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Project Delaware

Advisory Services Provided to the
Delaware Department of Insurance in connection with
the Proposed Affiliation between Highmark Inc. and
Blue Cross Blue Shield of Delaware

September, 2011

This report is provided to the Delaware Department of Insurance ("DDI") pursuant to our engagement letter, dated June 13, 2011, and is subject in all respects to the terms and conditions of that engagement letter, including restrictions on disclosure of this report to third parties.

If this report is received by anyone other than our client, the recipient is placed on notice that the attached report has been prepared solely for our client for its own internal use and this report and its contents may not be shared with or disclosed to anyone by the recipient without the express written consent of DDI and KPMG LLP. KPMG LLP shall have no liability, and shall pursue all available legal and equitable remedies against recipient, for the unauthorized use or distribution of this report.

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September 6, 2011

PRIVATE

Gene T. Reed
Deputy Insurance Commissioner
Delaware Insurance Department
841 Silver Lake Blvd
Dover, DE 19904

Dear Mr. Reed:

We have completed our engagement to assist the Delaware Department of Insurance ("DDI", "Client" or "you") in providing integration advisory support associated with your review of a proposed affiliation between Blue Cross Blue Shield of Delaware ("BCBSD") and Highmark Inc. ("Highmark") in accordance with the terms of our engagement letter dated June 13, 2011, including its Standard Terms and Conditions.

Objective

The objective of our engagement was to assist DDI with its assessment of the proposed affiliation between BCBSD and Highmark. You requested that KPMG assess and comment upon the consultant's Report referenced in our engagement letter and which was the focus of our work. Specifically, you requested we provide our point of view with regard to certain observations made in the report around systems and technology capability gaps and various investments the report outlined as necessary for BCBSD to remain competitive in its marketplace. You also requested we comment on specific issues regarding affiliation integration and potential disaffiliation with Highmark. We understand DDI will consider our comments when deciding whether to approve the affiliation. In all cases, however, it will be DDI's sole decision whether or not to approve the affiliation agreement between the parties.

Basis of information

Appendix 1 of our engagement letter provides additional details around the scope of advisory services we were asked to perform; it is included as an appendix to this report. Those services were selected by you and were determined to best fit your needs for this engagement. We make no representation regarding the sufficiency for your purposes of the services you selected, and those services will not necessarily disclose all significant matters about BCBSD or Highmark. This report was prepared on the basis of the consultant's reports, and relevant documents concerning affiliation plans and the technology environments of both BCBSD and Highmark as provided in the data room of Morris, Nichols, Arsht & Tunnell, LLP. We also conducted interviews with BCBSD and Highmark executives and a representative of the consulting firm involved in the development of the 2008 and 2010 BCBSD assessment reports. Further, we referenced industry publications, internal and external benchmark data, and other publicly available materials to inform our analysis.

Based on our agreed-upon scope of services, we did not carry out the full set of diligence procedures, operational analyses, and supporting calculations as performed by the consulting firm who prepared the original reports, to render our own assessment. Rather, we sought to understand the underlying factors, key assumptions, and reasonableness of the consultant's observations, recommendations and estimates. We then either confirmed our general agreement with the consultant's results or provided observations, recommendations and cost estimates in accordance with our own analyses, points of view, and industry experience.

The services we performed were in accordance with the terms and conditions of our engagement letter and do not constitute an audit, examination, attestation special report, or agreed-upon procedures engagement as those services are defined in the American Institute of Certified Public Accountants ("AICPA") literature applicable to such engagements conducted by independent auditors.

Accordingly, the services we performed will not result in the issuance of a written communication to third parties by KPMG directly reporting on financial data or internal control or expressing a conclusion or any other form of assurance.

You have advised that KPMG may be asked to provide public comment and testimony upon our report during the Commissioner's hearing on the proposed affiliation. Should DDI request that someone from KPMG provide fact-based testimony at such Commissioner's hearing, DDI and KPMG will discuss and mutually agree on who should provide such testimony. Given independence guidelines associated with serving as the State of Delaware's auditor, DDI and KPMG agree that KPMG may act as a percipient witness (e.g., testify as to his or her direct knowledge of the facts or events in dispute from the performance of the services contemplated hereby for DDI, such as the matters reviewed and services performed). KPMG will not provide expert testimony.

The data included in this report was obtained on or before August 9, 2011, and all conclusions are those of the KPMG personnel involved on this engagement. We have not reviewed a draft of this report with BCBSD or Highmark management for the purpose of confirming the factual accuracy of the information we presented. We presented our interim findings to you in various phone conversations throughout the course of our work.

Please contact Steve Miller at (281) 216-5016 or Micky Houston at (214) 840 8042 if you have any questions or comments on this report. We look forward to continuing to provide service to the Delaware Department of Insurance in the future.

Frequently used terms

$m	US dollar millions
ACA	Affordable Care Act
ACO	Accountable Care Organization
ASA	Administrative Services Agreement
ASP	Application Services Provider
BAU	Business As Usual
BCBSD	Blue Cross Blue Shield Delaware
BPO	Business Process Outsourcing
CDH	Consumer Driven Healthcare
CPA	Central Pennsylvania
CRM	Customer Relationship Management
DDI	Delaware Department of Insurance
EDI	Electronic Data Interchange
EDW	Enterprise Data Warehouse
FTE	Full Time Equivalent
HCR	Health Care Reform
HIPAA	Health Insurance Portability and Accountability Act
ICD-10	International Classification of Diseases, 10th version
ITO	Information Technology Outsourcing
MLR	Medical Loss Ratio
PMO	Program/Project Management Office
SFA	Sales Force Automation
TBS	The Business System - single platform for core operations including enrollment, billing and claims
TIBCO	"The Information Bus" Company – a provider of infrastructure software
WPA	Western Pennsylvania

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Executive Summary

Purpose and Objectives

Highlights	
Based on its 2010 assessment, Deloitte estimates an investment in the range of $88m to $140m would be needed for BCBSD to address required capability improvements to remain competitive in the Delaware market and comply with government mandates. **Alternatively, a business strategy based on an affiliation with Highmark would allow BCBSD to capitalize on the strengths (e.g., systems, operating scale, innovative products and services, and financial position) of a much larger organization.** **The primary costs of affiliation would involve the migration and integration of BCBSD onto Highmark's business and technology platform. This affiliation between the companies has been estimated to require an investment from $35m to $37m, a significant savings over the standalone case.**	**Purpose and Objectives for this Engagement** ■ The Delaware Department of Insurance ("DDI") is currently assessing whether to approve a proposed affiliation between Blue Cross Blue Shield of Delaware ("BCBSD") and Highmark Inc. ("Highmark"). As part of its rationale for approval of the affiliation agreement, BCBSD has stated that there are specific systems and technology (capability) gaps and improvements that must be addressed if the company is to meet government mandates and remain competitive in the Delaware market. ■ There are two governmental mandates in particular that are discussed throughout this report: ICD-10 and HIPAA 5010. A brief summary of these mandates is presented on the following page. ■ BCBSD suggests these capability gaps and related solutions can be implemented at a significantly lower cost through an affiliation with Highmark, as opposed to funding and implementing required solutions as a standalone business. In summary, from a systems and technology perspective, the benefits of an affiliation with Highmark have been stated to include: – Access to state of the art systems and technology – Comprehensive and innovative products and services – Access to industry leading capabilities and resources – Efficient transition and integration ■ BCBSD commissioned Deloitte to produce a report supporting Deloitte's position that the investments needed for the company to remain competitive in the Delaware market and address government mandates would range from $88m to $140m; and, alternatively, that affiliation costs with Highmark would be significantly lower, approximating $35m. Since any higher costs for improved standalone capabilities or affiliation integration would potentially impact Delaware consumers, the DDI is considering the proposed cost benefits of affiliation as part of its review. ■ To support this effort, the DDI has requested that KPMG assess and comment on the Deloitte report and provide its point of view on the capability gaps and attendant solutions and estimated costs identified for the BCBSD standalone and affiliation business models. The DDI may then consider KPMG insights and commentary when deciding whether to approve the affiliation.

Purpose and Objectives, *continued*

Highlights	
On January 15, 2009, the Department of Health and Human Services (HHS) released the final rule for the implementation of the International Classification of Diseases, Tenth Revision, Clinical Modification (ICD-10-CM) and the International Classification of Diseases, Tenth Revision, Procedural Classification System (ICD-10-PCS). **The final rule moved the ICD-10 implementation date to October 1, 2013, instead of the October 1, 2011 date that was originally proposed.** **In a related announcement on January 15, HHS released the final rule on implementation of the Health Insurance Portability and Accountability Act (HIPAA) 5010 transaction standard. The 5010 implementation deadline was also pushed back two years, from January 1, 2010 to January 1, 2012.**	**Summary of Key Government Mandates addressed in this Report** ■ **ICD-10**. ICD stands for International Classification of Diseases. The ICD system is an international coding scheme developed by the World Health Organization. It is a systematic way to classify diseases, using standardized codes. In more than 100 countries, including the U.S., providers and payers use ICD codes in connection with health insurance claim reimbursements (for example, to standardize the way a health insurance provider bills for services, and to ensure accuracy of payments by insurance companies). The U.S. is the only country operating under ICD-9, the coding scheme in place prior ICD-10. ICD-9 is outdated and does not always accurately describe the diagnoses and inpatient procedures of current medical practice. ICD-10 is more complex than ICD-9, and reflects changes in disease detection and treatment regimens. There are also a number of structural changes within the ICD-10 code sets that will impact the many health information systems that have traditionally used ICD-9 data. These structural changes include, for example, revisions to field lengths and alphanumeric characters (i.e., systems, interfaces and databases will need to accommodate the larger seven-digit fields used in ICD-10 and the specific alphanumeric characters used in ICD-10 Procedural Classification System (PCS) codes). The U.S. Government has required a move from the ICD-9 to the ICD-10 system, which move must be completed by October 1, 2013. The goal is to improve healthcare and to help the U.S. healthcare system gather and share data more accurately in diagnosing and treating diseases. See *Appendix M, ICD-9 and ICD-10 Diagnostic and Procedure Code Comparison,* for additional information. ■ **5010**. HIPAA stands for Health Insurance Portability and Accountability Act. HIPAA is a standard to regulate the electronic exchange of administrative health data (e.g., claims, payment, eligibility, etc.), and is intended to protect clients, reduce fraud, improve quality of health care, and set strict standards for how private information about clients is transmitted. The current HIPAA standard is HIPAA 4010. The U.S. Government has required a move to HIPAA 5010, with a January 1, 2012 compliance deadline. See *Appendix N, HIPAA 5010 Overview*, for additional information. ■ During the transition to the new code sets, most systems will need to simultaneously run ICD-9 and ICD-10 coded transactions, as well as the HIPAA 4010 and 5010 transaction standards.

Scope and Approach

Highlights	
As part of this engagement, we also considered the additional alternatives of a long-term Business Process Outsourcing (BPO) arrangement with a services provider.	**Scope** ■ The KPMG scope of work for this engagement included: 1. Review and assess the Deloitte reports (2008 Capability Assessment/2010 Capability Assessment Update) to consider: – Completeness of the reports – Key tenets of the analysis framework – Basis for key assumptions – Observed gaps and opportunities – Degree to which system-driven costs in business processes were considered – Recommended IT actions and modifications (e.g., capability gaps/solutions) – High-level cost-range estimates – Efficient transition and integration 2. Assess and comment on the nature and amount of BCBSD's estimated costs to achieve its intended upgrades on a standalone basis. 3. Assess and comment on the nature and amount of BCBSD's estimated costs to achieve similar upgrades by transitioning BCBSD systems and other relevant business process infrastructure onto Highmark's business and technology platform. 4. Assess and comment on the nature of assertions in the Deloitte report regarding the potential impact of the proposed affiliation not being approved by 12/31/2011; given that BCBSD and Highmark have stated that additional costs and operational delays may be incurred if the affiliation is not approved by then. 5. Assess and comment on the degree to which the proposed system integration with Highmark may lead to significant separation costs if BCBSD disaffiliates from Highmark in the future.

Scope and Approach, *continued*

Approach to Work

- Our approach featured an evaluation of company documents, reviews of industry research and benchmarking data, interviews with company management and the Deloitte team, detailed analysis of Deloitte's 2008/2010 assessment reports, and BCBSD and Highmark affiliation planning deliverables. We reviewed analyst reports and publications from sources such as Gartner, AHIP, TriZetto, Hay Group, HIMSS, Milliman, and McKinsey Research.

Project Initiation → **Consolidate Research Data and Develop Fact Base** → **Conduct Analysis and Prepare Recommendations**

Milestones	Data from Industry Research, Benchmarks and Data Requests	Interviews	Analysis of Capability Gap Assessment and Affiliation Plans	Findings and Recommendations
▪ Obtain briefings on the proposed affiliation between BCBSD and Highmark ▪ Validate the goals and objectives for the assessment of the standalone and affiliation cost scenarios as set forth in the Deloitte Reports ▪ Develop the analytical framework of key issues and questions to be addressed in order to achieve assessment goals and objectives (see Appendix B, Analysis Framework)	▪ Obtain industry perspectives on issues and costs related to HIPAA 5010 and ICD-10 remediation of core administrative systems, processes and supporting applications ▪ Obtain quantitative and qualitative data on industry health plan strategic options for achieving compliance mandates by the required deadline dates ▪ Collect data from BCBSD and Highmark on current IT environments, and IT strategies, plans and budgets/costs developed in support of BCBSD legacy system remediation and/or the migration and integration implementation of the affiliation scenario between the companies	▪ Interview key BCBSD senior executives and department level managers to understand the BCBSD organization response to previously identified capability gaps, the resulting business and IT strategies developed, and the status of remediation plans, approved budgets and expenditures ▪ Meet with the Deloitte team involved in the preparation of Deloitte's 2008 and 2010 assessment reports to understand capability gaps, cost range estimates and underlying assumptions ▪ Meet with Highmark to understand: (1) the current IT environment, including Application Service Provider/BPO capabilities, (2) the details and status of Highmark plans for legacy system modernization, HIPAA 5010 and ICD-10 compliance; and (3) plans and cost estimates regarding Highmark's platform integration of BCBSD	▪ Review ongoing affiliation program plans, roadmaps, future state operating/ organization models, migration projects, cost estimates, risk factors and assumptions ▪ Comment on the reasonableness of Deloitte's 2010 estimates of systems and technology costs required by BCBSD to remain competitive in the Delaware market, and to address health care reform and government mandates as a standalone or non-affiliated entity. ▪ Identify any observed gaps, opportunities or alternative approaches that may contribute to additional/reduced investment levels. ▪ Comment on the potential issues, timelines, risks, assumptions and estimated costs related to affiliation migration, and same as relates to future disaffiliation of BCBSD from the Highmark business and technology platform	▪ Present final report of key findings and recommendations addressing: – Estimated costs for BCBSD to achieve its intended upgrades on a standalone basis – BCBSD estimated costs to achieve similar upgrades through an affiliation with Highmark or long term Business Process Outsourcing (BPO) arrangement with a service provider – The potential cost impact of the proposed affiliation not being closed by 12/31/2011 – The potential range of separation costs should BCBSD seek disaffiliation from Highmark's business and technology platform

Executive Summary

Summary Conclusions: BCBSD business strategy options

BCBSD's options	Costs			Strategic Goals	Capability Enhancements
	Estimated One-Time Cost Range	Estimated Annualized/ Recurring IT Cost Range[1]	Comments		
Standalone operation **(with capability enhancements per Deloitte)**	Deloitte $88m to $140m ($121m[1])	• 2012: $21.3m • 2013: $23m • 2014: $27.4m • 2015: $30.8m • 2016 – 2020: $34m+	• Capability needs would require from $93m to $150m in investment over 3 to 5 years. • Due to the overall complexity and risks inherent in the transformation program, the level of expected costs ($121m) may increase significantly as well as the timeframe for overall program delivery.	• Given the size of the Delaware market, BCBSD cannot realize the economies of scale on its own to compete with its much larger competitors. • As explained in the Blackstone Report, this option is not consistent with the decision of the Board of Directors as to the strategic priorities of the Company.	• From a technology and capabilities perspective, BCBSD would remain competitive in the Delaware marketplace • Areas of weakness identified in the Deloitte assessments need to be addressed, including IT strategy and planning, program/project management, vendor alliance management, resource management, applications, and analytics, data management and reporting.
	KPMG ($93m to $150m)	Annualized cost not estimated for the KPMG range			
Long term outsourcing arrangement*	$30m - $45m (further analysis required)	$30m - $60m (further analysis required)	• Off-loads core and non-core support functions and business processes to vendors who can perform them better, faster and cheaper (e.g., payer savings in operating costs from 30 to 50 percent). • BCBSD would still need to incur the cost ($3m to $5m) to ensure its systems meet minimum ICD-10 compliance before migration to an outsource environment. • Administrative services are generally provided at cost plus additional margin.	• A long term outsourcing arrangement would fail to meet the strategic goal of continued employment for the BCBSD workforce.	• Provides improved access to process/ technology expertise; better service quality. • BPO vendors are likely to offer improved business processes and IT infrastructure support capabilities based on leading practices and deep subject matter expertise. • BCBSD would not be able to benefit from the full range of partner's other capabilities (e.g., the claims guarantee, economies of scale, product offerings, and back-end, centralized support.
Proposed affiliation with Highmark	$35m - $37m[2]	$21m - $23m, (including direct costs of $4m and $17m - $19m[3] in allocated costs from Highmark)	• Highmark offers low cost structure/ economies of scale and access to capital/ strong financial position. • Administrative services are provided at cost, with no provision for profit for Highmark.	• Highmark offers a commitment to seek full employment for the BCBSD workforce.	• Highmark offers state-of-the-art technology and systems to meet the evolving needs of BCBSD's customer base. • BCBSD will be able to achieve timely compliance by migrating to Highmark's technology platform. • If affiliation approval is delayed beyond January 2012, BCBSD may incur "throw away" costs to achieve minimum ICD-10 compliance by following a neutralizaton approach.

Source: KPMG analysis

*Note: * BCBSD should potentially have several possible outsourcing partners, including Highmark. Highmark, however, has already indicated that it will not consider a long term outsourcing arrangement with BCBSD. Even if an outsourcing option were available with Highmark, BCBSD would not gain any of the other substantial benefits (e.g., the claims guarantee, economies of scale, product offerings, and back-end, centralized support) that it will gain through the affiliation with Highmark. These other benefits are discussed herein and in Blackstone's Report.*

[1]For the Deloitte standalone cost scenario, an investment of up to $121m was assumed by BCBSD for gap capability projects and staged over the period from Q3 2010 (CareFirst disaffiliation) to Q4 2015. Incremental recurring or ongoing support expenses above business as usual level ($21m) ramp up beginning in 2012 to reach a steady state level of $13m in 2016 and continue at that level through 2020.

[2] Current estimated affiliation integration costs for capability gap projects as reported by the BCBSD and Highmark affiliation planning teams.

[3] Ongoing business as usual costs based on BCBSD transaction volume plus an equitable cost allocation from Highmark ($2.7m+) for benefits derived from the legacy modernization project

Summary Conclusions: BCBSD business strategy options, *continued*

BCBSD's options	Ease of Implementation	Ease of Disentanglement
Standalone operation **(with capability enhancements per Deloitte)**	• The BCBSD IT organization's lack of core capabilities and experience in delivering a complex, multi-year IT transformation program contributes to the risk that capability gap initiatives can be delivered on-time within established budgets. • A neutralization approach must be undertaken to ensure core administrative systems meet minimum ICD-10 compliance by the deadline of October 2013 before the launch of a transformation program to implement required capability gap programs.	• No disentanglement necessary.
Long term outsourcing arrangement	• BCBSD may require multiple vendors to handle its business process and IT outsourcing needs – a potentially complex and costly approach. • There could be insufficient time to identify, select and complete a contractual arrangement with an outsourcing firm(s) in order to migrate to their ICD-10 compliant systems platform prior to the October 2013 deadline. • It may not be feasible to complete a fully operational BPO arrangement in time to meet the ICD-10 compliance mandate deadline. • BCBSD does not have the in-house Account Management expertise required to manage a long term relationship with a third party BPO provider.	• There could be a potentially less complex and less costly separation or disentanglement from a third party business and technology platform, due to a lesser degree of business process/IT integration.
Proposed affiliation with Highmark	• Highmark has a proven history of successful affiliations and system migrations. • However, BCBSD will compete with Highmark and its other affiliates and partners to ensure its business strategies and ongoing projects are adequately vetted, prioritized, funded and executed.	• Due to BCBSD's high dependency on Highmark's business processes and technology platform in an affiliation arrangement, a future disaffiliation will be costly for BCBSD. BCBSD will need sufficient time to disentangle data and any systems under a Transition Services Agreement while seeking an alternative business arrangement, such as a BPO relationship, Administrative Partnership, or an affiliation with another health plan. • BCBSD may spend from $38m to $55m to disaffiliate from Highmark over a 24 to 36 month period due to the level of business and technology integration between the companies.

