Recomendation#1

The Senate Banking and Insurance Committee recommends the Pennsylvania Insurance Department disapprove the proposed merger between Highmark and Independence Blue Cross (IBC). The Committee believes the proposal of the new corporation (NewCo) violates three of the seven standards in Section 1402(f)(1) of the Insurance Company Act and the Committee believes the proposal fails to meet the standard for approval in Section 1403(d) of the Act.

The subsections in Section 1402(f)(1) are:

(ii) The effect of the merger, consolidation or other acquisition of control would be to substantially lessen competition in health insurance in this Commonwealth or tend to create a monopoly therein.

(iv) The plans or proposals which the acquiring party has to consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable and fail to confer benefit on policyholders of the insurer and are not in the public interest.

(vi) The merger, consolidation or other acquisition of control is likely to be hazardous or prejudicial to the insurance-buying public.

The subsections in Section 1403(d) are:

(d)(1) The department may enter an order [of disapproval] under subsection (e)(1) with respect to an acquisition if there is substantial evidence that the effect of the acquisition may be substantially to lessen competition in any line of insurance in this Commonwealth or tend to create a monopoly therein…

(d)(3) An order [of disapproval] may not be entered under subsection (e)(1) if: (i) the acquisition will yield substantial economies of scale or economies in resource utilization that cannot be feasibly achieved in any other way, and the public benefits which would arise from such economies exceed the public benefits which would arise from not lessening competition….

Violation of Section 1402(f)(1)(ii) and Section 1403(d)(1): NewCo would substantially lessen competition and tend to create a monopoly.

NewCo as created by the proposed consolidation will produce the seventh largest insurance company in the nation and would have more market share in its primary state (70% of the commercial market and 53% of the overall market) than any insurer in the country. This considerable combined market share increases the merged entity’s negotiating power over both providers and policyholders, therefore creating still higher barriers to competition and tending to create a monopoly.
The Pennsylvania Insurance Holding Companies Act (HCA) provides a specific framework for addressing the impact of the proposed consolidation on competition. In particular, the HCA sets out standards for determining if “prima facie evidence of violation of the competitive standard...exists.”

On September 10, 2008, the Department’s expert – LEGC - issued its 192 page report on the competitive impact of the proposed consolidation and concluded that data for 2007 show Highmark and IBC have combined share of premiums for each of these products that typically exceed 60 percent state-wide.....moreover, even if we assume that fully insured Commercial, and fully and self-insured Commercial markets are not concentrated, the firms’ shares still exceed 5 percent each, and so there exists a prima facie violation.

According to the Pennsylvania Insurance Department’s experts, compared to the largest 15 insurers, the merged plan “would become the seventh largest national insurer in terms of medical enrollment,” and “would maintain the highest market share in its top state (51.4%) and have the smallest closest competitor (UPMC at 6.5%).”

As the LECG report detailed, such market dominance will make it harder for existing health insurance competitors to expand their market share and make it more difficult for new competitors to enter Pennsylvania’s health insurance market. LECG concluded, “based on a qualitative review of a proposed consolidation’s impact on potential barriers to entry in the Pennsylvania health insurance market, future competitors may have a harder time entering the market after the proposed consolidation.”

This committee heard expert testimony making the same point for the past, present and future. We heard Dr. Monica Noether, retained by Capital Blue Cross and not rebutted by Highmark and IBC, detail that numerous local firms have attempted to enter into the area and have failed. Moreover, national health insurers have been unable to establish more than a minimal presence in the market. This is striking considering that Pittsburgh and southeastern Pennsylvania have been among the most economically sound and fastest growing markets in the state. The combination of Highmark and IBC, and the loss of potential competition between them, perpetuate and exacerbate this barrier. It is important to note that Dr. Noether’s testimony and report are credible and generally undisputed by the Department experts.

Due to the size and power of the merged entity, it will be extremely difficult if not impossible to regulate and control and will allow it to dominate and unduly influence health care policy and health care financing in Pennsylvania. Given the market power and vast footprint that the merged plan will have, it is unlikely hospitals or physicians who serve patients could refuse the terms dictated by the plan.
As a result, this will mean a greater market share over time for the merged entity and an increasing dominance for one insurer – the tendency to create a monopoly the Holding Company Act warns of. For example, the southeastern Pennsylvania health insurance market is already highly concentrated, and the merger will only enhance that. Today, IBC dominates the southeastern Pennsylvania market with a market share of 71%. There are only four other competitors in the market and the positions and market shares of those firms have been relatively stable for several years. This is clearly the type of market in which competition concerns are particularly important.

