately familiar with the health care environment in Pennsylvania and has consulted with other health insurers, hospitals, and physician practices. He will discuss in some detail why the transaction will not lessen competition in Pennsylvania.

Dr. David Knott is a senior vice president at Booz & Company, an international global management consulting firm based in New York. Dr. Knott will discuss how the combined company expects to achieve benefits of more than \$1 billion through economies of scale, more efficient use of resources and growth. Joe and I will discuss how we intend to use these resources to help benefit Pennsylvania.

One of the reasons we are here today is to talk about the future of our health care system. To better understand how this proposed transaction can help bring about meaningful change, we would first like to briefly review the history of our two companies.

IBC and Highmark's predecessor companies, Pennsylvania Blue Shield and Blue Cross of Western Pennsylvania, were started 70 years ago as non-profit corporations with a community mission. Our common mission at IBC and Highmark – and we feel passionate about it – is to provide access to quality, affordable health care, enabling people to live longer, healthier lives and strengthening the well-being of Pennsylvania communities.

We have embraced a community vision as part of our heritage. Throughout our history, Highmark and IBC have tailored health insurance programs for unique population groups, including children, lower-income individuals and older adults. We believe these efforts have helped to keep Pennsylvania's uninsured rate among the lowest of the 50 states and the lowest among heavily populated states.

Our mission also includes supporting the economy of Pennsylvania and the local communities and regions where our employees live and work and that we specifically serve. Currently, Highmark and IBC have a total annual economic impact of \$4.2 billion on the state's economy. These are monies generated in the Commonwealth because Highmark and IBC are Pennsylvania-based companies.

We employ more than 18,000 people in high-quality jobs in Pennsylvania and have historically strived to maintain jobs in the Commonwealth. Moreover, we purchase a significant amount of goods and services from Pennsylvania-based companies. By doing so, we support and help create additional jobs across the state and help boost local and state tax revenue. This local focus differs from some of our competitors, particularly national, for-profit companies, whose principal focus is enhancing shareholder value by using the lowest-cost alternative, including outsourcing jobs off-shore.

Highmark and IBC have interests in a number of subsidiary companies. Some of these subsidiary companies provide health insurance and other types of insurance to many Pennsylvanians and people across the United States. The subsidiary companies are critically important to helping Highmark and IBC maintain financial stability and fulfill their mission. The returns they generate flow to the non-profit parent companies to help them meet the common mission.

We believe this transaction will allow us to build on our history and lay a foundation for significant, tangible impact in the way health care is delivered and paid for in Pennsylvania.

The combination will enable us to remain a strong and financially sound Pennsylvania-based business that will be better able to sustain a community mission. The mission drives everything we do. We are committed to ensuring that the new company maintains a non-profit status and a community mission.

The transaction will provide opportunities to achieve operating efficiencies and savings that will benefit Pennsylvania. We expect the transaction to generate more than \$1 billion in benefits that we plan to use for addressing health care costs, quality of care and access to health care coverage in Pennsylvania.

And finally, we believe that a combination of our two companies will strengthen our contribution to the economy of Pennsylvania and our communities – by expanding employment opportunities across the Commonwealth and supporting local businesses.

Continuing this proud tradition is important to us, although we are confronted by a challenging environment. The health care system appears to be nearing a watershed, with increasing concerns about medical costs, the quality of care and patient safety, and access to medical care.

The cost of health care, including hospital and physician services and prescription drugs, is ever increasing. As a result, the burden of health insurance costs on individuals and businesses continues to rise.

Every year, employees shoulder more of the cost of health insurance.

Businesses of all sizes and in all industries are choosing to remain competitive by either curtailing their employee health benefits, or eliminating them altogether. As the number of employers offering health insurance in the state goes down, the number of uninsured in Pennsylvania goes up.

As employer-sponsored health insurance faces increased cost pressures, the government's role in financing coverage for more Americans is expanding. At the same time, in an effort to cope with rising insurance costs, we are seeing a growing interest in regional and statewide purchasing coalitions in both the public and private sectors.

