Department of Insurance – BCBSD/Highmark Affiliation
DOI Direct Examination

Q: Ms. Sizemore, could you please introduce yourself?

A: My name is Linda Sizemore. I am the Director of Company Regulation at the Delaware Department of Insurance. My position is also called Director of BERG (B-E-R-G), the Bureau of Examination, Rehabilitation, and Guaranty. This section of the Department of Insurance examines and regulates the solvency of insurance companies licensed and domiciled in the State of Delaware.

Q: Could you please give us a brief overview of your educational and professional background?

A: I have a Bachelors Degree in International Relations from the University of Delaware, and an Associates Degree in Accounting from Delaware Technical & Community College. I have been a Certified Public Accountant in Delaware since 1982, and since 2005 I have been a Certified Financial Examiner with the Society of Financial Examiners. I have worked for the Department since May 2001. Initially I served as a Financial Analyst. In September 2007, I became Chief Financial Examiner, and in August 2010, I became Director of Company Regulation. Immediately before my service in the Department, I worked for seventeen years as a CPA and Principal of my own public accounting firm in Georgetown, Delaware.

Q: I'll refer to BCBSD, Inc. as Blue Cross and will refer to Highmark Inc. and its affiliates as Highmark. Can you please describe the Department of Insurance's role with respect to the proposed Affiliation between Blue Cross and Highmark?

A: The Delaware Department is charged with regulating the insurance industry in the State of Delaware for the protection of all policyholders and the Delaware insurance-buying public. The decision of Blue Cross, a non-profit Delaware health service corporation, to enter into an affiliation with Highmark requires the Department to evaluate the proposed Affiliation.

Q: How has the Department evaluated the proposed Affiliation?

A: The Department has examined the proposed Affiliation according to the statutory criteria found in Section 5003(d)(1) of the Delaware Insurance Code. Where we have determined that additional elements are needed to ensure that the Affiliation meets the statutory criteria, we have recommended that certain conditions be imposed before the Commissioner would approve the Affiliation.

Q: Has the Department of Insurance reviewed proposed affiliations involving Delaware health service corporations before?

A: Yes, in fact the Department was involved in reviewing the affiliation – and the later disaffiliation – of Blue Cross and CareFirst, a Maryland corporation. In 1998, Blue Cross entered into an affiliation with CareFirst, which the Department approved in 2000. Ultimately, in 2006, as a result of legislation passed in Maryland that impacted the governance of CareFirst and the Department's ability to regulate Blue Cross, the Department required that the affiliation between Blue Cross and CareFirst be terminated.

Q: Does the Department believe that the disaffiliation between Blue Cross and CareFirst has relevance to this proposed affiliation between Blue Cross and Highmark?

A: Yes. The disaffiliation between Blue Cross and CareFirst demonstrated that affiliations sometimes need to be unwound, and that planning for a potential disaffiliation is essential to ensuring that policyholders are protected. The Department's experience with the Blue Cross disaffiliation from CareFirst colored how the Department reviewed the proposed Affiliation between Blue Cross and Highmark, and served as the basis for some of the conditions the Department seeks to impose here.

Q: Would you please describe how the Department conducted its review of the proposed Affiliation of Blue Cross and Highmark?

A: The Department conducted a comprehensive review of the proposed Affiliation and its potential impact on Delaware consumers and the Delaware public. We engaged several advisors, including our outside legal counsel, Morris, Nichols, Arsht & Tunnell; our financial advisor, Blackstone Advisory Partners; and our information technology advisor KPMG. With the assistance of our advisors, the thousands of pages of documents that were produced by Blue Cross and Highmark were reviewed. We also solicited input from the Delaware public, including at three public information sessions, and from various Delaware stakeholders, including healthcare providers, employers, and customers. We met extensively with executives and management from both Blue Cross and Highmark. We spoke with our peers at the Pennsylvania Insurance Department, because Highmark is based in Pennsylvania; we also spoke with our peers at the West Virginia Department of Insurance, because Highmark was involved in a similar affiliation with the West Virginia Blue Cross Blue Shield.

Q: Why did the Department hire these advisors?

A: We hired Morris, Nichols to provide legal advice and assistance to us during our review. Morris, Nichols had also advised the Department in connection with the CareFirst affiliation, and so we wanted to draw on that experience. We hired Blackstone as our financial advisor to assist with our review of the statutory criteria set forth in Section 5003; and we hired KPMG as our technology advisor to address and analyze the assertions made by Blue Cross concerning the technology-related reasons why they sought the proposed Affiliation.

