PUBLIC VERSION
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Report on the Proposed Affiliation between Blue Cross Blue Shield of Delaware and Highmark Inc.

September 13, 2011

This report has been prepared and is being filed to assist the Delaware Department of Insurance ("DOI") in its ongoing consideration of the Form A Application of Highmark Inc., dated October 7, 2010, as amended. Blackstone reserves the right as may be required in its judgment to amend and/or supplement this report based upon additional or new information that may be provided during the public comment period or thereafter or in response to comments by the Applicants, the public or DOI officials.

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Note: Standard "e" is outside the scope of Blackstone's assignment and therefore not addressed in this report.

I. Executive Summary

Blackstone

Introduction

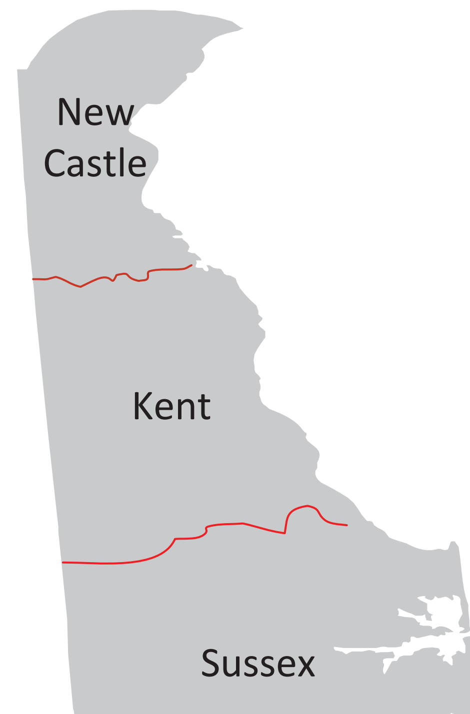
Blackstone Advisory Partners L.P. is serving as the financial advisor to the Delaware Department of Insurance (the "DOI") in connection with the DOI's review of the proposed Affiliation (the "Affiliation") between BCBSD, Inc., doing business as Blue Cross Blue Shield of Delaware ("BCBSD" or the "Company"), and Highmark Inc. ("Highmark") (collectively, the "Applicants").

- On August 19, 2010, BCBSD and Highmark signed an agreement to affiliate their organizations, both of which are currently independent licensees of the Blue Cross Blue Shield Association ("BCBSA" or the "Association")
  - BCBSD provides health insurance services in Delaware and has approximately 400,000 members
  - Highmark, based in Pennsylvania, is one of the ten largest health insurers in the country with a total membership across all product lines of 32.6 million, of which 4.8 million are health plan customers
- BCBSD and Highmark are non-profit corporations in Delaware and Pennsylvania, respectively
- The proposed Affiliation is subject to review by, and the approval of, the DOI
- The DOI has asked Blackstone to analyze several aspects of the proposed Affiliation as part of its process of determining whether the Affiliation meets certain of the standards contained in 18 *Del. C.* §5003(d)(1) that are required in order for the Affiliation to be approved

BCBSD Overview

BCBSD is incorporated as a non-profit corporation and operates as a health service corporation in the State of Delaware. As a licensee of the Blue Cross and Blue Shield Association, BCBSD underwrites managed care health insurance products.

- Headquartered in Wilmington, Delaware
- Approximately 394,000 members
- Service area includes all 3 counties in Delaware: New Castle, Kent and Sussex
- In addition to health services, BCBSD offers Self-Funded, Federal Employment Program and Stop-Loss plans(1)
- The Company also jointly offers vision plans through a partnership with Davis Vision, a subsidiary of Highmark
- BCBSD is a leader in the Delaware market and has a significant share of the Delaware health insurance market
- 620 employees
- 2010 Revenue and Net Income of $550.1 million and $15.9 million, respectively(2)



Source: BCBSD
(1) Stop-Loss is defined as a form of insurance for self-insured members that limits the amount customers are obligated to pay.
(2) Represents GAAP results.

Highmark Overview

Highmark is incorporated as a non-profit corporation and operates as a hospital plan and a professional health services plan in the Commonwealth of Pennsylvania. As a licensee of the Blue Cross and Blue Shield Association, Highmark underwrites various indemnity and managed care health insurance products.

- Headquartered in Pittsburgh, Pennsylvania
- 4.8 million health plan members
  - 3.1 million in Western Pennsylvania
  - 856,000 in Central Pennsylvania / Lehigh Valley
  - 330,000 in Northeastern Pennsylvania
  - 213,000 in Southeastern Pennsylvania
  - 265,000 in West Virginia
- Service area includes:
  - 29 counties in Western Pennsylvania
  - 21 counties in Central Pennsylvania
- Jointly markets various health insurance products with 1) Blue Cross of Northeastern Pennsylvania in northeastern Pennsylvania ("BCNEPA") and 2) Independence Blue Cross in southeastern Pennsylvania ("IBC")
- Mountain State Blue Cross Blue Shield, which is a West Virginia non-profit health services corporation and is now known as Highmark West Virginia, Inc., is a controlled affiliate of Highmark
- Approximately 19,500 employees
- 2010 Revenue and Net Income of $14.6 billion and $462.6 million, respectively(1)

(1) Represents GAAP results.

Transaction Overview

Affiliation structure as set out in the proposed Affiliation Agreement

- BCBSD will become a "controlled affiliate"[1] of Highmark and Highmark will be the sole member of BCBSD
  - BCBSD will remain a non-stock Delaware corporation
- BCBSD's board will have 9 Directors, consisting of:
  - 4 Class A Directors selected by BCBSD prior to closing who will serve staggered initial terms of 1, 2, 3 and 4 years
  - 4 Class B Directors who, for the first three years, will include Highmark's CEO and two Highmark executive officers who report directly to Highmark's CEO. The Class B Directors will serve 1-year terms
  - The BCBSD President
- Highmark will become the primary BCBSA licensee in Delaware
- Highmark will extend a $45 million line of credit to BCBSD. The line of credit is available if necessary to help BCBSD pay costs of systems conversion and integration.[2] The line will be available for 4 years after closing, and amounts outstanding under the line will bear interest at a rate equal to the lesser of LIBOR plus 350 basis points or the U.S. Prime Rate
- Highmark will provide administrative and corporate services to BCBSD pursuant to an Administrative Services Agreement ("ASA"). BCBSD will compensate Highmark for services in an amount equal to BCBSD's fair and reasonable allocable share of the total actual cost without provision for profit to Highmark for its services
- Upon occurrence of certain "Triggering Events," BCBSD has the right, exercisable by the Class A Directors, to require Highmark to withdraw as BCBSD's sole member and consent to the reestablishment of BCBSD as the primary BCBSA licensee in Delaware
- The proposed Affiliation has been structured, in part, based upon Highmark's affiliation with Mountain State Blue Cross Blue Shield ("MSBCBS"), now known as Highmark West Virginia, Inc. ("HMWV"), which was initially consummated in 1999 and continues in effect today

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(1) A "controlled affiliate" is defined by the BCBSA's "Guidelines to Administer the Controlled Affiliate License Agreement(s) and Standards (November 18, 2010)" as an entity organized and operated in such a manner, that it meets the following requirements:
(1) A Plan or Plans authorized to use the Licensed Marks in the Service Area of the Controlled Affiliate pursuant to separate License Agreement(s) with BCBSA, other than such Controlled Affiliate's License Agreement(s), (the "Controlling Plan(s)"), must have the legal authority directly or indirectly through wholly-owned subsidiaries to select members of the Controlled Affiliate's governing body having not less than 50% voting control thereof and to:
(a) prevent any change in the articles of incorporation, bylaws or other establishing or governing documents of the Controlled Affiliate with which the Controlling Plan(s) do(es) not concur;
(b) exercise control over the policy and operations of the Controlled Affiliate at least equal to that exercised by persons or entities (jointly or individually) other than the Controlling Plan(s); and Notwithstanding anything to the contrary in (a) through (b) hereof, the Controlled Affiliate's establishing or governing documents must also require written approval by the Controlling Plan(s) before the Controlled Affiliate can:
(i) change its legal and/or trade names;
(ii) change the geographic area in which it operates;
(iii) change any of the type(s) of businesses in which it engages.

(2) BCBSD management has stated that it does not intend to draw on the line of credit.

Transaction Overview: Affiliation versus Acquisition

The proposed Affiliation is contemplated as a business alliance between the Applicants. The transaction is not structured in the legal form of an acquisition or a merger.

Key Characteristics Typical of an Acquisition

- The acquirer pays consideration (typically a combination of cash and/or stock) to the target's shareholders in exchange for:
  - 1) Ownership of the current equity or unassigned surplus ("reserves") of the company
  - 2) Rights to the company's future profits and economic interests
- Although a seller may occasionally have the contractual right to repurchase its equity from the acquirer at a future date, acquisitions are typically not subject to dissolution once consummated
- The key issue for the seller is whether the total consideration the seller receives is sufficient, given that the seller is parting with ownership/control of current equity and future economic interests

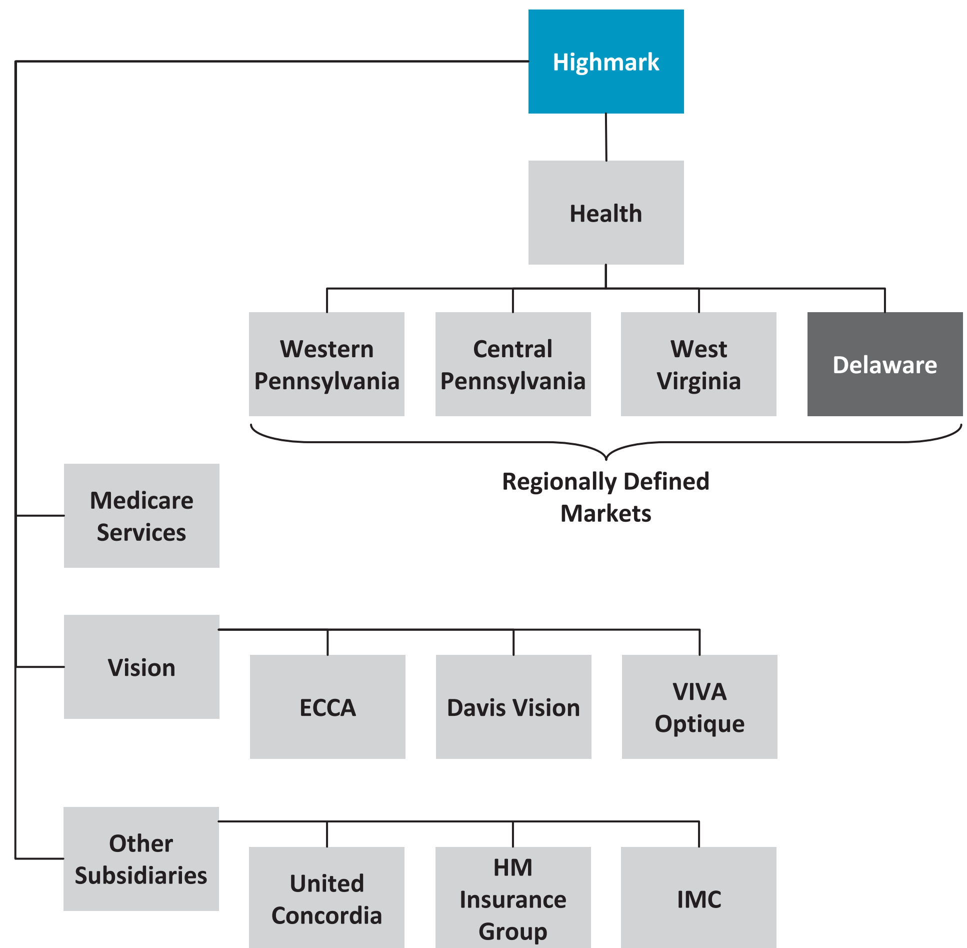
Key Characteristics of the Proposed Affiliation

- Highmark will assume control of BCBSD as the Company's sole member in exchange for providing (i) administrative services at cost, (ii) a guarantee of BCBSD's claims and (iii) overall corporate and strategic support; Highmark is also providing BCBSD the opportunity to draw upon a line of credit to facilitate BCBSD's IT systems conversion
- Highmark is not paying BCBSD any amount of consideration and will have no right to benefit from either BCBSD's current reserves or future profits
- BCBSD will retain the right to disaffiliate in the future under certain circumstances, which preserves the Company's ability to sell its equity and economic interests to a third party in exchange for consideration at a future date
- The key issues for the target in an affiliation of the type proposed include:
  - Ensuring that the target's reserves and future profits are not indirectly transferred to the controlling party
  - Carefully assessing the impact of the change of control on the target and its customers

Transaction Overview: Day 1 Organization Overview

The proposed Affiliation contemplates that BCBSD will maintain market-facing functionality (e.g., customer/provider services, pricing and sales functions) at the local level, while the Company's broader corporate operations will function in parallel to Highmark's distinct geographic segments.

- Market-facing functions will receive support from corporate departments and will provide geographic and product reports to corporate headquarters
- Functional reporting for middle / back office and corporate functions
  - Minimal impact on daily operations and staffing
  - Consistent policies / procedures across organization
  - Consistent functional management across organizations
  - Sharing of best practices
  - Guidance for end-state planning



Transaction Overview: End-State Operating Model

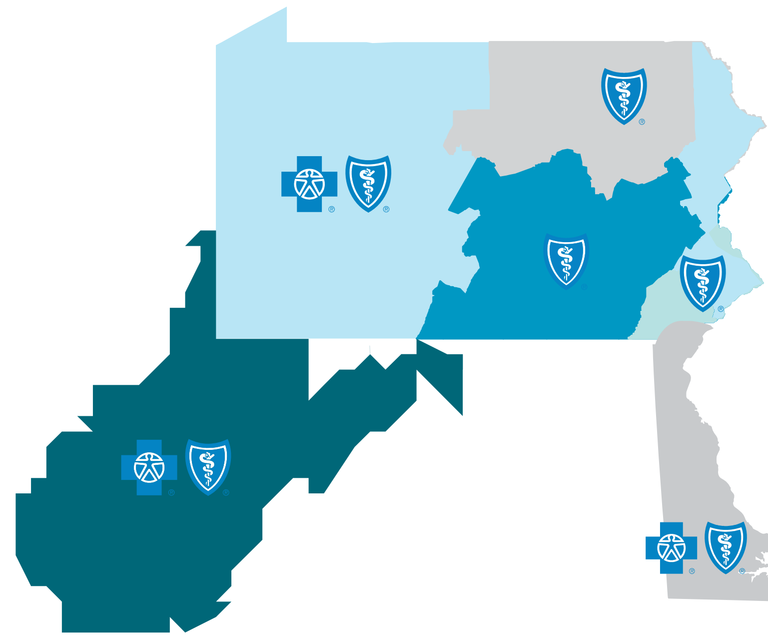
The level of end-state integration between the two organizations will vary by functional area, but the primary client-facing functions ("Front / Middle Office") will remain locally managed.

Functions	**Locally Managed** *The Locally Managed model entails functions that will be managed and delivered by local employees*	**Shared Services** *The Shared Services model entails consolidated functions supported by employees in each geographic region*	**Centralized Support Services** *The Centralized Support model entails functions that will be supported primarily by geographically centralized employees*
Front / Middle Office			
Sales & Distribution	X		
Product / Marketing		X	
Provider Relations	X		
Provider Contracting	X		
Medical Management		X	
Regulatory / Lobbying	X		
Regional Community Affairs	X		
Corporate			
Finance (Actuarial & Underwriting)		X	
Information Technology			X
Legal		X	
Human Resources		X	
Compliance		X	
Other Corporate Services			X
Back Office			
Member Service		X	
Provider Service		X	
Claims		X	
Billing		X	
Enrollment		X	
Information		X	

Transaction Overview: Post Affiliation

If the Affiliation is approved by the DOI, Highmark will become the sole member of BCBSD, which will continue as a Delaware non-stock corporation.

- Highmark will become the primary BCBSA licensee in Delaware, with BCBSD becoming a controlled affiliate of Highmark
- BCBSD retains the right, derivative from Highmark, to use the "Blue"(1) names and service marks in Delaware
- BCBSD will remain subject to regulation by the DOI
- BCBSD anticipates approximately $596 million and $9.3 million of pro forma revenue and net income, respectively, in 2012 as a controlled affiliate of Highmark
- BCBSD estimates a pro forma year-end 2012 Risk-based Capital ("RBC")(2) ratio of 1,014%(3)



Source: BCBSD.
(1) The terms "Blue" or "Blues" are also used in this report to refer generically to other BCBSA licensees.
(2) Represents an amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments.
(3) Refer to discussion of the Affiliation case projections in standard "d."

Blackstone's Mandate

Under 18 *Del. C.* §5003(d)(1), which by agreement of the Applicants has been deemed applicable to the proposed Affiliation, the DOI must approve the Affiliation unless it makes an affirmative finding that any one of six standards detailed below are violated. The DOI has asked Blackstone to assist in analyzing five of the six standards under Delaware law that have been deemed applicable to this transaction. These standards are "a," "b," "c," "d," and "f," summarized in the list below.[(1)]

a) After the affiliation, the domestic insurer would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed

b) The effect of the affiliation would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein. In applying the competitive standard in this paragraph:

- **1. The informational requirements of §5003A(c)(1) of this title and the standards of §5003A(d)(2) of this title shall apply**
- **2. The affiliation shall not be disapproved if the Commissioner finds that any of the situations meeting the criteria provided by § 5003A(d)(3) of this title exist; and**
- **3. The Commissioner may condition the approval of the affiliation on the removal of the basis of disapproval within a specified period of time**

c) The financial condition of the controlling affiliate (i.e., Highmark) is such as might jeopardize the financial stability of the insurer (i.e., BCBSD) or prejudice the interest of its policyholders

d) The plans or proposals which the controlling affiliate has to liquidate the insurer, sell its assets or 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 to policyholders of the insurer and not in the public interest

e) The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or

f) The affiliation is likely to be hazardous or prejudicial to the insurance buying public

Note: The DOI has not asked Blackstone to evaluate standard "e." The criteria forth in 18 *Del. C.*§5003(d)(1) are sometimes written as referencing merger or acquisition. The proposed Affiliation is neither (as explained herein). However, both Highmark and BCBSD agreed that the proposed Affiliation would be evaluated under the criteria set forth in §5003(d)(1).
(1) The statutory criteria are set forth in 18 *Del. C.* §5003(d)(1).

Analytical Framework

The following illustrates Blackstone's framework for analyzing each of these standards.

Standard	Blackstone's Approach	Methodologies Utilized
a) Satisfy license requirements	▸ Analyzed the relevant capital and surplus requirements, per DOI guidance, for each of the domestic insurers involved for issuance of a license	▸ Compared capital and surplus requirements, as appropriate, based on type of company to the actual capital and surplus of each of the relevant domestic insurers
b) Not substantially lessen competition or tend to create a monopoly	▸ Performed the numerical tests of market share and market concentration for this standard, per the Delaware Insurance Code ▸ Analyzed potential mitigating factors for reasonableness where prima facie evidence of an anticompetitive impact existed	▸ Market share testing using National Association of Insurance Commissioners ("NAIC") product categories ▸ Assessed any mitigating factors raised by the Applicants
c) Not jeopardize financial stability or prejudice the interest of BCBSD policyholders	▸ Analyzed the expected financial condition of the affiliated entity	▸ Analyzed Highmark's financial condition ▸ Analyzed the current financial strength of BCBSD
d) Any Highmark plans or proposals are not unfair and unreasonable to BCBSD policyholders and/or in the public interest	▸ Analyzed the non-financial benefits to BCBSD policyholders in this transaction ▸ Analyzed potential risks of the Affiliation from a policyholder perspective ▸ Public interest primarily addressed in standard "f"	▸ Analyzed the positive financial and market consequences to BCBSD's capabilities resulting from the Affiliation against the risks posed by changing control ▸ Reviewed Highmark's previous affiliation with Mountain State as a precedent for the impact of the transaction
f) Not hazardous or prejudicial to the insurance buying public	▸ Analyzed how the Affiliation affects the insurance market in Delaware ▸ Analyzed how the insurance buying public will be affected by the Affiliation	▸ Assessed input from written public comments, public hearings and interviews conducted with industry participants as part of the due diligence conducted in this matter ▸ Reviewed BCBSD's process to consider strategic alternatives and potential counterparties

Scope of Blackstone's Work

As part of its work on behalf of the DOI, Blackstone has completed the following:

- Reviewed the Form A filings, as amended, submitted by Highmark in connection with the proposed Affiliation
- Reviewed BCBSD's and Highmark's audited GAAP financial statements for the years ended December 31, 2006 to 2010
- Reviewed BCBSD's and Highmark's financial projections, including BCBSD's projections as both a standalone and affiliated entity
- Reviewed responses submitted by BCBSD and Highmark to the DOI's requests for additional materials
- Attended public information sessions in in Georgetown (May 16, 2011), Dover (May 17, 2011) and Wilmington, Delaware (May 19, 2011) and reviewed respective transcripts and the responses provided by BCBSD and Highmark to questions posed by the public
- Reviewed public comments submitted to the DOI by concerned parties
- Reviewed the Capabilities Assessment dated June 6, 2008 and Revised Capability Gap Closure Costing dated December 8, 2010 prepared by Deloitte on behalf of BCBSD
- Reviewed materials related to the proposed Affiliation
  - Reviewed more than 1,500 documents
  - Held more than 15 discussions with executives and senior management of both BCBSD and Highmark
- Held discussions with 14 third-party industry participants who provided their perspective on the proposed Affiliation and its potential impact on the health insurance market in Delaware
- Held discussions with the members of management of both BCBSD and Highmark to discuss their respective businesses, operating environments, financial conditions and strategic objectives

Scope of Blackstone's Work (cont'd)

As part of its work on behalf of the DOI, Blackstone has completed the following:

- Held discussions with Highmark's affiliate, Highmark West Virginia, Inc., as well as the West Virginia Department of Insurance to discuss this entity's experience integrating with Highmark
- Reviewed the report of KPMG, dated September 6, 2011, assessing the validity of IT-cost estimates reflected in BCBSD's pro forma financials
- Reviewed the operating and trading metrics of selected publicly-traded managed-care companies
- Reviewed documents related to BCBSD's search for a strategic partner
- Reviewed the Applicants' integration plans
- Reviewed such other information, performed such other studies and analyses and took into account such other matters as we deemed appropriate