The demographics of Pennsylvania are having a direct impact on health care costs and access to care. The state faces some critical challenges, including:

- How to more efficiently and effectively care for an aging population with more chronic medical conditions.
- How to recruit and retain physicians and other health care professionals when many practitioners are retiring or nearing retirement.
- How to ensure access to health care in rural areas, the inner city and other under-served communities.

Quality of care is also a major concern. Too much of the money we spend on health care does not improve health. A growing body of research shows variation in the treatment of common medical conditions, such as heart disease, without any appreciable difference in patient outcomes. There is now a widespread consensus that by improving quality and patient safety, we can slow the growth of medical costs.

These dynamics are driving changes in health care delivery and financing. Consumers are taking a more active role in all aspects of health care. Because they are more responsible for their costs, consumers are seeking more information about the cost and quality of care across providers and are playing a greater role in their own personal health. The growing consumer involvement is driving the need for greater investments in new technologies, products and services, such as health promotion and disease management programs, to meet the health care needs of a more informed population.

All participants in health care are being challenged to operate more efficiently and to access sufficient capital to support these growing demands.

Scale has become increasingly important to achieve greater efficiency and lower administrative costs. Health care delivery systems are getting larger. Multi-specialty physician practices are growing in size. Employer and labor-sponsored insurance purchasing pools are covering larger geographic areas. Health care suppliers and service companies in radiology, laboratory services, durable medical equipment and other products and services are operating more as multi-market and multi-product companies to help ensure a steady flow of capital and to gain greater operating efficiencies. As a result, the scale of competition in health care is moving from a local to a regional and national basis.

The health insurance industry has also evolved. Larger, for-profit companies now play a much larger role in the health insurance marketplace. Over the past 20 years, many for-profit insurance companies have joined together to create larger, mega-companies aimed at operating more efficiently and accumulating capital to offer new products and services and invest in health information technology. For-profit, national health insurance companies, like United Health Care, WellPoint and Aetna, have continued to grow by acquiring local or regional health plans and companies with leading-edge health information technology expertise.

The national Blue Cross Blue Shield system has also undergone consolidation. To underscore this point, look at what has happened with Blue Cross and Blue Shield companies across the United States. Today, there are 39 independent Blue Cross and Blue Shield companies. That is one-third the number since 1980, when there were 115 Blue Cross and Blue Shield companies.

Pennsylvania stands out. It is the only state in the country with four Blue Cross and Blue Shield companies. In fact, some Blue Cross and Blue Shield companies now operate in multiple states.

In Pennsylvania, we are operating less efficiently than we could be by spending lots of dollars on duplicate investments in technology and capabilities that add more cost to the state's health care system. In effect, every dollar spent on duplicate investments adds to the cost of health insurance and brings little additional value to our subscribers. For every dollar of unrealized cost savings, there is one less dollar of spending on what our subscribers and communities care about most: high quality and more affordable health care.

Highmark and IBC today compete against major, highly capitalized companies. As public, for-profit companies, they have ready access to capital and have the resources to invest in the new technologies that we discussed earlier. These companies have the scale and large subscriber base to buy services at lower cost and to significantly spread their operating costs over a larger number of subscribers.

WellPoint, for example, has almost 35 million subscribers, while United HealthCare has 31 million subscribers. By contrast, IBC and Highmark have a fraction of that number of subscribers.

The bottom line is that Highmark and IBC face tremendous market pressures to reduce administrative costs and access capital to finance substantial investments in technology to meet changing market demands. Each company, separately, reached the conclusion that it had to grow its subscriber base to remain a successful business and sustain the mission.

As the management teams and boards of directors at both companies planned for the future, we each realized the presence of a logical partner with a similar mission of providing access to quality, affordable health care coverage.