Q: Before we get into the specifics of the Department's review, can you give a brief overview of the conclusion that the Department has reached?

A: This transaction involves an out-of-state company assuming control of Delaware's largest not-for-profit health insurer. The Department wants to ensure that Blue Cross' reserves are protected; that Blue Cross maintains a meaningful level of local control; is not unfairly charged for services; and is in a strong enough position to protect the interests of its policyholders should a disaffiliation occur. The Department has determined that there are certain conditions that need to be imposed in order for the proposed Affiliation to fully comply with the statutory criteria and protect Blue Cross' policyholders. Subject to the conditions recommended by the Department, we recommend that the Commissioner approve the proposed Affiliation.

Q: I'd like to show you a document titled "Department of Insurance Conditions." Can you please identify this document?

A: This is a document that lists the specific language of each of the Department's proposed conditions to the affiliation, as well as provides the rationale and statutory citation for each condition. During my testimony, in the interests of time and efficiency, I will refer generally to the conditions that the Department seeks to impose, but this document contains the actual language of the proposed conditions.

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Q: Let's now begin a discussion of the statutory standards within Section 5003(d)(1) of the Delaware Insurance Code and the Department's conclusions and conditions related to each. Would you please describe and confirm for us the Department's conclusions regarding Standard "a," which requires that after the Affiliation, Blue Cross be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed?

A: Certainly. The proposed Affiliation does not involve a change to Blue Cross' corporate identity; its status as a health service corporation under Chapter 63 of the Delaware

Insurance Code; or its ability to satisfy all applicable licensing standards. After the Affiliation, all relevant entities will still continue to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which they are presently authorized. Therefore, the Affiliation meets Standard "a."

Q: Can you please discuss the Department's conclusions regarding Standard "b," relating to the effects of the Affiliation on competition in Delaware?

A: The Department worked with Blackstone to complete an analysis, based on the quantitative standards of Sections 5003 and 5003A of the Delaware Insurance Code. The purpose of these standards is to determine whether the Affiliation will result in any anti-competitive effect. We determined that there was one area of potential lessening of competition judging solely by the raw data on market share numbers. In the Dental category, based on the respective market shares of Blue Cross and of a Highmark subsidiary that offers dental services, there was what is called *prima facie* evidence of a competitive violation, because the dental market is highly concentrated and Blue Cross and Highmark have more than the statutory minimum of the dental market.

However, as Mr. Alderson-Smith described, the statute directs the Department to analyze whether there is any substantial evidence that would show that the affiliation will have no anti-competitive effect. We ultimately concluded that the Affiliation would not have an improper anti-competitive effect on the dental market.

Q: Notwithstanding, does the Department have any concerns about the potential competitive effect of the Affiliation?

A: Yes, the Department does have concerns about the potential for a different kind of anti-competitive effect, which relates to the issue of bundling two or more insurance products together. The Department is concerned about the possibility that Blue Cross might be able to leverage its strong position in core health products to require consumers to also buy secondary products that Blue Cross would have the ability to offer as a result of the Affiliation. Accordingly, as noted in Proposed Condition # 30, the Department seeks conditions that would prohibit Blue Cross and Highmark from engaging in any type of improper bundling of products or services. Therefore, with the addition of such conditions, the Department determines that the effect of the Affiliation would not be to substantially lessen competition in insurance in this State or tend to create a monopoly therein.

Q: Can you please describe the Department's conclusions regarding Standard "c," involving the strength of Highmark's financial condition?

A: In evaluating Standard "c," the Department, in consultation with Blackstone, examined Highmark's financial condition, including the potential impact of a recently-announced large transaction with another Pennsylvania company. We also analyzed Blue Cross' financial strength apart from Highmark, as well as its ability to successfully emerge from a future disaffiliation if necessary.

Q: What conclusions did the Department reach regarding the financial strength of Highmark?

A: After reviewing the company's financial data generated over the last five years, the Department has concluded that Highmark is in a strong financial position. On a GAAP basis, Highmark had total assets of $9.4 billion and total reserves of $4.6 billion as of December 31, 2010. Also at year-end 2010, Highmark had a risk-based capital ratio of 692% and recent trends indicate steady growth moving forward. Therefore, Standard "c" is satisfied in that the financial condition of Highmark is not such as might jeopardize the financial stability of Blue Cross, or prejudice the interest of its policyholders.

