

BEFORE THE INSURANCE DEPARTMENT
OF THE
COMMONWEALTH OF PENNSYLVANIA

RECEIVED
Corporate & Financial Regulation

AUG 13 2008

Pennsylvania
Insurance Department

In re:

Applications of Highmark Inc. and Independence Blue Cross :
regarding the Acquisition of Control of Domestic Insurers :
Highmark Inc.; Independence Blue Cross; First Priority Life :
Insurance Company, Inc.; Gateway Health Plan, Inc.; :
HM Casualty Insurance Company; HM Health Insurance :
Company, d/b/a Highmark Health Insurance Company; HM Life :
Insurance Company; Highmark Casualty Insurance Company; :
Highmark Senior Resources Inc.; HMO of Northeastern :
Pennsylvania, Inc., d/b/a First Priority Health; Keystone Health :
Plan West, Inc.; United Concordia Companies, Inc.; United :
Concordia Dental Plans of Pennsylvania, Inc.; United :
Concordia Life and Health Insurance Company; QCC Insurance :
Company; Keystone Health Plan East, Inc.; AmeriHealth HMO, :
Inc.; Vista Health Plan, Inc.; and Region 6 RX Corp. :

SUPPLEMENTAL RESPONSE TO PID INFORMATION REQUEST 14

- 14. Explain the complete compensation arrangements of the officers of each Applicant and Subsidiary immediately prior to signing the Consolidation Agreement. Explain how such officers will be compensated if the Transaction is consummated. Discuss and provide all new employment agreements, retention bonuses, bonuses, severance packages or other forms of compensation related to or resulting from the Transaction. Explain why the proposed compensation arrangements are reasonable. Provide all third party expert opinions supporting the reasonableness of the compensation arrangements. Explain all limitations on, and guidelines for, post-consolidation compensation.**

Supplemental Information Request:

Your response contained a promise to provide a supplementary response containing, among other things, all officer compensation agreements, plans and recommendations for compensation/benefits at the new company, supporting expert reports and all severance and/or non-competition agreements referenced in your response. In addition, your response included reference to a report from an independent consultant. Please provide the report of the independent consultant immediately, as well as the current employment contracts of all senior management, which should include all direct reports to the Chief Executive Officer (CEO) of each company, as well as each of the CEOs. For the employees that you outline in your response in which their employment contract was modified, please outline in an easy readable format, the additional compensation that could be paid to each. If you are unable to provide a supplementary response at this time, please indicate the reasons why, and provide us with a date

certain when the report of the independent consultant and supplementary response will be available.

For Highmark Inc. and Independence Blue Cross

Consistent with the previous response of Highmark Inc., (“Highmark”) and Independence Blue Cross (“IBC”), the Board Chairs of both companies appointed a Committee with representation from each company’s Board, to review and make a recommendation on the compensation of the senior management of Newco.

The companies jointly retained an independent consultant (Mercer) to assist them in developing the compensation strategy for the new company. The companies also jointly retained an independent consultant (Towers Perrin) to assist them in developing the benefits strategy for the new company. The Boards engaged Towers Perrin and Mercer to act as independent consultants for their expertise in the field of compensation and benefits to advise them on what compensation and benefit levels for the senior management of the new company would be reasonable.

Attached as Exhibit 14-C is a chart setting forth the existing and proposed pay structure of the senior management of Newco (the top ten highest paid). In addition, the individuals will continue to participate in the same type of medical and retirement benefit programs. Information regarding those benefit programs was previously provided to the Department in response to Supplemental Information Request #31.

Attached as Exhibit 14-D is the expert opinion of Richard Meischeld of Towers Perrin that the proposed compensation of the senior management of Newco is reasonable.

Attached as Exhibit 14-E is the expert opinion of Christopher McGee of Mercer that the proposed compensation of the CEO and COO is reasonable.

HIGHMARK INC.
120 Fifth Avenue
Pittsburgh, PA 15222

INDEPENDENCE BLUE CROSS
1901 Market Street
Philadelphia, PA 19103

August 13, 2008

Proposed NewCo Senior Management Pay Levels

Name	Current Target Compensation				Proposed Target Compensation			
	Base Salary	Short Term Incentive %	Long-Term Incentive %	Total Direct Compensation	Base Salary	Short Term Incentive %	Long-Term Incentive %	Total Direct Compensation
K. Melani	\$1,100,000	75%	95%	\$2,970,000	\$1,300,000	100%	100%	\$3,900,000
J. Frick	\$980,000	100%	100%	\$2,940,000	\$980,000	100%	100%	\$2,940,000
C. Butler	\$685,000	70%	80%	\$1,712,500	\$725,000	90%	100%	\$2,102,500
N. DeTurk	\$480,392	55%	75%	\$1,104,902	\$600,000	90%	100%	\$1,740,000
D. O'Brien	\$452,871	55%	65%	\$996,316	\$575,000	80%	90%	\$1,552,500
K. McEndy	\$470,000	50%	65%	\$1,010,500	\$550,000	80%	90%	\$1,485,000
P. Tufano	\$502,500	50%	65%	\$1,080,375	\$550,000	80%	90%	\$1,485,000
D. Holmberg	\$480,000	55%	60%	\$1,032,000	\$480,000	55%	60%	\$1,032,000
D. Lebish	\$405,000	55%	65%	\$891,000	\$450,000	60%	80%	\$1,080,000
Y. Bright	\$338,000	50%	60%	\$709,800	\$400,000	60%	80%	\$960,000
T. Tabor	\$350,023	35%	35%	\$595,039	\$400,000	60%	80%	\$960,000

