

### VIA FEDERAL EXPRESS

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November 11, 2004

RECEIVED CHIEF COUNSEL

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

**RE:** Surplus Application Process

Dear Ms. Ykema:

In response to your October 21, 2004 letter to Paul Tufano, Senior Vice President, General Counsel and Corporate Secretary for Independence Blue Cross ("IBC"), enclosed please find IBC's responses to your October 21, 2004 letter. Please note that some of the responses and attached documents are marked "Proprietary and Confidential" and, therefore, are not subject to public review or publication on the Department's website. IBC continues to gather information responsive to question #7 and a response to question #7 will be forwarded to you after the information is gathered.

If you should have any questions please call me at 215-241-3835.

Very truly yours,

Eleanor D. Thompson

Vice President and Deputy General Counsel

CC: Paul A. Tufano

Senior Vice President, General Counsel and Corporate Secretary

## **RESPONSE TO QUESTION #3**

# Surplus and Authorized Control Level Risk Based Capital Question #3 10/21/04 PID Letter

All data used in this response is taken directly from the Statutory Annual Statements filed with the Pennsylvania Insurance Department as noted:

	2003 (\$ 000)	2002 (\$ 000)
IBC		,,,,,,
Surplus (Page 34, Line 12)	840,917	707,106
Authorized Control Level Risk-Based Capital (Page 34, Line 13)	214,763	196,984
Percentage of Authorized Control Level	392%	359%
QCC		
Surplus (Page 34, Line 12)	357,278	270,915
Authorized Control Level Risk-Based Capital (Page 34, Line 13)	79,183	65,240
Percentage of Authorized Control Level	451%	415%
KHPE		
Surplus (Page 34, Line 12)	399,053	344,943
Authorized Control Level Risk-Based Capital (Page 34, Line 13)	93,130	89,326
Percentage of Authorized Control Level	428%	386%
AmeriHealth HMO, Inc.		
Surplus (Page 34, Line 12)	447,473	395,961
Authorized Control Level Risk-Based Capital (Page 34, Line 13)	110,786	107,823
Percentage of Authorized Control Level	404%	367%
Vista		
Surplus (Page 34, Line 12)	1,508	1,493
Authorized Control Level Risk-Based Capital (Page 34, Line 13)	2	2
Percentage of Authorized Control Level	MM	MM

#### NM - Not Meaningful

The consolidated authorized control level risk based capital is calculated in accordance with the NAIC RBC formula instructions. The calculation includes the risk computations from each of IBC's affiliated companies in addition to risks associated with the business that resides on IBC's books.

To calculate the IBC alone Authorized Control Level risk using the NAIC Health Risk Based Capital formula, IBC's consolidated risk would have to be adjusted to exclude the risk from each of its' subsidiaries. These subsidiaries underwrite and administer most of the IBC Family of Companies health business. The remaining risk would primarily represent the risk on non-affiliated asset holdings, underwriting risk, credit risk, and business risk.

IBC surplus is computed in accordance with Statutory Accounting Principles.

It is not possible to determine an IBC Standalone surplus. There is no such figure. IBC's surplus is the "consolidated" surplus reported on the IBC Statutory Annual Statement. It includes the statutory surplus values of its' subsidiaries; as such IBC's standalone statutory surplus is embedded in the overall surplus.

**Question #4**: 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.

## Response to question #4:

#### SUBSIDIES OF NON-GROUP PRODUCTS

Independence Blue Cross, the not-for-profit parent company, provides direct and indirect subsidies to its non-group benefit plans. In 2003, those subsidies totaled \$6.5 million.

The subsidizing of non-group benefit plans is a cornerstone of the Blue Cross mission. Since their formation, Blue Plans have been a source of health insurance for those who otherwise could not acquire it. Today, the availability of non-group coverage for those without access to group coverage stands squarely between thousands of Pennsylvanians and the uninsured rolls. The high cost of such programs, however, requires that they be subsidized in order to be at all affordable.