Q: You mentioned another transaction involving Highmark. What is that transaction, and what did the Department conclude with respect to that transaction?

A: Earlier this year, Highmark announced an intention to affiliate with West Penn Allegheny Health System, a large hospital system in western Pennsylvania. As part of that transaction, Highmark is expected to provide at least $475 million in financing to West Penn Allegheny and possibly more. Even if that transaction fails entirely, Highmark's risk-based capital levels would still remain above the levels for many large insurers, and well above the requirements of Blue Cross Blue Shield Association. Nonetheless, in order to prevent any direct or indirect costs of the West Penn Allegheny transaction from impacting Blue Cross, the Department has proposed a condition preventing Highmark from directly or indirectly passing any costs associated with the West Penn transaction onto Blue Cross, as discussed in Proposed Condition #35. In addition, in the event that the West Penn transaction impacts Highmark's RBC ratio, the Department has also proposed Condition #23 that would allow Blue Cross the ability to disaffiliate if Highmark's RBC ratio drops below a certain level.

Q: What conclusions did the Department reach regarding Blue Cross' financial strength?

A: We concluded that Blue Cross' current financial position is also strong, with a risk-based capital ratio of 1,056%. Under the Affiliation, Blue Cross' risk-based capital ratio will be significantly higher than the level projected if Blue Cross remains a standalone entity. The Affiliation will allow Blue Cross' risk-based capital ratio to remain within or above the recommended ranges. This is another reason why the Affiliation would not jeopardize Blue Cross' financial stability or prejudice the interests of Blue Cross policyholders.

Q: Turning to Standard "d", could you please describe the Department's conclusions regarding the fairness, reasonableness and public interest of Highmark's plans for Blue Cross?

A: Yes. Many of the Department's concerns about the Affiliation are implicated by Standard "d." This standard requires an analysis of the plans or proposals that Highmark has to make any material changes in Blue Cross' business, corporate structure or management. The statute requires the Department to determine whether any of these plans or proposals are unfair or unreasonable to Blue Cross' policyholders and not in the public interest. The Department focused on five key areas:

(1) The structure of Blue Cross after the Affiliation;

(2) Protecting Blue Cross' reserves, including an analysis of how money could be transferred from Blue Cross to Highmark;

(3) The Affiliation's impact on Blue Cross' IT capabilities;

(4) Ensuring Blue Cross' ability to disaffiliate if necessary;

(5) Ensuring that Blue Cross executives did not receive personal financial benefits from the transaction; and

(6) The effect on employment levels in the Delaware community.

I will discuss these five specific areas further. Before I do that, I would like to note that the Department also concluded that Highmark does not have any plans or proposals to liquidate Blue Cross, sell its assets, or consolidate or merge Blue Cross, which is another part of the required evaluation under Standard "d." The Department based this conclusion, in part, on representations made by Highmark, which have been made a condition of this transaction, as reflected in Proposed Condition #37.

Q: Did the Department have any concerns about the corporate structure of the post-Affiliation Blue Cross?

A: Yes. As part of the Affiliation, and as required for Blue Cross to retain use of the Blue Marks as a controlled affiliate of Highmark and receive Highmark's full guarantee of its claims, Blue Cross must give Highmark a certain level of corporate control. The Department is concerned that the degree to which Highmark will exercise control over Blue Cross could cause Blue Cross to, for example, lose its local control and not make decisions effectively considering the interests of Delaware policyholders.

From a corporate governance perspective, there will be four independent Class A directors on the post-Affiliation Blue Cross board, who will serve an important role for Blue Cross policyholders and the interests of Delaware. By statute, a majority of the Blue Cross Board must consist of individuals not currently employed by Blue Cross or its affiliates and who are residents of Delaware and have been so for at least 5 years. However, the Department believes that certain additional corporate governance conditions, reflected as Proposed Conditions 20, 21 and 22, which require at least one independent director to be present before the Board can act, and which extend the service of the initial independent directors, are necessary to ensure that the corporate governance structure appropriately protects the interests of policyholders and of the Delaware public.