Scope of Blackstone's Work (cont'd)

As part of its work on behalf of the DOI, Blackstone has not done the following:

- Independently verified the accuracy and completeness of financial and other information that is available from public sources or was provided to us by BCBSD, Highmark or their representatives or otherwise reviewed by us
- Made an independent appraisal of BCBSD's and Highmark's reserves or assets or expressed any opinion as to either the value of such reserves or such assets or the value of the projected income and cash flow expected to be derived therefrom
- Performed due diligence on BCBSD's and Highmark's physical properties, sales, marketing, distribution or service organizations or product markets
- Expressed any formal opinion regarding the fair value of BCBSD, Highmark or the affiliated entity
- Considered either the relative merits of the proposed Affiliation as compared to any other transaction that may be available to BCBSD or the effect of any other arrangement in which Highmark and BCBSD might engage

II. Overview of Highmark

Blackstone

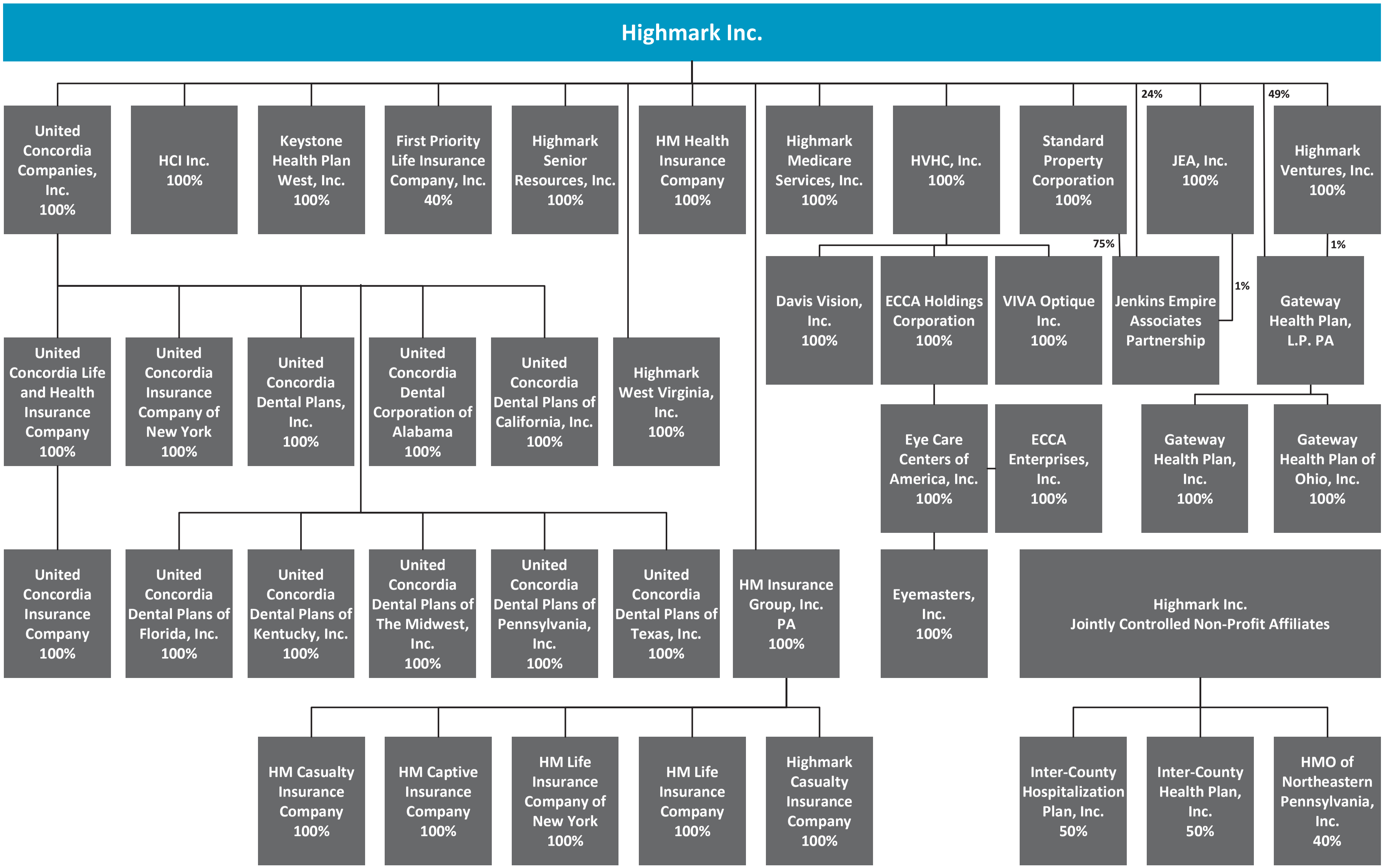
Highmark Overview

Highmark is incorporated as a non-profit corporation and operates as a hospital plan and a professional health services plan in the Commonwealth of Pennsylvania. As a licensee of the Blue Cross and Blue Shield Association, Highmark underwrites various indemnity and managed care health insurance products.

- Highmark has the 7th largest Medicare Advantage plan membership in the industry with 326,480 people
- As of 2009, Highmark is the largest Managed Care Organization in Pennsylvania, with an enrollment of 3,563,792 people representing 30.71% of the market
- In 2010, Highmark had the 9th largest commercial healthcare membership in the industry, with 3,356,113 members
- As of 2008, Highmark was the 4th largest Medigap company, with 234,860 members in the US(1)
- As of October 2009, Highmark was the 10th largest health plan in the country, with approximately 4.3 million total medical members (insured and self-funded)(2)

Source: Wall Street research.
(1) Medigap defined as an insurance product designed to supplement Medicare benefits.
(2) As of latest available information, Highmark membership is equal to 4.8 million.

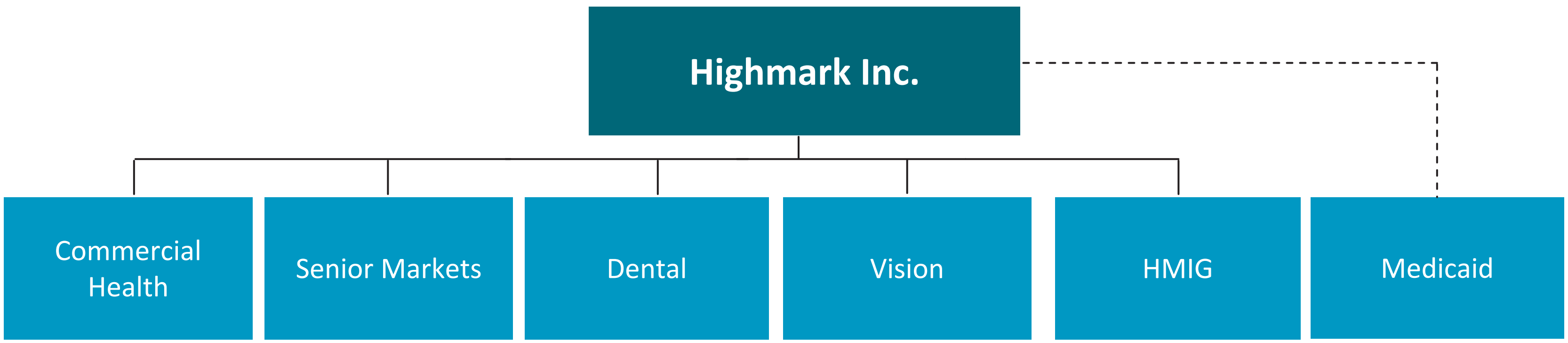
Legal Entity Overview



Product Overview

Highmark manages operations and financial results by segmenting its business into distinct classifications that include the health business and specialty products business.

- The health business is comprised of the Commercial Health and Senior Markets segments shown below
- The specialty products business includes Dental, Vision, Stop-Loss and Worker's Compensation (Stop-Loss and Worker's Compensation are collectively within HM insurance group ("HMIG"))



($ in millions)	2009 Revenue	2009 Operating Gain/Loss	2010 Revenue	2010 Operating Gain/Loss
Commercial Health	REDACTED			
Senior Markets				
Dental				
Vision				
HMIG				
Medicaid[1]				
Total[2]				

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

2010 Total Revenue by Segment

REDACTED

Source: Highmark.
(1) Accounted for using Equity Method and recorded as Equity Income of Affiliates. Amount is not included in Highmark's consolidated GAAP revenue.
(2) Total Revenue and Operating Gain/Loss inclusive of Medicaid and therefore different from GAAP reported results.

Commercial Health

- Highmark provides its Commercial Health products through the following entities:
  - Highmark
  - HM Health Insurance Company
  - Keystone Health Plan West
  - Highmark West Virginia
  - Inter-County Hospitalization Plan (50% ownership)
  - Inter-County Health Plan (50% ownership)
  - First Priority Health (40% ownership)
  - HMO of Northeastern Pennsylvania (40% ownership)
- Highmark manages its Commercial Health business in the following segments:
  - Health Maintenance Organization (HMO)
  - Preferred Provider Organization (PPO)
  - Indemnity and Consumer Driven Health Plans (CDHPs) products

Summary Financials: Commercial Health

($ in millions)

	2009A	2010A
Total Revenue	REDACTED	
Risk		
Premium Revenue		
Claims Expense		
Operating Expense		
Reported Risk Gain/(Loss)		
Non-Risk		
Management Services Revenue		
Other Non Risk Revenue		
Operating Expense		
Reported Non-Risk Gain/(Loss)		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

2010A Commercial Health Revenue Mix by Geography and Account Type

REDACTED

Source: Highmark.
Note: The "A" used on this and following pages, as in "2009A," refers to year-end actual results, and "E," as in "2011E,"refers to estimated results.
(1) Senior Markets are not specific to particular geographies.

Commercial Health (cont'd)

In 2009 and 2010, Highmark generated a large portion of its Commercial Health operating income from its Small Group and Large Group segments.

($ in millions)

	2009						2010					
	Individual	Medigap	Small Group	Experience / Large Group	Processing Arrangement Network Fees	Total	Individual	Medigap	Small Group	Experience / Large Group	Processing Arrangement Network Fees	Total
Risk												
Premium revenue												
Claims expense												
Operating expense												
Reported Gain/(Loss)												
Non-Risk												
Management services revenue												
Other non-risk revenue												
Operating expense												
Reported Gain/(Loss)												
Operating Income												
Medical Loss Ratio												
Administrative Expense Ratio												
Operating Income Margin												

REDACTED

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Highmark.

Senior Markets

- Highmark provides its Senior Markets products through:
  - Highmark
  - Keystone Health Plan West, Inc.
  - Highmark Senior Resources Inc. (Medicare prescription drug coverage in Pennsylvania and West Virginia)
  - Highmark Health Insurance Company (Medicare Advantage in West Virginia)
  - Gateway Health Plan, Inc. (Medicare Advantage coverage in 39 counties in Pennsylvania)
- Highmark provides the following products for Medicare beneficiaries:
  - Medicare Advantage Health Maintenance Organization ("HMO")
  - Medicare Advantage Preferred Provider Organization ("PPO")
  - Medicare Prescription Drug Plans
  - Medicare Supplement or "Medigap"
- Highmark partners with Highmark West Virginia and Blue Cross of Northeastern Pennsylvania to offer senior products outside of Highmark's core geographies
- Highmark also owns Highmark Medicare Services, Inc.
  - Highmark Medicare Services, Inc. is a for-profit subsidiary that administers Medicare Part A/B Fee-for-Service contracts

Summary Financials: Senior Markets

($ in millions)

	2009A	2010A
Total Revenue	REDACTED	
Risk		
Premium Revenue		
Claims Expense		
Operating Expense		
Reported Risk Gain/(Loss)		
Non-Risk		
Management Services Revenue		
Other Non Risk Revenue		
Operating Expense		
Reported Non-Risk Gain/(Loss)		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Senior Markets 2010 Revenue by segment

REDACTED

Source: Highmark.

Dental

- Highmark operates its dental insurance business through its for-profit subsidiary United Concordia Companies, Inc. ("UCCI")
- UCCI serves as the parent holding company for the Highmark family of dental companies, which includes:
  - United Concordia Dental Plans of Pennsylvania, California, Florida, Kentucky, Midwest, Texas Inc.
  - United Concordia Dental Corporation of Alabama
  - United Concordia Life and Health Insurance Company
  - United Concordia Insurance Company of NY
- UCCI serves the dental health needs of more than 8.1 million members in all 50 states, as well as the District of Columbia and Puerto Rico
  - Includes 2.0 million members in the Department of Defense's TRICARE Dental Program
  - Offers PPO, HMO, Fee For Service ("FFS"), Administrative Services Only ("ASO") and discount products
- UCCI has one of the largest dental networks in the country
  - 73,621 unique dentists in the Advantage Plus network

Summary Financials: Dental

($ in millions)

	2009A	2010A
Total Revenue	REDACTED	
Risk		
Premium Revenue		
Claims Expense		
Operating Expense		
Reported Risk Gain/(Loss)		
Non-Risk		
Management Services Revenue		
Operating Expense		
Reported Non-Risk Gain/(Loss)		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Highmark.

Vision

- Highmark operates its vision-related businesses through HVHC Inc., a for-profit subsidiary of Highmark
- HVHC Inc. is a holding company for the following businesses:
  - Davis Vision – a vision care PPO and a provider of vision services through an extensive network of providers
  - Eye Care Centers of America – a national chain of vision retail stores
  - Viva Optique – a designer and distributor of eyeglass frames and sunglasses
  - DVSC Inc. – a provider of administrative services for group and individual vision care coverage
- BCBSD has had a historical working relationship with Highmark via Davis Vision since 2006
  - BCBSD offers vision benefits through Davis Vision
    - Highmark, through Davis Vision, provides the benefits and BCBSD is compensated using a commission system
  - BCBSD members are offered discounts on prescriptive eyewear at Davis Vision retail centers
  - The Applicants do not envision a change to this working relationship due to the Affiliation, if approved

Summary Financials: Vision

($ in millions)

	2009A	2010A
Total Revenue	REDACTED	
Risk		
Premium Revenue		
Other Vision Revenue		
Claims Expense		
Operating Expense		
Reported Risk Gain/(Loss)		
Non-Risk		
Management Services Revenue		
Other Non Risk Revenue		
Operating Expense		
Reported Non-Risk Gain/(Loss)		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Highmark, discussion with BCBSD on 9/6/2011.

HM Insurance Group

- Highmark also offers other group insurance products through HM Insurance Group, a for-profit subsidiary of Highmark
  - Subsidiaries of HM Insurance Group include HM Life Insurance Company, Highmark Casualty Insurance Company, HM Casualty Insurance Company, HM Broker Services and HM Benefits Administration
- The portfolio of group products offered by HM Insurance Group includes:
  - Stop-Loss
  - Limited benefit medical plans
  - Worksite products
  - Group disability and life
  - Administrative services
- HM Insurance Group holds licenses in 50 states and the District of Columbia
- HM Insurance Group maintains 25 regional sales offices across the U.S.

Summary Financials: HM Insurance Group

($ in millions)

	2009A	2010A
Total Revenue	REDACTED	
Risk		
Premium Revenue		
Claims Expense		
Operating Expense		
Reported Risk Gain/(Loss)		
Non-Risk		
Management Services Revenue		
Other Non Risk Revenue		
Operating Expense		
Reported Non-Risk Gain/(Loss)		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Highmark.

Medicaid

- Highmark provides Medicaid products exclusively through Gateway Health Plan, Inc. ("Gateway")
  - Gateway is a limited partnership that Highmark jointly owns with Mercy Health System
- Gateway provides comprehensive managed care services to Medicaid and Medicare recipients
- Under the Pennsylvania HealthChoices Program, Gateway provides insurance to approximately 250,000 Medicaid and approximately 27,000 Medicare recipients in more than 20 counties across the state
  - Gateway is the Largest Medicaid HMO in the Southwest and Lehigh / Capital regions

Summary Financials: Medicaid

($ in millions)

	2009A	2010A
Premium Revenue	$1,005.0	$1,114.8
Other Operating Revenue	(64.2)	(103.8)
Total Operating Revenue	$940.8	$1,011.0
Total Health Care Costs	$901.6	$978.5
Net Operating Expenses	85.2	80.5
Total Operating Expenses	$986.8	$1,059.0
Premium Deficiency Reserve[1]	18.8	(21.4)
Operating Income	**($64.8)**	**($26.6)**
Medical Loss Ratio	89.7%	87.8%
Administrative Expense Ratio	9.1%	8.0%
Operating Income Margin	(6.9%)	(2.6%)

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Highmark.

(1) Premium Deficiency Reserve ("PDR") is an accounting entry that provides for projected losses to contracts currently in force. PDR requirements in the Gateway Health Plan are due to underfunding of the Medicaid program in Pennsylvania.

Historical Financial Results

The following represents Highmark's GAAP financial results for years 2006-2010.

($ in millions)

	Year Ended December 31,				
	2006	2007	2008	2009	2010
Premium Revenue					
Management Services Revenue					
Vision Revenue					
Other Revenue					
Total Operating Revenue					
Claims Incurred					
Operating Expenses					
Total Operating Expenses					
Operating Income					
Net Investment Income					
Net Realized Gain (Loss) on Investments					
Gain on Sale of Business Interests					
Interest Expense					
Change in Premium Deficiency Reserves					
Income before Income Taxes					
Income Tax Provision					
Net Income					
Medical Loss Ratio					
Administrative Expense Ratio					
Operating Income Margin					
Net Income Margin					

REDACTED

Source: Highmark.
Note: GAAP Total Revenue is equal to Total Operating Revenue plus Net Investment Income and Net Realized Gain (Loss) on Investments.

Discussion of Historical Financial Results

Management believes the following trends have affected Highmark's financial performance in recent years.

- The economic downturn impacted Highmark's financial results in the following ways:
  - The financial crisis that began in earnest in the fall of 2008 resulted in broad consumer uncertainty, and this uncertainty resulted in changes in consumer spending habits
  - Discretionary and elective procedures increased substantially in late 2008 and through the first half of 2009 as consumers took advantage of in-place health benefits
    - The growth in claim activity in late 2008 and early 2009 contributed to Highmark's decision to subsequently raise premium rates
  - This claim trend decreased in later 2009 and into 2010, largely due to greater economic certainty, and ultimately contributed to greater premium revenue performance for Highmark in 2010 as its underwriting cycle rebounded from the higher claim activity during the recession
  - The value of Highmark's investment portfolio suffered losses in 2008 and 2009 and has been recovering since 2010
  - Highmark's dental business has performed steadily in recent years as enrollment continues to grow slightly, but this is balanced by lower than expected utilization
  - In 2009, Highmark subsidiary United Concordia won a contract for select services and geographies within the Active Duty Dental Program, which results in a 100% cost reimbursement as well as fees for service
- Highmark's retail performance in the Vision category performed steadily in the downturn, while the managed care segment within Vision suffered from enrollment losses related to a loss of members employed in the auto industry

Source: Management discussions with Highmark representatives on 7/7/2011 and company filings.

GAAP Balance Sheet

As of December 31, 2010, Highmark had total assets of $9.4 billion and total reserves of $4.6 billion.

Balance Sheet – GAAP Basis

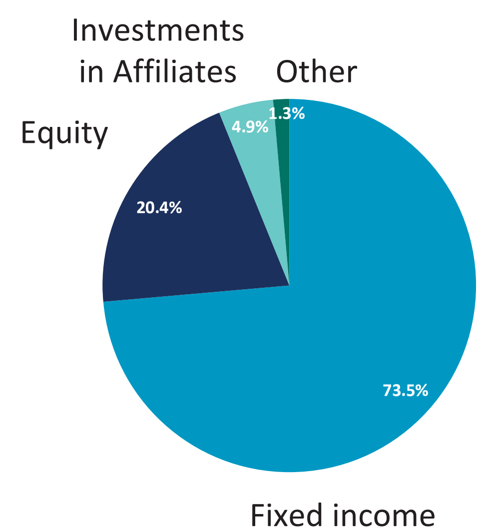
($ in millions)

	Year Ended December 31,				
	2006A	2007A	2008A	2009A	2010A
Cash and Cash Equivalents					
Investments					
Accounts Receivable					
Property and Equipment, Net					
Goodwill and Other Intangibles, Net					
Other Assets					
Total Assets					
Claims Outstanding					
Unearned Subscription Revenue					
Debt					
Other Liabilities					
Total Liabilities					
Accumulated Other Comprehensive Income					
General Reserves					
Total Reserves					

REDACTED

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

2010 Investment Portfolio Allocation[(1)]



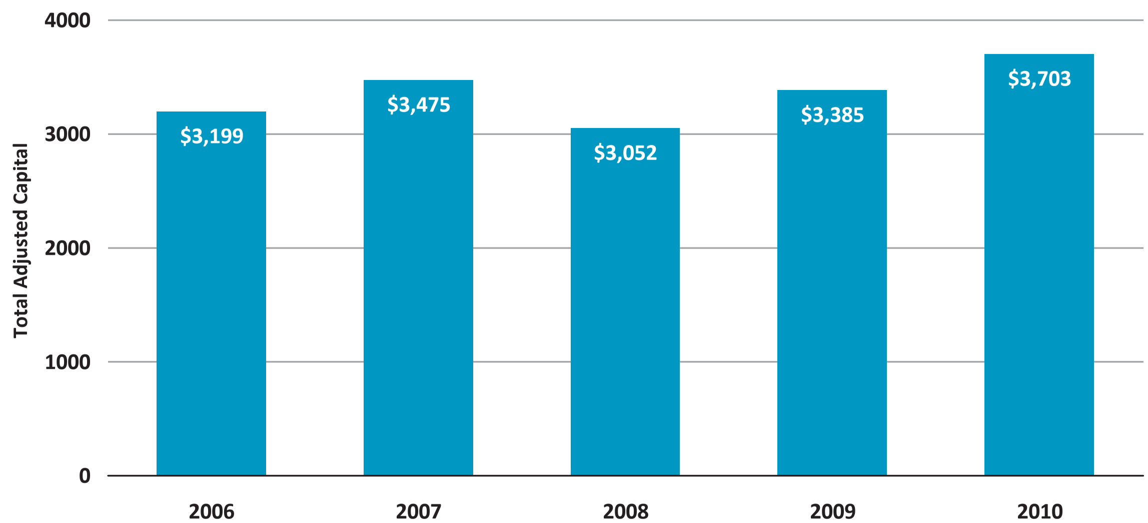
Source: Highmark.
(1) Based on $4.2 billion as of December 31, 2010.