IBC subsidizes its non-group products in two ways: **Direct subsidies of .5 % to 2½% are** built into the premiums of our IBC and QCC group customers. This longstanding practice is done with the approval of the Pennsylvania Insurance Department, which traditionally has supported fully the principle of group subsidies for non-group products. The second type of subsidies is **indirect**—they consist of the excess claims and administrative costs that IBC incurs as a result of offering the non-group products.

In addition, QCC Insurance Co., the IBC subsidiary that markets our Personal Choice PPO product, also offers non-group benefit plans and subsidizes them—in 2003, those direct and indirect subsidies totaled \$9.8 million. These subsidized products are particularly noteworthy

because QCC is a for-profit company with no more responsibility to offer non-group PPO products than our non-Blue competitors. Nevertheless, QCC does make them available, in keeping with the Independence Blue Cross Social Mission.

And finally, another for-profit IBC subsidiary Keystone Health Plan East provided indirect subsidies in 2003 to the CHIP and adultBasic programs of \$4.1 million.

The subsidizing of non-group insurance products qualifies as a Social Mission initiative. Whether the subsidy results from a small contribution from a group customer's premium or from IBC's coverage of claims and administrative costs that exceed the policy's premium, the subsidy dollars in question are making health insurance available to those who otherwise would, most likely, be uninsured. That not only qualifies as a Social Mission activity; it is an essential Social Mission activity.

#### INSURER OF LAST RESORT

IBC considers our longstanding practice of being the Insurer of Last Resort to be a crucial part of our Social Mission. The fact is, anyone who wants to buy health insurance can do so from IBC—and because we offer year-round Open Enrollment, you can buy that insurance whenever you need it. Moreover, we do not Medically Underwrite the premiums for these non-group policies.

While we do not quantify the investment associated with this practice, it has an inherent cost factor that results from the nature of the practice itself. It is not uncommon for someone to sign up for a non-group policy in February, for example, have a medical procedure in May and drop the coverage afterward. But in cases such as these, the costs that IBC incurs as a result of that member's claims easily exceed the premiums paid.

#### **CHIP and ADULTBASIC**

Another essential component of our Social Mission is The Caring Foundation, which administers the Commonwealth's CHIP and adultBasic programs in Southeastern Pennsylvania. The Foundation contributes all costs that exceed the administrative fee paid by the state.

The Foundation supports children in the low cost CHIP program through a subsidy, so parents pay a monthly premium per child of \$30, rather than the \$65.90 charged through the low-cost CHIP. In 1990 – before CHIP existed—the Caring Foundation for Children helped to insure more than 4,000 children of needy families. Today, that number exceeds 28,200 and continues to grow. Since its inception, the Caring Foundation has provided more than 2.6 million medical services to more than 145,000 children.

In addition, the Foundation continues to perform the outreach services used to identify potential CHIP recipients.

For more than two years now, the Foundation also has coordinated IBC's involvement with the adultBasic program. IBC is the only insurer in Southeastern Pennsylvania involved in adultBasic; in fact, no other insurer expressed any interest in getting involved.

#### **NURSE SCHOLARS PROGRAM**

One of IBC's two newest Social Mission initiatives represents our attempt to address the critical shortage of nurses in our region. The design of this initiative was drawn directly from input provided by the region's leading nursing advocates, who cited the pressing need for more nursing educators. IBC has dedicated \$3 million over three years to provide scholarships for those aspiring to be nurses or nurse educators; to date, about 575 undergraduate and graduate students have received funds from the Nurse Scholars Program and the Pennsylvania Higher Education Foundation (PHEF) Nursing Education Initiative. This

initiative has the potential to positively impact a crucially important public health crisis—one that is undeniably worthy of attention from IBC's Social Mission.

#### CHARITABLE MEDICAL CARE PROGRAM

IBC's commitment of \$6 million over three years to fund our Charitable Medical Care Grant Program represents another important Social Mission activity. Not only are these grants aimed at providing much-needed medical care for the uninsured; they also help address the crisis in uncompensated care that is plaguing our hospitals—and ultimately, purchasers of health insurance.