Q: What is the Department's view about the extent to which Blue Cross' reserves are protected under the Insurance Code?

A: One of the Department's primary concerns is to prevent Highmark from causing any inappropriate transfer of funds from Blue Cross to Highmark or any improper assessment of expenses against Blue Cross, which, if not kept in check, could drain Blue Cross' reserves to the detriment of its policyholders. I believe that this concern was also the same as the legislature's concern, when they amended Section 6311 of the Delaware Insurance Code to require that the Insurance Commissioner shall place conditions upon any approval of the change of control, which conditions are intended to prevent Highmark from improperly using Blue Cross' reserves. The statutorily mandated conditions, including Department approval of any individual or coordinated series of transfers from Blue Cross to Highmark or its affiliates, along with others discussed below, prevent – in the Department's opinion – the threat of improper movement of money from Blue Cross to Highmark and the erosion of Blue Cross' reserves as a result.

With the help of its legal advisors, the Department evaluated the statutory provisions that protect Blue Cross' reserves. The July 2011 legislation requires that a condition be imposed on the proposed Affiliation that mandates review and approval by the Department of any transfer of funds, individual or in the aggregate, by Blue Cross in excess of $500,000 to Highmark or any Highmark affiliate. Under the new law, the Department must review and assess the commercial reasonableness of the proposed expenditure or transfer, and the Applicants must consent to the Commissioner's standing to seeking relief in the Delaware Court of Chancery to enforce this condition. These statutory requirements are memorialized as Proposed Conditions 1 through 6. This law is strong protection against any attempt by Highmark to use Blue Cross' reserves for itself or its affiliates.

As for profits and dividends, Blue Cross is a not-for-profit, non-stock membership corporation. After the Affiliation, Blue Cross will remain a not-for-profit, non-stock membership corporation, with Highmark as its sole member. As such, Blue Cross has no stock or membership interests – or anything similar – to give to Highmark; Highmark simply does not share in Blue Cross' profits and losses and has no right to receive distributions of profits.

In addition, the Applicants have agreed to Proposed Condition #31, which requires that Blue Cross be subject to Delaware's Holding Company Act, which is Chapter 50 of the Delaware Insurance Code, after the Affiliation. Under the Holding Company Act, all transactions between Blue Cross and Highmark must be "fair and reasonable." This standard applies to fees that Highmark will charge to Blue Cross for the various services rendered under the Administrative Services Agreement. The Department may order Blue Cross and/or Highmark to produce books, records or other information to determine whether the Applicants have complied with, among other things, the "fair and reasonable" standard.

The Department believes that these statutory provisions and conditions will effectively prevent Highmark from taking any of Blue Cross' reserves to the detriment of Delaware's policyholders.

Q: Has the Department analyzed how Highmark may transfer monies from Blue Cross pursuant to the affiliation agreements?

Yes. The Department also reviewed the ways that Highmark can receive money from Blue Cross pursuant to the various contracts between Highmark and Blue Cross, to evaluate if there are ways to unfairly charge Blue Cross and inappropriately move money to Highmark.

Specifically, Highmark will charge Blue Cross for the expense of migrating onto Highmark's technology system, and for the future expense of operating on that system. Our advisors have evaluated the migration expenses and indicated that they are reasonable. To ensure that those expenses remain reasonable, the Department seeks a cap, discussed as Proposed Condition #17, on the costs of the integration process in the amount of $42 million, which is approximately 15% more than the current estimate of costs.

The Department also seeks an oversight role with respect to the manner in which Highmark charges Blue Cross for future services. The Department has therefore proposed a comprehensive set of conditions – some of which are now mandated by statute – which enhance its existing statutory powers. These conditions, as paraphrased, consist of the following:

1. Review and approval by the Department of any transfers of funds, individually or the aggregate, in excess of $500,000 to Highmark. (Proposed Condition # 1)

2. Highmark shall not improperly use the assets of Blue Cross for the benefit of Highmark, rather than the benefit of Blue Cross and its subscribers. Without DOI approval, and without limitations on any statutory requirements or other conditions on this Affiliation, the only economic transfers that Blue Cross is permitted to make to Highmark are: (i) payments for Blue Cross' integration to Highmark's IT systems; (ii) ongoing payments for the administrative services Highmark will provide to Blue Cross under the Administrative Services Agreement; and (iii) payments pursuant to the Line of Credit Agreement. (Proposed Condition # 9)