Source: KPMG analysis

Summary Conclusions, *continued*

Highlights	
As a standalone health plan, BCBSD would face major challenges to fund the projects needed to address current capability gaps. We estimate an investment from $93m to $150m would be needed to implement required systems and technology enhancements and to effectively plan and manage a complex, multi-year transformation program. **The organization would also need to prepare to absorb the impact of massive change on its core business functions, processes, and systems and technology platforms, all while maintaining normal business operations.**	**BCBSD Standalone Operations** ■ We are generally in agreement with the capability gaps detailed in the Deloitte assessments in 2008 and as updated in 2010. ■ However, based on our analyses and assumptions regarding emerging market trends, the recent impacts of health care reform, the Affordable Care Act, and other government compliance mandates, we believe there are some different solution approaches and investment levels that may be warranted in order for BCBSD to achieve par with other health plans and remain competitive in the Delaware marketplace. ■ Given these considerations, we estimate the overall cost impact would increase the likely range of investment from $93m to $150m as compared to Deloitte's $88m to $140m estimate. The key cost factor in both estimates is the proposed replacement of core administrative systems, which could cost between $35m to $50m. ■ We also believe that the significant upgrades needed in IT capability (applications, infrastructure, technology) to address gaps, meet compliance mandates (e.g., ICD-10), and overcome weaknesses such as large project management, resulting from chronic under-investment in IT, would represent major risks and challenges to BCBSD. These risks could negatively impact ongoing business operations, unless system integration capabilities are acquired. ■ Further, the upgrade of IT systems and technology as a result of BCBSD's transformation program would likely increase ongoing IT operating costs, although we are unable to quantify the potential increase in cost.

Summary Conclusions, *continued*

Highlights	
The business process outsourcing option could address specific operations and technology gaps and requirements, but would fail to address key strategic goals set forth by BCBSD, such as continued employment for its workforce. Moreover, such an arrangement could not be completed in time to meet the ICD-10 compliance deadline. **One-time costs for BCBSD to migrate to the BPO provider's environment could range from $30m to $45m, with an annualized spend from $30m to $60m for service charges.**	**Business Process and Information Technology Outsourcing (BPO/ITO)** ■ The BPO/ITO ("BPO") option could be feasible for BCBSD in addressing capability gaps from strictly an operations and technology perspective, but would fail to address key strategic goals set forth by BCBSD, including continued employment for its workforce. ■ BCBSD should potentially have several possible outsourcing partners, including Highmark. Highmark, however, has already indicated that it will not consider a long term outsourcing arrangement with BCBSD. Even if an outsourcing option were available with Highmark, BCBSD would not gain any of the other substantial benefits (e.g., the claims guarantee, economies of scale, product offerings, and back-end, centralized support) that it will gain through the affiliation with Highmark. These other benefits are discussed herein and in Blackstone's Report. ■ Based on BCBSD's business process and IT capability gaps and requirements, there is also the possibility that the use of multiple outsourcing providers with specific capabilities would be needed to ensure that the most effective business model could be implemented. ■ The use of multiple outsourcing providers would be complex to manage and consume many BCBSD resources. BCBSD lacks the required skills and experience to effectively manage multiple outsourcing providers. ■ An arrangement involving one or more BPO providers could represent a significant investment for a small health plan. Based on a high level, preliminary set of assumptions and rough order of magnitude cost estimates, we believe the BPO outsourcing option would likely cost more than an affiliation with Highmark, but less than a standalone option. One-time costs for BCBSD to migrate to the BPO provider's environment could range from $30m to $45m, with an annualized spend from $30m to $60m for service charges. ■ Further analysis would be needed to refine the estimates, as there are many types of service arrangements (e.g., onshore versus offshore outsourcing) that can be negotiated between health plans and BPO providers and a wide range of cost models as a result. ■ To pursue a BPO option, BCBSD would have to pursue a minimum ICD-10 compliance approach on its legacy systems that could be completed before the October 2013 deadline, as there would be insufficient time subsequent to affiliation approval or denial for a BPO solution to be implemented.

Summary Conclusions, *continued*

Highlights	
From a technology capability perspective, the affiliation with Highmark appears to not only offer significant strategic and operational benefits for BCBSD, but could be achieved with significantly less investment. The current affiliation integration cost estimate developed by the BCBSD and Highmark affiliation planning teams is $37m. **While the affiliation integration would involve a migration program that would be difficult for BCBSD given its limited resources, the experience of Highmark in planning and managing similar efforts of this scope and complexity would significantly reduce risk.**	**BCBSD Migration and Affiliation with Highmark** ■ The BCBSD and Highmark affiliation would tightly integrate the organizations on common processes and a shared business and technology platform. ■ The migration projects and supporting cost details developed by the BCBSD and Highmark teams currently show an affiliation integration cost estimate of $37m. A top down estimate based on the prior West Virginia affiliation suggests the cost will approximate $35m. Based on our understanding of the analyses and assumptions supporting these estimates, we believe the range of costs to be reasonable. ■ Delays to affiliation approval will increase the risk that BCBSD can be migrated to the Highmark technology platform before the deadline for ICD-10 compliance of October 2013. ■ If the affiliation is not approved, BCBSD would have to pursue a minimum ICD-10 compliance approach on its legacy systems that could be completed before the deadline. This could be achieved faster and at a lower cost than full remediation of core administrative systems. ■ As an affiliate, Highmark would provide state-of-the-art information technology services to BCBSD at Highmark's fully allocated cost to deliver such service. Thus, BCBSD will benefit from Highmark's systems and technology capabilities at a reduced unit cost due partially to Highmark's larger scale. ■ Highmark would also guarantee employment for BCBSD's workforce. ■ Also, as an affiliate, BCBSD would have the opportunity to participate in and benefit from a variety of other non-technology activities that are not generally shared with external partners[1]. ■ As an affiliate, BCBSD's business strategies and operations and technology initiatives would be influenced by or reliant upon Highmark's business and technology strategy, direction and priorities to a significant extent. BCBSD would also be competing for resources with Highmark and other Highmark affiliates. Therefore, BCBSD would need to ensure that executive or board level decision making processes ensure that its interests are adequately served, and that key strategic projects are adequately vetted, prioritized, funded and executed.

Note: [1] We understand Blackstone Advisory Partners L.P., financial advisor to the DDI, will address aspects of the proposed affiliation not related to systems and technology gaps

Summary Conclusions, *continued*

Highlights	
Market demands and burgeoning health care reform mandates have driven health plan consolidation in the industry, dramatically changing the competitive landscape. **National health plan conglomerates (e.g., Aetna, Cigna) are dominating the marketplace, posing a threat to small, local market, unaffiliated companies such as BCBSD. These larger health plans have the ability to conduct business with lower administrative cost ratios, and to take advantage of greater financial depth and resources to acquire and develop new products and services demanded by consumers, meet federal mandates, address health care reform, and withstand market and economic volatility.** **In collaboration with Deloitte, BCBSD performed a comprehensive assessment of capabilities it will need to be successful in this environment and strategic options for the company's future business direction.**	■ As part of a strategic planning effort in 2008, BCBSD engaged Deloitte to assess its operations capabilities. The 2008 Deloitte report highlighted a number of functional and technology areas that were critical for BCBSD to improve in order to meet its strategic goals and address high priority areas of opportunity, such as reducing its administrative cost structure, and increasing the efficiency of operations. Most capability gaps related to technology and systems. ■ While technology has a significant role in realizing improved operations capabilities, *BCBSD has made few investments in IT over the past ten years*. Moreover, recent market changes, health care reform, and federal mandates now require that BCBSD make significant investments in modernizing its systems to meet critical requirements. ■ The 2008 Deloitte assessment highlighted key capability gap areas that BCBSD would need to address, including improvements estimated to cost up to $129m. In 2010, Deloitte performed an update of its 2008 BCBSD Assessment to reflect the changing market environment, the impact of Health Care Reform, and HIPAA 5010 and ICD-10 federal mandates. This assessment resulted in changes to the proposed solutions needed to address capability gaps and increases in the high level costs. Deloitte estimated that as an independent or standalone company, BCBSD would need to make investments in the range from $88m to $140m over a three-to five-year period to maintain a competitive position in the Delaware market and meet government mandates. ■ BCBSD lacks human resources/skills to manage such a large, complex transformation program. After consideration of its options, the company has sought an affiliation with Highmark, a leading health plan with industry leading product and service capabilities, strong financial position, state of the art systems and technology, and a successful track record of affiliation/partnership with Blue Cross Blue Shield ("Blues") organizations. BCBSD and Highmark entered into an affiliation agreement that was filed with the DDI in October 2010 (as amended in 2011) and they are seeking a hearing in October 2011, and approval by December 2011. ■ With the Highmark affiliation, BCBSD would expect to invest approximately $35m over 18 to 24 months to migrate onto the Highmark technology and business platform. From a systems and technology perspective, this migration would eliminate all capability gaps and satisfy the ICD-10 code remediation mandate, while providing additional capabilities. ■ BCBSD believes that the affiliation offers substantial savings compared to a standalone operating model and is the most practical approach to assure the company can meet the near and longer term needs of its Delaware stakeholders, while remaining a viable and robust presence in the Delaware market. ■ There are multiple scenarios that will impact the timeframe and costs for affiliation integration (see Appendix A, *Impact of Affiliation Approval Timing on BCBSD Planning and Costs*). In the event the affiliation is not approved, BCBSD must still meet near term government mandates while pursuing an alternative business strategy.

Summary Conclusions, *continued*

Highlights	
Affiliation approval after January 2012 will require that BCBSD undertake a neutralization approach to ensure its systems are ICD-10 compliant by the October 2013 deadline. Full remediation of systems to meet compliance may take up to 36 months and would not be an option for BCBSD. **In the event of a delayed affiliation approval decision, we estimate BCBSD would incur "throw away" costs of $3m to $5m to achieve minimal ICD-10 compliance prior to its migration to the Highmark technology platform.**	**BCBSD Delayed Migration and Affiliation with Highmark** ■ The BCBSD and Highmark planning teams have proposed that the optimum timeframe for commencing affiliation integration implementation would be subsequent to the requested DDI approval of the affiliation agreement in December 2011. The effort would last 18 months, completing in June 2013 (see Appendix A). ■ Based on our understanding of the scope of work to be performed as detailed in the affiliation projects, we believe this time frame would be reasonable. ■ We also concur that *delays in affiliation approval beyond December 2011 would increase the risk and costs for BCBSD* to ensure that it is operating on systems that are ICD-10 compliant by the October 2013 deadline. – Full remediation of systems to meet ICD-10 compliance may take up to 36 months and would not be an option. – An outsourcing arrangement or replacement of legacy systems would also not be an option since there would be insufficient time for BCBSD to migrate from its legacy systems to a compliant software platform. – A neutralization approach would be the only viable option for achieving ICD-10 compliance by the deadline. ■ In a scenario where approval is subsequent to January 2012, BCBSD would have to incur "throw away" costs to ensure its systems are ICD-10 compliant. This effort would precede the migration to the Highmark business and technology platform. Considering these and other factors, we estimate the costs for this neutralization approach may range from $3m to $5m. ■ In the event of a delay in affiliation approval, or a denial, BCBSD will need to be prepared to quickly ramp up its resources (internal and external) to implement a neutralization solution. With other health plans also competing for resources in order to meet the deadline, it is unclear as to whether any additional external resource capacity could be acquired in the timeframe required.

Summary Conclusions, *continued*

Highlights	
In the event of disaffiliation, separation complexity will be high, as it will involve the decoupling of business functions, processes, data and services. **The disaffiliation of BCBSD from Highmark will represent a high degree of complexity and could range from $38m to $55m over a 24 to 36 month timeframe.**	**BCBSD Future Disaffiliation with Highmark** ■ The BCBSD future operating model, including governance structure, enterprise and shared business functions, core business processes, and systems and data, will be tightly integrated with Highmark as a result of the affiliation. ■ The benefits of tight integration with Highmark include, but are not limited to the ability for BCBSD to deliver improved products and services with faster time to market to its members at a lower costs due to high performance business processes and greater economies of scale. BCBSD members may also more fully benefit from the systems and technology capabilities provided by Highmark's technology platform and enabling IT services to support consumerism,[1] private exchanges and other emerging health care reform solutions. ■ In the event of disaffiliation from Highmark, separation complexity will be high due to the level of business process, systems and technology integration between BCBSD and Highmark, and significant risks will need to be mitigated. With regard to IT, consider the following: – Infrastructure and shared applications and/or data may need to be separated, cloned and migrated from the business and technology platform to a new operating environment, without disrupting service to the ongoing BCBSD and Highmark businesses. – BCBSD will have limited IT personnel to support the disaffiliation. In the effort to disaffiliate from Highmark, BCBSD will have a heavy reliance on Highmark resources and external contractors to perform the "heavy lifting" of IT separation. ■ The overall effort to disaffiliate will mirror that required for affiliation integration and involve many analogous planning, program management, migration project road mapping and execution processes. ■ We estimate the costs for disaffiliation will exceed current estimates for affiliation integration and range from $38m to $55m over a 24 to 36 month period.

Note: *[1]Consumerism in healthcare refers to empowerment for individual decision makers whereby an employer's or government health benefit plan is transformed into one that puts economic purchasing power and decision making in the hands of participants. Consumerism is about supplying the information and decision support tools individuals need, along with financial incentives, rewards and other benefits to encourage personal involvement in doing the right activities that improve their health and save money.*

Executive Summary

Commentary on Deloitte 2008/2010 BCBSD and Highmark Assessments

Highlights	Summary observations
Based on our proposed updates, the estimated range of standalone costs for BCBSD would be from $93m to $150m, compared to Deloitte's standalone cost estimates of $88m to $140m. **Additional details are provided in the Key Observations section of this report.**	■ We are largely in agreement with the capability gaps identified in the 2008 and 2010 BCBSD assessment reports prepared by Deloitte. ■ In 2008, the assessment of BCBSD IT capabilities available to support business strategy and respond to emerging market trends, health care reform, and regulatory mandates was generally subpar. The recommended initiatives needed to close the gaps were appropriate. As part of our work on this engagement, we reviewed the cost estimates and assumptions supporting the capability gaps, and found them to be reasonable. ■ We are also in agreement with Deloitte's observations regarding the capabilities of Highmark as a strategic partner for affiliation based on our discussions with members of their management team and the knowledge we gained of their capabilities in the course of this engagement. ■ Deloitte's costing approach was based on its experience, insights and benchmarks derived from delivering a large number of similar projects within various health plans, including Blue Cross Blue Shield organizations. Deloitte used its client reference models and benchmark data to develop the "top down" cost range estimates proposed for BCBSD's capability gap projects. ■ There were, however, gap areas that we believe would require different approaches and/or levels of investment, based on recent changes in the marketplace, and the shorter times now available to meet mandated compliance deadlines. There were also several gap areas that were not addressed in the Deloitte reports that we feel would be critical to BCBSD remaining competitive as a standalone or non-affiliated business. ■ In the final analysis, our capability gap and related cost changes propose a modest increase to Deloitte's standalone estimates of $88m to $140m. With our updates, the estimated standalone costs for BCBSD range from $93m to $150m.

Key Observations

Key Observations

BCBSD IT Upgrade to Support Standalone Operations

Highlights	Observations
Based on an ICD-10 assessment performed by Arcadia Solutions in 2010, BCBSD has chosen to implement a minimal approach to achieving ICD-10 compliance in the event affiliation approval is delayed beyond January 2012, or denied. **Under either a standalone or affiliation scenario, BCBSD must ensure its current legacy systems are ICD-10 compliant by the mandated deadline of October, 2013.**	**Key IT Standalone Considerations** ■ We concur that the capability areas and recommended portfolio of solutions set forth by Deloitte in its 2010 BCBSD Capability Assessment Update report are appropriate and critical to the success of BCBSD in maintaining its competitiveness in the Delaware market and in meeting government mandates for Health Care Reform and HIPAA 5010 and ICD-10 compliance. We believe, however, that in specific cases, alternative solution implementation approaches and additional areas of investment may be needed. ■ Since the previous 2008 BCBSD Capabilities Assessment performed by Deloitte, BCBSD has undertaken specific steps to address capability gap areas that would enhance its competitiveness as a non-affiliated health plan, while recently establishing an interim administrative services agreement with Highmark related to technology prior to pending affiliation approval. In addition: – BCBSD has completed its disaffiliation from CareFirst and replaced its services by engaging Highmark in a long term contractual relationship to support the HIPAA Gateway, Blue Exchange and BlueSquared. – BCBSD is expected to be ready to exchange key business transactional data with providers using the new HIPAA 5010 format via Electronic Data Interchange (EDI) by January 1, 2012. This effort included work on the Highmark HIPAA gateway that BCBSD will use under the Administrative Services Agreement that is part of the proposed affiliation. – In June, 2010, BCBSD engaged Arcadia Solutions to perform an initial ICD-10 assessment, including recommendations for compliance approach and initiatives, and a roadmap. ■ Deloitte recommended that BCBSD (if it remained a standalone health plan) perform full ICD-10 remediation to meet the compliance deadline of October, 2013 (estimated duration of up to 36 months) and replace its core administration systems (see Appendix C, *Current BCBSD Application Portfolio*). This approach was reasonable under the assumption of ongoing ICD-10 remediation work being performed, commencing in 2010. ■ Due to the affiliation agreement pursued by BCBSD and Highmark, BCBSD has not begun any ICD-10 remediation implementation work. However, BCBSD has confirmed a contingency compliance solution, a neutralization (aka "tactical cross walk") approach, that will be implemented in the event of a delay in affiliation approval, or a denial. This approach is described in Appendix D, *ICD-10 Conversion Strategies – Standalone Operations,* and further detailed in Appendix E, *Advantages and Disadvantages of ICD-10 Implementation Strategies.* We are in agreement with this approach for a standalone scenario, as it is the only realistic alternative, considering time constraints and risk factors. ■ The complete listing of 2010 capability gap areas, descriptions, and estimated one-time cost ranges, duration and ongoing cost ranges are shown in Appendix F, *BCBSD 2010 Capability Gap Closure Costing Detail*.

BCBSD IT Upgrade to Support Standalone Operations, *continued*

Highlights	Observations

We have concluded from our analysis of the capability gap areas and cost estimates that standalone costs may more likely range from $93m to $150m.

These adjustments to the range of costs proposed by Deloitte reflect additional areas of investment we believe would be necessary for BCBSD to address emerging market trends (e.g., consumer retail channel) and remain competitive in its market.

In addition, we believe different approaches to ICD-10 compliance and program management of the 3-Year Capability Roadmap will impact the 2010 cost range estimates.

Standalone Cost Estimates

- We reviewed each of the 2010 capability gap areas and cost estimate ranges prepared by Deloitte with a member of their team involved in the engagement. We sought to understand the costing approach, underlying assumptions and supporting benchmarks that provided input to their overall standalone cost of $88m to $140m.
- Based on our industry research, review of benchmark data from KPMG databases and health plan client engagements, as well as external benchmark and emerging market trend data, we suggest the following gap area and cost range adjustments to those proposed by Deloitte. These adjustments would provide for a total capability gap cost range of from $93m to $150m[1]. The chart below shows the differences between our analysis and Deloitte's capability gap analysis.