Total Adjusted Capital

Highmark's current total adjusted capital, for the purposes of an RBC analysis, is $3.7 billion, representing a $0.5 billion increase from 2006 levels.

Highmark Total Adjusted Capital – Statutory Basis(1)

($ in millions)



2010 RBC Ratio(2)

Authorized Control Level (ACL) RBC	$535
Reserves	3,703
Surplus / RBC ACL	**692%**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

(1) Total Adjusted Capital refers to an insurance company's capital base under Standard & Poor's capital adequacy model. It includes shareholders' funds with adjustments from GAAP made to equity, asset values and reserves.

(2) As of December 31, 2010.

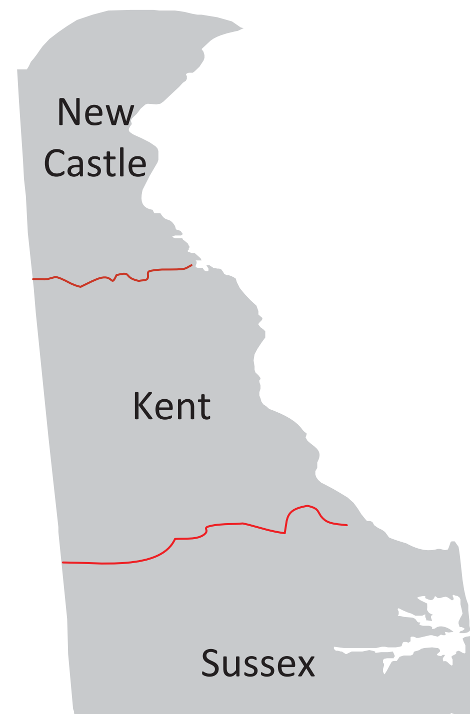
III. Overview of BCBSD

Blackstone

BCBSD Overview

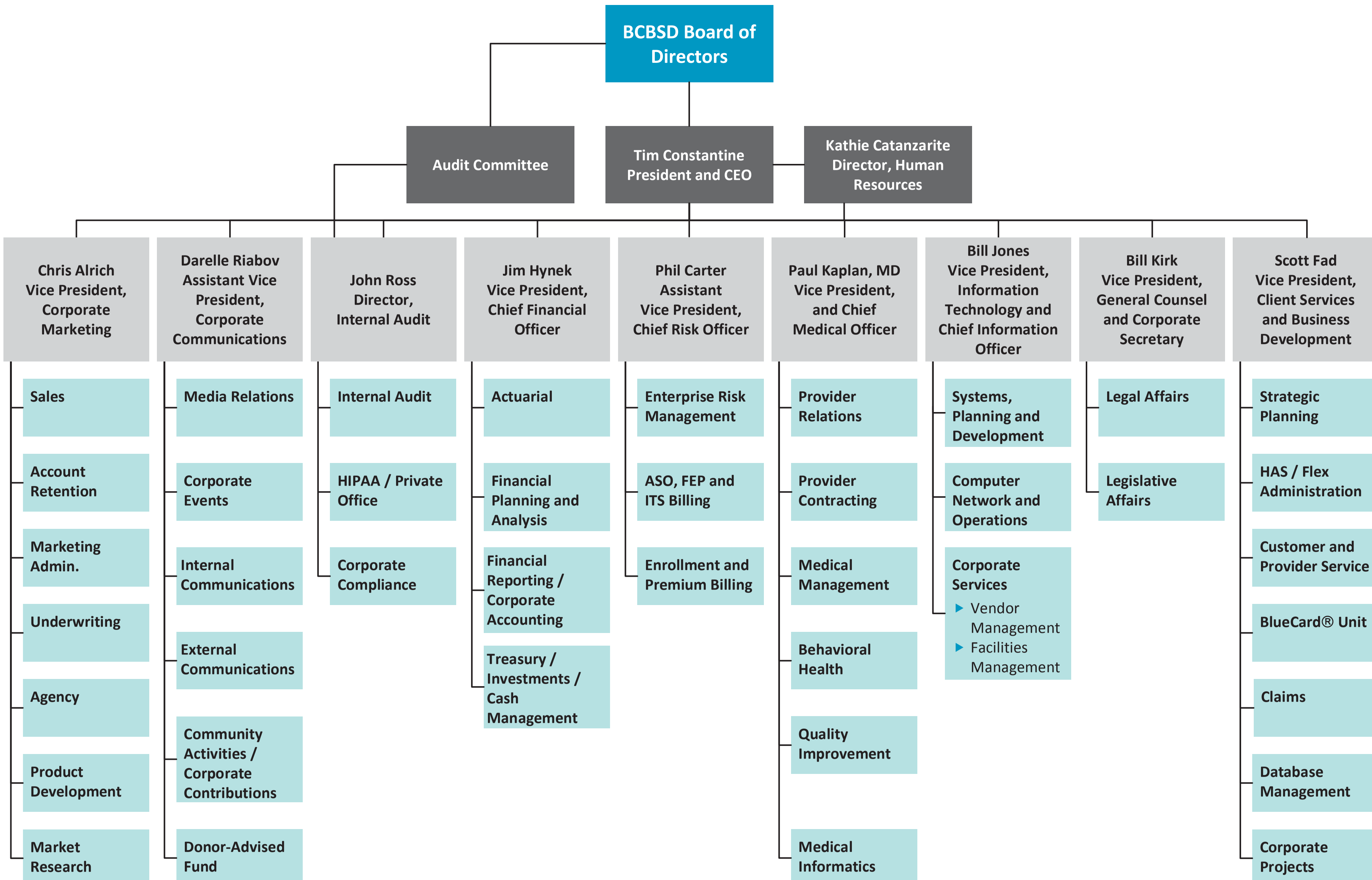
BCBSD is incorporated as a non-profit corporation and operates as a health service corporation in the State of Delaware. As a licensee of the Blue Cross and Blue Shield Association, BCBSD underwrites managed care health insurance products.

- Headquartered in Wilmington, Delaware
- Approximately 394,000 members
- Service area includes all 3 counties in Delaware: New Castle, Kent and Sussex
- In addition to health services, BCBSD offers Self-Funded, Federal Employment Program and Stop-Loss plans(1)
- The Company also jointly offers vision plans through a partnership with Davis Vision, a subsidiary of Highmark
- BCBSD is a leader in the Delaware market and has a significant share of the Delaware health insurance market
- 620 employees
- 2010 Revenue and Net Income of $550.1 million and $15.9 million, respectively(2)



Source: BCBSD
(1) Stop-Loss is defined as a form of insurance for self-insured members that limits the amount customers are obligated to pay.
(2) Represents GAAP results.

Legal Entity Overview

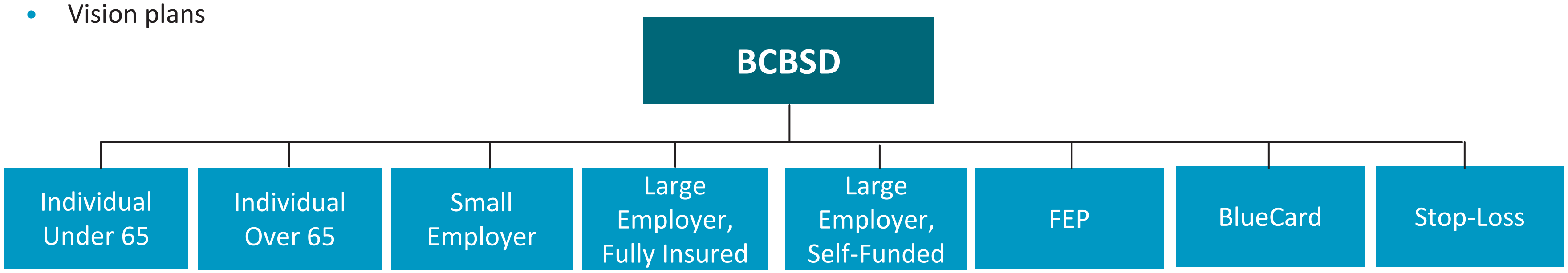


Blackstone

Product Overview

BCBSD manages operations and financial results by segmenting its business into distinct customer classifications.

- Customers are offered a full range of products:
  - Preferred Provider Organization ("PPO")
  - Exclusive Provider Organization ("EPO")
  - Traditional Indemnity and Comprehensive Major Medical ("CMM")
  - Point of Service ("POS")
  - Consumer Directed Health ("CDH")
  - Pharmacy plans
  - Health Maintenance Organization ("HMO")
  - Medigap and Medicare Carve-out
- BCBSD also offers ancillary products to accompany BCBSD medical plans
  - Dental plans
  - Vision plans



($ in millions)	2009 Revenue	2009 Operating Gain/Loss	2010 Revenue	2010 Operating Gain/Loss
Individual Under 65				
Individual Over 65				
Small Employer				
Large Employer, Fully Insured				
Large Employer, Self-Funded				
Federal Employee Program (FEP)				
BlueCard				
Stop Loss				
Total Consolidated				

REDACTED

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

2010 Consolidated Revenue by Segment

REDACTED

Source: BCBSD.

Individual

Under 65

- BCBSD's Individual Under-65 segment serves individuals who do not have access to employer-sponsored coverage
- Individual Under-65 financial performance began to deteriorate in 2008 as a result of under-pricing by BCBSD
  - To address declining financial performance, certain products were discontinued and significant price increases were implemented in 2009 and 2010
  - With the price increases, enrollment has dropped, and the Medical Loss Ratio ("MLR") has stabilized[1]
- The target MLR[1] for 2011 is REDACTED to address the new MLR requirements of the Patient Protection and Affordable Care Act ("PPACA")

Over 65 / Medicare Supplement

- BCBSD's Individual Over-65 segment serves individuals who are enrolled in Medicare and do not have access to employer-sponsored coverage
- Individual Over-65 segment has consistently delivered strong financial performance
- BCBSD is increasing the target MLR from REDACTED percent beginning with the rating period for January 1, 2011
- The target MLR is not subject to the requirements of PPACA

Summary Financials: Under 65

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Summary Financials: Over 65 / Medicare Supplement

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.

(1) Medical Loss Ratio is defined as the ratio of losses paid out in claims divided by earned premiums and is a profitability metric commonly used in the health insurance industry.

Small Employer

- BCBSD's Small Employer segment serves employers with as few as one and as many as fifty eligible employees
- BCBSD continues to be the dominant player in the Delaware Small Employer segment, with an estimated market share of REDACTED of small employers who offer health coverage
- Enrollment has declined following the economic downturn in 2008 as many small employers reduced employment or eliminated health insurance coverage. Despite these challenges, BCBSD has maintained a REDACTED retention rate in this segment during 2010
- Starting in October 2010, BCBSD raised the target MLR from REDACTED percent to address the requirements of PPACA

Summary Financials: Small Employer

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.

Large Employer, Fully Insured

- BCBSD's Large Employer, Fully Insured segment includes Delaware-based employers with more than 50 eligible employees who purchase fully insured plans
- BCBSD serves approximately REDACTED of the fully-insured large-group market in Delaware
- Membership in the market has flattened as large employers have reduced employment in response to economic conditions
- Large group financial performance deteriorated during 2008 and 2009
  - Beginning in late 2009, BCBSD initiated a comprehensive review of pricing methodologies, underwriting factors and base rates aimed at improving performance
- In 2011, the target MLR for the segment is being increased to REDACTED to address the requirements of PPACA, although targeted loss ratios for individual groups will continue to vary by size

Summary Financials: Large Employer, Fully Insured

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.

Large Employer, Self-Funded

- BCBSD's Large Employer, Self-Funded segment provides Administrative Services Only (ASO) or self-funded plans to Delaware-based employers with two hundred or more eligible employees
- BCBSD expects to maintain its strong market share through 2011
- The following are BCBSD's top Large-Employer, Self-Funded accounts as of October 2010

REDACTED

- BCBSD also offers Stop-Loss programs, which has recently become an unprofitable line of business

Summary Financials: Large Employer, Self-Funded(1)

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.
(1) Premium Revenue and Incurred Care are results of the Stop-Loss business.

Federal Employee Program and BlueCard Host

Federal Employee Program

- The Federal Employee Program ("FEP") program is the national Blue offering to employees of the federal government's Federal Employee Health Benefits Program ("FEHBP")
- Under FEP, BCBSD participates with all Blue plans around the country to provide for the national delivery of health care benefits and provider network and discounts to employees of the federal government
- BCBSD is compensated for the administrative services it provides under the program, including its marketing efforts to expand enrollment into the plan

BlueCard Host

- BCBSD's national BlueCard program allows members to receive full health care benefits while traveling or living outside of their home Blue plan service areas
- BCBSD's "Host" segment consists of members of other Blue plans who reside in and receive health care services in Delaware
- The 2008 economic downturn has resulted in a nationwide decline in employment, and enrollment results in recent years reflect that reduction
- Enrollment in 2011 is expected to remain stable

Source: BCBSD.

Summary Financials: FEP

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Summary Financials: BlueCard Host

($ in millions)

	2009A	2010A
Premium Revenue	REDACTED	
Fee / Other Revenue		
Total Revenue		
Incurred Care		
Total Operating Expenses		
Operating Income		
Medical Loss Ratio		
Administrative Expense Ratio		
Operating Income Margin		

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Historical Financial Results

The following represents BCBSD's GAAP financial results for years 2006-2010:

($ in millions)

	Year Ended December 31,				
	2006A	2007A	2008A	2009A	2010A
Premium Revenue	$423.1	$457.3	$483.8	$482.1	$498.7
Amounts Attributable to Self-Funded Arrangements	560.6	602.6	695.6	726.6	705.0
Less Amounts Attributable to Claims under Self-Funded Arrangements	(521.2)	(560.9)	(655.6)	(688.2)	(666.8)
Other	6.3	5.7	5.6	9.5	8.2
Total Operating Revenue	**$468.8**	**$504.7**	**$529.3**	**$530.0**	**$545.1**
Claims Incurred	349.1	387.8	422.2	422.2	424.0
General and Administrative	97.9	113.1	118.0	111.5	112.8
Pension Settlement and Termination Benefits	–	–	9.2	3.7	–
Total Operating Expenses	**$447.1**	**$500.9**	**$549.4**	**$537.5**	**$536.8**
Operating Income	**$21.7**	**$3.8**	**($20.1)**	**($7.5)**	**$8.3**
Gain from Sale of Real Estate	–	1.9	–	–	–
Investment Income, Net	11.0	13.9	10.6	11.8	11.6
Other-than-temporary Impairment Losses Recognized in Earnings	(0.2)		(13.1)	(0.5)	–
Income before Income Taxes	**$32.5**	**$19.6**	**($22.6)**	**$3.8**	**$19.9**
(Benefit) Provision for Income Taxes	5.4	2.5	(4.2)	(0.9)	4.1
Net Income	**$27.1**	**$17.1**	**($18.4)**	**$4.7**	**$15.9**

Medical Loss Ratio	REDACTED
Administrative Expense Ratio	
Operating Income Margin	
Net Income Margin	

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD. 2010 Revenue is shown prior to a reclassification of $5 million, which would increase 2010 revenue to $550 million.

Discussion of Historical Financial Results

Management believes the following trends have affected BCBSD's financial performance in recent years.

- Large Group and Individual Under-65 category growth contributed to premium growth of 6% and 9% in 2007 and 2008, respectively
- Self-Funded and other revenue remained consistent, in aggregate, from 2006 to 2010, though composition has changed
  - BlueCard host revenue has increased while Self-Funded fees have declined
  - BCBSD's election to not participate in the BlueCard consortium arrangement, effective January 2009, resulted in an increase in BlueCard host revenue
- Administrative Expenses have experienced material increases
  - In fiscal year 2006, while affiliated with CareFirst, BCBSD's total administrative expenses were approximately $84 million[1]
  - In 2008, BCBSD's total administrative expenses jumped to $99 million due to consulting expenses related to the Company's affiliation activities, early retirement programs and other corporate expenses
- Despite relatively steady incurred care costs in the Medigap and Small Group categories, other categories have experienced notable MLR volatility
  - Individual Under-65 MLR has risen from REDACTED in 2007 to approximately REDACTED in 2010
  - Large Group's MLR has been the highest over the last five years, reaching REDACTED in 2009, but has since declined to REDACTED in 2010
- BCBSD continues to face significant competition from for-profit insurers, which are generally national companies that have grown through acquisitions and industry consolidation

Source: Conference call with BCBSD representatives on 6/22/2011 and company filings.
(1) The CareFirst affiliation is discussed further in the partner search process timeline shown on pages 119-123.

GAAP Balance Sheet

As of December 31, 2010, BCBSD had total assets of $349 million and total reserves of $187 million.

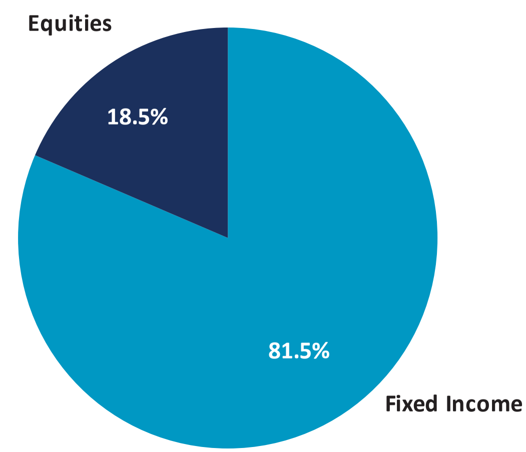
Balance Sheet

($ in millions)

	Year Ended December 31,				
	2006A	2007A	2008A	2009A	2010A
Cash and equivalents	$24.4	$20.8	$19.8	$13.4	$13.7
Short-term investments	14.2	26.7	8.9	10.7	21.3
Advances to providers	8.4	8.5	13.5	12.7	8.0
Accounts receivable	27.5	29.4	31.8	30.3	23.7
Other current assets	15.5	14.5	16.7	13.8	10.5
Total current assets	90.0	100.0	90.7	80.9	77.2
Long-term investments	207.1	206.8	183.9	214.2	239.7
Property and equiptment	9.0	19.5	19.5	18.2	19.0
Other non-current assets	20.1	7.4	13.9	13.1	12.9
Total non-current assets	236.2	233.8	217.3	245.5	271.5
Total Assets	**$326.1**	**$333.7**	**$308.0**	**$326.4**	**$348.7**
Short-term borrowings	25.4	18.8	17.8	12.1	9.9
Unpaid claims	41.0	44.4	41.7	36.9	35.3
Accounts payable and accrued expenses	41.6	41.2	40.8	38.4	42.9
Experience funds/advances	4.0	2.5	0.1	7.8	3.3
Unearned income	4.5	8.4	11.9	11.4	10.7
Total current liabilities	116.5	115.3	112.3	106.5	102.2
Other liabilities	20.5	36.0	55.9	54.9	60.1
Total Liabilities	**$137.0**	**$151.4**	**$168.2**	**$161.4**	**$162.2**
Reserves/unassigned funds	184.0	201.1	182.7	189.5	205.4
Accumulated other comprehensive income	5.2	(18.7)	(42.9)	(24.5)	(18.9)
Total reserves	**$189.2**	**$182.4**	**$139.8**	**$165.1**	**$186.5**
Total liabilities and reserves	**$326.1**	**$333.7**	**$308.0**	**$326.5**	**$348.7**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Investment Portfolio Allocation[1]



Breakdown By Asset Class[2]

Asset Class	% Allocation
Corporate	26.2%
Mortages	25.7%
Governments	18.5%
Cash	8.3%
Convertibles	7.2%
S&P Emerging Market Index	5.6%
S&P Indexed Fund	5.2%
S&P Developed Market Index	3.3%

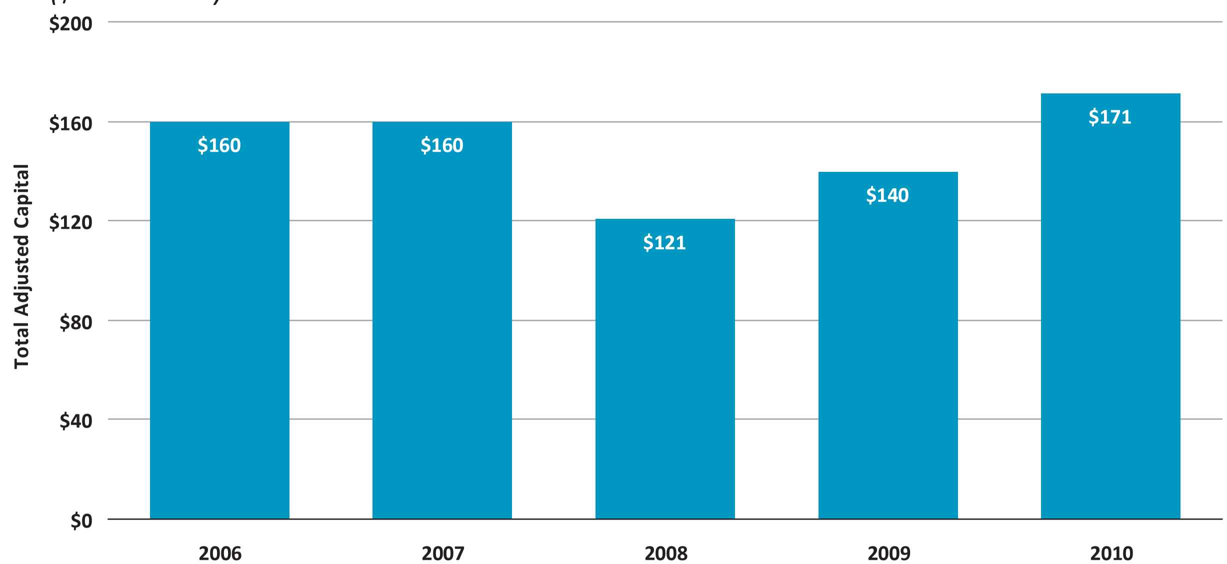
Source: BCBSD.
(1) Represents GAAP allocation of investments of $260 million as of December 31, 2010.
(2) As of September 30, 2010. Represents latest available allocation by asset class.