To date, IBC has given \$2.8 million in financial support to 13 clinics that provide free or nominal-fee care to uninsured residents who otherwise would not have access to health care.

To be eligible for a grant through the IBC Charitable Medical Care Grant Program, a clinic must be non-profit, privately funded and staffed by volunteer medical professionals. The 13 facilities awarded grants so far are located in Philadelphia and Bucks, Chester and Montgomery counties.

The Charitable Medical Care Grant Program is a perfect example of IBC's commitment to the overall health of our community. It also stands as a model for what a Social Mission activity should be.

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The fact is, all of the initiatives summarized above are reflections of IBC's commitment to the overall health of our community. Even IBC's financial support for the numerous charitable, fund-raising and wellness activities of local health care, educational and civic organizations—

support that our critics say any local corporation might make in the name of self-promotion—track consistently with our commitment to the community's overall good health.

Yes, while our competitors focus entirely on attracting a risk pool of healthy subscribers, IBC is committed to investing millions of dollars in initiatives that provide coverage to the uninsured; improve the quality of medical care for all residents of the community, and offer medical services to those without the means or insurance to obtain that access.

This is Social Mission work. And it is absolutely consistent with IBC's decades of service to the people of the Delaware Valley.

We invite our competitors to join the effort—even a little bit.

**Question #8**: 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.

Response to question #8: During 2000, IBC established an Insolvency Protection Trust Fund to comply with the Blue Cross and Blue Shield Association membership standards, which require plans to take steps to ensure the payment of claims liabilities and the continuation of coverage. The Trust replaces a similar arrangement that was put in effect pursuant to a Participation Agreement with all Pennsylvania plans dates December 31, 1995. The Participation Agreement terminated by the mutual consent of all the participants on October 2, 2000. The existing trust is required to fund the Independence Blue Cross (parent company only) claim liability for provider claims where a member would be liable for payment to the provider in the event of IBC insolvency, net of applicable reinsurance, for fully underwritten business as well as 2% net subscription revenue of self-funded business and the liability for unpaid claim adjustment expenses. As of December 31, 2003 the funded amount required for the Trust was \$9.9 million and the estimated fair value of investments on deposit was \$14.4 million These amounts are included in the 2003 surplus of \$840 million.

**Question #9**: Specify what, if any arrangements your corporation has made with other Pennsylvania Blues Plan for the payment of claims submitted by its policyholders or members.

Response to question #9: IBC does not assume any liability for any other Pennsylvania Blue Plan's claims, nor does any other Pennsylvania Blue Plan assume any liability for IBC's claims.

Question #10: 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.

## Response to question #10:

IBC is a not-for profit company that owns a number of for-profit entities. Keystone Health Plan East and QCC, the company through which IBC markets its Personal Choice product, are for-profit companies. So are AmeriHealth Administrators, the company that provides services to self-insured group health plans, and AmeriHealth, which has operations in New Jersey, Delaware and elsewhere.

The establishment and growth of these companies has been critically important to IBC's financial health over the past decade. These companies have permitted IBC to compete against much larger, publicly-traded companies with much easier access to capital.

But what sometimes seems to get lost in this discussion is that all of these for-profit companies have but one parent – one shareholder – and that is the not-for-profit Independence Blue Cross.

These companies are not publicly-traded. They do not have to address the profit expectations of multiple shareholders. They do not get managed quarter-to-quarter. They benefit just one entity – the not-for-profit Independence Blue Cross.

And it is to IBC that these entities – Keystone, QCC and the others – return the profits that permit IBC to successfully compete in today's very difficult health care marketplace.

It is because of these for-profit companies that IBC can preserve its commitment to the social mission, while delivering on the promise to give IBC's customers access to quality health care at the best price IBC can.

Before IBC formed these for-profit companies, IBC was losing 100,000 customers a year – which created a drain on IBC's remaining customers and hurt IBC's ability to deliver on its social mission. Since investing in the for-profit companies, IBC turned that situation around and added 1 million members in Southeastern Pennsylvania.

It is a structure that absolutely benefits IBC's customers and the community.