Area	Description	Deloitte One-Time Cost Range	Duration	KPMG One-Time Cost Range	Duration	*Comments*
ICD-10 Remediation	• Business and technology costs required to meet the ICD-10 compliance mandate of October 2013.	$10m - $15m	36 months	$3m - $5m	15-18 months	We are in agreement with BCBSD on the neutralization solution it has chosen to achieve minimum ICD-10 compliance versus the remediation solution proposed by Deloitte. This approach would also allow time for BCBSD to search for a long-term alternative to its core administrative systems (Refer to Appendix D).
Program/ Project Management	• Provides for a system integrator to set up a PMO and lead the execution of the capability gap transformation program	Not Included	Not Included	$6m -$9m	36 months	Assume full-time core team of 4 to 6 resources plus part-time Subject Matter Experts (SMEs); average billing rate of $2,000/day for 48 weeks/year.
Private Exchanges	• Develop a portal, configure products/benefits and link back to core systems	Not Included	Not Included	$3m-$5m	12-24 months	As health insurance costs rise, some employers may choose alternatives to defined benefit health plans. To overcome this issue, leading heath insurers are creating private exchanges to provide a defined contribution arrangement for their clients. We believe that BCBSD will need to do the same to be competitive.
Retail Distribution	• Addresses the need to create a multichannel strategy and to launch retail initiatives via multiple distribution channels e.g. retail and online marketing, wholesale, member letters, direct response open enrollment packages	Not Included	Not Included	$3m-$6m	24-48 months	Imposition of an individual mandate and introduction of state exchanges will lead to a major growth in the individual health insurance market over the next 5-10 years. BCBSD needs to be prepared to make the transition to this new B2C model by developing retail capabilities that can understand, attract and retain individual customers.

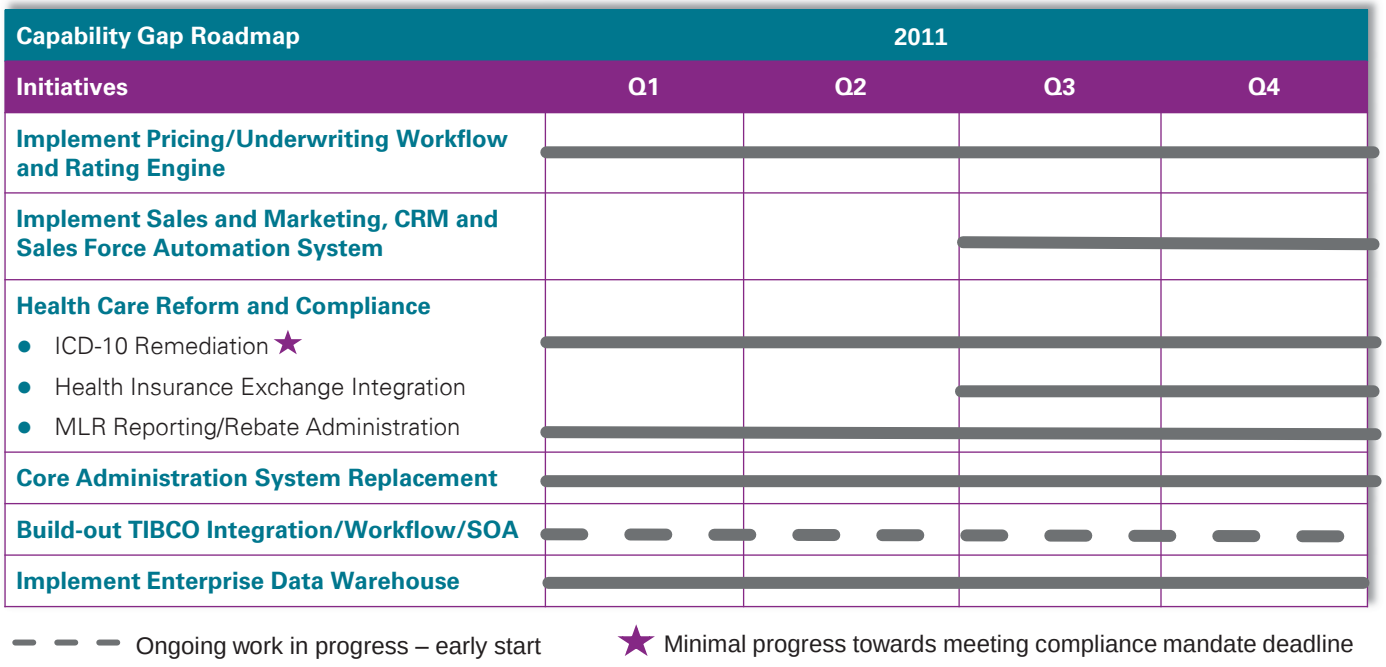
Source: Deloitte and KPMG analysis

Note: [1]The KPMG low end cost estimate is derived from a reduction of $7m in ICD-10 remediation costs from the Deloitte estimate plus $12m in additional capability costs using the low end figures for program management, private exchanges and retail distribution, a net increase of $5m ($88m to $93m). The same approach was used for the high end estimate which included a reduction of $10m in ICD-10 remediation costs offset by $20m in new capability costs, deriving an incremental spend of $10m and revised estimate of $150m.

BCBSD IT Upgrade to Support Standalone Operations, *continued*

Highlights	Observations
While an ICD-10 neutralization approach involves no invasive system changes, and can be performed more quickly and less costly than a full remediation approach, there are drawbacks and risks to be considered. **The BCBSD IT organization lacks the experience and many of the requisite capabilities needed to effectively plan, manage and implement large transformation programs.** **This capability gap introduces a significant risk that BCBSD can effectively deliver the capability gap projects set forth in the Deloitte 3 or 5 year roadmaps, while continuing to maintain stable IT operations and support.** **As a standalone health plan, there would be significant risk that BCBSD could fail to effectively deliver the capability gap projects. We believe that BCBSD would have to engage a system integration firm to manage the overall transformation program, and to provide consulting and technical support to the project teams.**	**Standalone Risk Considerations** ■ Based on current time considerations, a neutralization approach to achieving ICD-10 compliance by the October, 2013 deadline would be the only viable option for BCBSD as a standalone health plan. This approach involves the development of external mapping routines that will map existing ICD-9 codes to the newer version of ICD-10 (see Appendix M, *ICD-9 and ICD-10 Diagnostic and Procedure Code Comparisons*). ■ As in the scenarios involving a delay or denial in affiliation approval, BCBSD, as a standalone business, would need to be ready to quickly ramp up its resources (internal and external) to implement a neutralization solution. With other health plans also competing for resources in order to meet the deadline, it is unclear as to whether any additional external resource capacity could be acquired in the timeframe needed. ■ There are also other risks to consider in the neutralization approach, including: – Inability to utilize ICD-10 data in medical management or benefits design – Potential negative impact to analytical capabilities – Potential impact to institutional provider contracts – Inability of the BCBSD team to implement the changes in the allowed timeframe ■ The BCBSD IT organization lacks experience in managing the type of large scale, complex transformation programs needed to effectively implement the capability gap projects within desired timeframes. To mitigate this risk, we believe that BCBSD would have to engage a systems integrator to create and manage a Program Management Office, and to ensure all of the solution implementation projects are effectively managed and delivered by all functional teams. ■ BCBSD's core administration systems are antiquated and do not represent a platform that can support the market and customer needs of BCBSD. These systems would need to meet mandated ICD-10 compliance requirements by October, 2013, while concurrent or staged efforts are undertaken to swap out these core administration systems with new vendor software offerings, an affiliation with another company, or replacement via business process outsourcing (BPO). This effort would challenge BCBSD to manage and absorb the level of change involved in any of these migration/replacement options.

BCBSD IT Upgrade to Support Standalone Operations, *continued*

Highlights	Observations
The delayed start of a core administration systems replacement project could negatively impact BCBSD's ability to keep pace with competitors in its market with regard to the launch of new products, services and capabilities (e.g., health insurance exchange integration), and in achieving the benefits of lower administration costs.	**Standalone Risk Considerations**, *continued* *Deloitte Capability Gap: 3-Year Roadmap* ■ Deloitte recommended the following short term and long term activities to start early in 2011 in order to achieve business goals and meet compliance deadlines. The strategy to affiliate with Highmark has delayed BCBSD's launch of specific projects, including ongoing progress towards achieving ICD-10 compliance (see Appendix G, *Deloitte Capability Gap: 3-year roadmap*) and the replacement of core administration systems. ■ The following initiatives were scheduled for launch in Q1 through Q3 of 2011: **Figure 1**  *Source: Deloitte 2010 BCBSD Capability Gap Assessment Update and KPMG analysis*

Supporting Analysis

BCBSD IT Upgrade in Support of Standalone Operations, *continued*

New Capability	Observations
Private Exchanges **Companies have become increasingly reluctant to bear the full cost of health care as medical inflation continues to outpace the general inflation. They are rapidly shifting costs to workers by dropping health benefits, or sharing more of the cost with employees. One of the alternatives that is becoming increasingly popular is the offering of coverage through a defined contribution model, whereby the employer provides a fixed dollar amount, and the employee can choose how to allocate it among a variety of benefit options.**	**Considerations** ■ To maintain competitiveness in its market, we believe that BCBSD should assist employer clients to make a seamless transition to a defined-contribution model by offering a Private Exchange. A Private Exchange is an online marketplace where employers can allocate pre-tax dollars on behalf of each employee's health account and the employee can choose how to allocate those dollars among a customized list of health plans and other related services. ■ A Private Exchange should have the following major capabilities: – An employee portal that includes a recommendation engine and also provides customized wellness information – An employer portal to manage on-boarding, reporting, and ongoing life events – Functionality to generate reports on enrollment, payroll and customer service statistics ■ BCBSD may choose to develop a Private Exchange in-house, or partner with vendors, such as Bloom and Array Health, that provide turn-key solutions. **Benefits** ■ This arrangement will shield BCBSD's employer clients from unpredictable premium hikes because they can choose how much to increase their contribution each year. ■ State exchanges[1] will be challenging markets for health plans due to commoditization and removal of risk-control mechanisms. Investing in a Private Exchange now may help BCBSD retain its employer clients that may otherwise migrate to a state exchange after 2014. ■ BCBSD may use its existing wholesale distribution channels to sell the Private Exchange to employer clients. This would allow for lower customer acquisition costs. **Cost Estimates** ■ Based on our analysis, we believe that BCBSD, acting as a standalone company, would need to invest from $3m to $5m over next 1-2 years to offer defined contribution arrangements through a Private Exchange. These costs include software, hardware and external labor needed to develop the portals and interfaces required for back end integration. *Note: [1]State exchanges are marketplaces where individuals and small businesses can compare policies and premiums and buy insurance (with a government subsidy if eligible)*

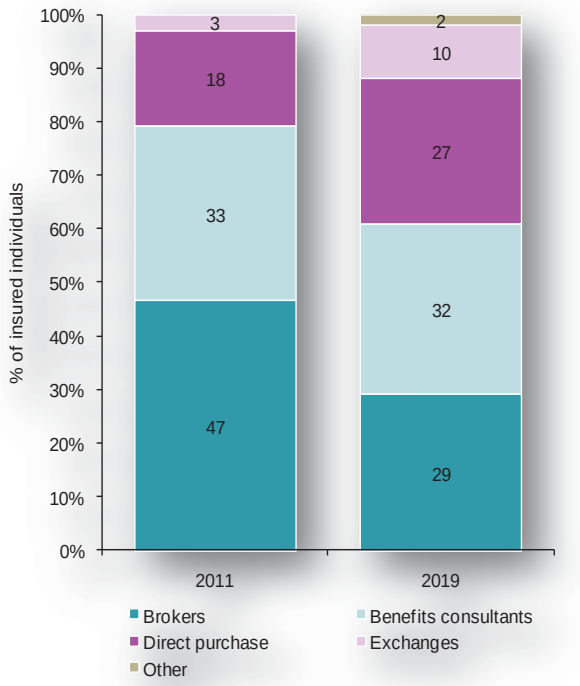
Supporting Analysis

BCBSD IT Upgrade in Support of Standalone Operations, *continued*

New Capability	Observations
Retail Distribution **US health plans have evolved as wholesale enterprises. Their strategies, competencies and organizational structures have been focused on serving groups, not consumers. However, the passage of the Affordable Care Act (ACA) will now significantly enhance the role of the consumer in making healthcare purchasing decisions. By imposing an individual mandate, and introducing state exchanges and federal subsidies, the number of individuals purchasing insurance directly (retail) will grow between 24 million and 39 million people by 2016.**	**Considerations** ■ Although BCBSD has a strong local brand in the Delaware market, it lacks the more sophisticated capabilities required to understand, attract and retain individual consumers. We believe that the imminent growth in the individual consumer market poses significant challenges for a standalone BCBSD in product design, marketing and customer retention. To succeed in this increasingly retail health insurance market, we propose that BCBSD begin developing these crucial capabilities: – ***Retail Distribution*** – the broker channel generates the primary share of BCBSD's business today, but the company will need to invest in new and increasingly important direct purchase channels (see Figure 1). BCBSD needs to develop a multichannel strategy and launch retail initiatives to reach the individual consumer. – ***Sales and Marketing*** – to retain customers in a retail marketplace, BCBSD will need to manage the customer life cycle. Sophisticated consumer-focused sales and marketing analytics tools can help by calculating the acquisition, retention and lifetime value of customers by target segment. – ***Customer service*** – to simplify member touch points, BCBSD may invest in developing customer-friendly access to member portals, featuring multichannel options, including phone, e-mail, and online interactive chat. – ***Consumer-oriented medical management*** – BCBSD will need to fortify customer relationships by serving as a valued partner – helping consumers access health and wellness services, make more informed decisions, and manage out-of-pocket healthcare expenditures.

Figure 2

Market Share of Health Insurance Distribution Channels as a % of Insured Individuals, 2011 and 2019



Source: BCG survey of payer responses to the Affordable Care Act; BCG interviews.

Supporting Analysis

BCBSD IT Upgrade in Support of Standalone Operations, *continued*

New Capability	Observations
Retail Distribution, *continued* **A BCG survey indicated that 73% of health insurers are planning to increase their marketing and sales capabilities in the near term, with a particular focus on direct-to-consumer market.**	**Considerations, *continued*** ■ The need for a competitive retail channel was not specifically identified as a capability gap in the 2008 Deloitte assessment. We believe the passage of the ACA in 2009 will now drive a retail orientation to individual consumers that will require a significant level of investment to ensure competitiveness. ■ As part of its legacy modernization initiative, Highmark is laying the architectural foundation for consumerism or retail distribution capabilities that BCBSD will be able to leverage in the future. **Estimated Costs** ■ Although the pace of the health plan industry shift to a retail orientation will depend on various marketplace factors, such as the success of the state exchanges, we believe BCBSD should be proactive in its efforts to enhance its consumer orientation. From strictly an IT perspective, this may involve, for example, the development and implementation of consumer oriented web portals that feature back end integration to product development, billing and customer service applications. Based on our high-level estimates, we believe that BCBSD, if it remained a standalone entity, would need to invest $3m to $6m over the next 2 to 4 years, at a minimum, to achieve par with other competitors.

Key Observations

Business Process and Information Technology Outsourcing

Highlights	Observations
Health plans (including the "Blues") are increasingly pursuing BPO/ITO with third party service providers as a business strategy. **Traditionally, health plans have outsourced various back office and core administrative functions (see Appendix K, *BPO Functionality for Healthcare Services*) such as Member Enrollment, Claims Adjudication, and maintained control of market facing functions such as Sales, Product Development and Account Management.** **IT Outsourcing (ITO), a service bought through a multi-year contract with an external service provider and involving the day-to-day management of IT operations allows for cost savings, access to new technology and other benefits.**	**Considerations** ■ Some of the purported benefits of business process and information technology outsourcing to health plans are an ability to: – Realize speed to market for new products – Achieve ICD-10 compliance – Drive down administrative costs by leveraging the technology, business expertise and economies of scale of the service provider (see Appendix J, *Potential BPO Outsourcing Benefits for a Health Plan,* for an example of cost savings achieved by adjudicating claims in an offshore environment) – Focus more attention on core competencies around business development, member services and provider services – Reduce risk of technology obsolescence and minimize upfront capital outlay – Achieve timely regulatory compliance given the extensive expertise of service providers with HIPAA and other mandates ■ Based on a high level analysis, there are a limited number of BPO outsourcers who may offer services equivalent to those offered by Highmark in the affiliation model, but possibly at a higher annual run rate or service cost. Representative BPO/ITO (IT outsourcing) providers include Accenture, Cognizant, Convergys, CSC, DST Health Solutions, IBM, Infosys, Patri, Dell Perot Systems, TMG Health, TriZetto, and Wipro. ■ The time necessary for BCBSD to develop its sourcing strategy (e.g., single or multi-vendor sourcing model), perform vendor selection, develop and negotiate and contract, and plan and migrate to their environment, would not likely be completed by October 2013, the mandated compliance deadline for ICD-10. A multi-vendor sourcing strategy would also be complex and consume many resources. BCBSD lacks experience in managing multiple vendors in this context. ■ Therefore, in a BPO scenario, BCBSD would still need to ensure its legacy systems are ICD-10 compliant by the mandate deadline. While implementing its ICD-10 compliance approach, BCBSD could commence the activities needed from strategy through contract negotiation with the outsourcing provider(s), then complete the migration and on boarding process some time after the compliance deadline.

Key Observations

Business Process and Information Technology Outsourcing, *continued*

Issue	Observations
BPO/ITO outsourcing may represent a long term option for BCBSD when viewed strictly from an IT perspective. This approach, however, includes potentially much higher costs ($30m to $60m annual service charge) and greater risks than the Highmark affiliation option. **Further analysis would be needed to gain a better understanding of the likely one-time and run rate expenditures of the BPO/ITO and standalone options for a health plan with the requirements and membership level of BCBSD.**	**Cost Estimates** ■ Based on our research, it is difficult to gauge the range of costs required for BPO/ITO outsourcing services due to the unique aspects of individual deals – e.g., the number of business processes administered and managed, the processing volumes, and the contract duration are just a few of the many factors that drive annual run rate services costs charged by the outsourcer. ■ Based on limited information from sales representatives at several vendors, the rough order of magnitude of annual outsourcing costs would appear to range from $30m to $60m for BPO/ITO (membership, claims, and tertiary processes) and support for the IT infrastructure, including applications development and maintenance. This cost range is significantly higher than the affiliation option (estimated at $17m annually). One-time migration and set up costs would also be incurred; however, we were unable to obtain estimates based on our research. **Risks** ■ BCBSD should potentially have several possible outsourcing partners, including Highmark. Highmark, however, has already indicated that it will not consider a long term outsourcing arrangement with BCBSD. Even if an outsourcing option were available with Highmark, BCBSD would not gain any of the other substantial benefits (e.g., the claims guarantee, economies of scale, product offerings, and back-end, centralized support) that it will gain through the affiliation with Highmark. These other benefits are discussed herein and in Blackstone's Report. ■ BCBSD appears to lack the in-house account management expertise required to effectively manage a successful long-term single or multi-sourcing relationship with the BPO/ITO service provider(s). ■ Business outcomes may not be ensured as BCBSD may not see significant cost savings in the early years of the outsourcing relationship due hidden costs or rate hikes that do not include commensurate benefits. Contract terms and provisions may not offer sufficient flexibility in the event of unforeseen circumstances or changing business conditions. ■ Due to the ICD-10 compliance mandate deadline of October 2013, the demand for BPO/ITO providers may increase significantly, possibly decreasing BCBSD's leverage to negotiate a favorable pricing model. ■ BCBSD may have difficulty in finding a good cultural match with a BPO/ITO provider. ■ To mitigate the risk of receiving subpar service, BCBSD should negotiate a Service Level Agreement (SLA) with the provider that specifies the service level targets against which the provider's performance will be measured.

BCBSD Migration and Affiliation with Highmark

Highlights	Observations

Affiliation planning has involved joint teams from BCBSD and Highmark with additional support from Deloitte.

The planning process was logically structured, and appears to have been thorough (e.g., no obvious gaps or omissions related to key migration projects) and effectively executed. As importantly, there was significant involvement of senior management and key stakeholders from both firms.

The scope and detail included in the affiliation planning deliverables we reviewed suggests that both organizations will be well prepared to begin execution of the program plan if the affiliation is approved.

Affiliation Integration Considerations

Affiliation Program Planning

- Based on our review of the affiliation planning process and work completed to date, we believe the planning phase of the migration effort is on strong footing.
  - Phase 1 of the effort was conducted from December 2010 through May 2011 . After 300 individual sub-projects were initially identified, a rationalization and consolidation process led to the development of project charters, plans and cost worksheets being developed for 70 projects.
  - Twenty-three of the 70 projects were prioritized to start in 2011 pre-close (Phase II). All projects have been classified as migration, support, strategy or departmental/low resource related; and prioritized and sequenced as part of an affiliation roadmap (see Appendix H, *BCBSD Affiliation Roadmap*).
  - The 70 affiliation roadmap projects (see details of each in Appendix I, *BCBSD Affiliation Roadmap Projects*) address each capability element or gap identified in the 2008 Deloitte strategic assessment. As highlighted in Highmark's RFP response, they are able to not only offer solutions that meet the capability elements or gaps, but provide an additional 42 capabilities. The summary of capabilities addressed by Highmark are shown in the table below.