Risk-Based Capital Analysis

BCBSD's current total adjusted capital, for the purposes of an RBC analysis, is $171 million, representing a $11 million increase from 2006.

BCBSD Total Adjusted Capital – Statutory Basis[1]

($ in millions)



RBC Ratio[2]

Authorized Control Level (ACL) RBC	$16
Reserves	171
Surplus / RBC ACL	**1,056%**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

(1) Total Adjusted Capital refers to an insurance company's capital base under Standard & Poor's capital adequacy model. It includes shareholders' funds and adjustments on equity, asset values and reserves.
(2) As of December 30, 2010.

Overall Strategic Position of BCBSD

Though BCSBD maintains a strong competitive position in Delaware’s health insurance market, the Company faces considerable challenges.

Strengths	Challenges
• Strong brand recognition as sole BCBSA licensee in Delaware	• Core IT administration system in need of updating
• Historic relationships with Delaware-based businesses and community stakeholders	• Limited product development capabilities
• Reputation for customer / client service has resulted in admirable market share in select products	• Less than 5% population growth in Delaware limits membership trajectory
• Current financial position, as shown by an RBC greater than 1,000%, appears stable	• Impending regulatory reform creates uncertainty
	• Economies of scale are difficult as a standalone entity
	• Aging workforce with limited options for replacement of retiring personnel, particularly in the IT department

IV. Review of Approval Standards

Blackstone's Mandate

Under 18 *Del. C.* §5003(d)(1), which by agreement of the Applicants has been deemed applicable to the proposed Affiliation, the DOI must approve the Affiliation unless it makes an affirmative finding that any one of six standards detailed below are violated. The DOI has asked Blackstone to assist in analyzing five of the six standards under Delaware law that have been deemed applicable to this transaction. These standards are "a," "b," "c," "d," and "f," summarized in the list below.[1]

a) After the affiliation, the domestic insurer would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed

b) The effect of the affiliation would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein. In applying the competitive standard in this paragraph:

- **1. The informational requirements of § 5003A(c)(1) of this title and the standards of § 5003A(d)(2) of this title shall apply**
- **2. The affiliation shall not be disapproved if the Commissioner finds that any of the situations meeting the criteria provided by § 5003A(d)(3) of this title exist; and**
- **3. The Commissioner may condition the approval of the affiliation on the removal of the basis of disapproval within a specified period of time**

c) The financial condition of the controlling affiliate (i.e., Highmark) is such as might jeopardize the financial stability of the insurer (i.e., BCBSD) or prejudice the interest of its policyholders

d) The plans or proposals which the controlling affiliate has to liquidate the insurer, sell its assets or 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 to policyholders of the insurer and not in the public interest

e) The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or

f) The affiliation is likely to be hazardous or prejudicial to the insurance buying public

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Note: The DOI has not asked Blackstone to evaluate standard "e." The criteria forth in 18 *Del. C.*§5003(d)(1) are sometimes written as referencing merger or acquisition. The proposed Affiliation is neither (as explained herein). However, both Highmark and BCBSD agreed that the proposed Affiliation would be evaluated under the criteria set forth in §5003(d)(1).

(1) The statutory criteria are set forth in 18 *Del. C.* §5003(d)(1).

A. Standard “a”

Blackstone

Standard "a": Satisfy License Requirements

Blackstone has reviewed BCBSD's current status as a licensee under the Delaware Insurance Code and inquired as to any potential changes to this status as a result of the proposed Affiliation. Blackstone has also reviewed Highmark's Delaware-based subsidiaries, which must meet certain capital balance criteria.

Standard "a" : After the change of control, the domestic insurer would not be able to satisfy the requirements for the issuance of a license to write the lines of insurance for which it is presently licensed

BCBSD's Satisfaction of Licensing Requirements

- BCBSD is authorized to write insurance as a health service corporation under Chapter 63 of Title 18, the Delaware Insurance Code
  - As a health service corporation in Delaware, BCBSD is not authorized to write insurance under Chapter 5 of Title 18, as Chapter 5 applies only to non-health service corporations
  - Additionally, because BCBSD was founded prior to November 1st, 1968, the Company is not required to obtain a certificate of authority from the Department of Insurance under section §6304 of Title 18
- Following the consummation of the transaction, BCBSD will remain a non-stock, health service corporation and will not be required to re-establish its licensing status
- Because BCBSD will continue to be regulated under Chapter 63 of Title 18, BCBSD must remain solvent and avoid those conditions or circumstances that would place it into supervision or receivership under Chapter 59 of Title 18

Highmark Subsidiaries' Satisfaction of Licensing Requirements

- In order for Highmark's subsidiaries to satisfy requirements for issuance of a license to write insurance in Delaware, these entities must meet capital balance requirements; based on information provided by the DOI, the requirements are met

Highmark Subsidiaries	Capital Balance 2010	Capital Balance Requirement	Satisfy?
HM Life Insurance Company	$189,158,122	$550,000	Y
HM Health Insurance Company	$66,555,296	$550,000	Y
United Concordia Life and Health Insurance Company	$165,059,542	$550,000	Y

Based on its review of both BCBSD's status as a licensee under the Delaware Insurance Code, and the status of the Highmark subsidiaries that write insurance in Delaware, Blackstone believes that the proposed Affiliation would not violate standard "a" under 18 *Del. C.* §5003(d)(1).

Source: BCBSD memo received 7/11/11 and Highmark data provided by the DOI.

B. Standard “b”

Standard "b": Competition

Blackstone analyzed the effect on the competitive environment in insurance in Delaware according to §5003(d)(1) of Title 18 of the Delaware Insurance Code, which outlines the applicable competitive standard.

Standard "b" : The effect of the affiliation would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein…In applying the competitive standard in this paragraph: (1) The information requirements of §5003A(c)(1) and the standards of §5003A(d)(2)of this title shall apply…"

- The informational requirements outlined in § 5003A(c)(1) are below:

  The pre-affiliation notification shall be in such form and contain such information as prescribed by the National Association of Insurance Commissioners ("NAIC") relating to those markets which, under subsection (b)(2)e of this section, cause the affiliation not to be exempted from the provisions of this section. The Commissioner may require such additional material and information as the Commissioner deems necessary to determine whether the proposed affiliation, if consummated, would violate the competitive standard of subsection (d) of this section. The required information may include an opinion of an economist as to the competitive impact of the acquisition in this State accompanied by a summary of the education and experience of such person indicating the person's ability to render an informed opinion

- The DOI has notified Blackstone the information requirements were satisfied

Standard “b”: Competition

- § 5003A(d)(2) states that prima facie evidence of a violation of the competitive standard exists if the transaction involves 2 or more insurers competing in the same market and;

1. If the market is highly concentrated[1] and the involved insurers possess the following shares of the market:

Insurer A[2]	Insurer B[2]	
4%	4%	or more
10%	2%	or more
15%	1%	or more

2. or, if the market is not highly concentrated and the involved insurers possess the following shares of the market:

Insurer A[2]	Insurer B[2]	
5%	5%	or more
10%	4%	or more
15%	3%	or more
19%	1%	or more

- Further, prima facie evidence of a violation of the competitive standard exists if the transaction involves 2 or more insurers competing in the same market and:

   1. There is a significant trend toward increased concentration in the market;
      – This occurs when the aggregate market share of any grouping of the largest insurers in the market, from the two largest to the eight largest, has increased by 7% or more of the market over a period of time extending from any base year 5 to 10 years prior to the acquisition up to the time of the acquisition
   2. And 1 of the insurers involved is also 1 of the insurers in a grouping of such large insurers showing the requisite increase in the market share;
   3. And another involved insurer’s market share is 2% or more

Note: The term market is defined by the Delaware Insurance Code as within the bounds of the state of Delaware and by line of business.
(1) A highly concentrated market is one in which the share of the 4 largest insurers is 75 percent or more of the market. Percentages not shown in the tables are interpolated proportionately to the percentages that are shown. If more than 2 insurers are involved, market shares exceeding the total of the 2 columns in the table is prima facie evidence of violation of 18 *Del. C.*§5003A(d)(2).
(2) For the purpose of this subparagraph, the insurer with the largest share of the market shall be deemed to be Insurer A.

Standard “b”: Market Share Analysis

According to the DOI, Highmark, through various subsidiaries, earned 2010 premium revenue in Delaware in the product lines of stop-loss, dental, limited benefits medical and student indemnity travel. Of these four product lines, BCBSD earned 2010 premium revenue in Delaware in stop-loss and dental.

1) 2010 Stop-Loss Premiums Written

- According to the DOI, complete and consistent data with respect to the Delaware health insurance stop-loss market is not available for the following reasons:
  - Insurers do not report stop-loss premiums within NAIC categories that are exclusive to the stop-loss product; BCBSD, for example, records stop-loss premiums as an 'Other' category revenue within its health insurance statutory report, and the Company’s stop-loss revenues are not specifically identifiable within the NAIC data
  - Insurers do not report stop-loss premiums consistently within NAIC categories that are exclusive to health insurance (i.e. Comprehensive Health); Highmark, for example, records stop-loss premiums under the NAIC classification of Life Accident and Health, which classification includes premiums from other insurers that are unrelated to health insurance
- As consistent data on stop-loss market share is not available for the Delaware market, a direct application of the mathematical tests promulgated by §5003A(d)(2) is not feasible
- It is noted, however, that Highmark’s total 2010 health insurance premiums written in Delaware (inclusive of stop-loss, dental, limited benefits medical and student indemnity travel) can be compared against total premiums attributed to the NAIC Comprehensive Health category. Based on this measure, BCBSD and Highmark would have 66.6% and 0.8% market share, respectively (see page 53 for details)

Source: DOI.

Standard "b": Market Share Analysis (cont'd)

Highmark's total 2010 health insurance premiums written in Delaware (inclusive of stop-loss, dental, limited benefits medical and student indemnity travel) would represent a market share of 0.8% when compared to total 2010 premiums reflected in the Delaware NAIC Comprehensive Health category.

1) 2010 Stop-Loss Premiums Written (cont'd)

($ in Thousands)

2010 Comprehensive Health Premiums Written in Delaware[(1)] Company Name	Domicile	Direct Premiums Written	Market Share
BCBSD Inc	**DE**	**$498,775**	**66.6%**
Coventry Hlth Care of DE Inc	DE	99,091	13.2%
Aetna Hlth Inc PA Corp	PA	61,889	8.3%
Delta Dental of DE Inc	DE	15,596	2.1%
Sterling Life Ins Co	IL	11,854	1.6%
Amerihealth Hmo Inc	PA	9,059	1.2%
Coventry Hlth & Life Ins Co	DE	6,488	0.9%
Optimum Choice Inc	MD	6,155	0.8%
Highmark Inc.[(1)]	PA	5,764	0.8%
QCC Ins Co	PA	4,817	0.6%
Vision Benefits of Amer Inc	PA	3,976	0.5%
Vision Serv Plan Ins Co	CT	3,970	0.5%
Dominion Dental Serv Inc	VA	3,775	0.5%
Wellcare Prescription Ins Inc	FL	3,244	0.4%
Medco Containment Life Ins Co	PA	3,149	0.4%
Health Care Serv Corp A Mut Legal Re	IL	2,652	0.4%
First Care Inc	MD	2,236	0.3%
SilverScript Ins Co	TN	1,556	0.2%
Atlantic Inc	MD	1,209	0.2%
Other		4,034	0.5%
Total		**749,289**	**100.0%**
Market share of top 4		**90.1%**	
BCBSD share		**66.6%**	
Highmark share		**0.8%**	

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimals not displayed.

- Although §5003A(d)(2) is not directly applicable due to data limitations as discussed at left, if the mathematical test were applied based on all 2010 Highmark premiums in Delaware being measured against the NAIC Comprehensive Health classification, the competitive standard would not be prima facie violated

Source: DOI.

(1) Includes Highmark's total 2010 premiums written in Delaware (inclusive of stop-loss, dental, limited benefits medical and student indemnity travel); of the $5,764 million in total Highmark premium shown, $4,307 million is classified by Highmark outside of the Comprehensive Health category, but is included above for purposes of the illustrative calculation.

Standard “b”: Market Share Analysis (cont’d)

Both BCBSD and Highmark maintain material market share in the Dental category. As shown below, there does exist prima facie evidence of a violation of §5003A(d)(2)(a) of Title 18 of the Delaware Insurance Code.

2) 2010 Dental Premiums Written

($ in Thousands)

2010 Dental Premiums Written in Delaware Company Name	Domicile	Direct Premiums Written	Market Share
Delta Dental	DE	$16,478	65.9%
Dominion Dental Serv Inc	VA	3,775	15.1%
BCBSD Inc	**DE**	**2,766**	11.1%
United Concordia (HM Subsidiary)	**PA**	**1,457**	5.8%
Renaissance Life & Hlth Ins Co of Am	IN	281	1.1%
Cigna Dental Hlth of DE Inc	DE	93	0.4%
Mamsi Life & Hlth Ins Co	MD	73	0.3%
Group Dental Serv Of MD Inc	MD	59	0.2%
Health Care Serv Corp A Mut Legal Re	IL	31	0.1%
Total		**25,013**	**100%**
Market Share of Top 4			**97.9%**
BCBSD Share			**11.1%**

- Because the market is highly concentrated (share of the 4 largest insurers is 97.9%), the below Standard “a” applies:
  - a. Any acquisition involving 2 or more insurers competing in the same market is prima facie evidence of violation of the competitive standards:
    - 1. If the market is highly concentrated and the involved insurers possess the following shares of the market(1):

Insurer A(2)	Insurer B(2)	
4%	4%	or more
10%	2%	or more
15%	1%	or more

- BCBSD and Highmark have 13.0% and 6.9% market share, respectively
  - The competitive standard is prima facie violated

Source: DOI.

(1) A highly concentrated market is one in which the share of the 4 largest insurers is 75 percent or more of the market. Percentages not shown in the tables are interpolated proportionately to the percentages that are shown. If more than 2 insurers are involved, market shares exceeding the total of the 2 columns in the table is prima facie evidence of violation of 18 *Del. C.* §5003A(d)(2).

(2) For the purpose of this subparagraph, the insurer with the largest share of the market shall be deemed to be Insurer A, 18 *Del. C.* §5003A(d)(2).

Factors Offsetting Potential Anticompetitive Effect

Although there is prima facie evidence of a potential lessening of competition in the Delaware dental market, the absence of any anticompetitive effect may be otherwise established (per 18 *Del. C.* §5003A(d)(2)(d)). Below is an analysis of factors pertaining to §5003A(d)(2)(d).[(1)]

1) Although Highmark (via its United Concordia ("UCD") subsidiary) accounts for nearly 7% of dental insurance premiums in Delaware (compared to the prima facie threshold of 2%), over 81%[(2)] of UCD's Delaware dental customers obtain their insurance via employment with companies that are not located within Delaware

- As BCBSD is not a potential provider of dental insurance for these employees and pricing actions taken by BCBSD for dental products in Delaware may have little impact, if any, on the pricing of dental insurance for these UCD customers, these customers are not effectively participating in the same market as BCBSD
- After adjusting for the percentage of UCD Delaware customers not sitused in Delaware, UCD's estimated dental market share based on premiums may be as low as 1.4%[(3,4)]
- After adjusting for the number of UCD Delaware customers not sitused in Delaware, UCD's estimated adjusted dental market share based on members may be as low as 0.8%[(3)]

Estimated Adjusted Market Share Calculation Based on Members[(2)]	
UCD membership in Delaware based on resident state	26,064
Less: UCD membership sitused outside of Delaware	(21,272)
UCD membership sitused in Delaware	4,792
Divided by: Delaware residents enrolled in a private dental plan[(5)]	588,752
Estimated[(3)] Adjusted UCD Market Share	**0.8%**

2) Highmark's potential increased presence in the Delaware dental market resulting from the Affiliation may serve to increase competition by providing an increased counter-weight to Delta Dental

- Delta's market share currently exceeds 73%, compared to 13% for BCBSD, the next largest competitor
- Highmark currently maintains a small presence in the Delaware dental market (particularly when viewing the market as excluding employees of companies located outside of Delaware)
- Unlike Delta, BCBSD currently offers only standard reimbursement plans in Delaware, which do not utilize provider networks; Highmark (via UCD) plans to offer more robust plans in Delaware, which would compare more favorably to the product offerings of Delta

Source: Highmark.

(1) Even if a transaction is prima facie violation of the competitive standard, the absence of the requisite anticompetitive effect may be established based on "substantial evidence," 18 *Del. C.* §5003A(d)(2).

(2) All UCD data and Delaware resident information is as of 2010 and was provided by Highmark.

(3) Calculation of Highmark's actual adjusted market share would require the subtraction of non-Delaware sitused customers from all Delaware dental carriers, which information is not available (i.e. the estimate shown adjusts the numerator of the calculation (UCD customers) but the denominator is adjusted only for the same UCD customers only and not for non-Delaware sitused customers of other dental carriers in the market).

(4) 1.4% equals 19% of UCD's 6.9% share of the total market, divided by the total market after eliminating 81% of UCD's 6.9% share; i.e. 1.4% = ((19% x 6.9%)/(1-(81% x 6.9%))).

(5) Reflects total number of Delaware residents enrolled in private insurance (610,024) less the number of UCD customers not sitused in Delaware (21,272).

Standard “b”: Conclusion

Blackstone believes the proposed Affiliation would not violate Standard “b”.

Standard “b” : The effect of the affiliation would be substantially to lessen competition in insurance in this State or tend to create a monopoly therein

Standard “b” Summary Conclusions:

- There are two products in Delaware in which both BCBSD and Highmark currently compete
  - i. Stop-Loss
  - ii. Dental
- Information necessary to measure BCBSD and Highmark’s respective shares of the health insurance stop-loss market in Delaware is unavailable and therefore application of the mathematical tests promulgated by § 5003A(d)(2) is not feasible; Highmark’s share of the total NAIC Comprehensive Health category, which include premiums written by BCBSD and its primary competitors, does not exceed the prima facie threshold that would constitute evidence of a lessening of competition under §5003A(d)(2)
- Highmark’s share of the Dental market is greater than 2%, and therefore constitutes prima facie evidence that the Affiliation may lessen competition in this market; however, potential mitigating factors per §5003A(d)(2)(d) include:
  - Highmark’s presence in the Delaware dental market is primarily a result of Delaware residents who receive Highmark dental insurance via employment with out-of-state employers; as these employers do not purchase their insurance within the Delaware market, they are unlikely to be affected by the Affiliation
  - Given the dominant market share of Delta Dental within Delaware, an increased presence of Highmark in the Delaware dental market may lead to increased competition in the market overall
- **Based on the above analysis, a condition(s) addressing bundling of products and services would be appropriate to bring the affiliation into compliance with the statutory criteria. The specifics of those conditions are within the purview of the Department of Insurance. Based on Blackstone’s analysis above and such a condition(s), Blackstone does not believe the proposed Affiliation is likely to substantially lessen competition in any of the markets in Delaware in which BCBSD and Highmark compete**

C. Standard “c”

Overview

Although BCBSD will remain a separate legal entity under the proposed Affiliation Agreement and will not be responsible for any Highmark liabilities, the standalone financial condition of Highmark is important to BCBSD from the perspective of Highmark’s ability to provide administrative and corporate services to BCBSD and also to honor the guarantee of BCBSD’s claims that Highmark will make as part of the Affiliation Agreement.

Standard “c” : The financial condition of the controlling affiliate (i.e. Highmark) is such as might jeopardize the financial stability of the insurer (i.e. BCBSD) or prejudice the interest of its policyholders

Blackstone’s review of Standard “c” included the following:

(i) Assessment of Highmark’s standalone financial projections
- Highmark’s standalone financial condition is an important consideration for BCBSD, as BCBSD must assess Highmark’s ability to be a long-term partner for the provision of various administrative and corporate support services
- Although BCBSD will have no direct exposure to Highmark’s claims or liabilities, Highmark’s ability to honor its guarantee of BCBSD’s claims is also an important component of the Affiliation Agreement for BCBSD

(ii) Assessment of BCBSD’s reserves
- An assessment of BCBSD’s reserves in conjunction with a review of Highmark’s standalone financial condition is also important, as the strength of BCBSD’s reserves will determine the likelihood of needing to rely upon Highmark to honor BCBSD’s claims
- BCBSD’s future reserves are also important in considering the viability of potentially disaffiliating in the future (as provided for in certain “Triggering Events” under the terms of the Affiliation Agreement) if Highmark were to encounter significant financial difficulties

(iii) Review of Highmark’s potential transaction with West Penn Allegheny Health System (“WPAHS”), as this transaction relates both to Highmark’s standalone financial condition and to potential financial exposures to BCBSD as a result of being an affiliate of Highmark subsequent to the WPAHS transaction

(i) Highmark's Standalone Financial Condition

A sample of large, publicly-traded health insurers reflect a mean RBC ratio of 478%. Highmark's RBC ratio is currently 692%.

Publicly Traded Companies	Market Cap	2010 Revenue	2010 Operating Income	2010 RBC ratio	2008-2010 Revenue CAGR[1]	2010 Operating Margin	2010 Net Income Margin	2010 Capex / Revenue	2010 Debt / Equity	2010 Debt / Total Cap
Unitedhealth Group	$49,439	$94,155	$7,864	537%	7.7%	8.4%	4.9%	0.9%	22.5%	18.4%
WellPoint	22,292	58,802	4,773	611%	(2.0%)	8.1%	4.9%	0.8%	40.2%	28.7%
Aetna	14,717	34,246	2,899	415%	5.2%	8.5%	5.2%	0.0%	29.8%	22.9%
Humana	12,272	33,868	1,855	512%	8.2%	5.5%	3.2%	0.7%	13.6%	12.0%
CIGNA	11,751	21,253	2,052	598%	5.5%	9.7%	6.3%	1.4%	24.2%	19.5%
Coventry Health Care	4,672	11,588	689	510%	(0.6%)	5.9%	3.8%	0.5%	34.2%	25.5%
HealthSpring	2,504	3,136	330	328%	19.7%	10.5%	6.2%	0.4%	25.0%	20.0%
AMERIGROUP Corporation	2,206	5,806	453	465%	14.4%	7.8%	4.7%	0.5%	11.1%	10.0%
Health Net	2,035	13,620	366	415%	(5.9%)	2.7%	1.5%	0.3%	19.6%	16.4%
Centene	1,531	4,448	157	374%	15.0%	3.5%	2.1%	2.7%	21.6%	17.8%
Universal American	831	5,687	294	634%	10.5%	5.2%	3.3%	0.2%	41.2%	29.2%
Molina Healthcare	799	4,086	106	337%	14.6%	2.6%	1.3%	1.2%	20.5%	17.0%
Mean	**$10,421**	**$24,225**	**$1,820**	**478%**	**7.7%**	**6.5%**	**4.0%**	**0.8%**	**25.3%**	**19.8%**
Median	**3,588**	**12,604**	**571**	**487%**	**7.9%**	**6.9%**	**4.2%**	**0.6%**	**23.4%**	**18.9%**
Highmark	**NA**	**$14,354**	**$483**	**692%**	**5.1%**	**3.4%**	**3.2%**	**0.7%**	**13.5%**	**11.9%**
BCBSD	**NA**	**$545**	**$8**	**1,056%**	**1.9%**	**1.5%**	**2.9%**	**0.8%**	**5.3%**	**5.0%**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: CapitalIQ and SNL as of September 9, 2011.