Due to this overriding dominance, access to quality health care is jeopardized for the citizens of Pennsylvania if one payer has the ability to control reimbursement and sets the reimbursement below rates that doctors and hospitals can afford to deliver quality care. That has the potential to drive up the costs of healthcare in other sectors particularly the public sector, so providers can offset those losses.

This merger also eliminates Highmark as a potential competitor in southeastern Pennsylvania. As the Department’s expert details, by virtue of its statewide license, Highmark is able to offer policies statewide, but “voluntarily chooses not to compete” in southeastern Pennsylvania. The Department’s expert concludes there is no reason Highmark could not enter the southeastern market and absent this proposed merger likely would. The Department’s expert noted that Highmark is already positioned to enter this market: It presently has a statewide network of professional medical providers, including the Southeast, because it has the statewide Blue Shield license, and it can offer full-line health insurance in any part of the state (as it does in Central Pennsylvania where it competes with Capital Blue Cross). Similarly, in order to offer full-line health insurance in the Southeastern Pennsylvania, Highmark needs only to contract with a relatively smaller number of hospitals for hospital services – making it a likely competitor, with that competition lost under the proposed merger – to the detriment of consumers.

While the current CEO of Highmark says he will not enter the southeastern Pennsylvania market, and that competition is generally to be avoided, such a decision is not permanent, and new leadership or changes in existing business plans would certainly lend itself to Highmark deciding to enter the southeastern market and injecting competition.

Additionally, NewCo, by virtue of its statewide license, will be able to charge access fees to the remaining Blue Cross Plans (Blue Cross of Northeastern Pennsylvania and Capital Blue Cross) when Cross Plan members use providers in NewCo’s network. Those access fees are charged at the discretion of NewCo while the Cross Plans are unable to charge similar fees as a result of NewCo’s statewide license.

Such an arrangement places NewCo in a dominant position over the remaining Cross plans to the point where fees may be assessed at a level making it economically unfeasible for the remaining Cross Plans to conduct business, further reducing competition among health insurers.
Violation of Section 1402(f)(1)(iv) and (vi): The proposed creation of NewCo fails to confer a benefit upon the policyholders of the insurer and is likely to be hazardous or prejudicial to the insurance buying public.

Missing from the Highmark and IBC filings proposing the creation of NewCo is any definitive analysis or guarantee of benefits to its policyholders. Adding to the overwhelming advantage Highmark and IBC already have in pricing with hospitals, doctors and other ancillary providers, the inevitable result of this merger, will further reduce options to the insurance buying public without quantifiable reductions in the rates of NewCo or the quality of its services or the care of providers.

The savings Highmark and IBC project as a result of the merger are not only minimal and questionable, but are not benefits to their policyholders, at least based on any of the filings from the applicants. They have not projected any reductions of premiums. They have not detailed any improvements in services or provider networks. They have claimed the creation of NewCo will result in more products but have not explained why this would not be possible without the merger.

The Department’s experts did not determine any such premium reductions or improved services or products, either. The Department’s experts did conclude the consolidation will increase barriers to competition from others and lessen both actual and potential competition. They concluded this will be to the detriment of the insurance buying public. Highmark and IBC rebut this only by claiming that they already face real competition - which is contradicted in the minimal market shares of existing competitors and the lack of new entrants - and stating that they would not compete with each other, which may be the position of current management now but could change as managements change. They have not offered any projections to quantify any reductions in premiums.

A further hazard to the insurance-buying public is that the current regulatory structure is not equipped to oversee a monopoly of this size. The existing structure and laws do not contemplate a monopoly, since they are designed to promote competition. As such, they are inadequate to police a monopolist’s pricing and negotiating practices with providers. They are also inadequate to monitor proper surplus and reserve requirements, where the only requisite is set forth in an ad hoc order from a former commissioner that was entered into without contemplation of an insurer of the size and market share of NewCo.
Violation of Section 1403(d)(3): The savings identified by ‘NewCo’ as being derived from the proposed merger can be achieved absent its approval and are insignificant to the policyholders when compared with the lost value of competition.