Business Area	Capability Element	Deloitte Capabilities Assessment	Highmark RFP Response	Affiliation Blueprint & Roadmaps
Go to Market	Informatics	✓	✓	✓
	External Client Reporting	✓	✓	✓
	Product	✓	✓	✓
	Commissions	✓	✘	✓
	Pricing/Underwriting	✓	✓	✓
Middle Office	Network and Medical Management	✓	✓	✓
Back Office	BlueCard	✓	✓	✓
	Core Administration – TBS (Claims, Enrollment, Billing, Provider)	✓	✓	✓
	Infrastructure (Service Oriented Architecture)	✓	✓	✓
Corporate	Financial Processes	✓	✓	✓
	Human Resources	✓	✓	✓

Key: ✓ Addressed; ○ Partially addressed; ✘ Not addressed

Source: *BCBSD Affiliation Capability Tracing Analysis*

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations

REDACTED

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations

REDACTED

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations
BCBSD is likely to gain significant benefits in all areas of its operations due to Highmark's commitment to innovation through the use of information technology, enterprise focus on improving business processes and service support, and overall IT capabilities and economies of scale. **The HIPAA Gateway Project (i.e., implementing a third party solution to replace the CareFirst provider portal, HIPAA gateway) offers BCBSD a long term, hosted and support services solution from Highmark to deliver HIPAA compliant (4010 and 5010 transaction types) EDI processing through a transaction gateway. The solution accepts inbound transactions from multiple sources, performs compliance checks on all inbound/outbound HIPAA regulated EDI transactions, and offers a portal for new trading partner registration and reporting.**	**Affiliation Integration Considerations** ■ Many of the BCBSD IT resources have skills and experience that can be of value to Highmark. Others are candidates for re-training, and would be able to assume new responsibilities within the Highmark IT organization. *Highmark Information Services* Overview ■ The Highmark Information Services Group is comprised of 1,650 employees and supported by 340 contractors. In 2008, Highmark ranked third in the nation's top 500 innovators of IT by InformationWeek magazine. Highmark is an organization that has proven to invest significantly in IT capabilities in response to marketplace challenges, mandates and health care reform initiatives, and in internal process improvement and support. – Highmark's aggregate IT spend over the past 3 years has been approximately $400m. Key spend items include an estimated $100m each for legacy modernization and compliance/regulatory mandates and $200m for hardware and software. Each year, over 50% of IT spend is purportedly related to new capabilities (e.g., enhancements, strategic projects). – Highmark's legacy modernization (core operational platform modernization) initiative will enhance core systems to support new products and capabilities, enable administrative cost savings, and modernize the technical architecture to improve flexibility, time to market, and scalability in response to growth. Since 2006, Highmark has spent over $363m on legacy modernization projects. There will be three more releases of new capabilities, the last in April, 2012. – Mandates for HIPAA 5010 (see Appendix N, *HIPAA 5010 Overview*) and ICD-10 compliance are being addressed with ongoing initiatives. Highmark was the first health plan in the US to become 5010 compliant, however, additional work is being done to assist trading partners in achieving compliance (BCBSD became HIPAA 5010 compliant when it switched to Highmark's HIPAA Gateway). Upon completion of its 5010 support activities in 2012, Highmark costs are estimated to be $27m. Highmark's ICD-10 remediation project is expected to be completed well before the mandate deadline in 2013 and is estimated to cost $32m (see Appendix L, *ICD-10 Cost Remediation Survey*). ■ Highmark's IT strategic efforts are focused on initiatives that not only address compliance mandates and regulated challenges, but deliver significant business value to the enterprise (e.g., customer service functions for consumerism).

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations
Highmark's previous experience in implementing the Mountain State Blue Cross Blue Shield affiliation and in supporting eighteen (18) existing joint arrangements with other health plans should serve to mitigate many of the risks involved in transitioning BCBSD onto its business and technology platform.	**Affiliation Integration Considerations** ■ The percentage of available hours expended by key focus area include: – Legacy system modernization (37%) – Administrative/Productivity (19%) – Consumerism[1] (8%) – Growth (2%) – Mandates (23%) – New Products (23%) ■ Highmark has developed product strategies and committed capital toward building a presence in emerging capability areas such as private exchanges and consumerism. For example, Highmark is pursuing a vendor to provide a private exchange capability which is estimated to cost from $3m to $6m. If BCBSD were an affiliate, Highmark estimates that the BCBSD allocable portion of the project costs would range from $200k to $400k. As a standalone, we estimated that BCBSD would spend from $3m to $5m for private exchange capability. Deloitte estimates that its clients' costs have ranged from $2m to $5m. *Highmark IT Affiliation Integration Experience* ■ The Mountain State ("West Virginia") BCBS affiliation initially focused on core administration systems and progressed to include other ancillary systems over time (a phased integration approach onto the Highmark technology platform). ■ The West Virginia affiliation experience did produce some "lessons learned" (e.g., understand how to plan for different provider data structures) that have been considered in past and current affiliations. ■ Currently, Highmark has up to 18 joint arrangements with other health plans where Highmark serves as the back office (for additional details, see Appendix O, *Highmark Business Partner Arrangements*). It also has arrangements with small plans where it manages the National Account Administration. As a result of its modular IT architecture, Highmark is able to run multiple businesses on a single technology platform and thus derive significant cost savings. ■ Although Highmark does not have a standard integration playbook for guiding its affiliation process, its project and process orientation helps IT staff to focus on all business and technology domains that need to be integrated. *Note: [1]Consumerism in healthcare refers to empowerment for individual decision makers whereby an employer's or government health benefit plan is transformed into one that puts economic purchasing power and decision making in the hands of participants. Consumerism is about supplying the information and decision support tools individuals need, along with financial incentives, rewards and other benefits to encourage personal involvement in doing the right activities that improve their health and save money.*

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations
Based on previous affiliation integration experience, Highmark executives estimated the "top down" costs to migrate BCBSD to their platform at $35m. **The affiliation planning team, consisting of both BCBSD and Highmark resources, have conducted a work in progress "bottom up" analysis of potential integration costs, currently estimated at $37m.** **Based on our understanding of the scope and complexity of work to be completed, review of planning documents, and related experience, we believe the range of estimated costs to be reasonable.**	**Affiliation Cost Estimates** *Affiliation Integration (one-time cost)* ■ A top down approach to estimate the cost of affiliation integration was conducted by key Highmark executives based on the effort expended by the integration teams involved in West Virginia BCBS affiliation, and other related work they have performed in "on boarding" new clients to their technology platform. ■ The West Virginia affiliation integration approach and approximate cost of $25m served as a model for the high level BCBSD affiliation integration estimate. The impact of differences in the migration approach and higher current staffing costs, and the effect of inflation, were considered in the BCBSD estimate of $35m. ■ During affiliation planning, the project teams have developed "bottom up" cost estimates for each of the (70) affiliation projects based on internal and external labor costs, hardware, software and other costs ■ As of early August, the estimated BCBSD affiliation integration summary of costs includes: – Migration Projects: $26,372,502 – Support Projects: $4,646,211 – Strategy Projects: $3,305,226 – Departmental/Low Resource Projects: $990,020 – Project Management Office: $1,931,058 **Total: $37,245,017** ■ There are ongoing discussions with the project teams to identify any costs that do not provide what is minimally required to integrate BCBSD on the Highmark technology platform, provide existing products and services and refine existing assumptions. Costs for future enhancements, products and services that don't relate strictly to integration and "business as usual" are being eliminated. This ongoing effort may close the gap between the $35m and the $37m. ■ Based on our review of affiliation planning documentation developed by the teams, including the project charters, plans and costs worksheets, and our experience in working on integration projects of similar scope and complexity, we believe that a range of costs from $35m to $37m is reasonable. ■ While the estimated range of costs appears reasonable, there is currently no cap on affiliation costs in the event that the affiliation costs are greater than those anticipated by Highmark and BCBSD. Therefore, it may be appropriate for the Department of Insurance to consider certain conditions relating to the affiliation costs of the Proposed Affiliation.

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations
In the event of an affiliation between the parties, Highmark's allocation of costs to BCBSD for use of its technology platform would not include built-in costs or cost escalators (e.g., an annual CPI adjustment). **As the technology platform increases in scale, lower costs are passed on to BCBSD.** **Beginning in 2013, BCBSD IT operating spend may approximate $21m, including $4m in direct costs, and $17m in allocated service charges from Highmark.**	**Affiliation Cost Estimates** *Allocated Service Charges (run rate)* ■ According to Highmark, BCBSD will incur an estimated $17m in annual service charges for use of the Highmark business and technology platform beginning in 2013. These annual costs include "business as usual" charges based on BCBSD transaction volumes, and BCBSD's estimated allocated share of costs associated with the legacy modernization project for which BCBSD will derive substantial benefits, including new systems capabilities. There is currently no cap on these annual costs. Therefore, it may be appropriate for the Department of Insurance to consider certain conditions relating to the allocated service charges under the Proposed Affiliation. *BCBSD Post Affiliation IT spend* ■ When adjusted for non-IT and reclassified expenditures (e.g., corporate building costs are in the IT budget), the BCBSD IT budget for 2011 is estimated at $17.3m (projected pre-affiliation IT spend level over the next two years). ■ REDACTED ■ It is estimated that beginning in 2013, BCBSD would have operating costs of $21m ($4m in direct costs, $17m in allocated service charges) that may slightly increase annually, based on any increased transaction processing volumes and/or ongoing allocable costs related to technology platform enhancements. REDACTED *Synergies and Benefits* ■ REDACTED ■ REDACTED

BCBSD Migration and Affiliation with Highmark, *continued*

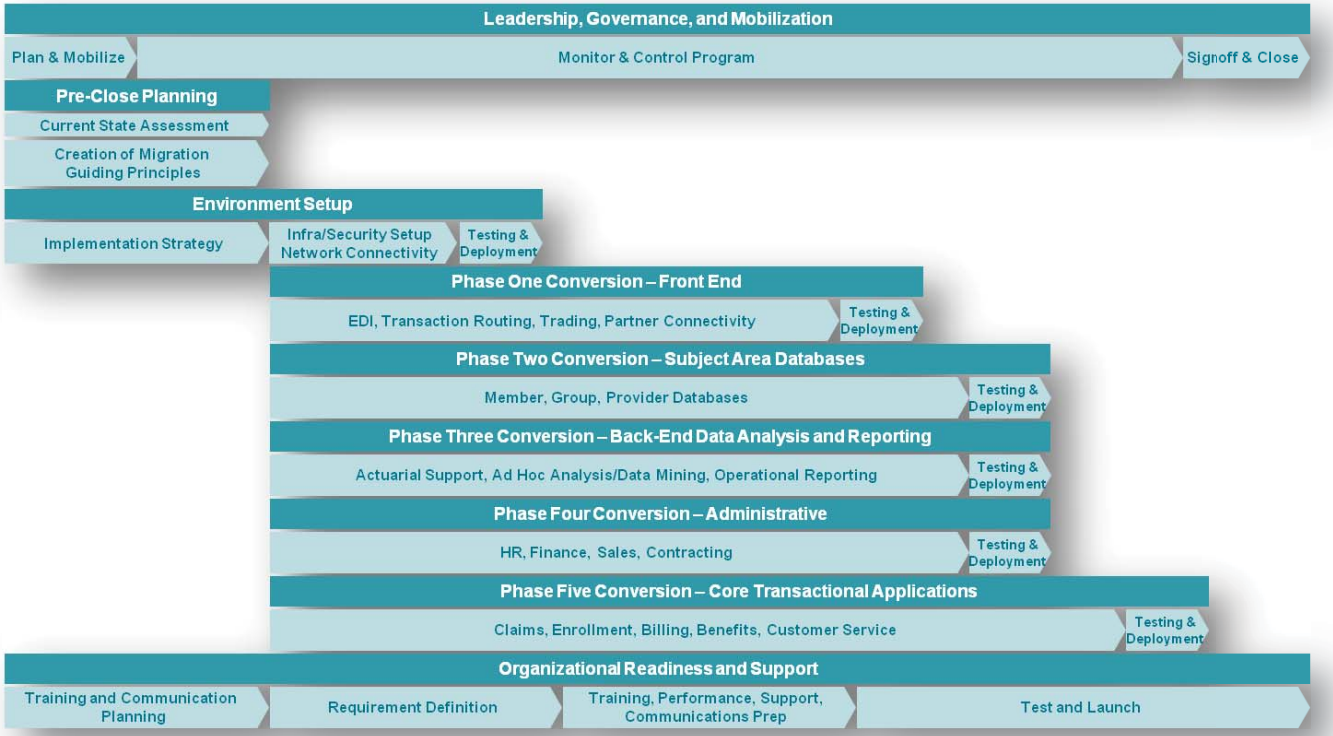
Highlights	Observations
While Highmark's IT organization is experienced in delivering large program initiatives, it is unclear whether the affiliation integration of BCBSD will stress or exceed the organization's ability to absorb the pace of change. Failure to do so could result in missed deadlines and cost overruns. **BCBSD can mitigate the risk that it does not receive the level of service from Highmark needed to meet its operations, IT and customer support performance expectations by entering into a Service Level Agreement (SLA) with Highmark. The SLA would establishes the target service levels and standards against which Highmark's performance would be measured and reported.**	**Affiliation Integration Risk Considerations** *(information technology)* ■ Highmark is currently pursuing its own legacy or core operational platform modernization program, supporting multiple client relationships on its business and technology platform, and planning for the integration of BCBSD. Highmark's legacy modernization is still ongoing, and is expected to be completed in 2012. While Highmark's IT organization is experienced in delivering large program initiatives, it is unclear whether the affiliation integration of BCBSD will stress or exceed BCBSD's ability to absorb the pace of change during the next few years. Failure to do so could result in missed deadlines and cost overruns. ■ There is risk that a small client like BCBSD will not receive adequate support for its service requests during and post integration. These requests may be for minor system changes, custom reports, or special projects. ■ A Service Level Agreement (SLA) between BCBSD and Highmark should be used to establish the target service levels and standards of performance for which Highmark will measured during affiliation. Highmark is currently providing electronic data interchange (EDI) services to BCBSD under a long term Administrative Services Agreement (ASA). The ASA is supported by an SLA between the parties (see Appendix P, *Highmark Service Level Agreement (SLA) with BCBSD*). ■ Ongoing reporting of service level performance on a monthly or quarterly basis could ensure that performance targets are being achieved by Highmark, and there are no troubling performance issues or trends that could negatively impact on BCBSD customers (see Appendix Q, *Highmark Service Level Report (SLR) to West Virginia* for an illustrative example of typical reports).

Supporting analysis

BCBSD Migration and Affiliation with Highmark, *continued*

Highlights	Observations
BCBSD may benefit from the investments Highmark has made and plans to make in new capabilities and operational improvements. **Business process modeling (BPM) software such as PEGA is being implemented to provide unified rules and processes across operational functions such as Claims and Customer Service.** **Service oriented architecture (SOA) will provide a standard approach to application integration that will enable faster speed to market and reductions in administrative costs.**	**Legacy modernization (core operational platform)** ■ BCBSD may have the opportunity to leverage the capabilities provided by an enhanced, modernized core administrative systems platform, fully exploiting the benefits of ICD-10 coding and new products and capabilities, such as consumerism (retail distribution) and real-time claim processing, on a robust technical architecture. The goals and benefits of this initiative are summarized in the diagram below. **Figure 5**  *Source: Highmark corporate data*

BCBSD Migration and Affiliation with Highmark, *continued*

Issue	Observations
We believe the affiliation integration approach for BCBSD is reasonable and balances speed and risk through the use of phased conversions, each concluding with testing and deployment.	**Affiliation integration approach** ■ For the integration of BCBSD, the infrastructure will first be rationalized and blended. During the setup of the infrastructure environment, the applications/data migration will commence in phases and take approximately a year to complete. This effort will be followed by the integration of IT resources. ■ A high level overview of the affiliation approach and phasing is shown in the diagram below. **Figure 6**  *Source: Highmark corporate data*

Key Observations

Impact of BCBSD Delayed Migration and Affiliation with Highmark

Highlights	Observations
Based on a neutralization approach, BCBSD has estimated it would incur "throw away" costs of from $2m to $2.5m to achieve minimal ICD-10 compliance, in the event of a delayed affiliation approval decision.	**Delayed Affiliation Approval Considerations** ■ The BCBSD and Highmark planning teams have proposed that the optimum timeframe for commencing affiliation integration implementation would be subsequent to the requested DDI approval of the affiliation agreement in December 2011. The effort would last 18 months, completing in June 2013 (see Appendix A). ■ Based on our understanding of the scope of work to be performed as detailed in the affiliation projects, we believe this time frame would be reasonable. ■ We also concur that *delays in affiliation approval beyond December 2011 would increase the risk and costs for BCBSD* to ensure that it is operating on systems that are ICD-10 compliant by the October 2013 deadline. – Full remediation of systems to meet ICD-10 compliance may take up to 36 months and would not be an option. – An outsourcing arrangement or replacement of legacy systems would also not be an option since there would be insufficient time for BCBSD to migrate from its legacy systems to a compliant software platform. – A neutralization approach would be the only viable option for achieving ICD-10 compliance by the deadline. **Cost Estimates for the Neutralization Approach** ■ In a scenario where approval is subsequent to January 2012, BCBSD would have to incur "throw away" costs to ensure its systems are ICD-10 compliant. This effort would precede the migration to the Highmark business and technology platform. ■ This approach is estimated by BCBSD to range from $2m to $2.5m. The cost estimates include: – Project management staff - $100k – Programming staff - $700k to $900k – PLASM coding staff - $699k to $800k – Consulting support - $400k – Communications - $100k – User training - $240k

Impact of BCBSD Delayed Migration and Affiliation with Highmark

Highlights	Observations
We considered the risks of the neutralization approach given the current state of the IT environment, and the potential for underestimation of the scope and complexity of the work to be performed. Based on these considerations, we estimate the costs may range from $3m to $5m.	**Cost Estimates for the Neutralization Approach,** *continued* ■ With a neutralization approach, there may be only minor programming requirements, and/or changes to application code within existing systems. However, given the scope of work to be performed, there is still the possibility that BCBSD costs could increase significantly over preliminary estimates. Factors such as underestimating of scope and complexity of the effort, and the organization's ability to manage a large project of this size and complexity could, for example, significantly increase required programming, consulting and user training costs. ■ Considering these and other factors, we estimate the costs for this neutralization approach may range from $3m to $5m. **Risk Considerations** ■ In the event of a delay in affiliation approval, or a denial, BCBSD will need to be prepared to quickly ramp up its resources (internal and external) to implement a neutralization solution. With other health plans also competing for resources in order to meet the deadline, it is unclear as to whether any additional external resource capacity could be acquired in the timeframe required. ■ While the neutralization approach chosen to meet the ICD-10 mandate should involve a reduced effort and provide a less costly, short term solution option, there are risks in this approach, including: – Inability to utilize ICD-10 data in medical management or benefits design – Potential for overpayment or medical management appeals (i.e., legal risk) – Potential negative impact to analytical capabilities – Potential impact to institutional provider contracts – Inability of the BCBSD team to implement the changes in the allowed timeframe