Highmark and IBC have worked together for more than 50 years to better serve the community. The two companies pioneered efforts to cover uninsured children of working families, serving as a model for the state's own Children's Health Insurance Program, or CHIP. We have jointly offered Medicare supplemental insurance programs for Medicare beneficiaries and insurance programs to individuals and families under-age 65 who cannot buy health insurance from any other carrier. And we have made some strategic investments together to operate our companies more efficiently and simplify administrative transactions with physician offices and hospitals.

The two companies also have a complementary portfolio of products and services to meet the needs of businesses of all sizes. As licensees of the national Blue Cross Blue Shield system, we have a shared commitment to promote the Blue brand.

Although Highmark and IBC operate in the same state, we do so in different geographic regions. Each company is uniquely familiar with the subscribers, health care providers and community needs in its respective service area.

Perhaps most important, the two companies have a common culture built around the mission. Our employees share similar values, both on a personal and business level.

Simply put, the two companies are a good fit. By taking the next logical step of integrating our two organizations, we can harness our resources to help remain a strong Pennsylvania-based corporation while also better serving our subscribers, health care providers and the community at large.

With that backdrop about the health care industry environment and the reasons why IBC and Highmark are a natural fit, we would like to talk specifically about the proposed transaction. We believe the combined company will achieve five major goals to better serve the people of Pennsylvania:

- Make health insurance more affordable.
- Help improve health care quality and the overall wellness of our subscribers and communities.
- Assure access to quality doctors, hospitals and other health care providers.
- Continue and expand contributions to the Pennsylvania economy and enhance our commitment to the Commonwealth.
- Make it easier for subscribers and health care providers to do business with us.

These goals are real and attainable because the transaction provides opportunities for significant synergies and operating efficiencies.

The new company will be able to operate more efficiently than our two companies could do separately. For example, the cost of processing health care claims represents a major operating expense for health insurance companies.

The combined company will be able to achieve greater efficiency by spreading administrative costs associated with claims processing over a larger base of subscribers. The result will be a lower unit price to process a single health care claim.

A combined subscriber base will also generate additional financial resources for the new company to invest more cost-effectively in new technologies and create new technology-driven capabilities that will be mainstays of the health insurance business in the years to come.

For example, greater scale will help us prepare for substantial and costly information system changes that are likely to result from the move toward uniform medical claim codes and standardized personal health records. It will also allow the new company to participate in health insurance programs across larger regions and even statewide as purchasing pools for employer and government-sponsored programs expand their geographic reach.

Moreover, the proposed transaction will yield more efficient use of our companies' existing resources. The new company can achieve efficiencies by eliminating the costs associated with duplicate systems for processing claims, medical management and other administrative functions.

By avoiding redundant spending on information technology and administrative services, the new company will free resources for other important activities, such as developing new consumer-driven products and services, and addressing community health care needs.

We can achieve these efficiencies without lessening competition in the state's regional health insurance markets.

How, specifically, will Pennsylvania benefit by this transaction?

Here is the big picture. We expect the transaction will generate \$1 billion in savings, synergies and growth opportunities that will free resources to spend on meeting subscriber needs, addressing community health needs and dealing with the vital cost, quality and access issues that are affecting health care today.

These are monies that go beyond any commitments we have today, and will be available only because of the proposed transaction.

We will also voluntarily agree to extend our commitment under the Community Health Reinvestment Agreement for three years through 2013, representing an additional, estimated \$350 million to help more Pennsylvanians obtain health insurance.

For our subscribers, we believe the new company will improve the affordability of health insurance.

Virtually every day our companies receive calls or e-mails from one of our group customers or individual subscribers complaining about the high cost of health insurance. These calls and e-mails drive home the point that the rising cost of health care is one of the reasons many Pennsylvania businesses and families are struggling to make ends meet.