(1) Compounded Annual Growth Rate, calculated by taking the nth root of the total percentage growth rate, where n is the number of years in the period considered.

(i) Highmark's Standalone Financial Condition (cont'd)

Highmark projects revenue growth at a compound annual growth rate greater than 6% over the next 3 years with net income margins remaining between 3% – 4%.

Management Discussion of Projections

- The company expects only minor growth (1-2% annually) in health business enrollment during the projected period
- Highmark acquired $100 million worth of stop-loss insurance business from Mutual of Omaha in 2010
- Heavy cost-cutting initiatives aimed at reducing per-member, per-month ("PMPM") costs in the health business as well as in the interest of achieving operational efficiencies are helping to hold operational expenditures relatively flat
- Positive cash flow production will be contributing to growth in the investment portfolio and in investment income
- The reduction in interest expense is largely a result of the Vision businesses paying down debt more quickly than anticipated
- Highmark lost a contract serving retirees within the Tricare Dental Program and this contract will fully run-off in late 2012
- These projections account for two recent developments
  - In 2011, Highmark issued $600 million in corporate bonds to take advantage of the low-interest rate environment as well as to finance corporate expenditures[1]
  - In 2011, Highmark announced its intent to affiliate with the West Penn Allegheny Health System
    - Highmark has publicly announced a total commitment of $475 million to WPAHS; REDACTED of this consideration will be in the form of loans to the hospital network
- These projections do not consider the results of an approved affiliation with BCBSD

Highmark Standalone P&L Projections

($ in millions)

	Year Ended December 31,				
	2010A	2011E	2012E	2013E	2010-2013 CAGR
Revenue	REDACTED				
Operating Expenses					
Operating Income					
Operating Income Margin					
Income before Income tax					
EBT Margin					
Income tax provision					
Net Income					
Net Income Margin					

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

- Highmark's pre-tax margins appear lower than comparable insurers, while its net income margin is materially higher than comparable insurers. This result is due to Highmark's status as a non-profit

Source: Highmark.
(1) $350 million at 4.75% due in 2021 and $250 million at 6.125% due in 2041.

(ii) Assessment of BCBSD's Reserves

Although BCBSD will be supported by a claims guarantee from Highmark and industry participants generally acknowledge that larger carriers are able to operate comfortably with RBC ratios that are lower than those currently maintained by BCBSD, maintaining strong reserve levels while affiliated with Highmark will help BCBSD retain local control in ordinary-course operations and better position BCBSD in the event of a disaffiliation.

- Among the rationales for BCBSD choosing to enter a relationship with Highmark in the form of an affiliation instead of an acquisition are:
  - (i) the ability for BCBSD to retain control over its reserves by avoiding a sale of its economic interests (including the reserves) to a transaction partner[(1)]
  - (ii) maintaining a greater degree of local operating autonomy than would typically be possible in a sale scenario[(1)]
  - (iii) reserving the right to withdraw from the Affiliation (i.e., disaffiliate) under certain circumstances, which would typically not be possible in a sale scenario
- Given that Highmark has agreed to guarantee BCBSD's claims, Highmark will be incented to closely monitor BCBSD's operating and financial condition; BCBSD's strong reserve level therefore may comparatively strengthen the Company's relative ability to maintain local operational decision making (e.g., pricing and coverage decisions) as a result of decreased potential dependence on Highmark for financial stability
- BCBSD's maintenance of strong reserves will be an important element in retaining flexibility in the event of a disaffiliation, as the Company is likely to have fewer strategic options available if its reserve levels are insufficient to operate on a standalone basis

(1) Refer to page 7 for differences between an affiliation and an acquisition. Also refer to standard "d" for discussion of direct economic transfers between BCBSD and Highmark and anticipated corporate and governance structure changes.

(ii) Assessment of BCBSD's Reserves (cont'd)

As of December 31, 2010, BCBSD had reserves of $171 million and an RBC ratio of 1,056%, which compares favorably to a selection of comparably sized health insurance carriers and decreases the relative likelihood that BCBSD may need to rely upon Highmark in order to pay its claims.

Publicly Traded Companies	Market Cap	Total Assets	2010 Revenue	2008-2010 Revenue CAGR	2010 Op. Income	2010 Op. Income Margin	2010 RBC (%)
Unitedhealth Group	$49,439	$60,063	$94,155	7.7%	$7,864	8.4%	537%
WellPoint	22,292	50,167	58,802	(2.0%)	4,773	8.1%	611%
Aetna	14,717	37,739	34,246	5.2%	2,899	8.5%	415%
Humana	12,272	16,103	33,868	8.2%	1,855	5.5%	512%
CIGNA	11,751	45,682	21,253	5.5%	2,052	9.7%	598%
Coventry Health Care	4,672	8,496	11,588	(0.6%)	689	5.9%	510%
HealthSpring	2,504	2,349	3,136	19.7%	330	10.5%	328%
AMERIGROUP Corporation	2,206	2,283	5,806	14.4%	453	7.8%	465%
Health Net	2,035	4,132	13,620	(5.9%)	366	2.7%	415%
Centene	1,531	1,944	4,448	15.0%	157	3.5%	374%
Universal American	831	3,656	5,687	10.5%	294	5.2%	634%
Molina	799	1,509	4,086	14.6%	106	2.6%	337%
Mean		**$19,510**	**$24,225**	**7.7%**	**$1,820**	**6.5%**	**478%**
Median		**6,314**	**12,604**	**7.9%**	**571**	**6.9%**	**487%**
Highmark	**N/A**	**9,397(1)**	**$14,354**	**5.1%**	**$483**	**3.4%**	**692%**

BCBSD Non-publicly Traded Comparable Companies	Total Assets	2010 Revenue	2008-2010 Revenue CAGR	2010 Op. Income	2010 Op. Income Margin	2010 RBC (%)
Capital Health Plan	$352	$580	7.7%	$26	4.5%	1,307%
HMO Louisiana Inc.	342	469	13.5%	24	5.0%	1,393%
WI Physicians Svc Ins Corp.	313	458	0.9%	(14)	(3.1%)	660%
Wellmark of South Dakota	309	596	5.1%	11	1.8%	783%
Health Options Inc.	292	486	(25.6%)	52	10.7%	1,284%
Blue Cross & Blue Shield of MT	275	529	1.3%	(6)	(1.2%)	654%
Anthem Health Plans of NH Inc.	256	505	(1.5%)	28	5.6%	489%
Kaiser Foundation Health Plan of Ohio	246	561	(0.4%)	(48)	(8.5%)	365%
Mean	**$298**	**$523**	**0.1%**	**$9**	**1.9%**	**867%**
Median	**300**	**517**	**1.1%**	**17**	**3.2%**	**721%**
BCBSD	**349(1)**	**$545**	**1.9%**	**$8**	**1.5%**	**1,056%**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: SNL, CapitalIQ, company filings. Market information as of September 9, 2011.
Note: Represents statutory results unless otherwise noted.
(1) GAAP.

(ii) Assessment of BCBSD's Reserves (cont'd)

A widespread standard on appropriate RBC levels does not exist. However, the BCBSA has threshold guidelines for financial solvency and some states have created their own standards. Of its own accord, BCBSD has attempted to follow reserve levels that were suggested by Milliman Inc. to ensure its financial stability

- The BCBSA states that an RBC ratio of 200% is the minimum threshold required for insurers to ensure their financial stability and states that intensified monitoring by the Association begins when RBC falls below 375% (the BCBSA Early Warning Level)
- In their November 2003 report to the DOI concerning the modification of BCBSD's affiliation with CareFirst, Sandler O'Neill & Partners noted that the Company's management operated with a goal of maintaining an RBC ratio of at least 800%, in order to comply with general guidance on preferred RBC ratios from the BCBSA
- In a 2005 report prepared specifically for BCBSD by Milliman Inc., BCBSD received guidance that an appropriate target RBC ratio range was 950%-1,200%
  - Milliman's recommended range of 950%-1,200% reflects that BCBSD, as a small non-profit Blue plan, faces greater concentration of certain business risks and has significantly fewer options for raising capital as compared to for-profit competitors
  - Milliman's recommend range was determined based on Monte Carlo simulations of potential reserve loss scenarios and reflects the level of reserves necessary to maintain total reserves above the BCBSA thresholds in the event of a sustained loss cycle; potential loss cycles were estimated with reference to 99 actual loss cycles incurred by 30 Blue plans from 1980-2003
- As of December 31, 2010, BCBSD had statutory reserves of $171 million and an RBC ratio of 1,056%
  - Under BCBSD's Affiliation case projections, statutory reserves and the RBC ratio are expected to decline to $167 million and 1,014%, respectively, by 2012 before increasing in the later years of the projection period
  - BCBSD's statutory reserves and RBC ratio have recently been as low as $121 million and 731%, respectively, in 2008
  - If the Company were to incur an unforeseen decline in reserves during 2012, similar to the actual decline experienced by the Company during 2008, pro forma 2012 statutory reserves under the Affiliation case would fall to $128 million and the resulting pro forma RBC ratio would be 777%[1]

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(1) Calculated as projected 2012 Affiliation case statutory reserves of $167 million, reduced by $39 million (amount by which BCBSD reserves declined during 2008 due to poor economic conditions and investment returns), divided by projected 2012 Authorized Control Level of $16.5 million.

(iii) West Penn Allegheny Health System Transaction

Highmark recently proposed to affiliate with the West Penn Allegheny Health System ("WPAHS"), a large hospital provider system in Western Pennsylvania. Definitive documentation has not yet been executed between the parties, but preliminary terms of the transaction are discussed below(1).

Preliminary Transaction Overview

- Highmark has proposed an affiliation with WPAHS. The proposed relationship involves a financial commitment from Highmark as well as a change to Highmark's corporate structure and business functions

West Penn Allegheny Health System Overview

- WPAHS is a non-profit provider organization that operates hospitals in the Pittsburgh region:
  - Allegheny General Hospital
  - Allegheny Valley Hospital
  - Forbes Hospice
  - Forbes Regional Hospital
  - The Western Pennsylvania Hospital
- FY 2010 operating revenue was $1.6 billion
- Medical staff includes 1,664 physicians and 457 residents and fellows and over 3,000 nurses
- WPAHS has 9,075 total full time employees and 2,348 total part time employees

Preliminary Financial Terms

REDACTED

Source: WPAHS website, conversation with Highmark August 26, 2011.
(1) The parties have not yet filed a Form A with the Pennsylvania Insurance Department and have not publicly released details of the proposed transaction.

(iii) West Penn Allegheny Health System Transaction

Highmark's proposed legal structure for the WPAHS relationship, as well as Highmark's potential financial exposure as a result of affiliating with WPAHS, are discussed below.

Preliminary Legal Structure

REDACTED

Preliminary Potential Financial Exposures to BCBSD

REDACTED

Source: Conversation with Highmark on August 26, 2011. Final financial terms have not yet been determined.

Standard "c": Conclusion

Blackstone believes the proposed Affiliation would not violate Standard "c".

Standard "c": The financial condition of the controlled affiliate is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders

Standard "c" Summary Conclusions:

- BCBSD will not have direct exposure to any liabilities of Highmark
- The standalone financial condition of Highmark does not appear to be such that BCBSD's reliance upon Highmark for the provision of administrative services would jeopardize BCBSD's ability to effectively serve its policyholders in the foreseeable future
- BCBSD's current reserve levels are such that it is unlikely that BCBSD would need to rely upon Highmark to honor its claims in the near future
- Highmark's potential transaction with WPAHS is not likely to interfere with Highmark's provision of services to BCBSD or Highmark's claims guarantee to BCBSD in the near future
- **Based on the above analysis, Blackstone does not believe that the financial condition of Highmark is such as might jeopardize the financial stability of BCBSD or prejudice the interest of its policyholders. Other categories of conditions suggested in this report under other statutory criteria may also affect this standard "c." For purposes of this analysis, such conditions are addressed in connection with standards "d" and "f."**

D. Standard “d”

Overview

The change of control resulting from the proposed Affiliation entails risks to BCBSD and its policyholders, but those risks must be weighed against the benefits that may accrue to the policyholders as a result of BCBSD gaining access to enhanced capabilities and overall corporate support services.

Standard "d" : The plans or proposals which the the controlling affiliate (i.e. Highmark) has to liquidate the insurer (i.e. BCBSD), sell its assets or 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 to policyholders of the insurer and not in the public interest

Blackstone's review of Standard "d" included the following:

(i) Assessment of the anticipated changes to BCBSD's corporate and governance structures, including

- Management compensation
- Impact on the local autonomy of BCBSD in key areas such as pricing and product offering
- Maintenance of market-facing presence in the Delaware market
- Potential impact on Delaware employment
- BCBSD's ability to withdraw from the affiliation in the future

(ii) Assessment of anticipated impact of the Affiliation on BCBSD's financial condition, including

- Direct economic transfers to Highmark in connection with the Affiliation
- Impact on BCBSD operating results

(iii) Assessment of the anticipated impact of the Affiliation on BCBSD's corporate capabilities and provision of services to its customers, including

- Enhanced capabilities (and related costs) gained from Highmark versus those available on a standalone basis
- Potential to outsource or otherwise contract for services as an alternative to the Affiliation

(iv) Review of Highmark's affiliation with Highmark West Virginia, including

- Functional impact of full operational integration with Highmark
- Views on Highmark as a corporate partner

(i) Corporate and Governance Structure and Market Presence: Management Compensation

Transaction-linked executive compensation could potentially influence the behavior of BCBSD management in its pursuit of the closing of the proposed Affiliation and could ultimately be a drain on the Company's reserves.

- BCBSD management to be incorporated into Highmark organizational hierarchy
- BCBSD executives, including the CEO and 6 Vice Presidents (one of whom is designated a Senior Vice President), have employment agreements that pre-date the proposed Affiliation that include provisions for payment of severance benefits under certain conditions
  - Severance benefits within these employment agreements are based on time remaining on each individual contract
    - If a change of control occurs at BCBSD, the 6 Vice Presidents would get a "fresh start" date to their employment contracts based on the closing date of the transaction
    - The CEO's three-year employment contract does not contain a "fresh start" provision
  - A worst case scenario, as developed by BCBSD to account for the full payout of severance benefits based on termination of all 7 executives after the closing of the proposed Affiliation, would involve an approximate $6 million payout
- BCBSD has publicly stated that no management or executive incentives are tied to the completion of the proposed Affiliation
- Latest revisions to executive employment agreements did not include provisions for transaction-related compensation
- A change of control alone does not allow an executive to collect severance benefits:
  - There must be an additional trigger such as involuntary termination of the executive's employment, a substantial reduction of duties or compensation or a significant geographic relocation
- Highmark commits to competitive remuneration to all BCBSD employees retained as part of the transaction; there will be no change to current management compensation
- Total actual transaction-related bonuses are limited to non-executive employees and are projected to be approximately $300,000 in total
  - BCBSD offered eight non-executive employees "stay" bonuses, that are to be paid in two installments; the first installment will be paid at closing, and the second installment will be paid six months following closing
  - The bonuses were approved by the BCBSD Board of Directors in June of 2010 and range between 25% and 30% of the recipients' annual salaries

(i) Corporate and Governance Structures and Market Presence: Operational Structure

BCBSD will retain autonomy as a Delaware-based entity with regard to market-facing functionality. Key market-facing decisions, such as how to price products and decide which products to offer in the Delaware market, however, will be subject to both input from the BCBSD Board and approval by Highmark through the annual budgeting process.

- BCBSD will become a controlled affiliate of Highmark, while remaining a Delaware non-stock corporation
- BCBSD Board will consist of 4 Class A Directors, 4 Class B Directors and 1 President Director
  - Class A Directors cannot be officers or employees of Highmark or BCBSD
  - Initial 4 Class A Directors chosen by BCBSD prior to the closing of the Affiliation. Initial 4 Class A Directors will serve staggered terms of 1, 2, 3 and 4 years, and such time thereafter until their successors are elected and qualified
  - Thereafter, new Class A Directors will be nominated by the current Class A Directors and are subject to election by Highmark. New Class A Directors will serve 3-year terms, and such time thereafter until their successors are elected and qualified
  - The 4 Class B Directors are chosen by Highmark and serve 1-year terms. For the first 3 years, Class B Directors will include the Highmark CEO and two Highmark CEO direct reports
  - President Director is the President of BCBSD, who will serve as a director for as long as she/he is President of BCBSD and whose election is subject to the approval of Highmark. President Director may serve terms not to exceed 5 years, and may be removed at any time, for any reason or no reason at all, by the Class B Directors
  - A majority of the BCBSD Board of Directors must be residents of Delaware
- BCBSD President will report to the Highmark Executive Vice President in charge of health insurance business operations (a direct report to the Highmark CEO), but will maintain relative autonomy as to pricing and selection of insurance products and services subject to input from the BCBSD Board and Highmark approval through the annual budget process
  - BCBSD Chief Executive will become Delaware Market President of Highmark with role of guiding market-facing functions
  - Delaware Market President will have an initial term of three years but may be removed by Highmark for any reason during that time
- There are no projected changes to BCBSD executive management or BCBSD executive management compensation based on the approval of the proposed Affiliation
- The BCBSD President will have relative autonomy regarding market-facing decisions. However, some BCBSD corporate departments/functions will report to Highmark leadership (e.g. BCBSD finance professionals will report to senior Highmark finance professionals just as BCBSD operations professionals will report to Highmark operations professionals)
- Annual corporate budgeting process is top-down. However, the BCBSD President and select personnel will have periodic input into Highmark costing process to address any extraordinary cost issues impacting BCBSD or to introduce strategic changes (e.g. pricing, products)

(i) Corporate and Governance and Structures and Market Presence: Market-Facing Functions

The level of end-state integration between the two organizations will vary by functional area, but the primary client-facing functions ("Front / Middle Office") will remain locally managed.

Functions	**Locally Managed** *The Locally Managed model entails functions that will be managed and delivered by local employees*	**Shared Services** *The Shared Services model entails consolidated functions supported by employees in each geographic region*	**Centralized Support Services** *The Centralized Support model entails functions that will be supported primarily by geographically centralized employees*
Front / Middle Office			
Sales & Distribution	X		
Product / Marketing		X	
Provider Relations	X		
Provider Contracting	X		
Medical Management		X	
Regulatory / Lobbying	X		
Regional Community Affairs	X		
Corporate			
Finance (Actuarial & Underwriting)		X	
Information Technology			X
Legal		X	
Human Resources		X	
Compliance		X	
Other Corporate Services			X
Back Office			
Member Service		X	
Provider Service		X	
Claims		X	
Billing		X	
Enrollment		X	
Information		X	

(i) Corporate and Governance Structures and Market Presence: Delaware Employment

Though the DOI's primary mandate is to uphold the interest of insurance policyholders in the State of Delaware, the DOI is also concerned with the impact that the proposed Affiliation may have on the Delaware community at large. A potential drawback of the proposed Affiliation concerns the potential impact on Delaware employment levels at BCBSD, if the Affiliation is approved.

- The Affiliation may have a detrimental impact on the Delaware economy, predominantly through a decline in employment at BCBSD after the Affiliation, if approved. Highmark has stated its intentions to use commercially reasonable efforts to maintain employment levels that are proportionate to those in other Highmark service areas. Highmark has made the following commitments:
  - Highmark will assure the total full-time employee positions in Delaware will be the same after implementation of the Affiliation is complete (approximated at 18 months) as it was at the start of the Affiliation activities. The positions will be either Highmark or BCBSD positions located in Delaware
  - Any BCBSD employees whose positions are eliminated due to the implementation will be given the first opportunity to fill any new positions that are created in Delaware
  - If there is a significant decrease in BCBSD's enrollment or market share during the implementation period (i.e., from loss of a large customer) that results in any lost positions, Highmark will not be responsible to replace those lost positions
  - Highmark will also make good faith efforts to locate additional FTE positions in Delaware as Highmark's business opportunities arise
- Job transfers from BCBSD to Highmark (while remaining in Delaware) will be determined on an employee-by-employee basis after the closing of the Affiliation and are anticipated to be in the areas of finance, operations and IT. Refer to KPMG analysis for discussion of IT employment[2]
- Highmark's policy regarding job cuts when necessary, is to cut jobs across its organization so that each region eliminates positions according to its pro-rated portion of overall employment
- Highmark's best practices provide a vehicle by which BCBSD can remain highly competitive in the Delaware market by promoting greater efficiency

(1) Source: Highmark pre-hearing submissions.
(2) Source: KPMG.

(i) Corporate and Governance Structures and Market Presence: Option to Disaffiliate

BCBSD’s ability to disaffiliate from Highmark in the future is a key component of the Affiliation Agreement. Although the disaffiliation process would entail significant operational challenges and risks, BCBSD’s option to unwind the Affiliation provides a meaningful protection for BCBSD’s customers and stakeholders.