Key Observations

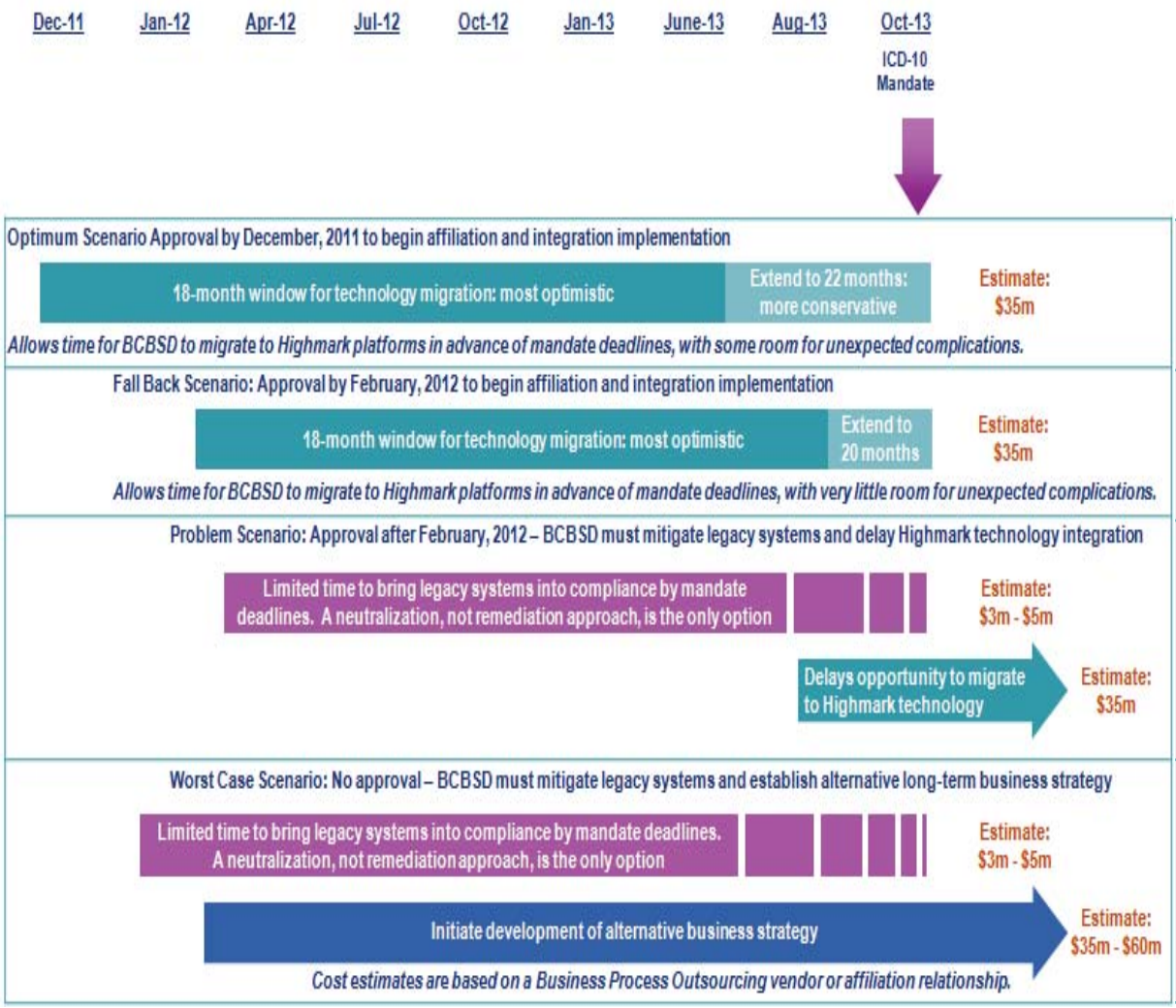
BCBSD Future Disaffiliation with Highmark

Highlights	Observations
The scope and complexity of work effort involved in a disaffiliation would likely exceed that of affiliation integration. **It is unlikely that shared applications, such as core administrative systems, owned by Highmark, would be cloned and transferred to BCBSD as part of a disaffiliation due to their scale, complexity and total cost of ownership. Therefore, BCBSD would likely need to replace all applications and infrastructure required to run its business, either through another affiliation, the use of another provider's business and technology platform under an Administrative Services Agreement, or from one or more BPO/ITO outsourcing relationships.** **Based on high level, rough order of magnitude estimates, we believe the costs for BCBSD to disaffiliate from Highmark could range from $38m to $55m over a 24 to 36 month period.**	**Disaffiliation and Risk Considerations** ■ We were asked to consider the implications of BCBSD needing to disaffiliate from Highmark at some future date. ■ Generally, IT separation complexity is determined by the degree to which the IT systems of the two entities are dependent on each other. Complexity is driven primarily by the degree to which applications are shared or integrated. The number of applications, the technical platform in which they are used and the volume of transactions managed by these applications also have an impact on complexity and business risk. With the migration to Highmark, BCBSD will be adopting Highmark business processes and systems, with few exceptions. BCBSD data will be uniquely identified, but remain co-mingled within the Highmark data stores. ■ With only a few exceptions, BCBSD will operate its business using Highmark systems across all areas of the business. Disaffiliation will not only encompass applications, but infrastructure, data, IT services and access. ■ The disaffiliation planning effort will mirror the affiliation integration effort. Teams representing all key business function areas, including IT, will need to be formed. Disaffiliation projects will need to be scoped, chartered and supported with execution plans and costs estimates. A disaffiliation roadmap with high priority and sequenced projects will need to be developed over a 24 to 36 month time horizon. BCBSD data will need to have its data extracted from Highmark production systems, and put in flat files for load into the target systems. ■ Depending on the BCBSD business strategy, the target systems and IT infrastructure used by BCBSD post disaffiliation from Highmark may be owned by another affiliation partner, an administrative services provider, or one or more business processing outsourcing vendors. Each arrangement would offer unique considerations with regard to timing, risk, complexity, and one-time and annual service costs. **Cost estimates** ■ The estimated disaffiliation costs may exceed the affiliation integration costs. This effort may also be governed by a Transition Services Agreement (TSA). The TSA to be negotiated with Highmark will need to specify the separation and transition services required (in addition to ongoing work) for a certain duration (i.e., 24 to 36 months) and the cost basis. Based on the current estimated $17m annual allocation cost that Highmark plans to charge BCBSD for use of its technology platform beginning in 2013, a 24 to 36 month disaffiliation period may involve costs from $38m to $55m. This cost range reflects the additional costs (allocable cost share plus 8% margin) BCBSD would bear as an external, non-affiliated partner to Highmark. While the Proposed Affiliation would require Highmark to provide transition services to BCBSD at cost plus 8% for a period of two years, it may be appropriate for the Department of Insurance to consider certain conditions on the transition process in the event of BCBSD's future disaffiliation from Highmark.

Appendix

Appendix A

Impact of affiliation approval timing on BCBSD planning and costs



	KPMG Comments
Optimum Scenario Approval by December, 2011 to begin affiliation and integration implementation	We believe this scenario could allow BCBSD sufficient time to migrate to Highmark's platform due to: 1) the rigorous pre-approval affiliation planning undertaken; and, 2) Highmark's affiliation integration experience and ability to backfill resources if needed.
Fall Back Scenario: Approval by February, 2012 to begin affiliation and integration implementation	We believe this scenario increases the risk that BCBSD can migrate to Highmark's platform prior to the compliance date due to other concurrent or competing initiatives – ICD-10, legacy modernization, PEGA process workflow and other strategic projects.
Problem Scenario: Approval after February, 2012 – BCBSD must mitigate legacy systems and delay Highmark technology integration	Neutralization would be the only viable solution (as opposed to remediation) to achieve ICD-10 compliance by the mandate deadline. Neutralization involves no or minimal system changes, requires less effort and time, and involves less throw away costs (less than the estimated $13m - $21m) for a remediation approach. Once BCBSD's legacy systems are compliant, they would be replaced by Highmark's systems as part of the technology integration.
Worst Case Scenario: No approval – BCBSD must mitigate legacy systems and establish alternative long-term business strategy	In this scenario, BCBSD would need to implement a neutralization solution to meet the October 2013 ICD-10 compliance mandate, and concurrently evaluate long-term alternatives for replacement of their core administrative systems. This may include another Blues affiliation partner's core platform, vendor software packages, or a BPO outsourcing approach.

Source: *BCBSD data and KPMG analysis*

Appendix B

Key Analysis Framework

Were Deloitte's estimated BCBSD systems costs related to standalone operations and migration and integration with Highmark's business and technology platform based on appropriate analyses and assumptions?

1 Are the estimated systems costs for BCBSD to achieve standalone operations reasonable?

a Have the potential costs of compliance with federal mandates such as HIPAA 5010, ICD-10 and Medical Loss Ratio (MLR) Rule, ACO Reform and Health Insurance Exchanges been appropriately estimated?

- What are the barriers to achieving 5010 and ICD-10 compliance?
- What are the strategic options and their corresponding costs for achieving remediation of core administrative applications within regulatory deadlines (Dec 31, 2011 for 5010 and October 1, 2013 for ICD10)?
- What are the cost drivers involved in remediating/augmenting core administrative systems with new flexible technology?
- What are cost/timeline implications of 5010 and ICD-10 migration of external stakeholders – vendors, trading partners (Claims Clearinghouses etc.)?
- Is there a limitation of internal resources, knowledge and skills to support the remediation effort? How will this impact costs?
- Does the current estimate take into account potential cash flow disruptions in the initial period(6 months -1 year) post ICD-10 implementation (e.g. delay in provider billing, delay in account payables, decrease in coding accuracy)?
- Have the costs of providing dual support of ICD-9 and ICD-10 systems been estimated? (Note: even if all systems are converted to process ICD-10 codes in October, 2013, dual support of both systems will need to be maintained for some period of time).
- What are the implications of the MLR rule on existing administrative systems (e.g., functions, processes, interfaces with other systems if any) and what are the estimated costs for remediation?
- How will ICD-10 implementation costs impact the client's MLR since it does not qualify as a Quality Improvement Activity(QIA)?

b Have the BCBSD capability gaps been scoped appropriately and are the supporting one-time and ongoing cost ranges and durations reasonable?

- Are there additional capability gap areas that have not been addressed in the 2010 capability gap closure costing detail?
- Are there optional/modified approaches to solution implementation and integration (e.g., BPO outsourcing) that might offer significantly less costly options than recommended by Deloitte?
- In the aggregate, would any additional gap areas and associated estimated costs require investments significantly less than or greater than the estimated range of from $88m to $140m?
- Do the estimates include additional costs related to – business process changes, employee training, additional staffing, system maintenance, and on-going support?
- What is the current status of the initiatives/projects listed in BCBSD's IT Roadmap?

2 Are the migration scenarios, timelines and estimated costs for BCBSD to transition to Highmark platforms based on a reasonable approach and set of assumptions?

a Does the integration with Highmark address BCBSD's capability gaps and are the supporting cost/timeline estimates reasonable?

- What is the BCBSD/Highmark platform integration strategy and approach?
- What is the status of the affiliation program/ integration plans, including project charters, completed activities, actual expenditures to budget, and expected completion dates?
- How will data be migrated from BCBSD and segregated within Highmark systems?
- Is the current cost estimate of $35m to migrate to the Highmark technology platform reasonable? What are the detailed cost components? What factors might lead to cost escalators?
- What is the current status of Highmark's legacy core administration system modernization? What are its cost/timeline estimates? How will it assist BCBSD in decreasing its administrative costs?
- Will Highmark systems (actuarial and underwriting) be able to handle the highly flexible/modular set of benefits and requirements of BCBSD products?
- Do the parties have the skills and resources to keep the current business running while executing the migration and integration?
- Is there a need to restructure vendor/ outsourcing contracts and/or create new ones? Are there any software re-licensing costs associated with the migration?
- What new organization structures will be put in place post migration? What is the scope and size of change management effort required?
- Are there other relationships that BCBSD might consider other than an affiliation with Highmark to address its capability gap requirements, such as a BPO outsourcing arrangement or Administrative Services Agreement with Highmark?

b Will the integrated organization be able to comply with all regulatory mandates within the current cost/ timeline estimates?

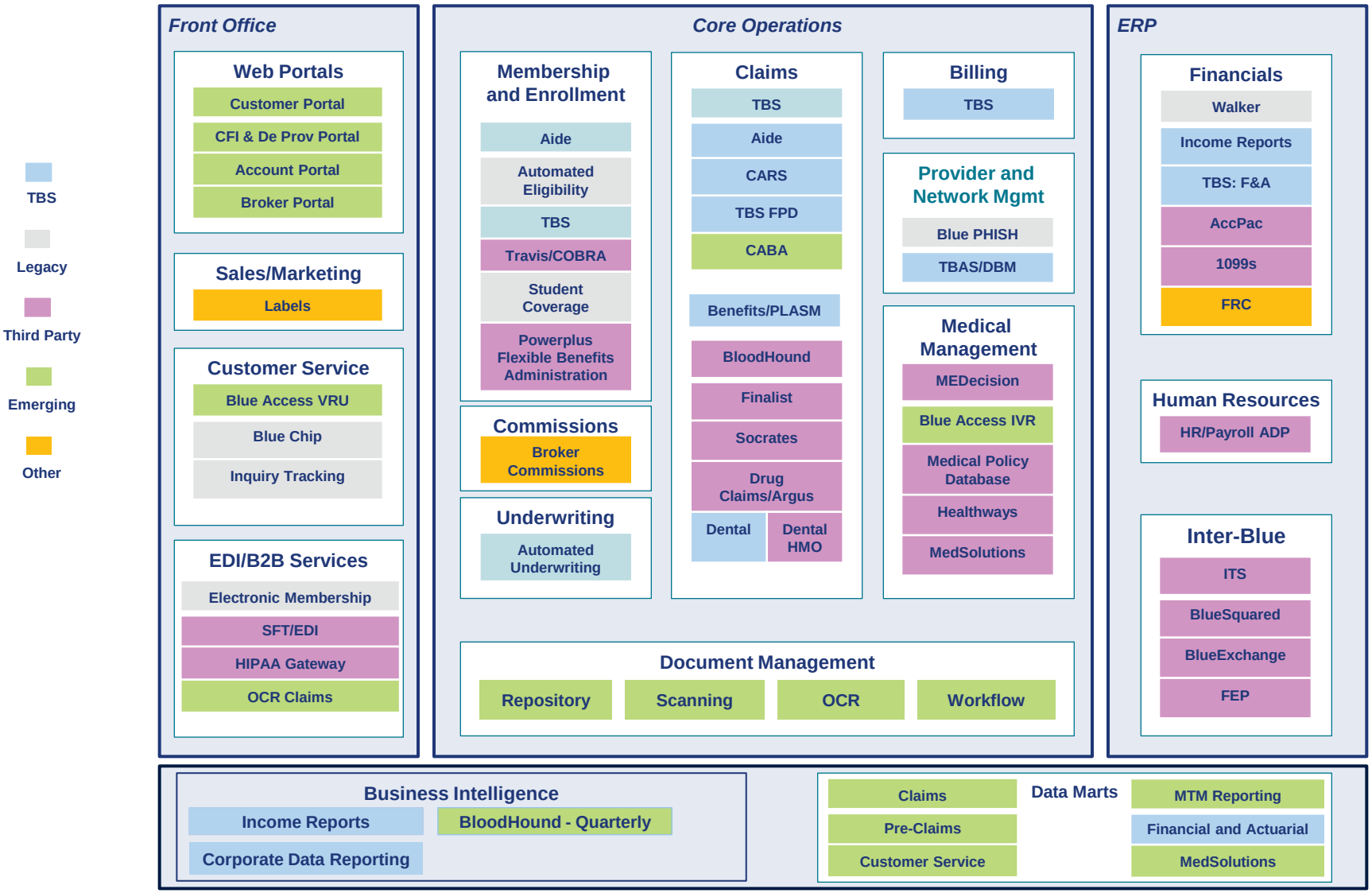
- What is Highmark's detailed strategy/roadmap to be compliant with various healthcare reform mandates?
- What is the current status of Highmark's 5010 and ICD-10 compliance efforts?
- Is Highmark's current map-and-wrap strategy for implementing ICD-10 a viable long-term solution for the combined organization?
- How will the various external dependencies - disaffiliation with CareFirst, BCBSA mandates etc. - impact the timeline of migration?

c Will BCBSD integration with the Highmark business and technology platform lead to significant separation costs in the event of future disaffiliation?

- What is the likely disaffiliation approach and associated risks?
- What are the key separation points, timeline and related costs that BCBSD will bear in case of disaffiliation?
- After affiliation, to what extent will there be functional dependencies or shared processes between BCBSD and Highmark? What applications will be shared, integrated or outsourced?
- Will the data migrated during integration be modular (and not hard-wired) so that data segregation is seamless in case of disaffiliation?
- Will the disaffiliation force changes to business processes (e.g., new functionality, process rationalization, functional interface changes)?
- How will existing vendor/outsourcing contracts impact on the separation cost and time estimates?
- What impact will the potential future healthcare mandates (e.g., insurance exchanges, individual mandate) and the political landscape have on separation/ disaffiliation costs?

Appendix C

Current BCBSD Application Portfolio



Source: BCBSD corporate data

Appendix D

ICD-10 Conversion Strategies – Standalone Operations

Source	Recommended Approach	Pros	Cons	Timing	Estimated Costs
Arcadia Solutions	• **Phase I** – Target systems and components that can be migrated right away, neutralize or "cross walk" others. • **Phase II** – Remediation of remaining systems and phase out "cross walks".	• Lease expensive option • Some benefit realization, but delayed impact to 2016 • Lease impact to the business, supporting ongoing support to business functions while moving through multiple phases of remediation	• Some "throw away" costs • BCBSD's antiquated core administration systems are retained in service – hampering BCBSD's ability to compete in the market and efficiently address future government mandates	• Phase 1 – BCBSD should be able to meet the Jan 1, 2013 compliance mandate if the implementation begins in Q4 2011. • Phase II: Complete full migration on, or before 2016.	• Does not explicitly specify costs
Deloitte	• Parallel execution of: - ICD-10 remediation (blended approach of remediation and crosswalk depending upon business function) - Core administration system replacement	• Brings systems capabilities of BCBSD to par with the competition • All systems migration completed by 2013 • Quick value realization from ICD-10 migration (e.g., specificity from codes will allow for better pricing of services)	• Most expensive option; maximum throwaway costs since remediated core administration systems will eventually be replaced • Aggressive schedule; significant risk that compliance deadline could be missed • More impact (cost, human capital, process change) across all business functions at the same time	• Timeline: Q1 2011 – Q4 2013	ICD-10 remediation: $10m - $15m Core administration system replacement $35m - $50m
KPMG	• **Phase 1: Tactical cross walk solution** - Migrate trading partner facing systems to ICD-10 - Use cross walks to map to ICD-9 for internal applications - Create technical framework to transmit ICD-10 across the enterprise systems - In parallel, assess options for: • Third party software packages • Affiliation • Administrative services partnership/Business Process Outsourcing • **Phase II: Full replacement** - Perform full core administration system replacement or migrate to a partner's ICD-10 compliant platform.	• We concur that BCBSD's core administration systems need to replaced to bring them to par with competitors. This option allows BCBSD to achieve minimal ICD-10 compliance, while providing time to evaluate alternative options for replacing core administration systems • Offers maximum likelihood of meeting the ICD-10 compliance deadline • Offers the least costly Phase I implementation	• Some "throw away" costs • Capital investment or run rate operating expenditure (BPO option) may be prohibitive given BCBSD's financial condition KPMG proposes a more accelerated, less costly approach to ICD-10 compliance in Phase I, and a full replacement of core administration systems in Phase II	•Timeline: Phase I: Q4 2011 – Q4 2012; meets January 1, 2013 compliance mandate • Phase II: 24 – 48 months, depending on the alternative chosen for core administration systems replacement	Phase I: ICD-10 neutralization $3m - $5m Phase II: Core administration system replacement $35m - $50m

Source: KPMG analysis

Appendix E

Advantages and Disadvantages of ICD-10 Implementation Strategies

Advantages and Disadvantages of ICD-10 Implementation Strategies			
	Approach	**Advantages**	**Disadvantages**
Remediation	This involves a line-by-line analysis of code and an upgrade of references from ICD-9 to ICD-10's code structure. Logic that may have grouped many ICD-9 codes must be amended to refer to the enhanced structure and volume of ICD-10 codes.	Detailed review of code and business process allows for business process improvement opportunities. Independent of vendor commitments to other clients.	Time- and staff-consuming, little net new advantages and retention of large pockets of old application code.
Replacement – New Application	Involves swapping out of core administration systems with new vendor software offerings that are inherently ICD-10 compliant.	Ability to achieve compliance while gaining access to new technologies, which can allow for new product definitions and business processes.	New vendors, codes and processes in a time-constrained environment.
Replacement – New Version	Involves swapping out of core administration systems with new version upgrades of vendor software offerings that are inherently ICD-10 compliant.	Familiarity with existing application while targeting specific conversion needs.	Time and resources.
Replacement – BPO	Replace legacy systems via business process outsourcing (BPO).	Eliminates the need to remediate code or manage business processes.	New business model with management, cultural and integration issues.
Neutralization	This baseline of compliance (aka "tactical cross walk") involves surrounding the ICD-9 processing systems and insulating them from the need to address ICD-10 code formats or volumes.	The least-intrusive strategy. Little changes in claims inventory, business processes and/or diagnosis grouping.	Time-vault strategy. Healthcare insurer is basically compliant, but frozen in the logic and processes associated with ICD-9.

Source: Gartner, 2009

KPMG concurs with BCBSD that a neutralization approach for ICD -10 compliance is required should the affiliation decision be delayed, or denied, based on time constraints and cost considerations.