The new company will help make health care coverage more affordable. Here is how we plan to do this. The health insurance premium dollar is made up basically of two parts: medical costs and operating expenses. In 2007, IBC and Highmark used between 88 cents and 90 cents of every premium dollar they received to pay for medical services for their subscribers. The national, for-profit insurance companies typically pay out much less of their insurance premium revenues for patient care.

As the cost of those medical services goes up – either because medical costs go up or subscribers use more medical services, or both – premiums go up proportionately. Rising medical costs are the driving force behind premium increases.

Highmark and IBC do not have any direct control over medical costs. However, we have a measure of control over our administrative expenses, which make up eight to nine cents of the insurance premium dollar. We intend to use some of the savings generated by the proposed transaction to offset a portion of the operating expenses that would otherwise be included in health insurance premiums. The new company will pledge to keep administrative fees flat for two years after it is formed. This will save our subscribers approximately \$295 million in their premiums over six years.

In addition to the administrative cost commitments, we believe the new company will save its subscribers an estimated \$285 million in pharmacy savings over six years. It is important to note that we could not achieve these pharmacy savings on behalf of our subscribers if Highmark and Independence Blue Cross remained separate companies. These savings will result from better pricing and efficiencies the new company will realize to reduce overall prescription drug costs, which will help hold down subscriber premium increases.

We expect about \$100 million of the savings generated by the proposed transaction will be used to fund health care quality programs. These could include continuing and expanding each company's ePrescribing programs and encouraging implementation of standardized personal health records and electronic medical records. We believe that greater use of these tools leads to higher quality care and fewer medication errors, which will result in greater efficiency and greater savings for subscribers in the long run.

These investments will expand upon current Highmark and Independence Blue Cross activities – many of them built around health information technology – to help address quality and patient safety issues. Together, the two companies have nearly 1,100 physicians engaged and regularly using electronic prescribing for prescription drugs. EPrescribing helps improve patient safety, increases the use of appropriate generic drugs and sharply minimizes the potential that patients will receive the wrong medications from hand-written prescriptions.

We also plan to increase investments in health information technology tools designed to provide more cost and quality information to our subscribers, which will help them make more informed decisions about health benefits and their personal health. Moreover, we will be better able to identify and reach out to subscribers with chronic medical conditions with more focused health management programs.

The new company also plans to combine and expand the best of the health promotion and wellness programs offered today by Highmark and IBC to help improve the health and well-being of our subscribers. Over time, a healthier population will be more productive at work and consume fewer health services. In addition, we will offer more integrated products and services incorporating vision, dental and medical programs – all of which will help our group customers satisfy multiple employee benefit needs with one insurance company.

Over the past 18 months, we have met with a number of provider groups and organizations, and we have heard a common theme. Health care providers are deeply concerned that the changes taking place in health care delivery may be affecting relationships between physicians and patients and the quality of patient care.

We believe the transaction will benefit hospitals, physicians and other health care providers. Health care providers have been a valued asset to the long-standing mission of Highmark and Independence Blue Cross in providing our subscribers with access to very broad networks of high-quality providers – and they will remain important partners in the future.

The new company will be in a better position to identify and invest in technologies to simplify administrative transactions. Planned investments in ePrescribing tools and electronic personal health records have the potential to improve the quality of care and patient safety in the long term. At the same time, these activities help ease administrative burdens for hospitals and physician office practices, freeing them to pay more attention to patient health and service.

The new, combined company will be committed to provider payment levels that preserve our networks and help promote optimal quality of care. We must do this or risk undermining our provider networks and losing subscribers to other competitors. This is why we plan to expand pay-for-performance programs that provide incentives for health care providers to deliver increasingly high-quality care.

At the same time, our reimbursement levels to providers must be balanced against an equally important goal of making health insurance more affordable for our group customers and individual subscribers.

As we have often said, the \$1 billion in economic benefits that we have discussed today will not result from reductions in physician and hospital reimbursement levels.

As a new company, we will expand our commitment and resources to regional and state-wide working relationships with provider organizations to address health care quality and patient safety issues. For example, our companies have played instrumental roles in the progress made by the Pennsylvania eHealth Initiative, which has been committed to advancing statewide electronic medical records.