An analysis of the Highmark and IBC filings on projected economic benefits shows that savings would be approximately sixteen ($16) dollars annually per policyholder for six (6) years. The projected savings of $1 Billion spread over six years equates to just .7 percent of NewCo’s projected annual revenues.

The key consideration under the Pennsylvania Holding Company Act is whether the acquisition of control would substantially lessen competition in insurance in this Commonwealth, and whether the reduction of competition is exceeded by unique economic benefits as a result of the merger. Consistent with the findings of the Insurance Department’s LECG expert, the professed unique economic benefits of NewCo do not exceed the value of the lost competition.

The Department’s expert’s analysis shows that the consolidation will save very little, which is also conceded in the filings of Highmark and IBC. They project savings of $1 billion spread over six years, meaning annual savings of $170 million. That is in comparison with projected annual revenues of $20 billion, meaning the anticipated savings are no more than .7% of annual revenues.

That is not the “substantial economies of scale or economies in resource utilization” required in the Holding Company Act. To the contrary, it is insubstantial, and many of the savings are possible through means other than a merger, as with joint operating agreements or better internal practices.

Further, even these minimal savings are questionable given the promises made by NewCo. It promises to maintain headquarters in both Pittsburg and Philadelphia and to not reduce employment. It has also committed to not reducing provider reimbursements. Those do not suggest an ability to hold administrative costs flat for two years or produce other efficiencies or economies that would be feasible only through the merger.
Summary

Highmark and IBC are and will remain valued corporate citizens and insurers in Pennsylvania despite this consolidation. But this consolidation presents too great a danger of a monopoly in the health insurance market with too little economic benefits to consumers, especially considering outdated projections in these economic times.

Highmark and IBC may be well served to withdraw the proposed filing and resubmit it to the Department with more concrete data quantifying the economic benefits of the merger showing they unquestionably outweigh the loss of competition in the marketplace, and can only be derived from the creation of NewCo.

Highmark, Inc. and Independence Blue Cross (IBC) have criticized the Department’s experts as making projections that are outdated because they were made in early September and the financial markets have since collapsed. Accepting their argument, Highmark’s and IBC’s projections, which were made in early 2007, are certainly outdated and should be revised before approving this proposed merger.

In these dangerous economic times, we should not endorse the creation of such a dominant insurer in such a vital line of insurance based on projections from a much different economic climate. It fails to meet the standards of the Holding Company Act in preserving competition and requiring unique economic benefits. And it is based on calculations and projections that are outdated in today’s new economic realities.
Addendum

Violation of Section 1402(f)(1)(ii) and Section 1403(d)(1): NewCo would substantially lessen competition and tend to create a monopoly.

UPMC Health Plan, October 14, 2008, Key Considerations for Legislators.

Pennsylvania Medical Society, Mixing Blues, October 7, 2008, Testimony before the Senate Banking and Insurance Committee.

The Hospital & Healthsystem Association of Pennsylvania, October 7, 2008, Testimony before the Senate Banking and Insurance Committee.

Mr. David Balto, September 23, 2008, Testimony before the Senate Banking and Insurance Committee.


Violation of Section 1402(f)(1)(iv) and (vi): The proposed creation of NewCo fails to confer a benefit upon the policyholders of the insurer and is likely to be hazardous or prejudicial to the insurance buying public.

Mr. David Balto, September 23, 2008, Testimony before the Senate Banking and Insurance Committee.

The Insurance Federation of Pennsylvania, House of Representatives Roundtable Discussion, November 12, 2008

Mr. Ted Robinson, Staff Attorney, Citizen Power, Submission to Commission Joel Ario, Pennsylvania Insurance Department, July 8, 2008, Pittsburgh.


Violation of Section 1403(d)(3): The savings identified by ‘NewCo’ as being derived from the proposed merger can be achieved absent its approval and are insignificant to the policyholders when compared with the lost value of competition.

UPMC Health Plan, October 14, 2008, Key Considerations for Legislators.

Dr. Stephen Foreman, PhD, JD, MPA, Submission to Commission Joel Ario, Pennsylvania Insurance Department, July 8, 2008, Pittsburgh.

The Insurance Federation of Pennsylvania, House of Representatives Roundtable Discussion, November 12, 2008