Appendix F

BCBSD 2010 Capability Gap Closure Costing Detail

Area	Description	One - time Cost Range	Duration	Ongoing Cost Range[1]
Pricing/ Underwriting Workflow and Rating Engine	■ Implement workflow system ■ Implement rating engine to automate pricing and underwriting processes	$2m - $5m	9-15 months	System Maintenance 18%
Sales and marketing	■ Implement CRM System (vendor-provided software) – Marketing (Marketing Resource Management, Campaign Management) – Sales Force Automation (Lead/Opportunity Management)	$4m - $8m	12-30 months	System Maintenance / Ongoing Administration (1-2 FTEs) 18%
Network and Medical Management	■ Implement a provider profiling system and pay-for-performance capabilities and integrate with new core admin system ■ Fully integrate iExchange with new core admin system to automate pre-authorizations	$4m - $8m	18-24 months	System Maintenance 18%
Work Portals	■ Enhance or replace member/plan sponsor/broker/provider portals (e.g., CDH member tools, transactional capabilities)	$8m - $10m	18-24 months	System Maintenance 18%
Health Care Reform and Compliance	■ *ICD-10 Remediation*	$10m - $15m	36 months	System Maintenance 18%
	■ *ACO/Payment Reform Administrative Capabilities*	$2m - $5m	12-18 months	System Maintenance 18%
	■ *Implement Health Insurance Exchange Integration*	$3m - $6m	24-36 months	System Maintenance 18% - Ops TBD
	■ *MLR Reporting/Pool Management/Rebate Administration Capabilities*	$1m - $3m	9-15 months	System Maintenance 18% - New Ops Function

Source: *Deloitte BCBSD 2010 Capability Gap Closure Costing Detail*

Note: [1] The ongoing cost range estimated by Deloitte involves system maintenance, which is calculated as a percentage (18%) of the one-time costs. The 18% represents an average for annualized hardware and software maintenance spend. BCBSD and Highmark have developed more detailed maintenance cost estimates which are reflected in the pro forma projections for the affiliation.

Key: New implementation (capability that does not exist currently and is required to achieve competitiveness)

Replacement/upgrade (capability that exists currently, but needs to replaced/upgraded to maintain/achieve competitiveness)

Appendix F

BCBSD 2010 Capability Gap Closure Costing Detail, *continued*

Area	Description	One-Time Cost Range	Duration	Ongoing Cost Range[1]
Core Administration Replacement	■ Perform full core administrative system replacement (TBS to third party software package replacement) impacting all core operations areas (i.e., claims, membership, case installation, billing, provider, accounts receivable, service) ■ Migrate CDH products to the future core administration system and build more advanced CDH tools ■ *Support Health Care Reform Administrative Simplification Compliance mandates*	$35m - $50m	24-48 months	System Maintenance 18%
Membership and Billing	■ Implement online bill presentment and payment (for group and individual)	$2m - $3m	12-18 months	System Maintenance 18%
Service Oriented Architecture (SOA)/ Enterprise Service Bus	■ Built out TIBCO integration/workflow/SOA infrastructure and deploy capabilities ■ Leverage integration infrastructure to support core administration platform replacement	$3m - $5m	12-24 months	System Maintenance 18%
Informatics/ Data Warehousing	■ Implement an Enterprise Data Warehouse: Establish an enterprise data warehouse (EDW), ETL, ODS, Analytics. Operational and Mgmt Reporting, and Ad Hoc Reporting	$9m - $13m	24-36 months	System Maintenance 18% Operational Support TBD
	■ Implement External Client Reporting: Implement interactive and robust plan sponsor reporting capabilities	$3m - $5m	12 months	System Maintenance 18%
	■ Implement a management decision support information system (EIS/Dashboards)	$2m - $4m	12-18 months	System Maintenance 18%

Source: *Deloitte BCBSD 2010 Capability Gap Closure Costing Detail*

Note: [1] The ongoing cost range estimated by Deloitte involves system maintenance, which is calculated as a percentage (18%) of the one-time costs. The 18% represents an average for annualized hardware and software maintenance spend. BCBSD and Highmark have developed more detailed maintenance cost estimates which are reflected in the pro forma projections for the affiliation.

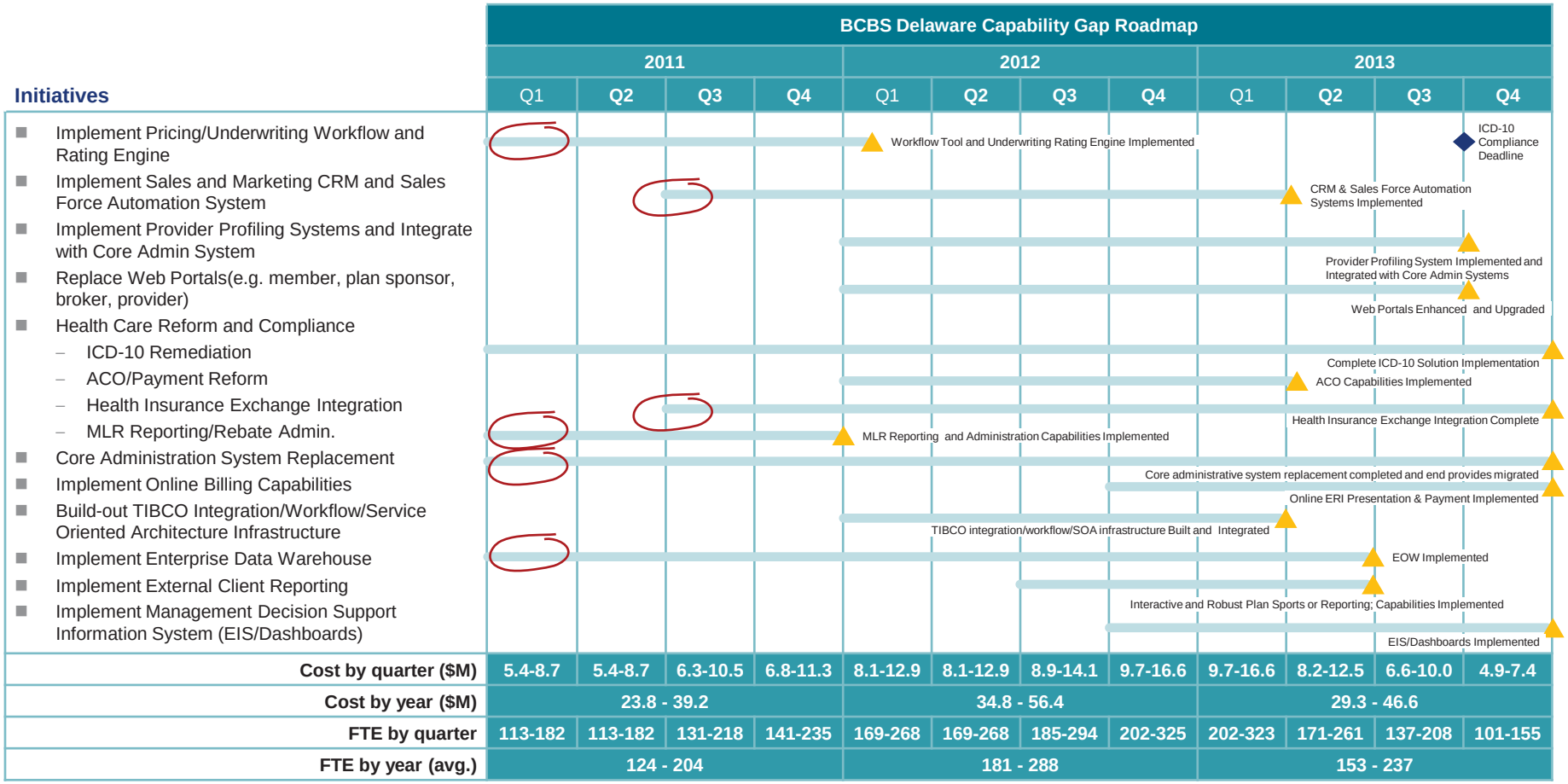
Key: New implementation (capability that does not exist currently and is required to achieve competitiveness)

Replacement/upgrade (capability that exists currently, but needs to replaced/upgraded to maintain/achieve competitiveness)

Appendix G

Deloitte Capability Gap: 3-year roadmap

Numerous short term and long term activities were recommended to start early in 2011 to achieve business goals and meet compliance deadlines. The affiliation strategy with Highmark and pending approval has delayed the launch of key projects.



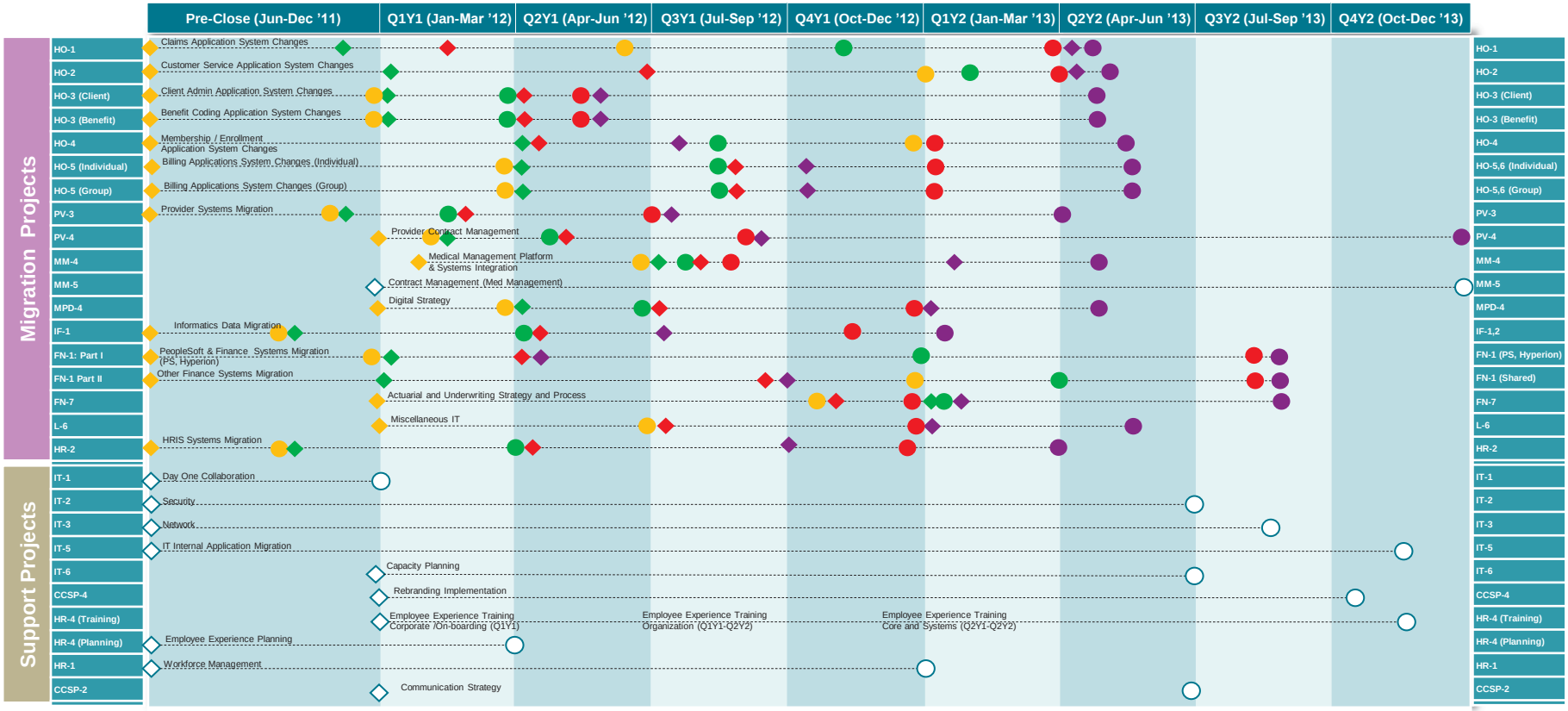
	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4
Cost by quarter ($M)	5.4-8.7	5.4-8.7	6.3-10.5	6.8-11.3	8.1-12.9	8.1-12.9	8.9-14.1	9.7-16.6	9.7-16.6	8.2-12.5	6.6-10.0	4.9-7.4
Cost by year ($M)	23.8 - 39.2				34.8 - 56.4				29.3 - 46.6			
FTE by quarter	113-182	113-182	131-218	141-235	169-268	169-268	185-294	202-325	202-323	171-261	137-208	101-155
FTE by year (avg.)	124 - 204				181 - 288				153 - 237			

Key: ▲ Major Milestones/Deliverables
◆ Compliance Deadlines
Initiatives that have not been launched

Source: Deloitte and KPMG analysis

Appendix H

BCBSD Affiliation Project Roadmap (1 of 3)

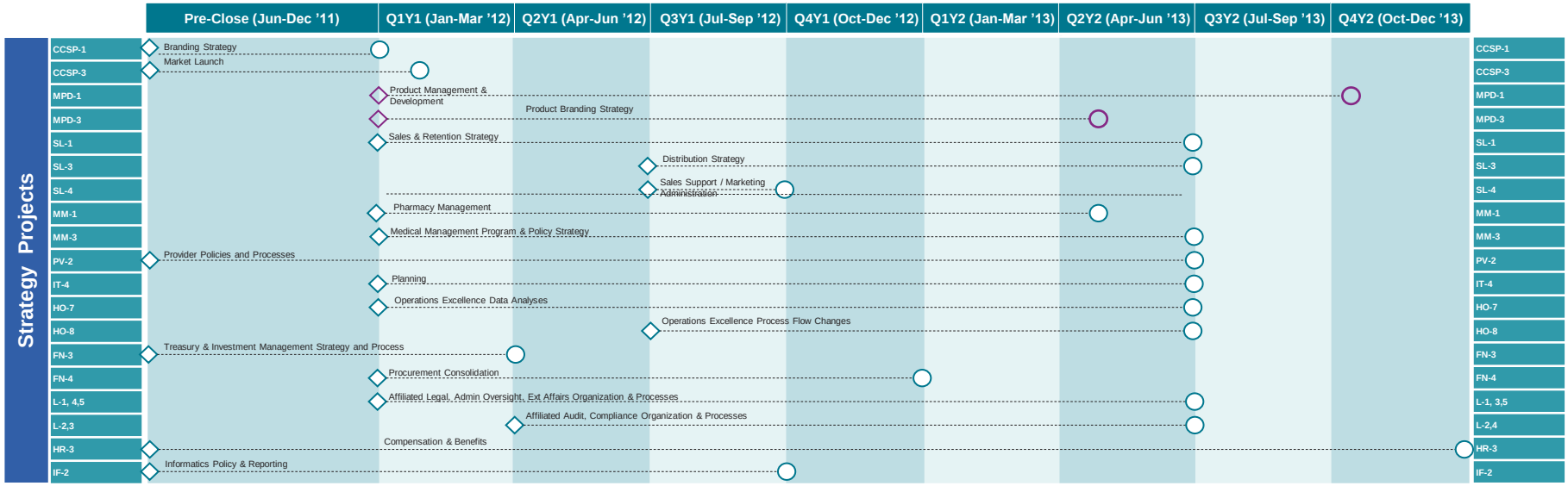


Key:
- Preliminary Analysis – define problem statement and gain agreement on project scope
- Requirements – gather and analyze user requirements for the proposed system/future state
- Integration Testing – run tests to ensure that application components operate properly when combined to execute together
- Migration / Go-Live – migrate/convert data to the new system; deploy the new system and decommission the old system
- End of Phase
- Single Phase Project

Source: BCBSD Affiliation Project Roadmap and KPMG analysis

Appendix H

BCBSD Affiliation Project Roadmap (2 of 3)

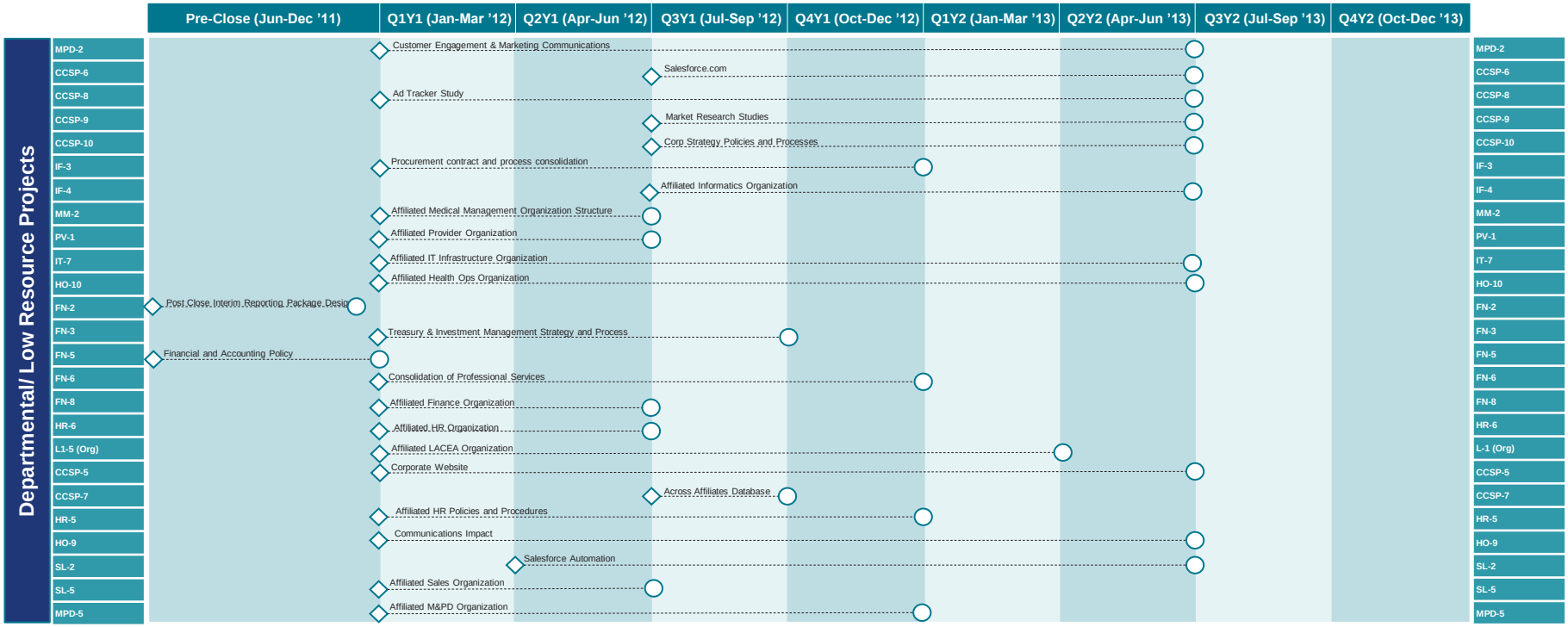


Key:
- Preliminary Analysis – define problem statement and gain agreement on project scope
- Requirements – gather and analyze user requirements for the proposed system/future state
- Integration Testing – run tests to ensure that application components operate properly when combined to execute together
- Migration / Go-Live – migrate/convert data to the new system; deploy the new system and decommission the old system
- End of Phase
- Single Phase Project

Source: BCBSD Affiliation Project Roadmap and KPMG analysis

Appendix H

BCBSD Affiliation Project Roadmap (3 of 3)



Key:
- Preliminary Analysis – Define problem statement and gain agreement on project scope
- Requirements – Gather and analyze user requirements for the proposed system/future state
- Integration Testing – Run tests to ensure that application components operate properly when combined to execute together
- Migration / Go-Live – Migrate/convert data to the new system; Deploy the new system and decommission the old system
- End of Phase
- Single Phase Project

Source: BCBSD Affiliation Project Roadmap and KPMG analysis

Appendix I

BCBSD affiliation roadmap projects (1 of 6)

ID	PTO[1]	Area	Project Name	Project Description
CCSP-1	✘	Go to Market-Corp Communications and Strategic Planning	Branding Strategy	Development of the strategy that defines how to brand BCBSD if the Affiliation Agreement with Highmark is approved by the DE Insurance Department.
CCSP-2	✘	Go to Market-Corp Communications and Strategic Planning	Develop internal and external Communications Strategy	Branding as part of Highmark must maintain the market leadership of the BCBSD brands and extend Highmark's brand strength into Delaware, without market disruption and with positive reception by all stakeholders.
CCSP-3	✘	Go to Market-Corp Communications and Strategic Planning	Market Launch	Create a positive image for the combined enterprise, generate goodwill and maintain relationships with group accounts, providers, customer members, broker/agents and Associates (employees) that publicly launches to all customer touch points how the organization will be known by the community at large.
CCSP-4	✘	Go to Market-Corp Communications and Strategic Planning	Rebranding Implementation	Make all the necessary changes on all external communications and building signage, all systems and all business processes to use the new name and logo for Delaware, as efficiently as possible.
CCSP-5	✘	Go to Market-Corp Communications and Strategic Planning	Corporate Website	Incorporate BCBSD into the Corporate Highmark Website – Highmark.com, and determine how the BCBSD Intranet will be integrated to Highwire, i.e., Highmark's intranet.
CCSP-6	✘	Go to Market-Corp Communications and Strategic Planning	SalesForce.com	To support Market Study, ensure SalesForce.com (i.e., an application service provider software solution that provides sales force automation capabilities such as opportunity tracking and revenue forecasting) can accommodate the information needed to support Market Research.
CCSP-7	✘	Go to Market-Corp Communications and Strategic Planning	Across Affiliates Database/ Company Profile DB	Capture all BCBSD Client information on AADB to support Sales, Marketing, etc. front-end functions. Use the new matching component of the Company Profile DB.
CCSP-8	✘	Go to Market-Corp Communications and Strategic Planning	Ad Tracker Study	Determine if the Ad Tracker Study would provide value for Highmark to re-institute or if an alternative solution to provide BCBSD with an Advertising Effectiveness Study is needed.
CCSP-9	✘	Go to Market-Corp Communications and Strategic Planning	Market Research Studies	Make all the necessary changes to existing Highmark Market Research Studies to include BCBSD.
CCSP-10	✘	Go to Market-Corp Communications and Strategic Planning	Corp Strategy Policies & Processes	Understand differences between Highmark and BCBSD departments and develop or modify processes and policies for the affiliated company in the areas of Advertising, PR, Sponsorships, and Communications.