A high priority for the new company will be maintaining cooperative working relationships with physicians and hospitals at the local level. Through these sustaining partnerships, we can address the unique medical needs of their patients and our subscribers at the community level.

We are committed to continuing our mission by supporting Pennsylvania communities. IBC and Highmark have carried out their mission in many ways, none more critical than offering health insurance to people who the large, for-profit carriers will not insure. They can and do choose whom they will cover. We do not. The population we insure includes low-income families, the elderly and people in poor health. Highmark and IBC offer health insurance programs to everyone in Pennsylvania, regardless of their medical history, current health, age or gender. For these individuals, our products are often truly their only insurance option.

The new company will continue this commitment to making health care coverage available to everyone in Pennsylvania. We envision this happening in two ways. First, as part of the \$1 billion in new economic benefit from the transaction, the new company will provide over \$300 million to new and existing programs for the uninsured, the underinsured and small business employees.

The increasing number of people in Pennsylvania without health insurance has many negative consequences. People without coverage are generally in poorer health because they are less likely to obtain medical care than people with insurance. The uninsured routinely postpone or forego medical care and are more likely to be hospitalized with avoidable health problems.

The increasing number of uninsured in the Commonwealth drives up health care costs, for which each of us with health insurance ultimately pays. Acute care hospitals provide more uncompensated care, often in costly emergency room settings. This shifts more costs to people with private health insurance.

For these reasons, we believe it is imperative to direct some of the savings from the proposed transaction to expand health insurance programs for the groups that make up most of the uninsured and underinsured population.

People obviously have different ideas on how best to expand health insurance coverage. We intend to work cooperatively with all of our partners in health care to identify the most effective use of these monies to make health insurance available to more Pennsylvanians.

The second way of improving access to health insurance for the uninsured and underinsured is by voluntarily extending our commitment under the Community Health Reinvestment Agreement through 2013 by a total of approximately \$350 million. This commitment is over and above the \$1 billion in net economic impact.

The new company will also continue to subsidize the cost of our under-age 65 individual products that are available to everyone and Medicare supplemental programs for Medicare beneficiaries. In other words, we will charge less in premiums than the products actually cost. Highmark and IBC have done this for many years. We are not aware of any for-profit, national health insurance company that offers and subsidizes an insurance program to anyone in Pennsylvania who needs it. In the past five years, Highmark and IBC subsidized our individual programs by \$291 million.

It is ironic that some skeptics try to turn our mission on its head by saying that our share of the health insurance market is too large. The reality is that we have many subscribers in Pennsylvania because we serve all of the counties and municipalities in our service areas and offer the best value to our subscribers.

We don't avoid counties. We don't target or intend to service only certain markets. We make health insurance available to as many Pennsylvanians as possible. We would like to see all Pennsylvanians have more health insurance choices – not just healthy Pennsylvanians.

To quantify our commitment to the community, let's take a closer look at 2007. Last year, Highmark and IBC provided almost \$200 million in community contributions, which included approximately \$154 million to fulfill the commitments of the companies under the Community Health Reinvestment Agreement.

How was the money used? A large share of our community contributions advanced our core mission activities: holding down the cost and expanding access to health care coverage for lower-income families, older adults and uninsured children.

In addition, IBC and Highmark provided grants, programs and support aimed at addressing community health needs:

To be specific, we supported programs that included:

- Funding for medical and dental clinics for the uninsured,
- Increasing the supply of nurses through scholarships,
- Fighting health care-associated infections,

- Helping eliminate disparities in health care, and
- Addressing childhood health issues such as obesity, lack of exercise and bullying.

Our commitment to the community has a broad scope that goes beyond health insurance programs. The new company will have a \$4.2 billion annual impact on the economy of Pennsylvania and local communities across the state. We employ 18,000 people in high-quality jobs in Pennsylvania, and we believe the transaction will build the foundation for more jobs in the state and greater tax revenues for the Commonwealth, counties and local communities.