- The post-Affiliation BCBSD Class A directors have the option to disaffiliate (i.e., to cause BCBSD to withdraw from the Affiliation) under the following three broad conditions:
  - (1) Change of control (for-profit conversion; Highmark placed into receivership; due to a change in Pennsylvania law, Highmark becomes unable to select its own Board of Directors, or a third party controls the management or operations of Highmark, or a third party controls a significant portion of Highmark’s assets or a third party has the power to approve/disapprove actions that the Highmark Board would otherwise approve/disapprove)
  - (2) Deterioration of Highmark’s financial condition such that it makes an assignment for the benefit of its creditors, admits its inability to pay debts, files a voluntary petition for bankruptcy or admits material allegations in an involuntary bankruptcy
  - (3) Highmark’s loss of status as primary licensee of the registered marks owned by BCBSA
  - These triggering events do not include an ability to terminate for Highmark’s failure to perform its obligations under the relevant affiliation agreements or for Highmark’s filing of a notice of conversion or change-of-control
  - The Class A Directors must notify Highmark of their decision to disaffiliate, which must occur within 60 days of receiving notice from Highmark of one of the above triggering events
- Depending on the time period in which BCBSD potentially opts to disaffiliate with Highmark, BCBSD’s core IT and administrative functionality likely will be intertwined with Highmark’s systems and operating structure
  - In the event of disaffiliation, BCBSD will be forced to find an alternative IT service provider or build its own IT capability; as well as find an alternative service provider for non-IT services or to internally build these capabilities
  - As the Affiliation Agreement is currently written, in the event of disaffiliation, the Line of Credit balance outstanding will become immediately due
  - Disaffiliation from CareFirst in 2006 was less complex because BCBSD was not fully integrated into CareFirst’s organizational structure and processes
  - In the event of a termination of the Agreement, Highmark will consent to the reestablishment of BCBSD as the primary Delaware licensee of the “mark”. However this consent does not guarantee that Highmark will affirmatively assist in the process of BCBSD regaining its BCBSA credentials nor that BCBSD will be in the requisite financial position to obtain the “mark”

(ii) Financial Condition: Overview

BCBSD’s financial condition would be impacted in the Affiliation by direct economic transfers to Highmark, including payments made for IT systems upgrades and ongoing administrative services, and the pro forma impact of the Affiliation on BCBSD’s financial results and reserves as compared to a standalone scenario.

Direct Economic Transfers:

- The proposed Affiliation Agreement provides for three types of direct economic transfers from BCBSD to Highmark:
  - Payment for IT systems upgrades that are to be provided by Highmark to BCBSD
  - Payment for ongoing administrative services that are to be provided by Highmark to BCBSD
  - Payment of interest on a line of credit to be made available by Highmark to BCBSD for financing BCBSD’s IT systems upgrades
- With the exception of the administrative services agreement and line of credit, the proposed Affiliation Agreement does not provide Highmark with any rights to BCBSD’s current reserves or future profits, nor does it provide any mechanism through which a direct transfer of reserves from BCBSD to Highmark (whether by dividend, loan or otherwise)
  - Transfers or other disposition of BCBSD’s reserves in amounts exceeding $500,000 are governed by §6311 of Title 18 of the Delaware Insurance Code and require review and approval by the DOI
  - Under Title 18, the Delaware Insurance Code, explicit approval from the DOI is required for any material transfer of reserves from BCBSD to Highmark
  - Although Highmark is providing a guarantee of BCBSD’s claims, BCBSD is not providing a reciprocal guarantee to Highmark

Pro Forma Impact on BCBSD’s Financial Results:

- The primary pro forma impact of the proposed Affiliation on BCBSD’s financial condition will result from the variance between the cost incurred by BCBSD to upgrade its IT systems as an affiliate of Highmark versus the projected cost BCBSD will incur as a standalone entity
- In addition to IT costs, the proposed Affiliation is expected to further impact BCBSD’s financial condition as a result of changes to BCBSD’s operating cost structure, access to ancillary Highmark products and enhanced ability to address new and uncertain regulatory mandates

(ii) Financial Condition: Direct Economic Transfer

A significant factor in BCBSD's decision to affiliate with Highmark was the ability of Highmark to work with BCBSD on a comprehensive upgrade of BCBSD's technology systems. The Applicants believe the total cost of BCBSD's systems upgrade may reach $37 million as an affiliate of Highmark, compared to as much as $140 million if BCBSD were to achieve the same level of upgrades as a standalone entity.

- BCBSD believes that its current systems do not allow it to provide its clients and providers with the level of value-added functionality that is expected of leading health insurers
  - The Company's core IT system is over 20 years old, difficult to maintain and very expensive to upgrade
  - Recent federal healthcare regulation has added significantly to the IT requirements that health insurers such as BCBSD must meet
- Highmark has spent over $400 million on IT in the past 3 years and considers its platform to be industry-leading
- Highmark will work with BCBSD to convert the systems over a period of 18 to 24 months, beginning immediately upon closing (see below for standalone versus Affiliation basis implementation costs)
- Highmark and BCBSD have been working cooperatively since December 2010 on a detailed plan of integration, which the Applicants believe fully supports the estimated costs and planned functionality
- The upgrade work provided by Highmark will be billed to BCBSD according to the Administrative Services Agreement; the DOI will maintain approval authority over BCBSD charges paid to Highmark via periodic review of invoices received via its target exam authority
- As part of its review of the proposed Affiliation, the DOI engaged KPMG to review the reasonableness of projected costs in light of the functionality expected to be obtained; a summary of KPMG's conclusions are provided on the following page

Deloitte Findings Regarding the Cost of Standalone IT Upgrades

($ in millions)

	Standalone Cost	
Area	**Low**	**High**
Core Administration Replacement	$35	$50
Membership / Billing	2	3
SOA / Enterprise Service Bus	3	5
Informatics / Data Warehousing	14	22
Pricing / Underwriting Workflow and Rating Engine	2	5
Sales and Marketing	4	8
Network and Medical Management	4	8
Web Portals	8	10
Health Care Reform and Compliance	16	29
Total Range	$88	$140

Source: BCBSD, Highmark, KPMG, Deloitte reports.

(ii) Financial Condition: KPMG Summary Findings

KPMG was retained by the DOI to assess the proposed Affiliation with regard to the capability gaps identified in the 2008 and 2010 BCBSD assessment reports prepared by Deloitte and with regard to the capabilities to be provided by Highmark via the Affiliation.

Overall Conclusions

- KPMG has undertaken a separate review and delivered a separate report regarding the IT challenges and costs facing BCBSD and the benefits and risks from a technology perspective of the proposed Affiliation with Highmark. KPMG is largely in agreement with the capability gaps identified in the 2008 and 2010 BCBSD assessment reports prepared by Deloitte
- KPMG also agrees with Deloitte’s observations regarding the capabilities of Highmark as a strategic partner for affiliation
- KPMG reviewed Deloitte’s 2010 cost estimates, which range from $88 million to $140 million, and assumptions supporting the capability gaps and found them to be reasonable
  - KPMG identified several approaches and/or levels of investment where they believed a revised estimate was warranted based on recent changes in the marketplace
  - KPMG’s assessment resulted in an estimated standalone cost range of $93 million to $150 million

Assessment of Highmark’s IT Capabilities / Investments

- Highmark has made significant investments in IT capabilities in response to marketplace challenges and health care reform initiatives and as part of its internal process improvement and support
  - Total IT spend over the past 3 years has been in excess of $400 million
  - Highmark’s ongoing legacy modernization initiative will enhance its core systems to support new products and capabilities while enabling administrative cost savings (spending on its legacy modernization project has totaled $363 million since inception)
  - Highmark was the first health plan in the U.S. to become HIPAA 5010 compliant. ICD-10 remediation is expected to be completed well before the mandate deadline in 2013

Source: BCBSD, Highmark and KPMG.
Note: See KPMG report dated September 6, 2011 concerning HIPAA 5010 and ICD-10 requirements.

(ii) Financial Condition: Payment for IT Systems Upgrades

KPMG reviewed BCBSD's plans for upgrading its IT systems both as a standalone entity and as an affiliate of Highmark. KPMG concluded that BCBSD's estimated total range of costs to achieve the upgrades as a standalone entity may have been too low.

KPMG Variance from Deloitte Estimates:

- *1) ICD-10 Remediation:* KPMG believes that a neutralization approach would be better for BCBSD than remediation
- *2) Program / Project Management (not included in Deloitte's estimates):* KPMG believes BCBSD would need to hire a system integrator, consisting of a full-time core team of 4 to 6 people, on a standalone basis
- *3) Private Exchanges (not included in Deloitte's estimates):* KPMG believes BCBSD would need to create private exchanges to remain competitive on a standalone basis
- *4) Retail Distribution (not included in Deloitte's estimates):* KPMG believes BCBSD needs to develop retail capabilities to meet the needs of the growing individual health insurance market on a standalone basis

Standalone IT Upgrade Cost Estimates

($ in millions)

		Deloitte Cost Range			KPMG Cost Range		
Area	Description	Low	-	High	Low	-	High
Core Administration Replacement	Full replacement impacting all core operations, health care reform compliance mandates	$35	-	$50	$35	-	$50
Membership / Billing	Online bill presentment and payment	2	-	3	2	-	3
SOA / Enterprise Service Bus	Build out TIBCO integration / workflow / SOA infrastructure and deploy capabilities	3	-	5	3	-	5
Informatics / Data Warehousing	Implement Enterprise Data Warehouse, External Client Reporting, management decision support information system	14	-	22	14	-	22
Pricing / Underwriting Workflow and Rating Engine	Implement workflow system / rating engine to automate pricing / underwriting processes	2	-	5	2	-	5
Sales and Marketing	Implement CRM System	4	-	8	4	-	8
Network and Medical Management	Implement a provider-profiling system and pay-for performance capabilities	4	-	8	4	-	8
Web Portals	Enhance or replace member / plan sponsor / broker / provider portals	8	-	10	8	-	10
ICD-10 Remediation	**Business and technology costs required to the meet the ICD-10 compliance mandate of October 2013**	**10**	**-**	**15**	**3**	**-**	**5**
OtherHealth Care Reform and Compliance	ACO, Health Insurance Exchange Integration, MLR Reporting	6	-	14	6	-	14
Program / Project Management	**Provide system integrator to set up a PMO and lead executation of capability gap transformation program**	**N/A**	**-**	**N/A**	**6**	**-**	**9**
Private Exchanges	**Develop portal, configure products / benefits and link back to core systems**	**N/A**	**-**	**N/A**	**3**	**-**	**5**
Retail Distribution	**Address need to create a multichannel strategy and to launch retail initiatives via multiple distribution channels**	**N/A**	**-**	**N/A**	**3**	**-**	**6**
Total Range		**$88**	**-**	**$140**	**$93**	**-**	**$150**

Source: BCBSD, Highmark and KPMG.

(ii) Financial Condition: Payment for IT Systems Upgrades (cont'd)

KPMG also reviewed BCBSD's plans for upgrading its IT systems as an affiliate of Highmark and concluded that BCBSD's estimated cost to achieve the upgrades as an affiliate of Highmark was reasonable.

Migration Cost Estimates and KPMG Commentary:

- A top down approach to estimate the cost of affiliation integration was conducted by key Highmark executives based on the West Virginia affiliation and other related work
  - Based on this top-down approach, Highmark executives estimated the costs to migrate BCBSD onto their platform at $35 million
- Since then, an affiliation planning team, consisting of both BCBSD and Highmark resources, has worked together to analyze potential integration costs based on the internal and external labor costs, hardware, software and other costs for each of the 70 affiliation costs
  - As of September 2011, the planning team estimated the affiliation integration costs at $37 million
  - Ongoing discussions with the project teams may close the gap between the $35 million and $37 million estimates
- Based on its review of affiliation planning documentation developed by the teams and experience in working on integration projects of similar scope and complexity, KPMG believes that a range of costs from $35 million to $37 million is reasonable

Affiliation IT Upgrade Cost Estimates

($ in millions)

Area	BCBSD / Highmark Estimate
Migration Projects	$26.4
Support Projects	4.6
Strategy Projects	3.3
Departmental / Low Resource Projects	1.0
Project Management Office	1.9
Total Cost	**$37.2**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD, Highmark and KPMG.

(ii) Financial Condition: Direct Economic Transfers to Highmark

Subsequent to the conversion of BCBSD's IT systems to Highmark's platform, the primary economic transfer between BCBSD and Highmark will occur via payment from BCBSD to Highmark for ongoing administrative services. The provision of these services are governed by an administrative services agreement included in the Form A filed by Highmark.

Overview of Administrative Services Agreement between Highmark and BCBSD

- Scope: Services to be provided by Highmark to BCBSD include (but are not limited to):
  - Executive management
  - Finance, financial administration, accounting and investment management, audit and compliance
  - Payroll, employee benefits management and human resource/employee relations
  - Computer and data processing
  - Provider relations
  - Customer service, including grievances and complaints
  - Claims adjudication and administration
  - Enrollment and membership
  - Broker and agent administration
  - Actuarial and underwriting
  - Corporate training
  - Procurement
  - Corporate communications
  - Marketing and sales
  - Pharmacy/prescription drugs
  - Member agreements and literature
  - Such other services as the parties may agree from time to time
- Pricing: BCBSD will compensate Highmark for services in an amount equal to BCBSD's "fair and reasonable allocable share of the total actual cost without provision for profit to Highmark of providing the Services"
- Length: 1 year term, with automatic annual renewal
- The following are termination triggers:
  - Highmark is no longer BCBSD's sole member
  - BCBSD ceases to be a Highmark-controlled affiliate
  - BCBSD becomes the subject of a delinquency proceeding
  - The agreement is determined to be unlawful
  - BCBSD defaults on the line of credit extended by Highmark
- Run-out Period: Highmark will continue to provide services for up to two years after termination, under a modified pricing structure
- Dispute Resolution: First via BCBSD/Highmark management, next to BCBSD Board of Directors, finally to Highmark Board of Directors

Source: Proposed Administrative Serves Agreement between BCBSD and Highmark
(1) Includes synergy projections.

(ii) Financial Condition: Direct Economic Transfers to Highmark (cont’d)

Administrative charges from Highmark to BCBSD are anticipated to reach an annual run-rate of $21.7 million by 2015, which will account for approximately 14.2% of BCBSD’s total non-care operating expenses.

- The Applicants’ projections assume that the Affiliation becomes effective January 1, 2012
- BCBSD’s migration onto Highmark’s platform is projected to be completed by June 2013
- BCBSD will be allocated costs annually by Highmark for management services information technology
- BCBSD projects synergistic benefits as a result of the Affiliation

Projected Charges to BCBSD for Highmark Administrative Services

REDACTED

(1) Includes G&A, Corporate Initiatives, Disease Management, Capability Enhancements and other non-care expenses.

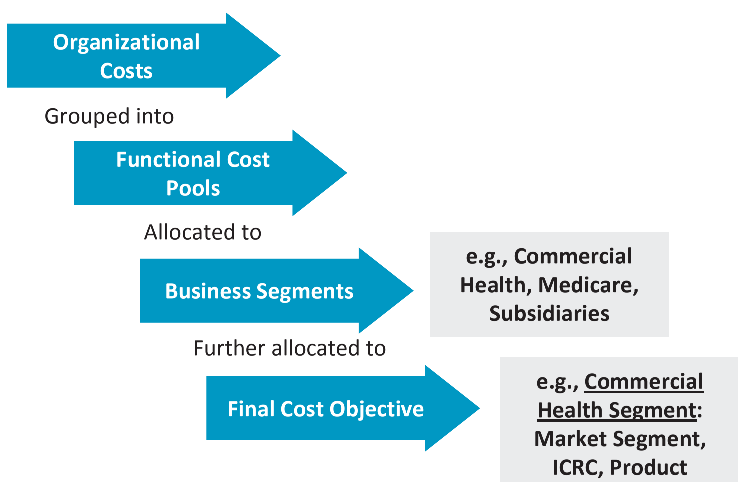
(ii) Financial Condition: Direct Economic Transfers to Highmark (cont'd)

Highmark applies a broad costing process across all operating segments within its organization. This method is based on utilization of services such that each subsidiary or affiliate is charged, without a profit mark-up, for its share of Highmark's total cost burden.

Overview of Highmark Cost Allocation Process

- BCBSD will be allocated charges for corporate and shared services via the same method as all other Highmark subsidiaries and affiliates, including Highmark West Virginia
- A significant portion of Highmark's allocated charges are subject to Federal Cost Accounting Standards ("CAS")[1]
  - CAS-covered contracts are subject to ongoing disclosure of cost accounting practices and Comprehensive Area Assessment ("CAA") audit
  - Other contracts, including FEP, are subject to Federal Acquisition Regulations

Highmark Cost Allocation Process Flow:



Monitoring, Approval and Dispute Mechanisms

- BCBSD management will be responsible for their business unit's profit and loss performance within Highmark and are therefore incented to actively monitor allocated charges from Highmark
- The DOI has the opportunity to review BCBSD's operating budget each year, which may include a review of variances to the prior year's budget
  - The DOI will also be provided with monthly budget-to-actual variance reports
  - Under the provisions of 18 *Del. C.* §6311 , the DOI must approve any charges from Highmark in excess of $500,000 prior to payment by BCBSD
- The ASA specifies a dispute resolution mechanism in the event of any dispute or other controversy between BCBSD and Highmark related to, or arising out of, the ASA

(1) Cost pools that are partially allocated to Highmark's Medicare services and United Concordia Dental unit are subject, in total, to CAS standards.

(ii) Financial Condition: Direct Economic Transfers to Highmark (cont'd)

Highmark will provide BCBSD with a $45 million line of credit for the purpose of financing BCBSD's costs associated with converting its IT systems onto Highmark's platform. Borrowing under the line of credit is at BCBSD's option, and there are no unused capacity fees or early repayment penalties.[(1)]

Key provisions of the Line of Credit Agreement include:

- Purpose: Intended solely to support certain infrastructure improvements and transition matters associated with the proposed Affiliation, including payment of costs associated with the systems conversion and integration as contemplated by the Administrative Services Agreement
- Amount: Maximum borrowing capacity of $45 million
  - Advances under this line provided in $500,000 increments
  - Advances may be made until 4 years after closing
- Pricing: The lesser of 1-month LIBOR plus 350 basis points or the U.S. Prime Rate
- Termination: 7 years after closing
  - All amounts owed will become immediately due in the event of a Change of Control or upon an Event of Default
  - Events of Default include:
    - BCBSD fails to make a principal or interest payment
    - BCBSD fails to perform obligations set forth in the credit agreement
    - BCBSD becomes the subject of a delinquency proceeding by the Commissioner of the Delaware Department of Insurance
    - BCBSD becomes insolvent
    - BCBSD admits, or does not contest, a material allegation of any petition filed in any involuntary action commenced against it or any such petition is not denied, discharged or stayed within 60 days
    - The current events of default do not contain provisions addressing the materiality of the Event of Default or provisions permitting a cure of the Event of Default
  - Change of Control events include:
    - Any business combination, division, conversion to a for-profit corporation, affiliation, merger, etc.
    - Any transaction in which Highmark ceases to have the power to elect/appoint at least a majority of the board of Directors of BCBSD
    - Any transaction in which BCBSD grants to a third person the power to control the management of BCBSD, its operations or its assets
- Pre-Payment Penalty: None
- Unused Fee: None
- Other: BCBSD is under no obligation to borrow under the line of credit; there are no fees for unused borrowing capacity or early repayments and borrowing under the line is strictly at BCBSD's option

(1) BCBSD management has stated that it does not intend to draw on the line of credit.

(ii) Financial Condition: Direct Economic Transfers to Highmark (cont'd)

A sample of unsecured lines of credit of other health insurance companies reflects interest rates ranging from ~1% to ~4% with terms ranging from 3 to 5 years. BCBSD's current borrowing rate would be 3.25% for a repayment due in 7 years.

Comparable Industry Credit Facility Pricing

($ in millions)

Name of Company	Date of Origination	Principal	Principal/GAAP Assets	Principal/Statutory Reserves	Spread to LIBOR	Interest Rate[1]	Payback Period (yrs)
Humana	12/21/2010	$1,000	6.21%	22.04%	1.70%	1.93%	3
WellPoint	9/30/2010	2,000	3.99%	24.46%	N/A	N/A	3
Universal American Corp	9/18/2007	150	4.10%	24.21%	0.75%	0.98%	5
HealthSpring	2/11/2010	175	7.45%	36.64%	3.75%	3.98%	4
CIGNA	6/19/2007	1,750	3.83%	37.61%	N/A	N/A	5
Molina	4/29/2010	150	9.94%	38.45%	2.75-3.75%	3.48%	5
Centene	1/25/2011	350	18.01%	71.64%	1.25-3.25%	2.48%	5
Median		**$350**	**6.21%**	**36.64%**		**2.48%**	**5**
BCBSD	**2011 TBU**	**$45**	**12.91%**	**26.30%**	**3.50%**	**3.73% or U.S. Prime Rate[2]**	**7**

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: Company financials, SNL.

(1) Calculated using the 1-month LIBOR rate as of September 9, 2011.

(2) BCBSD's cost of borrowing is equal to the lesser of 3.50% plus the one-month LIBOR or the US Prime Rate. The US Prime Rate was 3.25%, which was below the sum of the one-month LIBOR Rate and 3.50% as of September 9, 2011.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD

BCBSD prepared two sets of distinct financial projections – a standalone case and an Affiliation case.

- The pro forma financial projections compiled by BCBSD management represent their best estimation of the future state of the Company in either a standalone or Affiliation basis
  - Standalone case assumes that BCBSD does not consummate the Affiliation and does not enter into any other change-of-control transaction
  - The Affiliation case assumes that the Affiliation with Highmark, as described herein, becomes effective as of January 1, 2012
- To construct these two distinct sets of projections, BCBSD management first envisioned its operating model as a controlled affiliate of Highmark
  - Both BCBSD and Highmark management worked to develop the affiliated financials
  - BCBSD recognized that its membership would benefit from Highmark's advanced IT functionality, depth of administrative functionality and general market strength
    - The outcome of the process to build the Affiliation case financials ultimately resulted in greater membership across individual, group and self-funded product lines, as well as an increase in BCBSD's ability to deliver ancillary products
    - BCBSD then projected changes to its administrative and operating cost structure
    - BCBSD will pay Highmark an administrative services fee for services covered under the Administrative Services Agreement
    - BCBSD will upgrade its systems in order to convert to Highmark's already robust IT platform
    - BCBSD projects to achieve operational synergies as the Company benefits from Highmark's scale and market presence
- Next, BCBSD developed forward projections based on remaining an independent company
  - BCBSD believes there is slightly greater uncertainty to this set of projections based on the Company's lack of size and operational capacity to deal with the implementation of recently enacted federal healthcare regulation as compared to Highmark
  - The Company assumes a gradual erosion of its membership based on its inability to compete with national competitors in such areas of product customization and data analytics
  - BCBSD would also need to spend a considerable amount greater than the Affiliation case in order to fully upgrade its IT system as a standalone entity and would also need to budget for expenses to maintain this upgraded equipment
  - BCBSD projects that it would have to raise premium rates in a standalone scenario in order to recoup a portion of the capital costs required to upgrade its IT platform; this increase in rates would further drive membership declines

Blackstone notes that BCBSD is likely to issue revised pro forma financial statements in respect of both the standalone and Affiliation scenarios subsequent to submission of this report. Consequently, Blackstone's analysis contained on pages 85 – 96 and conclusions reached thereon remain subject to change pursuant to any such revisions.