3. There shall be a $42 million cap on integration costs. (Proposed Condition # 17)

4. Prior to closing, Blue Cross and Highmark shall file with the Department the cost allocation methodology and formula, and will file an annual budget describing the planned charges, which the Department will review

and approve under a "fair and reasonable" standard. (Proposed Condition # 10)

5. Blue Cross and Highmark shall agree on a service level agreement, and Blue Cross shall provide quarterly reporting to the Department concerning whether the standards in such agreement are met. (Proposed Condition # 16)

6. Blue Cross agrees that it is subject to the general supervisory authority of the Delaware Department of Insurance. (Proposed Condition # 31)

7. Highmark agrees that it is an affiliate of Blue Cross such that Highmark is governed by the relevant provisions of Chapter 50 and agrees that it will provide information to the Department to assure compliance with, and enforcing conditions imposed on, or commitments made by Highmark in this application. (Proposed Condition # 32)

8. The Department has also proposed a condition relating to any disputes about costs charged to Blue Cross. In general, the President of Blue Cross and the Chief Executive Officer of Highmark will first attempt to resolve any dispute, after which the dispute will be referred to the Blue Cross Board. If the dispute is still not resolved, it will be submitted to the Department, which will have final decision-making authority with respect to whether the disputed charge is "fair and reasonable" to be allocated to Blue Cross. (Proposed Condition # 19)

Q: Does the Department have concerns about the Line of Credit Agreement?

A: Yes. The Line of Credit Agreement, as currently written, requires that after a disaffiliation, there is an immediate repayment of any outstanding funds under the Line of Credit. To ensure that disaffiliation is a viable option, the Department recommends that Blue Cross be given a longer period of time—three years—to repay its obligations should disaffiliation occur. Also, as written now, the Line of Credit Agreement would allow Highmark to terminate the Agreement for any reason, without giving Blue Cross the opportunity to resolve whatever concerns Highmark has. The Department believes that there should be some limit on Highmark's ability to terminate the Line of Credit Agreement, and these are noted as Proposed Conditions 27, 28 and 29.

Q: We've been talking about the amount of money that Blue Cross will spend to migrate on to Highmark's technology platform. Can you please describe the Department's analysis regarding the Affiliation's impact on Blue Cross' IT capabilities?

A: Yes. One rationale for the proposed Affiliation is Blue Cross' stated concern that it needs significant technology and systems upgrades to remain competitive in Delaware and meet government mandates. The Department and its advisors reviewed whether these concerns are legitimate and whether the Affiliation would address them.

We concluded that Blue Cross does in fact face significant challenges, including those posed by upcoming government mandates and by Blue Cross' outdated technology and systems. The Department and its advisors reviewed the potential solutions to the challenges faced by Blue Cross, including reviewing the costs of the proposed Affiliation and comparing those costs to certain alternatives, which include Blue Cross entering into a long-term contractual outsourcing relationship or remaining a standalone company and upgrading its IT systems on its own.

Of these choices, the Department determined that the proposed Affiliation is fair and reasonable and, quite frankly, the best option. The up-front cost of the proposed Affiliation is approximately $37 million, compared to the $95-$150 million cost range of the standalone option and the $30-$45 million cost range of the outsourcing option. Blue Cross will pay approximately $20 million per year during the Affiliation to Highmark, compared to an approximately $30-$60 million annual range in an outsourcing option.

In sum, the proposed Affiliation is the least expensive option, but it also allows Blue Cross to address its IT capabilities needs and gain access to overall corporate support services, as described by Mr. Alderson-Smith and Mr. Jackson.

Q: Does the Department have concerns about the Administrative Services Agreement?

A: Yes. In addition to seeking conditions to ensure that Highmark does not unfairly allocate costs to Blue Cross pursuant to the Administrative Services Agreement, the Department also seeks conditions to ensure that the terms of the ASA are in the best interests of Blue Cross' policyholders and the public.

The Administrative Services Agreement can currently be terminated by Highmark, after the first year, for any reason Highmark chooses. One of the conditions proposed by the Department requires the Department to approve a voluntary termination of this agreement to protect the interests of Blue Cross policyholders. This is Proposed Condition #15.

Q: Does the Department have concerns about the ability of Blue Cross to disaffiliate in the future?