We intend to maintain dual headquarters in Philadelphia and Pittsburgh while continuing an operating presence in localities across the state. The dual headquarters will ensure that the new company can continue to preserve working relationships with employers, providers and communities at the local level.

Highmark and IBC are unique organizations. We are non-profit corporations, but we are taxpayers at the same time. Both companies pay taxes every year and we provide substantial tax revenue for the state. In 2007, the two companies and their subsidiaries paid approximately \$375 million in federal, state and local taxes. This includes nearly \$62 million in premium taxes paid by subsidiaries of the two companies.

Because of our non-profit status, Highmark and IBC, but not our for-profit subsidiaries, are exempt from some state taxes, most notably the insurance premium tax. In 2007, the estimated value of the premium tax exemption was \$90 million for the two companies. But this premium tax exemption must be balanced against the community contributions our companies make. Last year, our community contributions exceeded by more than 2 to 1 the amount of taxes not paid because of the premium tax exemption.

Before concluding, we believe it is important to address an issue that has received lots of attention: competition.

At legislative hearings and during the Department's public comment period, it has been suggested by some that the proposed transaction would lessen competition in health insurance. This claim is simply not true.

The proposed transaction will not reduce competition or choice in any market in Pennsylvania. We would like to offer some common sense, business observations on this subject. Simply put, the two companies and their Pennsylvania insurance subsidiaries do not compete with each other in any meaningful way.

Let me explain what this means. Highmark and IBC primarily serve two separate geographic areas of Pennsylvania. Highmark offers commercial health insurance products in 49 counties of Central and Western Pennsylvania. IBC offers commercial health insurance products in the five Southeastern Pennsylvania counties.

In our separate markets, the two companies today compete against a wide range of other health insurers but, and we want to emphasize this point, not against each other. Neither Highmark nor IBC considers the other company to be a competitor in the commercial health insurance business.

This is not merely our view, but also the perception of health care consumers across the state. The purchasers of commercial health insurance – whether in Western Pennsylvania, Central Pennsylvania, or Southeastern Pennsylvania – do not consider IBC and Highmark as competitors vying for their business.

Another observation is that the two companies face significant competition in their respective service areas – and will continue to do so. Both Highmark and IBC compete against a variety of health insurers with important features. Some are major, national, highly capitalized companies, like Aetna, CIGNA, Coventry and United Healthcare. These are not Mom and Pop companies. They are mostly well-financed, publicly held, for-profit companies.

Other health plans have the advantage of being integrated with important regional health care delivery systems, like UPMC Health System and Geisinger Health System. And still others include Capital Blue Cross, another non-profit Blue company.

In the future, we fully expect that our subscribers will continue to have a wide variety of choice from a competitive health insurance market. There are no Highmark subscribers who will be denied a choice that they have today as a result of the transaction. No IBC subscriber will lose a competing choice. Subscribers of the companies will have the same competitive choices if we become a combined company as they have today – except for one major difference. The new, combined company will be better able to serve our subscribers with higher-quality products and services, which will push our competitors to enhance their service and capabilities.

In conclusion, we think it is important to note that no one company or organization, alone, can solve all the problems of the health care system. We believe this transaction offers a pathway to positive change in our health care system that Pennsylvanians are seeking and demanding.

Like many other businesses, we face strong competition every day. We are trying to develop and grow our workforce. We are trying to meet the changing needs of our customers. And we are trying to fashion an efficient business model to succeed in the future.

What distinguishes us from for-profit, national health insurance companies is that we are driven to achieve business success to sustain our community mission, rather than maximizing returns. The mission has guided our companies in the past and will serve as a linchpin for the success and relevance of the proposed new company in the future.

We look forward to the opportunity to harness the resources and talents of Highmark and Independence Blue Cross for the benefit of Pennsylvania.