

BEFORE THE COMMISSIONER OF INSURANCE STATE OF KANSAS

IN THE MATTER OF THE CONVERSION AND ACQUISITION
OF BLUE CROSS AND BLUE SHIELD OF KANSAS, INC.

CASE NO. 3014-DM

PREFILED TESTIMONY OF SANDRA S. HUNT

Credentials

Q. Please state your name.

A. Sandra S. Hunt

Q. Please identify your employer and state your position.

A. I am a Principal with PricewaterhouseCoopers LLP (APwC@). I specialize in government health policy, statistical modeling, Medicaid managed care plans, and development of models for new health care delivery systems.

Q. Please describe your professional background.

A. I have 17 years of experience in health care economics research, including nearly 15 years consulting to the public sector and private industry. I have a Masters of Public Administration, Public Policy Analysis from the University of Washington, and a B.A. in Political Science from Washington State University. Recent assignments include:

Consulting to the Missouri Consolidated Health Care Plan on risk assessment and risk adjustment methods, as well as other purchasing issues;

Consulting to Pac Advantage, formerly the Health Insurance Plan of California, on risk assessment and risk adjustment techniques and purchasing strategies;

Consulting to General Motors on application of risk assessment and risk adjustment methods using the DxCG software for measuring differences in risk in certain geographic locations;

Consulting to the Massachusetts Group Insurance Commission on risk assessment and risk adjustment methods;

Consulting to the Utah Medicaid program on contracting issues and risk adjustment, including the Title XXI program;

Development of the pricing methodology and estimation of program costs for the Oregon Health Plan: Medicaid Demonstration, including budget estimates used by the legislature for

determining the level of covered benefits and capitation rates paid to contracting health plans, including the Title XXI program;

Preparation of an extensive analysis of the TennCare program, including the actuarial soundness of the capitation rates, comparing rate increases to commercial premium trends, analyzing charity care provided in the state over time, and examining health plan financial results;

Development of per capita costs and capitation rates for TennCare, including application of the Chronic Disease and Disability Payment System for risk adjustment;

Development of capitation rates for Kentucky Medicaid=s Behavioral Health Partnership program, development of capitation rates for Kentucky=s Partnership program, development of costs for the K-CHIP Title XXI program, and development of a budget model for the program;

Development of capitation rates for the Virginia Medicaid program and heading the actuarial advisory committee consisting of health plan representatives;

Development of capitation rates for a managed care pilot project for the California Children=s Services program;

Development and ongoing consulting for the Health Insurance Plan of California, a small group purchasing pool, including development of a risk assessment and risk adjustment methodology;

Development and ongoing consulting for the Major Risk Medical Insurance Program in California, a program that provides subsidized health insurance to high risk individuals who have been denied health insurance due to their health status;

Administration of the Kentucky Department of Insurance risk assessment/risk adjustment program for small groups and individuals;

Consulting to the California Managed Risk Medical Insurance Board regarding the development of Healthy Families, California=s Title XXI program;

Assistance to the State of Illinois in development of a Medicaid Managed Care Demonstration 1115 waiver application, and analysis of the Disability Payment System for the Aged, Blind and Disabled group;

Development and ongoing consulting for the Access for Infants and Mothers program in California, a program to provide subsidized health insurance for moderate income pregnant women and their newborn children during their first two years of life;

Consulting to Health Access New Jersey for development and implementation of a subsidized individual insurance program, including an enrollment projection model and a cost-monitoring model; and

Consulting to the states of Montana and Maine to develop universal health insurance programs, including providing actuarial pricing, benefit analysis, and economic modeling.

Q. Have you been engaged by the Kansas Insurance Department Testimonial Team (ATestimonial Team@) to assist it in the evaluation of the proposed Plan of Conversion and Acquisition (the APlan@) of Blue Cross and Blue Shield of Kansas, Inc. (ABCBSKS@)?

A. Yes.

Summary of Testimony

Q. Specifically, what were you asked to review with respect to the Plan?

A. PwC was engaged by the Testimonial Team to assess the potential market impact of the purchase of BCBSKS by Anthem Blue Cross and Blue Shield (AAnthem@). The market impact analysis was structured to address questions related to potential changes in insurance coverage in Kansas resulting from the transaction. In particular, we examined issues and assessed their likely impact as a result of the proposed transaction relating to 1) choices, availability, and cost of insurance coverage; 2) provider contracting arrangements; 3) administrative process; 4) employment levels in Kansas; and 5) factors likely affecting Anthem=s general performance.

Q. Are you prepared to provide testimony in connection with that work?

A. Yes.

Q. Please summarize your review.

A. To assess the potential effects of the transaction, we specifically considered:

1. Choices, availability, and cost of insurance coverage:
 - a. Premium rates and coverage levels in Kansas compared to general market conditions;
 - b. Recent Changes in premium rates and coverage levels;
 - c. Anthem=s premium rate changes compared to those of other health plans during the same time period;

- d. Likely insurance coverage level changes in Kansas in the absence of the change in ownership of BCBSKS; and
 - e. The financial performance of BCBSKS and Anthem by product line and market.
2. Provider contracting arrangements:
- a. Contracting and administrative arrangements with providers following Anthem=s entrance into insurance markets in other states.
3. Administrative processes:
- a. Changes, if any, in utilization review practices and other processes critical to the availability of health care services; and
 - b. Differences in Anthem and BCBSK=s administrative processes, including differences by state.
4. The potential impact on employment levels in Kansas:
- a. Differences in wage rates and administrative capabilities in Kansas as compared to those of other states in which Anthem operates; and
 - b. Anthem=s staffed operations in other states.
5. Factors likely affecting Anthem=s general performance:
- a. Anthem=s market position (*i.e.*, penetration) and its effect on its relationship with providers, consumers, and regulators;
 - b. Anthem=s longer term plans for expansion, and how those plans might affect its performance in Kansas; and
 - c. Rules imposed as a condition of an Anthem transaction in other states and the likely impact on Anthem=s performance.