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*
Note: *[1]Possible to Outsource*

Key: ✘ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)
✓ Business process is more typically outsourced in a long term business process outsourcing relationship

Appendix I

BCBSD affiliation roadmap projects (2 of 6)

ID	PTO[1]	Area	Project Name	Project Description
FN-1	✓	Corporate Finance	Part I – PeopleSoft and Hyperion Migration	BCBSD finance currently uses Walker as the primary financial system along with various supplementary finance systems and applications. As the end-state goal is for BCBSD to apply all Highmark technology, it is important to migrate BCBSD's finance activities onto Highmark's PeopleSoft G/L and all relevant modules as well as other finance system and applications used by Highmark.
FN-1	✓	Corporate Finance	Part II – Other Finance System Migration (including CBS)	BCBSD finance currently uses Walker as the primary financial system along with various supplementary finance systems and applications. As the end-state goal is for BCBSD to apply all Highmark technology, it is important to migrate BCBSD's finance activities onto Highmark's PeopleSoft G/L and all relevant modules as well as other finance system and applications used by Highmark.
FN-2	✓	Corporate Finance	Post Close Interim Reporting Package Design	FAR Post Close and FP&A Post Close Reporting Packages Design.
FN-3	✗	Corporate Finance	Treasury and Investment Management Strategy and Process	BCBSD will utilize Highmark's banking relationships and investment managers in achieving synergies from banking fees. Bank accounts need to be transitioned and the entire investment management strategy and processes need to be re-aligned with Highmark's operating model in the area.
FN-4	✗	Corporate Finance	Procurement Consolidation	Consolidation of BCBSD into Highmark Procurement systems and process. Consolidation of vendors to gain efficiencies.
FN-5	✗	Corporate Finance	Financial and Accounting Policy	Review of BCBSD policies and adoption of Highmark Financial and Accounting Policies by BCBSD.
FN-6	✗	Corporate Finance	Consolidation of Professional Services	Consolidation of services for Audit, Tax and Corporate Insurance post-affiliation.
FN-7	✗	Corporate Finance	Actuarial and Underwriting Strategy and Process	Consolidation of Actuarial and Underwriting policies and processes and adoption of Highmark policies by BCBSD (unless otherwise dictated by Delaware requirements).
FN-8	✗	Corporate Finance	Affiliated Finance Organization	Create an effective post-affiliation Finance organization.
HO-1	✓	Back Office Health Operations	Corp Strategy Policies and Processes	Understand differences between Highmark and BCBSD departments and develop or modify processes and policies for the affiliated company in areas of Advertising, PR, Sponsorships, and Communications.
HO-2	✓	Back Office Health Operations	Customer Service Application System Changes	BCBSD and Highmark will ensure that BCBSD migrates to one common customer service system. This will include call routing, grievance / appeals, IVR support, etc. The team will understand the tactical next steps required to complete this migration.

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*
Note: *[1]Possible to Outsource*

Key: ✗ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)
✓ Business process is more typically outsourced in a long term business process outsourcing relationship

Appendix I

BCBSD affiliation roadmap projects (3 of 6)

ID	PTO[1]	Area	Project Name	Project Description
HO-3	✓	Back Office Health Operations	Client Admin / Benefit Coding Application System Changes	BCBSD and Highmark will ensure that BCBSD migrates to one common client administrative / benefit coding system.
HO-4	✓	Back Office Health Operations	Membership/Enrollment Application System Changes	BCBSD and Highmark will ensure that BCBSD migrates to one common membership / enrollment system. This will include the conversion of enrollment to ECS. The Team will understand the tactical next steps required to complete this migration.
HO-5	✘	Back Office Health Operations	Banking Arrangements (Treasury)	BCBSD and Highmark will determine lockbox/bank arrangements necessary for invoice generation.
HO-6	✓	Back Office Health Operations	Billing Application Systems Changes	BCBSD and Highmark will ensure that BCBSD migrates to one common billing application system. This will include conversion of current and historical data. The Team will understand the tactical next steps required to complete this migration.
HO-7	✓	Back Office Health Operations	Operational Excellence Data Analyses	BCBSD and Highmark will ensure that there is alignment with Highmark's Operational Excellence data analyses.
HO-8	✓	Back Office Health Operations	Operational Excellence Process Flow Changes	BCBSD and Highmark will ensure that there is alignment with Highmark's Operational Excellence process flows.
HO-9	✘	Back Office Health Operations	Communications Impact	This project will be incorporated into the overall CC&SP project.
HO-10	✘	Back Office Health Operations	Affiliated Health Operations Organization	N/A
HR-1	✓	Corporate Human Resources	Workforce Management	Manage workforce transition into new affiliated company, including cost analysis, alignment of roles, responsibilities and job grades.
HR-2	✓	Corporate Human Resources	HR Systems Migration	Assess and consolidate current HR Systems into one, centralized platform which enables the day to day activities of each HR Function.
HR-3	✓	Corporate Human Resources	Compensation and Benefits	Analysis of differences in compensation structures and alignment of compensation and benefits in end-state organization.
HR-4	✓	Corporate Human Resources	Employee Experience (Change Management and Training)	Manage employee experience throughout the affiliation process and develop strategies and plans to prepare for appropriate HR communications, training, on-boarding requirements, orientation and assimilation.

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*
Note: *[1]Possible to Outsource*

Key: ✘ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)
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Appendix I

BCBSD affiliation roadmap projects (4 of 6)

ID	PTO[1]	Area	Project Name	Project Description
HR-5	✓	Corporate Human Resources	Affiliated HR Policies & Procedures	Assess HR policies across Highmark and BCBSD and align to ensure all obligations are appropriately met when developing affiliated organization policies. Ensure consistency of policy and training across all functions.
HR-6	✗	Corporate Human Resources	Affiliated HR Organization	Development of affiliated HR organization structure.
IF-1	✓	Go to Market-Informatics	Informatics Data Migration	Consolidation of core systems and migration to a centralized platform. Develop a consistent system across the organization.
IF-2	✓	Go to Market-Informatics	Informatics Policy and Reporting	Establish a consistent method of reporting in Informatics.
IF-3	✗	Go to Market-Informatics	Procurement Contract and Process Consolidation	Consolidation of all vendors and vendor management process (SAS, Verisk).
IF-4	✗	Go to Market-Informatics	Affiliated Informatics Organization	Create an integrated post-affiliation informatics organization. Reorganize key talents to achieve an optimized workforce for the end state organization.
IT-1	✗	Back Office IT/Infrastructure	Day one collaboration	Develop “Day 1 Collaboration” plan.
IT-2	✓	Back Office IT/Infrastructure	Security	Expand security configurations.
IT-3	✓	Back Office IT/Infrastructure	Network	Develop network capabilities, centralize the dialing plan and communication services.
IT-4	✓	Back Office IT/Infrastructure	Planning	Create post-close timeline to align with business timeline.
IT-5	✓	Back Office IT/Infrastructure	IT Internal Application Migration	Migrate the set of IT applications from BCBSD to Highmark to establish a centralized IT structure.
IT-6	✓	Back Office IT/Infrastructure	Capacity Planning	Review infrastructure current capacities, utilization forecast.
IT-7	✓	Back Office IT/Infrastructure	Affiliated IT Infrastructure Organization	Create an integrated post-affiliation IT infrastructure organization. Reorganize key talents to achieve an optimized workforce for the end state organization.
LACEA *1	✗	Corporate LACEA	Affiliated Legal Organization and Processes	Consolidation of Legal organization processes and creation of an affiliated organization structure.
LACEA *2	✗	Corporate LACEA	Affiliated Audit Organization and Processes	Consolidation of Audit organization processes and creation of an affiliated organization structure.

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*
Note: *[1]Possible to Outsource*

Key: ✗ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)
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Appendix I

BCBSD affiliation roadmap projects (5 of 6)

ID	PTO[1]	Area	Project Name	Project Description
LACEA *3	✘	Corporate LACEA	Affiliated Admin Oversight Organization and Processes	Admin functions will apply a mixture of Shared Services Model and Centralized Support Services Model. It is important to define and develop the affiliated organization structure and standardized processes aligned with the end state operating model (including Facility Management and Enterprise Risk Management).
LACEA *4	✘	Corporate LACEA	Affiliated Compliance Organization and Processes	Consolidation of Compliance organization processes and creation of an affiliated organization structure for both Privacy Office and Integrity Office.
LACEA *5	✘	Corporate LACEA	Affiliated External Affairs Organization and Processes	Consolidation of External Affairs organization processes and creation of an affiliated organization structure.
LACEA *6	✘	Corporate LACEA	Miscellaneous IT (BlueSTAR and other miscellaneous systems)	Systems and application consolidation and migration for the Legal, Audit, Compliance, External affairs and Admin Oversight functions.
MM-1	✘	Middle Office – Medical Management	Pharmacy Management	Assessment of BCBSD Pharmacy Management and transition to Highmark Pharmacy management program and platform as soon as possible following regulatory approval.
MM-2	✘	Middle Office – Medical Management	Affiliated Medical Management Organization Structure	Create an effective post-affiliation medical management organization.
MM-3	✘	Middle Office – Medical Management	Medical Management Program and Policy Strategy	BCBSD and Highmark will review their Medical Management Program & Policy Strategy, including an understanding of Provider Management.
MM-4	✓	Middle Office – Medical Management	Medical Management Platform and Systems Integration	Integrate medical management platforms and systems and migrate BCBSD data to Highmark systems.
MM-5	✓	Middle Office – Medical Management	Contract Management (Med Mgmt and Provider)	Shift of all Delaware and potentially Highmark medical management contracts to recommended vendors for improved pricing and efficiency.
MPD-1	✘	Go to Market – Marketing and Product Development	Product Management and Development	BCBSD and Highmark will work to create centralized product management and development processes to ensure we meet market and customer demands.
MPD-2	✘	Go to Market – Marketing and Product Development	Customer Engagement & Marketing Communications	For Day One, BCBSD and Highmark will create a strong customer engagement strategy for its members, employers, consultants, and brokers to better understand the demands of the market. BCBSD and Highmark will also include providers in this strategy.
MPD-3	✘	Go to Market – Marketing and Product Development	Product Branding Strategy	BCBSD and Highmark will define / create a product branding strategy that is consistent with the enterprise branding strategy. The BCBSD and Highmark teams will work in lockstep with CC&SP.

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*

Note: *[1]Possible to Outsource*

Key: ✘ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)

✓ Business process is more typically outsourced in a long term business process outsourcing relationship

Appendix I

BCBSD affiliation roadmap projects (6 of 6)

ID	PTO[1]	Area	Project Name	Project Description
MPD-4	✓	Go to Market – Marketing and Product Development	Digital Strategy	BCBSD and Highmark will create an even more robust digital strategy that will include improving the portal functionalities, platforms and technical capabilities. This will also align with Healthcare Reform mandates.
MPD-5	✗	Go to Market – Marketing and Product Development	Affiliated M&PD Organization	This project will be incorporated into the overall HR/EE project.
PV-1	✗	Middle Office Provider	Affiliated Provider Organization	Create an integrated post-affiliation provider organization. Reorganize key talents to achieve an optimized workforce for the end state organization.
PV-2	✗	Middle Office Provider	Provider Policies and Processes	Development of a single, consistent process for working with providers, and ensure alignment in reimbursement and other policies.
PV-3	✓	Middle Office Provider	Provider Systems Migration	For Day One, migration of systems and applications used within the provider organization, and by Providers within the network. Seamless migration is essential to ensure no impact is felt outside the companies.
PV-4	✓	Middle Office Provider	Contract Management (Med Mgmt and Provider)	Shift of all Delaware provider contracts into Highmark contract management system, and consolidation of vendor relationships for improved pricing and efficiency. Ultimately develop a contract that is consistent with methodology, language and policies of Highmark.
SL-1	✗	Go to Market - Sales	Sales & Retention Strategy	BCBSD and Highmark will create opportunities to cross-sell, up-sell, and offer new products to strengthen sales retention.
SL-2	✗	Go to Market - Sales	Salesforce Automation	BCBSD and Highmark will utilize Highmark's sales automation tools and quoting and rating tools. Please note that there are two phases to this project: Phase 1) CRM Management and Phase 2) Institutionalizing Back Office.
SL-3	✗	Go to Market - Sales	Distribution Strategy	BCBSD and Highmark will work to create a distribution strategy, leveraging all media to promotes Sales. This effort will align with the Sales Retention Strategy.
SL-4	✗	Go to Market - Sales	Sales Support / Marketing Administration	BCBSD and Highmark will work to build a strong sales support and marketing administration model.
SL-5	✗	Go to Market - Sales	Affiliated Sales Organization	N/A

Source: *BCBSD Affiliation Capability Tracing Analysis, KPMG Analysis*
Note: *[1]Possible to Outsource*

Key: ✗ Business process is typically not a candidate for outsourcing (e.g., high strategic value, low cost savings potential)
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Appendix J

Potential business processing outsourcing benefits for a health plan

The following case study is for a health plan that is benefiting from adjudicating claims in an offshore environment.

Current administrative costs for a health plan			
Number of members	160,000	Number of claims manually adjudicated	600,000
Number of annual claims	2,000,000	Total claims adjudication cost	$4,300,800
Auto adjudication rate	70%	Cost of manually adjudicating a claim	$7,168

Each of the three scenarios represents the average price options offered by offshore providers. Savings will vary based on the plan's current transaction cost. In each case, the significant savings realized would support a decision to go offshore.

Administrative costs with offshore outsourcing[1]			
Pricing scenarios	**Scenario I**	**Scenario II**	**Scenario III**
Per claim cost to adjudicate offshore	$1.00	$2.00	$3.00
Number of claims adjudicated	600,000	600,000	600,000
Adjudication cost	**$600,000**	**$1,200,000**	**$1,800,000**
Remaining onshore cost (20%) Project oversight/management	$860,160	$860,160	$860,160
Total cost	$1,460,160	$2,060,160	$2,660,160
Total cost savings	**$2,840,640**	**$2,240,640**	**$1,640,640**
Savings as a % of original cost	66%	52%	38%

Source: *Tela Sourcing BPO Whitepaper*

Note: *[1]Offshore outsourcing refers to the hire of an external organization to perform some business function in a country other than the one where the product or service is developed or manufactured. Offshore outsourcing may often provide labor arbitrage opportunities leading to significant cost savings.*

Appendix K

Business processing outsourcing functionality for healthcare services

Front-end processes	Core administrative functions	Customer service	Provider management
■ Claims data entry ■ Imaging ■ Mailroom services	■ Member enrollment ■ Benefit enrollment ■ Claims adjudication ■ Billing and capitation	■ Full spectrum	■ Provider setup ■ Credentialing ■ Performance analysis ■ Provider directories

Care management	Underwriting support	CRM	Communication processes
■ Precertification ■ Referral authorization ■ Discharge planning ■ Case management	■ Quote generation ■ Compilation of claims history, employee census files and medical history data	■ Member acquisition ■ Retention and service	■ Production delivery and management of consumer campaigns to drive health behavior

Source: Gartner 2009

These functions have been adopted in many outsourcing deals as stand-alone services or in combination with each other.

Appendix L

ICD-10 cost remediation survey

Industry Source	Analysis Approach	Cost Drivers	Derived Cost Range	Comments
America's Health Insurance Plans (AHIP)	Twenty health insurance companies were surveyed, including (7) small (<1m members), (7) Medium (1m – 5m members) and (6) large (> 5m members) health plans. Includes business and technology costs to implement ICD-10.	Does not provide an explicit cost breakdown.	$3.2m - $27.2m for a small (<1M members) health plan. **Average estimate for a plan of BCBSD's size = $15.2m**	One of the most recent surveys cited by various industry stakeholders to estimate ICD-10 costs. The survey revealed average per-member implementation costs ranging from $38 for small health plans (<1m members) to $11 for large plans (> 5m members). Does not include administrative costs (e.g., HIPAA 5010) and ongoing maintenance costs.
Hay Group	Reviewed existing industry estimates and estimated preliminary cost impact to the US health system.	**Industry costs**: - Systems $330m - $750m - Training $60m - $120m - Contract Renegotiation* $30m - $130m	$6.1m - $12.5m for a large health plan.**	Does not include post-implementation costs related to delays in provider billing and account payables, decreases in coding accuracy and productivity, and increases in fraudulent claims.
Deloitte	Top down estimate based on Deloitte's experience with other health plans including Blue organizations. Includes incremental labor, training, business process change, decommissioning of legacy systems and data migration.	Does not provide an explicit cost breakdown	$10m-$15m for BCBSD.	Additional items that may not be adequately reflected in this estimate are: - contract renegotiation costs - post-implementation costs identified above. - increase in labor rate as the ICD-10 compliance deadline of October 1, 2013 nears
KPMG	Bottoms-up estimate based on KPMG's advisory work for multiple Blues and private health plans on ICD-10 impact	Costs for a large plan (> 3m members) - Business Remediation $11m - Business/IT Integration $7m - Application Remediation $24m	$34.5 million for a large Blues plan	KPMG teams performed rigorous bottom up analyses, working in tandem with all business functions, to develop this estimate. The cost estimate closely matches AHIP survey results for a large Blues plan. Does not include contract renegotiation and post implementation costs. No work has been performed for a small or medium size health plan.
Robert E. Nolan Company	A number of large, mid-sized and smaller health plans were surveyed to estimate overall industry costs	**Industry costs:** - Systems $400m - $1b - Training $60m - $100m - Rework * $300m - $600m - Contract Renegotiation* $100m - $400m	$6.5m - $13m for a large health plan.***	One of the earliest (2003) ICD-10 estimates by the Nolan Management consulting company for the BCBS Association. Does a good job in identifying all underlying cost drivers in detail.
Highmark	Currently implementing ICD-10 conversion. Implementation began in 2009, and is expected to complete by mid-2013.	**Costs Incurred/ICD-10 Budget:** Incremental Personnel $20m Budget - Hw/SW/Other Costs $5m - Additional Personnel Costs(BAU) $7m	$32m	Highmark ICD-10 conversion approach is a mix of native remediation and neutralization depending on the business function being converted. The cost estimate contains the costs incurred in 2009-10 and ICD-10 budget for the remaining implementation activities through 2013.

Note: * Rework and Contract Renegotiation costs includes cost to both health plans and providers.