Routine annual Board approved compensation processes will continue e.g., annual merit review process.

Short and long term incentives reflect award levels for target performance; individuals may exceed or fall below target levels based upon individual and/or company performance



August 13, 2008

J. Robert Baum, PhD
Chairman of the Board
Highmark, Inc.
Fifth Avenue Place
120 Fifth Avenue
Pittsburgh, PA 15222

Mr. M. Walter D'Alessio
Chairman of the Board
Independence Blue Cross
1901 Market St.
Philadelphia, PA 19103

Dear Dr. Baum and Mr. D'Alessio:

This letter summarizes Towers Perrin's opinion on the total compensation opportunity for NewCo's executive group. In their letter dated August 13, 2008, Mercer provided you with their opinion on the total direct compensation - the sum of base salary, annual incentive and long-term incentives - for the Chief Executive Officer (CEO) and the President and Chief Operating Officer (President/COO). Towers Perrin reviewed the analysis developed by Mercer for the top two executives and concluded that the methodology and resulting total direct compensation levels are comparable to like organizations and are therefore reasonable.

To provide you and the Interim Committee of the boards of the two companies with a perspective on the reasonableness of total compensation, this letter addresses the following:

- Total direct compensation for executives reporting to the CEO and President/COO
- Qualified and non-qualified retirement benefits for NewCo's executive group

Evaluation of Positions Reporting to the CEO and President/COO

In their August 13, 2008 letter, Mercer provided a description of the process for evaluating the market levels for NewCo's top two executive officers—the CEO and President/COO. In evaluating the compensation levels for the other NewCo executives reporting to the CEO and President/COO, Towers Perrin followed a similar process.

Consistent with the approach followed for the top two executives, the primary data source was Mercer's Integrated Health Networks (IHN) survey. The IHN survey provides data on BCBS organizations, as well as publicly traded healthcare organizations. As a secondary reference, we also reviewed data from Towers Perrin's general industry database. In both cases, we analyzed data based on NewCo's projected revenues of \$22.5 billion. Towers Perrin provided data for each of the positions at the 50th and 75th percentiles.

In Towers Perrin's opinion, the proposed total compensation levels (the sum of base salary, annual incentive and long-term incentives) for the positions reporting to the CEO and President/COO are comparable to the total compensation provided to similar positions at like organizations (taxable and tax-exempt), and therefore constitutes reasonable compensation.

Retirement Benefits

Executives at NewCo will be eligible for qualified and non-qualified retirement benefits, consisting of defined benefit and defined contribution plans. These executives will be in the same qualified plans as all other employees. In general, the non-qualified plans will mirror the qualified plans, but will cover base pay and annual incentive compensation above statutory pay limits that apply to qualified plans. This type of arrangement is common and reasonable.

In the President/COO's case, long-term incentives (LTI) were included in covered pay in the non-qualified retirement plans. Effective in 2008, LTI is no longer included in covered pay in the non-qualified defined benefit plan and therefore, LTI will not impact the defined benefit pension benefit upon normal retirement. LTI inclusion in covered pay for the non-qualified defined contribution plan is not expected to provide substantial economic value. Inclusion of LTI is not prevalent for non-qualified retirement plans. Going forward, NewCo's non-qualified retirement plans for new executive hires will not include LTI in the definition of covered pay, which does reflect prevalent market practice.

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PERRIN**

Defined Benefit Pension Plans

The defined benefit plans are expected to provide benefits of approximately 50% of final average earnings (base and annual incentive) at age 65 for a long service (e.g., 25 or more years) executive. This level of benefit is reasonable and we find that a benefit level of 45% to 60% of final average earnings for senior executives is common (based on our review of both taxable and tax-exempt organizations).

The defined benefit formulas (qualified and non-qualified) include a subsidy for early retirement. Such subsidies are common. A number of the executives, including the CEO and President/COO, are eligible for an additional early retirement subsidy. Such an approach is common for senior executives.

The defined benefit plans provide payment on an annuity basis or a lump sum. The basis for converting the annuity benefits to lump sums in the non-qualified defined benefit plans mirrors the legally mandated basis used by the qualified defined benefit plans. This is a prevalent market practice.