Source: BCBSD.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont’d)

Below is a side-by-side comparison of BCBSD’s standalone and Affiliation case projections.

Standalone Financials – GAAP Basis	Affiliation Financials – GAAP Basis
REDACTED	REDACTED

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

BCBSD believes it will face increasing challenges from competition and the changing regulatory landscape which will lead to an erosion of profitability and reserves if BCBSD remains a standalone entity.

REDACTED

Source: BCBSD.

REDACTED

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

(1) Statutory.

D. Standard “d”

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont’d)

BCBSD has prepared pro forma financial statements on the basis of the Affiliation being approved, reflected below.

REDACTED

Source: BCBSD.

REDACTED

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

.

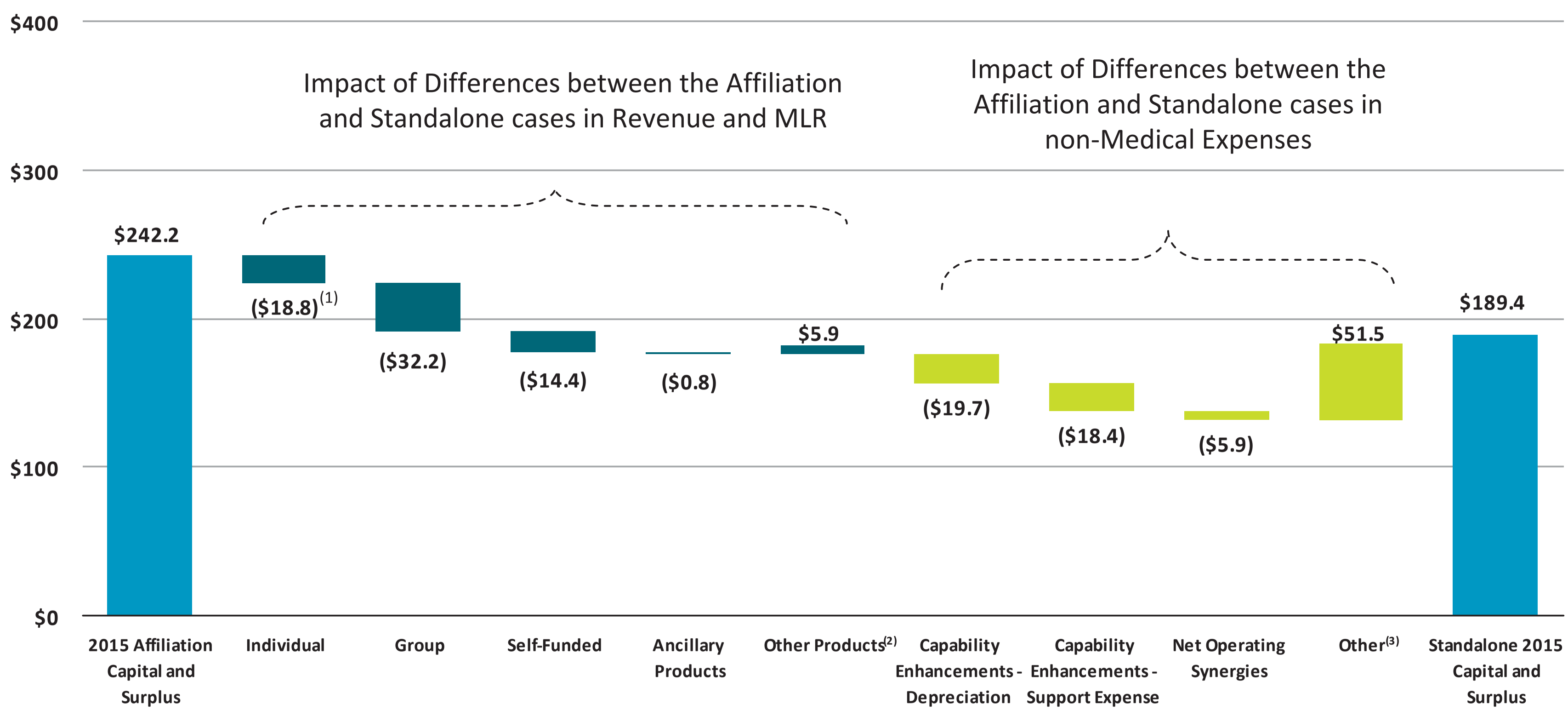
(1) Statutory.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

2015 Reserves are projected to be $53 million less in the standalone case compared to the Affiliation case, largely due to IT-related depreciation and support expense. Financial results are projected to be different between the standalone and Affiliation scenarios, and these differences impact membership and relevant expenses. Largely BCBSD will gain membership as a result of the Affiliation and will incur greater expenses as a result of remaining a standalone entity.

GAAP Reserves Bridge

($ in millions)



Source: BCBSD.

(1) For example, this indicates that BCBSD's reserves in the standalone case will be $18.8 million less than its reserves would be in the Affiliation case due to decreased membership and revenue in the individual segment.

(2) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories

(3) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

BCBSD's reserves reflect the Company's capital base. Blackstone notes that BCBSD's reserves are solely impacted by the Company's net income. Blackstone has reviewed the financial projections under both scenarios and discusses below the differences between the scenarios as they affect the BCBSD's reserve levels.

Discussion of Reserves Bridge Items

Individual

- Refers to Contribution Margin (Revenue less cost of Incurred Care) for Individual products
  - While revenue generated per member per month ("PMPM") is the same between both scenarios, the Affiliation case assumes increased member months (which is equivalent to an increase in membership) beginning in 2012. By 2015, individual member months in the Affiliation case in the 'less than 65' category is 110% larger than individual member months in the standalone case and is 120% larger in the 'greater than 65' category
  - Cost incurred PMPM is identical between the two scenarios. However, because the Affiliation case assumes greater membership the costs of incurred care are also greater in the Affiliation scenario

Group

- Refers to Contribution Margin for Group products
  - Revenue generated PMPM is different between the scenarios. In the Affiliation scenario, the revenue generated in the 'Small Group' and 'Large Group' categories is less than what is generated in the standalone scenario. For example, in 2015, the Affiliation scenario assumes $483.53 and $453.95 PMPM in the 'Small Group' and 'Large Group' categories, respectively. Conversely, the standalone scenario assumes 2015 PMPM for the 'Small Group' and 'Large Group' categories at $486.79 and $467.57, respectively. However, the Affiliation case assumes increased member months beginning in 2012. By 2015, member months in the 'Small Group' category are 32% greater in the Affiliation case and member months in the 'Large Group' category are 34% greater in the Affiliation case than in the standalone case
  - Cost incurred PMPM is identical between the two scenarios. However, because the Affiliation case assumes greater membership the costs of incurred care are also greater in the Affiliation scenario

Reserves Bridge

($ in millions)

2015 Affiliation Capital & Surplus	$242.2
Individual	(18.8)
Group	(32.2)
Self-Funded	(14.4)
Ancillary Products	(0.8)
Other Products[1]	5.9
Capability Enhancements - Depreciation	(19.7)
Capability Enhancements - Support Expense	(18.4)
Operating Synergies	(5.9)
Other[2]	51.5
2015 Stand Alone Capital & Surplus	$189.4
Total Change from Affiliation to Standalone	*(52.8)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.
(1) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories
(2) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont’d)

Discussion of Reserves Bridge Items (cont’d)

Self-Funded

- Refers to Contribution Margin for Self-Funded products
  - While revenue generated PMPM is the same between both scenarios, the Affiliation case assumes increased member months beginning in 2012. By 2015, member months in the Self-Funded category are ~23% greater in the Affiliation scenario
  - BCBSD does not incur any costs for incurred care in this category

Ancillary Products

- Refers to Contribution Margin for additional, or Ancillary, products offered as a result of the Affiliation
  - Assumes expansion in Dental and Vision categories, based on increased service offering to current BCBSD members
  - Assumes that BCBSD will generate a total of ~$825k between 2012 and 2015 in Ancillary product contribution margin

Reserves Bridge

($ in millions)

2015 Affiliation Capital & Surplus	$242.2
Individual	(18.8)
Group	(32.2)
Self-Funded	(14.4)
Ancillary Products	(0.8)
Other Products[(1)]	5.9
Capability Enhancements - Depreciation	(19.7)
Capability Enhancements - Support Expense	(18.4)
Operating Synergies	(5.9)
Other[(2)]	51.5
2015 Stand Alone Capital & Surplus	$189.4
Total Change from Affiliation to Standalone	*(52.8)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.
(1) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories
(2) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

Discussion of Reserves Bridge Items (cont'd)

Other Products

- Refers to Contribution Margin for Federal Employee Program (FEP), Non-Risk Par and Stop-Loss categories
- While revenue generated PMPM is the same between both scenarios for the FEP category, the Affiliation case assumes increased member months in this category beginning in 2012. By 2015, member months in the FEP category are ~6% greater in the Affiliation scenario. Costs incurred PMPM is identical between both scenarios
- Revenue generated PMPM for the Non-Risk par category in the Affiliation case is ~.5% greater than that of the standalone scenario beginning in 2012 and membership by 2015 is ~6% greater in the Affiliation scenario. BCBSD does not incur any costs for incurred care in the Non-Risk Par category
- For the Stop-Loss category, BCBSD assumes that as a standalone entity Stop-Loss revenue will grow at an annual rate of 15% beginning in 2012 and costs of incurred care will remain constant at 85% of revenue (based on a targeted MLR). In the Affiliation scenario, BCBSD projects an intentional discontinuing of its stop-loss product offering as of 2012, as the stop-loss line will be solely offered by Highmark

Capability Enhancements – Depreciation

- Refers to depreciation expense related to information technology capital equipment purchased as BCBSD upgrades its platform
  - Both scenarios assume depreciation expense begins in 2013
  - Affiliation scenario assumes $35 million capital spending, depreciated until 2015 while the standalone scenario assumes $114 million capital spending depreciated until 2018

Reserves Bridge

($ in millions)

2015 Affiliation Capital & Surplus	$242.2
Individual	(18.8)
Group	(32.2)
Self-Funded	(14.4)
Ancillary Products	(0.8)
Other Products(1)	5.9
Capability Enhancements - Depreciation	(19.7)
Capability Enhancements - Support Expense	(18.4)
Operating Synergies	(5.9)
Other(2)	51.5
2015 Stand Alone Capital & Surplus	$189.4
Total Change from Affiliation to Standalone	*(52.8)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.
(1) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories
(2) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont’d)

Discussion of Reserves Bridge Items (cont’d)

Capability Enhancements – Support Expense

- Refers to the expense required to maintain newly purchased capital equipment in the standalone scenario
  - Affiliation case does not assume a similar expense given that BCBSD will be paying Highmark for administrative support
  - Support expense increases to a run-rate of ~$13.1 million from 2016 onward, while the total expense from 2012-2015 is ~$18.4 million

Net Operating Synergies

- Refers to the benefit of synergies between the two organizations in the event of an affiliation as well as the offsetting Highmark Support Charges for administrative/corporate services
  - Two main categories of Highmark Support Charges are Home Office/Governance and IT Platform
    - Home Office/Governance charges include items such as BCBSD’s share of executive compensation while the IT Platform charges are for BCBSD’s cost for accessing Highmark’s IT system
- Three main categories of Synergies are Operational Efficiencies, Disease Management and Procurement Savings
  - All of the synergy projections developed by Highmark are based on previous affiliation with Highmark West Virginia

Reserves Bridge

($ in millions)

2015 Affiliation Capital & Surplus	$242.2
Individual	(18.8)
Group	(32.2)
Self-Funded	(14.4)
Ancillary Products	(0.8)
Other Products(1)	5.9
Capability Enhancements - Depreciation	(19.7)
Capability Enhancements - Support Expense	(18.4)
Operating Synergies	(5.9)
Other(2)	51.5
2015 Stand Alone Capital & Surplus	$189.4
Total Change from Affiliation to Standalone	*(52.8)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

Source: BCBSD.
(1) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories
(2) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

Blackstone

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

Discussion of Reserves Bridge Items (cont'd)

Other

- Refers to differences in the categories of Broker Fees, General and Administrative, Investment Income, Provision for Income Taxes and Other Expenses
  - Broker Fees: these fees are paid based on revenue generated by each insurance product. Largely as a result of the increased membership in the Affiliation scenario and thus greater revenue, broker fees are greater in the Affiliation scenario than in the standalone case
  - General and Administrative: fixed General and Administrative charges are identical between both scenarios. However, variable General and Administrative expenses, not including those costs associated with Medicaid products, are slightly higher in the Affiliation scenario based on increased membership in the Affiliation case
  - Investment Income: the investment portfolio is assumed to earn the same 4% return in both scenarios. Because the portfolio is considerably larger in the Affiliation case, due to much greater reserve levels ($242 million and $189 million in 2015 for the Affiliation and standalone scenarios, respectively), the Affiliation scenario projects much greater investment income
  - Income taxes: Taxes are a function of income earned. Because the Affiliation case assumes greater income, before the provision for income taxes, greater taxes are paid in the Affiliation scenario.
  - Other Expenses: Includes incremental expenses for both scenarios
    - Incremental expenses included in the Affiliation case include those required for rebranding, integration planning consulting, community related expenses, as well as corporate initiatives
    - Other Expenses valued at $30.1 million during the projection period in the Affiliation case and $27.0 million in the standalone case

Reserves Bridge

($ in millions)

2015 Affiliation Capital & Surplus	$242.2
Individual	(18.8)
Group	(32.2)
Self-Funded	(14.4)
Ancillary Products	(0.8)
Other Products[1]	5.9
Capability Enhancements - Depreciation	(19.7)
Capability Enhancements - Support Expense	(18.4)
Operating Synergies	(5.9)
Other[2]	51.5
2015 Stand Alone Capital & Surplus	$189.4
Total Change from Affiliation to Standalone	*(52.8)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

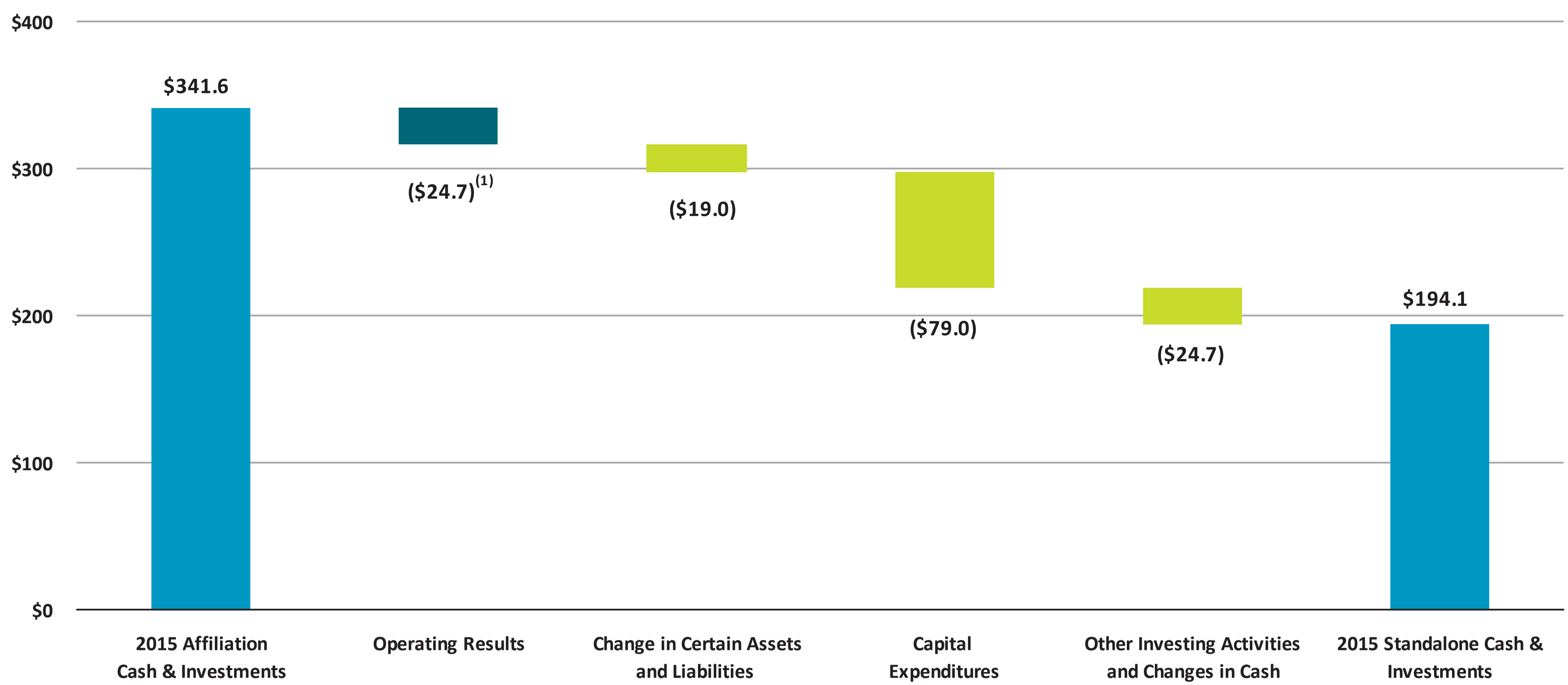
Source: BCBSD.
(1) Refers to Contribution Margin for Federal Employee Program (FEP), BlueCard and Stop-Loss categories
(2) Includes changes in Broker Fees, G&A, Investment Income, Provision for Income Tax and Other Expenses.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

Whereas BCBSD's 2015 estimated reserves are projected to be $53 million less on a standalone case, Cash & Investments are projected to be $147 million less on a standalone basis. The incremental difference at $90 million reflects capital expenditures that have not been depreciated by 2015 and therefore will decrease standalone basis resources in future years.

GAAP Cash & Investments Bridge

($ in millions)



(1) For example, this indicates that BCBSD's cash and investments in the standalone case will be $24.7 million less than its cash and investments would be in the Affiliation case due to decreased operating results.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont’d)

BCBSD’s Cash and Investments reflect the Company’s actual cash or liquidity position. Blackstone notes that BCBSD’s investments account is solely impacted by annual changes to the Company’s cash account. Blackstone has reviewed the financial projections under both scenarios and discusses below the differences between the scenarios as they affect the Company’s cash and investments.

Discussion of Cash and Investments Bridge Items

Net Income

- BCBSD is projected to earn $53 million more net income in the Affiliation scenario. These incremental earnings are a source of cash
  - The differences between the two scenarios are discussed in detail on pages 88-93

Depreciation

- In the standalone case, BCBSD is projected to depreciate $45 million of a total $114 million in capital expenditures between 2012 and 2015 in order to upgrade its IT platform
  - In the Affiliation case, BCBSD is projected to depreciate $26 million of a total of $35 million in capital expenditures between 2012 and 2015 as it integrates with Highmark’s IT platform

Changes in Certain Assets and Liabilities

- Refers to annual changes in certain assets and certain liabilities, sized according to BCBSD’s growth trajectory in the given scenarios

Cash and Investments Bridge

($ in millions)

2015 Affiliation Cash & Investments	$341.6
Operating Results[1]	(24.7)
Changes in Certain Assets and Liabilities	(19.0)
Purchase of Property and Equipment	(79.0)
Other Investing Activities and Changes in Cash	(24.7)
2015 Standalone Cash & Investments	$194.1
Total Change from Affiliation to Standalone	*(147.4)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

(1) Includes $7.9 million of investment income.

(ii) Financial Condition: Pro Forma Financial Impact on BCBSD (cont'd)

Discussion of Cash and Investments Bridge Items (cont'd)

Purchase of Property and Equipment

- Refers to the capital outlay for property and equipment
  - In the standalone case, BCBSD is projected to spend $114 million on property and equipment
  - In the Affiliation case, BCBSD is projected to spend $35 million on property and equipment

Other Investing Activities and Changes in Cash[2]

- BCBSD has reflected the use of greater cash resources in the standalone case as compared to the Affiliation case for purposes that are classified as investing activities other than purchases of property and equipment within the Company's projected cash flow statements

Cash and Investments Bridge

($ in millions)

2015 Affiliation Cash & Investments	$341.6
Operating Results[1]	(24.7)
Changes in Certain Assets and Liabilities	(19.0)
Purchase of Property and Equipment	(79.0)
Other Investing Activities and Changes in Cash	(24.7)
2015 Standalone Cash & Investments	$194.1
Total Change from Affiliation to Standalone	*(147.4)*

Note: Sub totals may differ from the sum of amounts shown by +/- .1 due to rounding of decimal places not displayed

(1) Includes $7.9 million of investment income.
(2) Certain balance sheet and income statement items related to Other Investing Activities and Changes in Cash in the projected cash flow statements for both the Affiliation and standalone scenarios remain under review by BCBSD management and may be subject either to reclassification or revision pending such review.

(iii) Corporate Capabilities: Summary Conclusions of Deloitte Assessment

BCBSD's ability to offer its customers and providers with market-leading services is currently compromised by BCBSD's lack of scale and ability to devote resources to various corporate functions. The Affiliation is structured to provide BCBSD with the ability to access and leverage the corporate resources of Highmark while maintaining a degree of market-facing operating autonomy that will allow the Company to continue to respond to the needs of its customers.