** Large health plan is not clearly defined by the Hay Group.

*** Nolan defines 'large health plans' as single or multi-state BCBS plans and other statewide and regional plans.

Source: KPMG analysis

Appendix M

ICD-9 and ICD-10 diagnostic and procedure code comparisons

ICD-9-CM diagnosis codes

- 3-5 characters in length
- Approximately 13,000 codes
- First digit may be alpha (E or V) or numeric; Digits 2-5 are numeric
- Limited space for adding new codes
- Lacks detail
- Lacks laterality
- Difficult to analyze data due to non-specific codes
- Codes are non-specific and do not adequately define diagnosis needed for medical research
- Does not support interoperability because it is not used by other countries

ICD-10-CM diagnosis codes

- 3-7 characters in length
- Approximately 68,000 codes
- Digit 1 is alpha; digits 2 and 3 are numeric; digits 4-7 are alpha or numeric
- Flexible for adding new codes
- Very specific
- Has laterality
- Specificity improves coding accuracy and richness of data for analysis
- Detail improves the accuracy of data used for medical research
- Supports interoperability and the exchange of health data between other countries and the U.S.

ICD-9-CM procedure codes

- 3-4 numbers in length
- Approximately 3,000 codes
- Based upon outdated technology
- Limited space for adding new codes
- Lacks detail
- Lacks laterality
- Generic terms for body parts
- Lacks description of methodology and approach for procedures
- Limits DRG assignment
- Lacks precision to adequately define procedures

ICD-10-PCS procedure codes

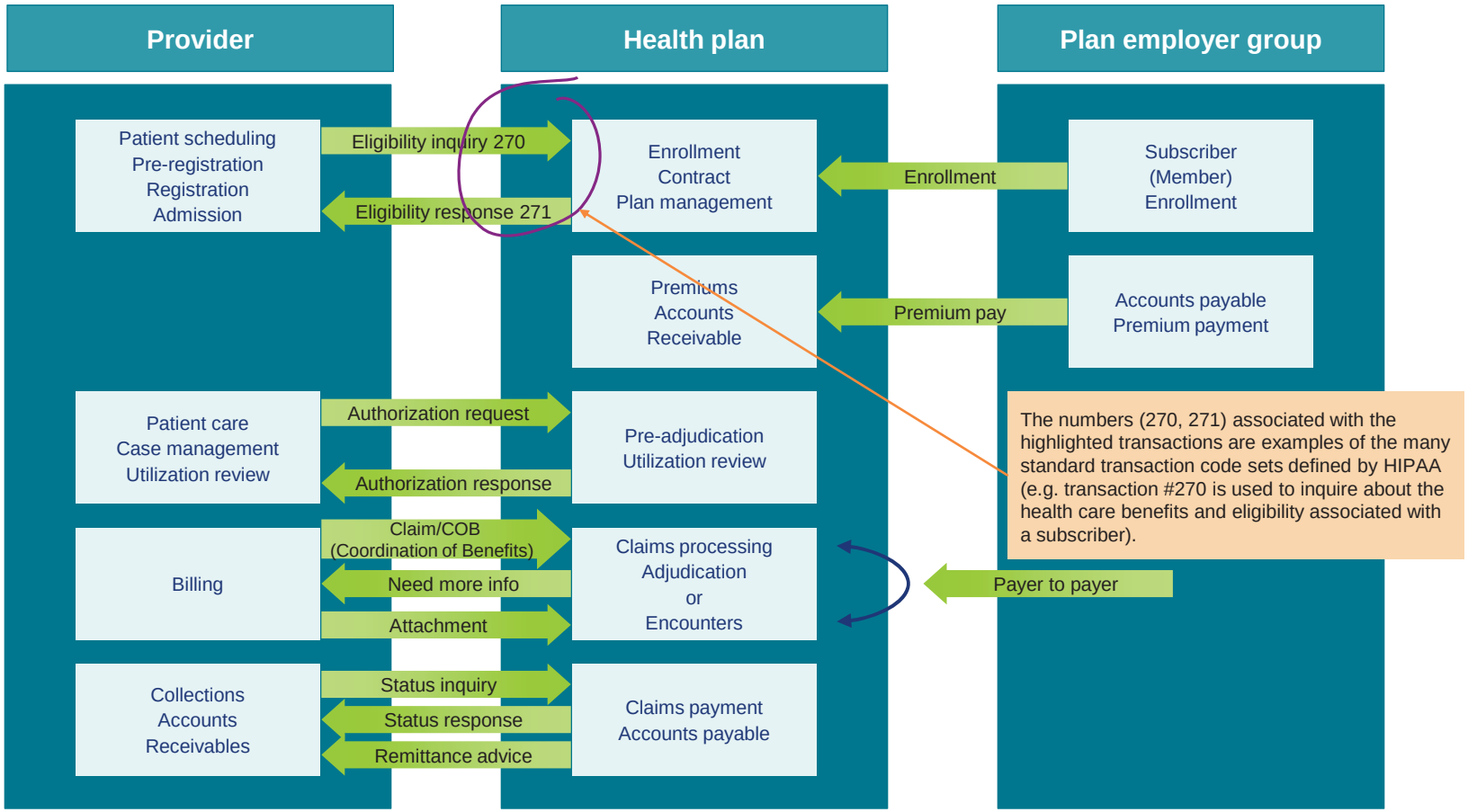
- 7 alpha-numeric characters in length
- Approximately 87,000 available codes
- Reflects current usage of medical terminology and devices
- Flexible for adding new codes
- Very specific
- Has laterality
- Detailed descriptions for body parts
- Provides detailed descriptions of methodology and approach for procedures
- Allows DRG definitions for better recognize new technologies and devices
- Precisely defines procedures with detail regarding body part, approach, any device used, and qualifying information

Source: Department of Health and Human Services, Federal Register, Vol. 73, No. 164, Friday August 22, 2008.

Appendix N

HIPAA 5010 Overview

In 2000, the government mandated the HIPAA 4010 standard to regulate the electronic exchange of administrative health data, including claims, payment, eligibility and other transactions between IT systems of healthcare organizations (see green arrows below). These standards became outdated over time and are now being replaced by a newer version – HIPAA 5010. Covered entities (e.g., health plans, providers) are required to confirm compliance with the new standard by January 1, 2012 to accommodate the extended diagnosis/procedure ICD-10 codes.



Source: eMids 2010 Whitepaper on 5010 and ICD-10

Appendix O

Highmark Business Partner Relationships

Business Partner Arrangements *(page 1 of 2)*

- Highmark provides administrative services to a variety of affiliated and non-affiliated business partners for a fee.
- In addition to generating revenue, this enables Highmark to better manage its own cost structure through additional scale by leveraging significant investments in operational capabilities and technological infrastructure across a broader customer base.
- These arrangements take a variety of forms both in terms of the services provided and the organizational relationship with the business partners.
  - With non-affiliated companies, the scope of provided services range from the entire spectrum of functions required to administer health plan business to a much more limited offering of merely sharing a secure data center environment with a company not interested in making this type of capital commitment on its own.
  - Similarly, with affiliated companies, the scope of provided services varies and is largely driven by the needs of the individual affiliate and Highmark's capability/capacity to provide value-added services to address those needs. These value-added services tend to focus on strategic capabilities (both IT and non-IT related) required in a rapidly changing healthcare marketplace, operational expertise, and state-of-the-art technology enabling users to operate in a highly automated efficient environment.
- Regardless of the arrangement, Highmark has generally offered these services to both internal and external customers at a price adequate to at least cover the fully allocated cost to deliver the service. Allocation methodologies used to allocate costs to both internal and external partners are consistent with those used to allocate costs throughout the Highmark organization. In the case of external partners, Highmark's secondary goal is to generate margin by offering its services at a price which is market competitive and a value-driver for its external partner. This is accomplished by operating at a cost structure which is well below industry averages for comparable services and capabilities.
- Examples of these types of arrangements include:

Partner	Relationship	Nature of Business	Pricing	Margin
BCNEPA	Business Partnership[1]	Core applications, claims front-end processing support and maintenance	REDACTED	
Highmark WV	Affiliate	Core applications support, integrated organization (e.g., shared business functions and processes)		
BCBS of Florida	External	Health plan administration		

Source: Highmark corporate data *Note: [1]Highmark has a majority ownership interest in a subsidiary of Blue Cross Northeastern Pennsylvania, the First Priority Life Insurance Company (FPLIC).*

Appendix O

Highmark Business Partner Relationships, *continued*

Business Partner Arrangements (*page 2 of 2)*

- As an affiliate, BCBSD's relationship to Highmark would likely closely resemble West Virginia's relationship with Highmark, both in terms of its organizational relationship to Highmark and the scope of services to be received from Highmark. Similar to its arrangement with Highmark West Virginia, Highmark is prepared to provide information technology services to BCBSD at Highmark's fully allocated cost to deliver such service. Thus, BCBSD will benefit from Highmark's capabilities at a reduced unit cost due partially to Highmark's larger scale.
- Also, as an affiliate, BCBSD will have the opportunity to participate in and benefit from a variety of other non-technology activities that are not generally shared with external partners.[2] These include but are not limited to a seat at the table during strategy development where BCBSD may have input to Highmark's IT direction, strategic IT initiatives and priority setting.
- Unlike external partnerships which have a defined life consistent with the term of the contract, an affiliation is generally assumed to have a perpetual life absent some extenuating event that would terminate the affiliation. Highmark is therefore willing to offer services to BCBSD at cost (without margin), because unlike an external relationship, there is less likelihood that the customer will take its business elsewhere resulting in less scale with a resulting adverse impact on Highmark's unit costs. However, there is no guarantee that even an affiliation will last forever, and due to the nature of the operational integration and reliance of both partners on one another to operate both efficiently and effectively, it is prudent to plan in advance for a separation strategy that works for both parties.
- In the event that the affiliation is terminated, Highmark has agreed that it will continue to provide any services then being provided to BCBSD for a period not to exceed two years. Since such termination would then place BCBSD in the position of an external partner, BCBSD would then compensate Highmark for the provision of such services at BCBSD's allocable share of the cost to Highmark to provide the services plus a margin not to exceed 8%. Highmark has an established relationship with West Virginia whereby the terms of the affiliation agreement specify that Highmark would be compensated for the provision of similar services by West Virginia on the basis of allocable cost plus 8% margin.

Source: Highmark corporate data

Note: [2] We understand Blackstone Advisory Partners L.P., financial advisor to the DDI, will address aspects of the proposed affiliation not related to systems and technology gaps.

Appendix P

Highmark Current Service Level Agreement (SLA) with BCBSD

Administrative Services Agreement (ASA) Exhibit B – Service Level Agreement: EDI Services *(page 1 of 3)*

This **Exhibit B** sets forth the agreement between the Parties relating to the Service Levels, against which Provider's performance of the Services will be measured. As of the Commencement Date, Provider will perform services for which a Service Level has been established at no less than the defined Performance Standard (as defined below). Provider will perform all Services in a cost-effective manner throughout the Term and Termination Assistance Period.

1. Definitions

All capitalized terms used but not defined in this Exhibit B shall have the respective meanings assigned to them in the Agreement. The following capitalized terms used in this Exhibit B shall have the meanings specified below:

"Performance Standard" means a measurable, quantifiable aspect of performance.

2. General

2.1 Provider shall implement new and/or utilize existing measurement and monitoring tools and procedures necessary to measure and report Provider's transition performance and ongoing performance against the applicable Performance Standards.

2.2 If a service interruption or degradation occurs which is attributable to Customer application flaws, Customer Data, or Customer Equipment, software or subsystem the effect of that interruption will not be assigned to Provider's performance.

2.3 Provider's services performed may be dependent upon Customer or Customer's vendors. Provider and Customer will make reasonable efforts and/or adjustments to Provider's performance measures to accommodate third party delays.

2.4 All Provider's services shall conform to the requirements of the Blue Cross Blue Shield Association and Delaware and federal laws, rules and regulations. To the extent such requirements, law, rules or regulations impose standards that are more stringent that those set forth herein, the standards set forth by such requirements, laws, rules or regulations shall control and shall be considered an Adjustment Event to be defined by the Customer to the Provider.

3. Definition of Service Level Measures and Performance Standards

3.1 **Transition Services:** Provider will meet mutually agreed upon milestones and perform tasks as established in the transition plan.

3.2 **Systems Availability:** Business applications are available 24x7 except scheduled maintenance (typically Sundays) and scheduled releases (typically weekends) and scheduled Holidays.

3.3 **HIPAA Gateway Processing**: Provider will perform to the agreed upon performance standards except during scheduled releases or scheduled maintenance activities.

Highmark Current Service Level Agreement (SLA) with BCBSD

Administrative Services Agreement (ASA) Exhibit B – Service Level Agreement: EDI Services *(page 2 of 3)*

1. Batch claim transactions are processed within 24 hours of receipt with a 997 returned to the submitter within an hour of submission.
2. Real Time claims transactions are processed within 30 seconds of receipt.
3. Enrollment transactions processed to backend systems within 24 to 72 hours of receipt.
4. BX Real Time Inquiry transactions are processed within 20 seconds of receipt.
5. BX Batch Inquiry transactions are processed within 24 hours of receipt.
6. Local Real Time Inquiry transactions are processed within 40 seconds of receipt.
7. Local Batch Inquiry transactions are processed within 24 hours of receipt.

3.4 **Blue Squared Processing**: Provider will perform to the agreed upon performance standards except during scheduled releases or scheduled maintenance activities.

1. Retry period for failed messages is every 2 hours for 96 hours.
2. CSRN Response Check Period within 4 days.
3. PQI Acknowledgement Check Period within 1 day.
4. PQI Response Check Period within 7 day.
5. Claim Appeal Auto Closer runs at minimum twice daily.

3.5 **Data Center Uptime**: Provider's Data Center facility supporting Customer Applications has a 99.90% Uptime. Uptime is determined by calculating the aggregate minutes, during the periods of scheduled uptime that the Data Center is available for use by the Customer divided by the total aggregate minutes of scheduled uptime for the month. If a Force Majeure Event occurs as described in Section 23.5 of the Agreement that causes the Data Center to become unavailable, the relevant period of the Force Majeure Event shall be subtracted from scheduled uptime. In the event of such Force Majeure Event, Provider shall implement its disaster recovery plan and promptly restore and repair the Data Center or the applicable damaged or destroyed portion as soon as reasonably possible.

3.6 **Problem Resolution – Severity 1**: Defined as a component down or unusable, critical impact, no alternative available; resolve 90% of Severity 1 Problems within 4 hours after problem detection.

3.7 **Problem Resolution – Severity 2:** Defined as a component down or degraded, not critical, but restricted function and some operational impact; resolution within 5 days after problem detection.

3.8 **Problem Resolution – Severity 3:** Defined as a component unusable but circumvention possible with no operational impact, not critical, deferred maintenance acceptable; resolution within 10 days after problem detection.

3.9 **Service Request Proposal:** Service estimation request issued by the Customer to the Provider. Provider's draft proposal for Customer's review, containing estimated cost, schedule, and other information within 2 weeks of written request.

Appendix P

Highmark Current Service Level Agreement (SLA) with BCBSD

Administrative Services Agreement (ASA) Exhibit B – Service Level Agreement: EDI Services *(page 3 of 3)*

3.10 **Failure to Meet Service Level Standards as Material Breach**: In the event that Provider fails to meet Service Level Standards set forth in paragraphs 3.1 through 3.9 on six (6) or more instances in any twelve (12) month period, and none of such failures are caused by a Force Majeure Event and none are caused by the Customer as set forth in paragraph 2.2, Provider will be in material breach of the Agreement, (as set forth in Section 10.2 of the agreement).

4. Management of Service Level Measurements

4.1 Reporting

Unless otherwise specified in this Exhibit B, Provider shall measure its performance with respect to each of the Services for which a Service Level has been established on a monthly basis during the Term and Termination Assistance Period. Within ten (10) business days after the end of each month, Provider will provide to Customer a set of reports in soft-copy form, verifying Provider's performance of the Services in relation to the Service Levels and any supporting information required.

Source: Administrative Services Agreement, HIPAA Transaction Gateway Exhibit B – Service Level Agreement (between Highmark and BCBSD)

Appendix Q

Highmark Service Level Report (SLR) to West Virginia

Highmark W.V. Finance & Administration

August 13-19, 2011

This Week's Score
3.92

RATING	
Outstanding	3.60-4.00
Excellent	2.75-3.59
Good	2.00-2.74
Adequate	1.00-1.99
Unsatisfactory	0.00-0.99

Month to Date SCORE
4.00

This Week's Reporting Details:

SERVICE	AVAILABILITY			RELIABILITY		
	Goal	Actual %	Score	Goal	Actual #	Score
Corporate Computing	REDACTED		4	10	0	4
Electronic Messaging			4	10	0	4
ESS - MSS			4	10	0	4
Hyperion AVB			3	10	1	4
Hyperion Enterprise			4	10	0	4
Hyperion ESSBase			4	10	0	4
Hyperion Planning & Reports			3	10	1	4
PeopleSoft Accts Payable			4	10	0	4
PeopleSoft Allocations			4	10	0	4
PeopleSoft Asset Mgt			4	10	0	4
PeopleSoft General Ledger			4	10	0	4
PeopleSoft HR			4	10	0	4
PeopleSoft Purchasing			4	10	0	4

Month to Date Reporting Details:

AVAILABILITY			RELIABILITY		
Goal	Actual %	Score	Goal	Actual #	Score
REDACTED		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	1	4
		4	10	0	4
		4	10	0	4
		4	10	1	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4

SLA Reference and Score:

Expected Available Hours		Hours/Day	Mon - Sun Days this Week
Mon	7:00am - 5:00pm	10	7
Tue	7:00am - 5:00pm	10	
Wed	7:00am - 5:00pm	10	
Thurs	7:00am - 5:00pm	10	
Fri	7:00am - 5:00pm	10	
Sat	7:00am - 5:00pm	10	
Sun	7:00am - 5:00pm	10	

SCORE	AVAILABILITY	RELIABILITY	Mon - Sun Days Month to Date
4	99.00% - 100.00%	0 - 1	21
3	98.00% - 98.99%	2 - 4	
2	97.00% - 97.99%	5 - 7	
1	96.00% - 96.99%	8 - 10	
0	0% - 95.99%	11 or more	

Source: Highmark corporate data

Appendix Q

Highmark Service Level Report (SLR) to West Virginia

Highmark W.V. Operations

August 13 - 19, 2011

This Week's Score
3.67

RATING	
Outstanding	3.60-4.00
Excellent	2.75-3.59
Good	2.00-2.74
Adequate	1.00-1.99
Unsatisfactory	0.00-0.99

Month to Date SCORE
3.90

This Week's Reporting Details:

SERVICE	AVAILABILITY			RELIABILITY		
	Goal	Actual %	Score	Goal	Actual #	Score
ACE	REDACTED		4	10	0	4
ACS			4	10	0	4
AGL			4	10	0	4
BlueSTAR			4	10	0	4
Cognos			4	10	0	4
CPBRE			4	10	0	4
CPR			2	10	1	4
eBILL			4	10	0	4
ECS			4	10	1	4
EDI			4	10	0	4
EDW			4	10	0	4
Group Database			4	10	0	4
HighBAR			3	10	1	4
Highview			0	10	1	4
ICIS/CCR			4	10	0	4
ID CARDS System			4	10	0	4
INSINQ			0	10	1	4
IVR			4	10	1	4
maxMC			0	10	3	3
OCR			4	10	0	4
OPIS			4	10	0	4
OSCAR			4	10	0	4
PeopleSoft Accounts Recievable			4	10	0	4
Subscriber Database			4	10	0	4
www.mybenefitshome.com (CRM)			4	10	0	4

Month to Date Reporting Details:

AVAILABILITY			RELIABILITY		
Goal	Actual %	Score	Goal	Actual #	Score
REDACTED		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	1	4
		4	10	0	4
		4	10	1	4
		4	10	0	4
		4	10	0	4
		4	10	0	4
		4	10	1	4
		3	10	1	4
		4	10	0	4
		4	10	0	4
		3	10	1	4
		4	10	1	4
		3	10	5	2
		4	10	0	4
		4	10	0	4
		4	10	1	4
		4	10	0	4
		4	10	0	4
		4	10	0	4

SLA Reference and Score:

Expected Available Hours		Hours/Day	Mon - Sun Days this Week	SCORE	AVAILABILITY	RELIABILITY	Mon -Sun Days Month to Date
Mon	7:00am - 5:00pm	10	7	4	99.00% - 100.00%	0 - 1	21
Tue	7:00am - 5:00pm	10		3	98.00% - 98.99%	2 - 4	
Wed	7:00am - 5:00pm	10		2	97.00% - 97.99%	5 - 7	
Thurs	7:00am - 5:00pm	10		1	96.00% - 96.99%	8 - 10	
Fri	7:00am - 5:00pm	10		0	0% - 95.99%	11 or more	
Sat	7:00am - 5:00pm	10					
Sun	7:00am - 5:00pm	10					

Source: Highmark corporate data