Defined Contribution Plans

The executives are each eligible for qualified (401(k)) and non-qualified defined contribution savings plans which provide an annual company contribution of 3.0% to 3.6% of covered pay, dependent on the level of their contributions. The level of company contribution for each executive is reasonable.

Summary - Total Retirement Income Benefits (Defined Benefit plus Defined Contribution)

In Towers Perrin's opinion, the proposed retirement benefits for the CEO, President/COO, and positions reporting to the CEO and President/COO are comparable to benefits provided to similar positions at like organizations (taxable and tax-exempt) and therefore constitute reasonable retirement benefits.

Please call us with any questions or if you require additional information.

Sincerely,



RFM:fm

Christopher McGee

MERCER

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August 13, 2008

J. Robert Baum PhD
Board Chair
Highmark, Inc.
Fifth Avenue Place
120 Fifth Avenue
Pittsburgh, PA 15222Mr. M. Walter D'Alessio
Board Chair
Independence Blue Cross
1901 Market Street
Philadelphia, PA 19103

Dear Dr. Baum and Mr. D'Alessio:

As requested by the interim committee of the boards of Independence Blue Cross and Highmark (the "Committee"), Mercer ("Mercer") has conducted an evaluation of the target compensation to be provided to the top two positions (CEO, President and COO) of the potential entity, NewCo, that would be constituted by the combining of your two entities. We provided a significant amount of data to help support a decision by this committee to establish target compensation levels for the CEO and President and COO of NewCo. This letter summarizes our opinion on the reasonableness of the compensation and the foundation upon which that opinion is formed.

Opinion

NewCo will seek to attract and retain highly motivated, competent, and creative professionals at all levels of the organization who are committed to carrying out the organizations programs in the most effective and efficient manner possible. NewCo's goal will be to attract employees who are among the best of their peers. Organizations, such as NewCo, that seek employees who are among the most qualified for the positions they hold, often must provide total compensation at or even above the median for comparable positions in the relevant market. In Mercer's view, in determining the reasonableness of compensation paid by such an organization, an appropriate benchmark is to generally target between the 50th and the 75th percentile of the compensation paid for comparable positions by organizations with which the organization competes for fully qualified and experienced candidates for the position in question. It is also important to acknowledge the above should be the guideline for establishing target pay in general, however, NewCo may desire to set compensation below or above depending on the experience of the individual executive, individual performance, and/or the specific requirements of a newly created position.

MERCER



MARSH MERCER KROLL
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In Mercer's opinion, the anticipated Total Direct Compensation (the sum of Base Salary, Annual Incentive, and Long Term Incentives)) targeted to be provided to NewCo's top 2 senior positions is comparable to the amount provided by like organizations (whether taxable or tax-exempt) for like services under like circumstances and therefore constitutes reasonable compensation. This opinion is based on a detailed analysis of peer companies and survey data for similarly situated organizations. For our analysis, we assumed revenue for the combined entities would be \$22.5 billion. We used data from organizations with one half (\$12 billion) to two times (\$45 billion) in revenues. We then analyzed proxy data for companies in the same industry (health insurance) who met the revenue criteria. In addition, to obtain data on similarly situated BCBS plans, other non-publicly traded health insurers as well as publicly traded providers, we analyzed data from the Integrated Health Networks survey conducted by Mercer using the same scope cut (one half to two times revenue). We understand the target potential Total Direct Compensation for the top 2 positions to be CEO, \$6.0 million and President/COO, \$4.5 million. The following table provides the results of the market analysis of competitive peer executives and provides the foundation for our opinion.

Chief Executive Officer

Data Source	Total Direct Compensation (\$000)	
	50th %ile	75th %ile
Peer Group Proxy	\$7,258	\$13,853
Survey Data	\$6,105	\$8,400
Average	\$6,682	\$11,127

Proposed Compensation \$6,000

*Percent Rank of Proposed Compensation
Based on Raw Data* 45%

President & Chief Operating Officer

Data Source	Total Direct Compensation (\$000)	
	50th %ile	75th %ile
Peer Group Proxy	\$4,009	\$4,597

Proposed Compensation \$4,500

*Percent Rank of Proposed Compensation
Based on Raw Data* 65%

The data for the CEO is clear and conclusive since all companies have a CEO. The proxy data for the President/COO uses the second highest paid executive and is consistent with

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the intended position in NewCo. Given that survey output is based on title only, and not enough companies have the title of President and COO to generate sufficient data, survey data is less conclusive and therefore, we are not using the survey data for the analysis of this position and are instead relying on the most accurate data available, proxy data. Since the individual taking the number 2 position currently holds the CEO position at a \$10 billion entity and given his level of experience and expertise, it is reasonable to target above the market median.

Per communications from you we are providing an opinion on cash compensation only. We understand from you that Towers Perrin will be providing you with an opinion on the market competitiveness of the non-cash rewards.

I hope this information is helpful for you. Please feel free to call me with any questions.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Chris', followed by a vertical line.

Christopher McGee

Copy: Jennifer Lavinbuk — Mercer