Yes, we do. Particularly given the disaffiliation between Blue Cross and CareFirst, the Department carefully analyzed the potential for disaffiliation here. The Department believes that, to protect Blue Cross policyholders, certain conditions should be imposed that allow Blue Cross to disaffiliate and successfully transition away from Highmark if necessary.

Presently, the independent Class A directors have the option to disaffiliate in only a limited number of circumstances. These do not include situations that may potentially harm Blue Cross policyholders, such as if Highmark's financial position deteriorates or Highmark undergoes certain changes of control. The Department believes that the Class

A Directors should have the option to disaffiliate if Highmark experiences these kinds of important changes, as noted in Proposed Condition #23.

In addition, under the current structure of the Affiliation, the decision to disaffiliate must be made on a very short timeframe with limited opportunity for the Class A Directors to fully evaluate alternatives for Blue Cross. For Blue Cross to have a meaningful chance of a successful transition from the Affiliation, the Department believes it is important that Highmark provide sufficient time – at least 180 days – and adequate support to Blue Cross to allow the Class A Directors to evaluate alternatives for Blue Cross. In addition, during any transition period, the Department believes that Highmark should be required to continue providing services to Blue Cross on terms that protect the interests of Blue Cross policyholders. This is addressed by Proposed Condition # 25.

Finally, the Department recommends that Highmark also be required to make all best efforts to help Blue Cross reacquire the Blue Cross Blue Shield marks if Blue Cross and Highmark disaffiliate. The marks are important to Blue Cross being able to serve its policyholders after a disaffiliation from Highmark. This is addressed by Proposed Condition #26.

Q: Can you describe the Department's analysis of Blue Cross' management and executive compensation as it relates to the Affiliation?

A: The Department and its advisors first determined that neither Highmark nor Blue Cross had made any agreements with Blue Cross executives to give them personal, financial incentives to go forward with the Affiliation. We then analyzed the employment agreements of the Blue Cross executives and the findings of a Blue Cross executive compensation consultant. In 2011, the compensation consultant concluded that the compensation of BCBSD's executives is generally below competitive median levels in the industry.

The Department also analyzed whether any executives would receive "golden parachutes" or other compensation as a result of the Affiliation. The Department examined the employment agreements of Blue Cross executives and determined that the executives will not receive any financial compensation as a result of the consummation of the Affiliation. Although certain Blue Cross executives have employment agreements that include severance payments under certain conditions, those rights were in place before the Affiliation was negotiated and will not be automatically triggered by the Affiliation. To further ensure that there are no inappropriate side agreements between Highmark and any Blue Cross executive that could influence the decisions of the executives to favor this Affiliation, the Department has proposed Condition # 36, which precludes any such arrangement.

Q: In evaluating the impact of the proposed Affiliation, did the Department assess the potential impacts on employment?

A: Yes. The Department noted that Highmark is contractually obligated under the Affiliation Agreement to use reasonable efforts to keep employment levels in Delaware consistent with levels in Highmark's other service areas. Nonetheless, it is likely that the Affiliation will result in employment changes at Blue Cross, including a decrease in employment. This is an unfortunate effect of Blue Cross becoming more efficient as a result of the Affiliation. To help mitigate this impact, Blue Cross and Highmark have voluntarily made a number of commitments regarding post-Affiliation employment levels, including:

(1) committing to maintaining Blue Cross' corporate headquarters in Delaware,

(2) assuring that the total number of full time equivalent positions in Delaware will be maintained during the 18-month integration period at the same level, assuming no significant decrease in enrollment or market share; however, if there is a significant decrease in Blue Cross' enrollment or market share during the integration period (for example, from the loss of a large customer) that results in any lost positions, Highmark will not be responsible to replace those lost positions, in order to maintain existing level of employment.

(3) allowing any Blue Cross employees who lose their jobs the first opportunity to fill any new jobs in Delaware, and

(4) ensuring that the quality of service provided by Delaware-based client service employees does not materially decline.

The exact terms of these commitments have been agreed upon by the Applicants and the Department proposes them as conditions to the Affiliation, as reflected in Proposed Conditions 7 and 8.

Q: Can you please describe the Department's conclusions regarding Standard "e," which evaluates the competence, experience, and integrity of those persons that will control Blue Cross?