Description of Work Performed

Q. Please describe the nature of the work that you have performed as a result of your engagement by the Testimonial Team.

A. The PwC team, consisting of Jean Wodarczyk and myself, examined issues related to the current circumstances in Kansas and the practices of Anthem in other states where they have purchased other BCBS plans. Economic conditions in Kansas and other Anthem states were examined to discern possible differences in performance. Current changes in the health care and health insurance markets were assessed in connection with potential changes, both with and without a transfer of ownership of BCBSKS. PwC's review involving the allocation of consideration to eligible policyholders from an actuarial point of view will be presented and summarized in Mr. Ken Beck's testimony, and matters related to accounting, auditing, and information technology will be presented and summarized in Ms. Denise Essenberg's testimony.

Specific methods used for our analysis included:

1. Information was requested from Departments of Insurance, Anthem and BCBSKS documenting:
 - a. Financial performance by product line;
 - b. Premium rates and rates of change over the past several years;
 - c. Administrative costs;
 - d. Product descriptions; and
 - e. Provider contracting practices.
2. Interviews were conducted with relevant parties in Kansas and other Anthem states to obtain information relating to Anthem's performance following the transaction, including reviewing market conduct examinations performed by departments of insurance.
3. Information on key economic statistics were obtained from various health-related web sites.
4. Filings prepared by Anthem and BCBSKS were reviewed regarding their strategic plan, IPO offering, and other public documents intended for shareholders or others with a financial stake in the transaction.

Q. Did you consider any potential for rate changes in connection with the proposed transaction?

A. Yes.

Q. And what did you find?

A. BCBSKS has historically had underwriting losses averaging 2% company-wide, with significant variation in the level of loss realized by market segment. The small group market has seen the largest losses, while some segments have been modestly profitable. BCBSKS Management (Management) has stated as its goal to return to underwriting gains ranging from 2% to 3% by 2007. However, in the valuation of the company, BCBSKS argued that an underwriting margin of 0% should be assumed.

Q. What is the significance, if any, of Management's stated goal to return to underwriting gains ranging from 2% to 3% by 2007?

A. To reach this goal, Anthem will have to either restructure its products to become more profitable, or increase premiums. Assuming Anthem will not significantly restructure the products currently offered by BCBSKS (*i.e.*, by reducing benefits or adjusting provider payment rates), this return to underwriting gains suggests significant premium increases in certain segments given the wide range of experience by market segment. We believe it is unlikely that increases would occur in all market segments, and estimated the range of increases that might be required in those segments that are more amenable to rate adjustments. Rate increase for some segments would need to be higher to the extent premiums cannot be increased for portions of BCBSKS' business.

We developed calculations of expected premiums for major product lines under three underwriting gain/loss scenarios:

1. Maintaining losses at -2%, consistent with BCBSKS' history over the past five years;
2. Achieving a 0% underwriting gain/loss consistent with the methods used to value the company; and
3. A 2.5% underwriting gain consistent with Management's stated goals.

Q. What did your calculations of expected premiums show?

A. Premium rates sufficient to generate a 2.5% underwriting gain by 2005 are approximately 14% higher than rates under the steady-state scenario of a 2% underwriting loss. Compared to a 0% underwriting margin, as used in the valuation of the company, premium rates will need to be approximately 7.3% higher by 2005.

Q. Why did you assume that Anthem would not significantly restructure its products by reducing benefits or adjusting provider payment rates to get to the projected underwriting gains?

- A. Because we have not identified any documentation from BCBSKS or Anthem that would serve to mitigate these rate increases.

Conclusion

- Q. In connection with your work, have you reached any conclusions?

- A. Based on the foregoing and such other matters as we deemed relevant, to date, the following are our conclusions:

1. With regards to choices, availability, and cost of insurance, we have concluded that it is likely that insurance coverage would remain available at current levels, but that premium rates would increase by 6% to 7% above the levels that might be expected in the absence of the Anthem acquisition, with broad variation by market segment. Alternatively, benefits designs would change, or fewer people would purchase insurance.
2. With regards to provider contracting arrangements, we have concluded that our review of Anthem=s contracting practices showed only modest differences from the approach taken by BCBSKS.
3. With regards to the administrative processes, complaint ratios against Anthem plans are generally below those of other plans operating in the same states relative to market share. This may be due in part to Anthem=s increased use of electronic claims submissions.
4. With regards to employment levels in Kansas, from the data available, it would appear there is little reason to believe jobs would be moved from Kansas to other locations, although improvements in productivity hold the potential for reducing the number of employees.
5. With regards to factors likely affecting Anthem=s general performance, Anthem would hold a dominant market share in Kansas if the transaction were consummated. As the dominant insurance plan in most other states in which it operates, Anthem is often able to affect common provider contracting arrangements and service delivery. Anthem, Inc. intends to continue to expand its operations over the next several years, and that goal has the potential to affect all aspects of Anthem=s operations.

- Q. Have you prepared a detailed report which includes your analyses, observations, and conclusions?

- A. Yes, it is attached to this testimony as Schedule 1.

Q. Does that conclude your testimony?

A. Yes it does.

Thank you Ms. Hunt.