A: The Department has reviewed the biographies, credentials, and records of the 21 board members and 11 executive officers of Highmark. The Department has focused on the education, employment history, experience, and professional licensing of these individuals, as well as answers to questions relating to any fraud, dishonesty, civil actions, and bankruptcy associated with companies for which these individuals have worked or served as directors. This review by the Department included the individuals proposed by Highmark to serve as Class B Directors on the Blue Cross Board.

Highmark has identified three of the four individuals who will serve as Class B directors on the post-Affiliation Blue Cross Board of Directors: Dr. Kenneth Melani, Deborah G. Rice, and Nanette P. DeTurk. Our review found that these three individuals are executives in a highly-regulated industry, whose qualifications have also been reviewed and accepted by other state departments of insurance. They collectively have forty-three (43) years of executive experience at health care entities.

Prior to the final approval of the Affiliation by the Commissioner, the Department will conduct the same thorough review of the fourth person Highmark proposes to appoint as a Class B Director and will complete its follow-up analysis with Highmark, in order to make a final determination as to whether the Affiliation satisfies the criteria of Standard "e".

The President Director will be Blue Cross' current President and CEO, Tim Constantine, and the initial 4 Class A directors will be chosen from the existing Blue Cross Board of Directors. The Department is familiar with Mr. Constantine and the current Blue Cross Board of Directors, and has no concerns about their competence, experience or integrity.

Based on this review, the Department has no reason to question the competence, experience, or integrity of these individuals such that their control of Blue Cross post-

Affiliation would be contrary to the interests of Blue Cross policy holders or to the public interest.

Q: Can you describe the Department's conclusions regarding whether the Affiliation would be hazardous or prejudicial to the insurance-buying public under Standard "f"?

A: In order to determine the Affiliation's impact on the insurance-buying public, the Department reached out to many different stakeholders in the Delaware community. Blue Cross clearly plays a significant role as one of the largest health insurers in Delaware, as a not-for-profit, and as the only locally-controlled insurer. Blue Cross is generally highly regarded by its customers and other stakeholders.

The Department reviewed Blue Cross' search for a strategic partner following Blue Cross' disaffiliation from CareFirst in 2006. It is clear that Blue Cross has identified many of the challenges it faces, particularly in terms of IT modernization, product development, and remaining compliant with federal guidelines, and has undertaken a long and extensive process to address these challenges.

Another important consideration is that Blue Cross is a local Delaware health insurer that faces competition from health insurance companies with much larger networks nationwide, including more financial resources to make important changes and remain in compliance with rapidly-changing laws and regulations. The Department has concluded that Blue Cross affiliating with Highmark as a strategic partner is not hazardous or prejudicial to the insurance-buying public, given the prospects and challenges for Blue

Cross and the risks to its local identity that it faces as a standalone entity in the coming years.

Q: Has the Department proposed any conditions that relate to Standard "f"?

A: Yes, many of the conditions I described earlier in connection with Standard "d" also apply to Standard "f." For example, conditions regarding Highmark's ability to access Blue Cross assets and Blue Cross' ability to disaffiliate are essential to ensuring that the Affiliation is not hazardous to the insurance-buying public. With these conditions, the Department does not believe that the proposed Affiliation would be hazardous or prejudicial to the insurance-buying public.

Q: Finally, does the Department have any conditions relating to its oversight of Highmark and Blue Cross relating to this Affiliation?

A: Yes. The Department sought, and the Applicants have agreed to, certain conditions relating to the jurisdiction of the Department over Blue Cross and Highmark for the purposes of implementing the conditions of the Affiliation, as well as the Department's ability to seek information and exercise its examination authority to assure compliance with the conditions of the Affiliation. These are found at Proposed Conditions 31 through 34.

Q: Ms. Sizemore, based on the Department's nearly year-long review of the proposed Affiliation, and on the statutory criteria we have discussed today, what recommendations has the Department developed regarding the proposed Affiliation?

A: The Department has conducted a very lengthy and thorough review of the proposed Affiliation. The Department has a number of concerns, particularly related to ensuring that the post-affiliation operations of Highmark and Blue Cross under this affiliation are fair to and in the best interests of Delaware policyholders and the public. These concerns are addressed by the conditions I have discussed today. Accordingly, the Department recommends that the Commissioner approve the Affiliation subject to the conditions recommended by the Department.

Q: Thank you, Ms. Sizemore. No further questions.

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