- BCBSD currently faces a number of challenges as a small nonprofit Blue and as a relatively small competitor in a rapidly changing industry, including:

REDACTED

- Company management believes the Affiliation will result in meaningful increased capabilities that will ensure the Company's long term viability and enhance BCBSD's ability to service its customers. These enhanced capabilities address capability gaps identified by Deloitte and are organized in the following functional categories:
  - Corporate agility/efficiency
  - Middle Office functionality
  - Back Office functionality
  - Go-To-Market functionality
- Blackstone reviewed the option to outsource the increased capabilities offered by the proposed Affiliation

Highmark Business Partner Relationships

Blackstone notes KPMG's analysis regarding Highmark's current business partner relationship, and the conclusions of KPMG's analysis are below.

- 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 ranges 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. 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 integrated organization (e.g., shared business functions and processes)		
BCBS of Florida	External	Health plan administration		

Source: KPMG.
(1) Highmark has a majority ownership interest in a subsidiary of Blue Cross Northeastern Pennsylvania, the First Priority Life Insurance Company (FPLIC).

D. Standard "d"

Highmark Business Partner Relationships (cont'd)

- 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[1]. 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 REDACT. 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 REDACT margin

Source: KPMG.

Blackstone

BCBSD Affiliation Roadmap Projects (1 of 6)

Highmark has submitted that BCBSD will gain various capabilities within the functional categories of "Corporate," "Go to Market," "Middle Office" and "Back Office" upon completion of the Applicants' integration plans. KPMG has noted that many of these functions are not typically well-suited for outsourcing relationships and are generally amenable to more comprehensive forms of business partnership, including acquisitions or affiliations.

ID	PTO[1]	Area	Project Name	Project Description
CCSP-1	✗	**Go to Market**-Corporate Communication 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**-Corporate Communication 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**-Corporate Communication and Strategic Planning	Market Launch	Create a positive image for the combined enterprise, generate goodwill and maintain relationships wilh 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**-Corporate Communication 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 BCBSD, as efficiently as possible.
CCSP-5	✗	**Go to Market**-Corporate Communication 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**-Corporate Communication 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**-Corporate Communication 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**-Corporate Communication 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**-Corporate Communication 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**-Corporate Communication and Strategic Planning	Corp Strategy Policies & Processes	Understand differences between HM and DE departments and develop or modify processes and policies for the affiliated company in the areas of Advertising, PR, sponsorships, and Communications.

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

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

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 into 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 GIL 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 Consolidatibn	Consolidation of BCBSD into Highmark Procurement systems and process. Consoidation of vendors to gain efficiencies.
FN-5	✗	**Corporate Finance**	Financial and Accounting Policy	Review of Delaware policies and adoption of Highmark Financial and Accounting Policies by Delaware.
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 HM and DE 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 enusre that BCBSD migrates to one common customer service system. This will include call routing, grievance / appeals, IVR support, etc. The Team will undertand the tactical next steps required to cmplete this migration.

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

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

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 will be incorporated into the overall Corporate Communications and Strategic Planning 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	Aanalysis of differences in compensation structures and alignment of compensation and benefits in end-state orgnization.
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.

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

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

Blackstone

BCBSD Affiliation Roadmap Projects (4 of 6)

ID	PTO[1]	Area	Project Name	Project Description
HR-5	✓	**Corporate**-Human Resources	Affilitate HR Policies and Procedures	Assess HR policies across Highmark and BCBSD and align to ensure all obligations are appropriately met when devleoping 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. Deveiop 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 Orgainzation	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

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

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

BCBSD Affiliation Roadmap Projects (5 of 6)

ID	PTO[1]	Area	Project Name	Project Description
LACEA*3	✗	**Corporate**-LACEA	Affliliated 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 regularory 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 Managemnet Program and Policy Strategy	BCBSD and Highmark will review their Medical Management Program and Policy Strategy, including an understanding of Provider Mangement.
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 (Meet 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 and 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 Corporate Communications and Strategic Planning.

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

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

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 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	Sqles & 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 distribullon 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

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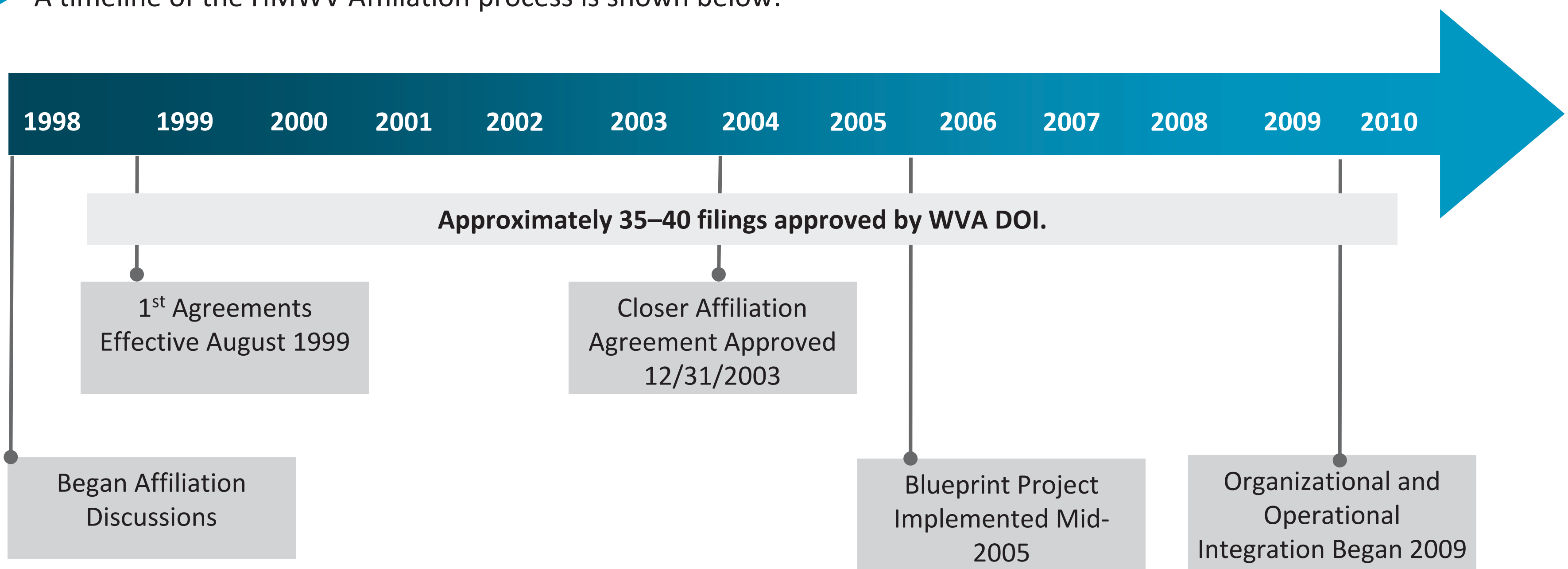
- ✓ Business process is more typically outsourced in a long-term business process outsourcing relationship

Source: *BCBSD Affiliation Capability Tracing Analysis*, KPMG Analysis.
(1) Possible to outsource.

(iv) Review of Highmark West Virginia Transaction

HMWV faced many of the same potential issues now faced by BCBSD when HMWV affiliated with Highmark and provides a useful case study for the current proposed Affiliation.

- The HMWV transaction was similar, but not identical, to the proposed transaction with BCBSD
  - HMWV was in financial distress in 1999
  - Highmark initially provided "rescue" capital to HMWV in 1999 and later in 2004 became its sole member
  - Since 2009, HMWV has experienced full integration with Highmark from an IT platform perspective and continues to exercise market-focused decision-making authority
- A timeline of the HMWV Affiliation process is shown below:



(iv) Review of Highmark West Virginia Transaction (cont’d)

Highmark West Virginia achieved full integration with Highmark incrementally over a 10-year period.

Phase I: 1999

- Financial Rescue
- 50/50 Board Split
- Highmark systems support but limited systems integration; provided at cost + margin
- “Stand Alone” operating structure, with only HMWV CEO reporting to Highmark
- Board oversight model

Phase II: 2004

- Highmark “Closer Affiliation,” results in Highmark becoming sole member of HMWV, assuming full control of the Board
- 5 directors of Board are West Virginia residents, including HMWV President
  - 3 of the 5 non-independent directors are Highmark executives
  - Highmark Board of Directors approves appointment of all Directors
- Greater level of integration was desired by HMWV
- Full systems integration (“Blue Print”) and system replacement
- Administrative services provided at internal cost (significant reduction to Phase I cost); no profit mark-up
- Board oversight model retained
- Subject to WVA DOI approval and hearing process
  - All administrative charges and multiple Form D’s filed with the DOI
- Addition of call center and back office capabilities

Phase 3: 2009

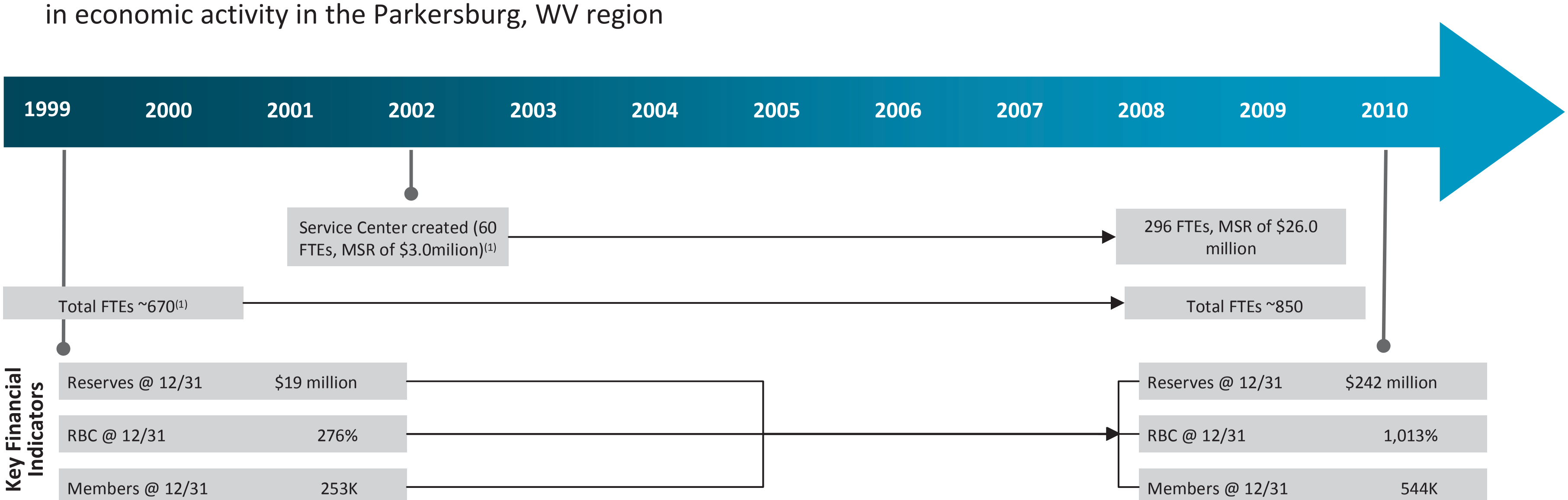
- “Full Integration”
- Matrix operating structure introduces numerous points of horizontal integration between Highmark and HMWV
- Market-facing capabilities report to HMWV President
- Non market-facing functions have dual reporting structure under both HMWV President and Highmark functional counterparts
- Master services agreement replaces need to file incremental Form D’s
- Highmark provides significantly greater level of corporate services
  - Product innovation
  - Pricing / actuarial support
  - National Account support
  - Regulatory planning
- WVA DOI sets maximum per member per month administrative charge, below which approval via Form D no longer required

(iv) Review of Highmark West Virginia Transaction (cont'd)

HMWV has experienced a growth in employees and financial health as a result of its affiliation with Highmark.

Transaction Overview

- Highmark notes that HMWV's:
  - Reserves have increased by a factor of 12.7 times from $19 million to $242 million
  - RBC has increased by a factor of 3.7 times from 276% to 1,013%
  - Membership has grown by a factor of 2.2 times from 253,000 to 544,000
- Further, Highmark estimates that the Service Center referenced above has helped to generate approximately $106 million in economic activity in the Parkersburg, WV region



(1) 1999 FTE count included 125 FTE's that worked on the PEIA account, which was lost in 2000. Those FTE's were redirected to other work, rather than displaced, due to the noted enrollment growth and creation of the service center.

(iv) Review of Highmark West Virginia Transaction (cont'd)

The DOI, along with Blackstone, held separate interviews with HMWV's current president, Fred Earley, and the West Virginia Department of Insurance in order to assess their views of HMWV's affiliation with Highmark.

Observations of Fred Earley, Highmark West Virginia President

- Prior to 2009, only the local president reported to Highmark and review was primarily conducted through the annual budget process
- Since 2009, HMWV has moved to an integrated structure where substantially all non-market facing functions report both to HMWV personnel and to their Highmark counterparts
  - The local president now has monthly meetings with Highmark's finance group to monitor performance and discuss trends
  - HMWV has had no reductions in client-facing personnel since 2009 and has increased provider relations personnel by 20% since then
- The following benefits have been realized since the 2009 full integration:
  - Highmark has provided significant guidance with respect to margin management, market research, regulatory planning and product development. Highmark's actuarial department is a significant benefit to HMWV, which previously had to use outside consultants
  - National account services support
  - Greater leverage with vendors, which helps contain operating expense
  - Enhanced pharmacy benefits services
- Although the integration process experienced implementation difficulties, the functionality and support have been beneficial
  - Integration challenges were experienced in the first 12 months, but customers have since largely been satisfied with the upgrades and functionality
  - Providers, in particular, have benefited from efficiencies gained in claims processing and adjudication and system support
- HNWV has not had any material disputes related to administrative charges from Highmark and does not believe Highmark's oversight has been a hindrance to local market-facing functions and personnel
- HMWV has maintained local control over community initiatives

Observations of West Virginia Department of Insurance

- No significant complaints related to loss of local autonomy have been received from market participants or customers since the 2009 full integration
- The technology upgrades have generally been beneficial to the company and its customers and providers
- Overall, Highmark has been a reasonable corporate partner and a responsible member of the local community

Standard "d": Conclusion

Blackstone believes the proposed Affiliation would not violate Standard "d".

Standard "d" : The plans or proposals which the controlling affiliate (i.e. Highmark) has to liquidate the insurer (i.e. BCBSD), sell its assets or 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 to policyholders of the insurer and not in the public interest

Standard "d" Summary Conclusions:

- The Affiliation is structured such that there is a high likelihood that BCBSD's market-facing functions will remain locally managed in the foreseeable future
- It is unlikely that BCBSD management will gain direct financial benefit from the Affiliation at the expense of the Company's policyholders
- BCBSD's contractual option to disaffiliate under certain adverse circumstances will help to protect the Company and its policyholders from potentially unfair and unreasonable outcomes in the context of certain potential Highmark actions, including conversion to for-profit status or insolvency
- The Affiliation does not provide Highmark with the means of accessing or controlling the current or future reserves of BCBSD
- Based on the KPMG report, the costs of the IT system upgrades to be provided by Highmark are not unreasonable given the level of functionality and service to be obtained, and the cost to BCBSD of upgrading via Highmark's IT platform does not appear to be higher than the cost to BCBSD of achieving the same level of functionality on a standalone basis
- Highmark's methodology for allocating ongoing operational and administrative charges to BCBSD is not unreasonable, subject to appropriate monitoring, authorization and dispute controls being implemented as planned
- The terms and interest rate of BCBSD's Line of Credit agreement with Highmark, considered as a whole, are not unreasonable
- It is unlikely that the financial condition of BCBSD will be materially worse in the foreseeable future as a result of an affiliation with Highmark than it would otherwise be if BCBSD were to remain a standalone entity
- Based on KPMG's review, the functionality that BCBSD anticipates gaining via the Affiliation should address many of the Company's current gaps in capabilities as compared to industry norms and expectations of customers and providers
- Neither an outsourcing relationship with a business process provider nor investing in additional capabilities as a standalone entity would be expected to provide BCBSD with capabilities that exceed those anticipated in the Affiliation; furthermore, such arrangements would likely entail greater cost to BCBSD and would not address BCBSD's lack of scale and resources in areas such as strategic development, product innovation and regulatory planning
- Based on the views of HMWV's local president and the West Virginia Department of Insurance, Highmark's Affiliation with HMWV has resulted in HMWV gaining significant capabilities and corporate support and has not been detrimental to HMWV's policyholders

Standard “d”: Conclusion (cont’d)

Blackstone believes the proposed Affiliation would not violate Standard “d”.

Standard “d” : The plans or proposals which the controlling affiliate (i.e. Highmark) has to liquidate the insurer (i.e. BCBSD), sell its assets or 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 to policyholders of the insurer and not in the public interest

Standard “d” Summary Conclusions (cont’d):

- The proposed corporate governance structure, including certain terms of the proposed amended bylaws of BCBSD, gives Highmark control over the affairs of the BCBSD Board. Accordingly, Blackstone believes that certain conditions proposed by the DOI that are intended to increase the autonomy of the BCBSD Board may be appropriate to ensure that the proposed changes to BCBSD’s corporate structure are not unfair and unreasonable to BCBSD’s policyholders or against the public interest of Delaware
- While BCBSD’s ability to disaffiliate from Highmark in the future is a key component of the Affiliation Agreement, Blackstone believes that additional conditions proposed by the DOI regarding BCBSD’s ability to disaffiliate in the future may be appropriate for the protection of BCBSD’s policyholders and the public interest of Delaware
- Blackstone believes that a condition proposed by the DOI that would assist BCBSD in successfully withdrawing from the affiliation may be appropriate for the protection of BCBSD’s policyholders and the public interest of Delaware
- Blackstone believes that a condition proposed by the DOI regarding the terms of the termination of the Line of Credit may be appropriate for the protection of BCBSD’s policyholders and the public interest of Delaware
- Blackstone believes that a condition proposed by the DOI regarding Highmark’s active assistance in BCBSD regaining its status as the primary licensee of the “marks” in Delaware may be appropriate for the protection of BCBSD’s policyholders and the public interest of Delaware
- Blackstone believes that additional conditions proposed by the DOI regarding the notice and terms under which the ASA may be terminated, as well as conditions regarding DOI oversight of cost allocations, may be appropriate for the protection of BCBSD’s policyholders and the public interest of Delaware
- **Based on the above analysis, conditions addressing (i) BCBSD’s corporate governance structure; (ii) the terms of BCBSD’s contractual option to disaffiliate upon certain events; (iii) certain terms of the Administrative Services Agreement and the Line of Credit Agreement; (iv) BCBSD’s employment and community initiative commitments in Delaware; and (v) the terms of any proposed rate increases or any changes to benefits or products would be appropriate to bring the Affiliation into compliance with the statutory criteria. The specifics of those conditions are within the purview of the Department of Insurance. Based on Blackstone’s analysis and the above conditions, the plans and proposals related to the Affiliation do not appear unfair and unreasonable to BCBSD’s policyholders and do not appear to be against the public interest of Delaware**

F. Standard “f”

Blackstone

Overview

Given BCBSD’s unique position as the dominant locally-based participant in the Delaware health insurance market, the proposed Affiliation could have a significant impact on the insurance buying public.

Standard “f” : The affiliation is likely to be hazardous or prejudicial to the insurance buying public

Blackstone’s review of Standard “f” included:

(i) Assessment of BCBSD’s Current Market Position

(ii) Review of the Company’s consideration of strategic alternatives

- In reviewing the Company’s search for strategic alternatives, the following factors were considered:
  - BCBSD’s long-term strategic goals
  - Methods considered to achieve the long-term strategic goals
  - Potential partners contacted and proposals evaluated
  - Criteria for key decision points, including the decision to affiliate with Highmark versus other options

(iii) Assessment of public feedback concerning the Affiliation

- Blackstone participated in public information sessions hosted by the DOI and attended by the Applicants and conducted private diligence meetings with various market participants
- Among the questions asked by Blackstone of the market participants were:
  - Views on BCBSD’s capabilities as a health insurance provider versus the capabilities of its competitors within Delaware
  - Whether having a sizeable non-profit provider of health insurance in the Delaware community is important to a market participant’s organization
  - The importance of BCBSD remaining locally managed
  - Whether a market participant’s organization has had any prior dealings with Highmark
  - Whether a market participant’s organization has any concerns about the potential impact on competition in the Delaware health insurance market resulting from the proposed Affiliation

(i) BCBSD Market Position

BCBSD is in a favorable position within the Delaware insurance market. However, the Company faces significant challenges as a standalone entity.

- While the Delaware market is on an upward growth trajectory, the relatively small size of the population limits BCBSD's future prospects for expansion in Delaware
  - The 2010 Delaware population was 895,173[(1)]
    - State population growth is projected at 14% from 2010 to 2025[(1)]
    - New Castle, Kent and Sussex population growth is projected at 7.5%, 16.3% and 29.3% respectively from 2010 to 2025[(1)]
- BCBSD presently maintains generally high satisfaction rates from stakeholders, including members, providers, employers, brokers and members of the community
  - Adequately servicing current accounts will require continued capital spending and modernization
  - Strong brand strength will be at risk by potentially rising premiums necessitated by capital requirements and likely declines in service metrics during a systems upgrade
- Similar to other insurers, significant uncertainty remains regarding recent healthcare legislation and associated regulatory reform
  - As a smaller organization relative to larger peers, BCBSD does not appear to have significant resources available to study the impact of changing legislation on the Company's ability to provide competitively priced insurance products to current and future policyholders
- Additionally, BCBSD's lean business model does not provide for resources to develop new products, improve data management or address other needed capability enhancements

(1) Delaware state website, http://www.delaware.gov, updated October 28, 2010.

(i) BCBSD Market Position (cont'd)

BCBSD currently maintains a unique position in the Delaware health insurance market.

- Approximately 300,000 of BCBSD's members are Delaware residents[1]
  - Based on 2010 statewide population of 897,934, BCBSD provides services to approximately 33% of Delaware residents
  - In addition to Delaware residents, BCBSD provides services to approximately 100,000 members who reside outside of Delaware
- BCBSD is the only significant market participant in Delaware that is a non-profit
- As a non-profit corporation, BCBSD performs a socially beneficial mission while not expressly maximizing profits at the expense of policyholders
- BCBSD is the only significant market participant that is locally controlled

Source: BCBSD management.

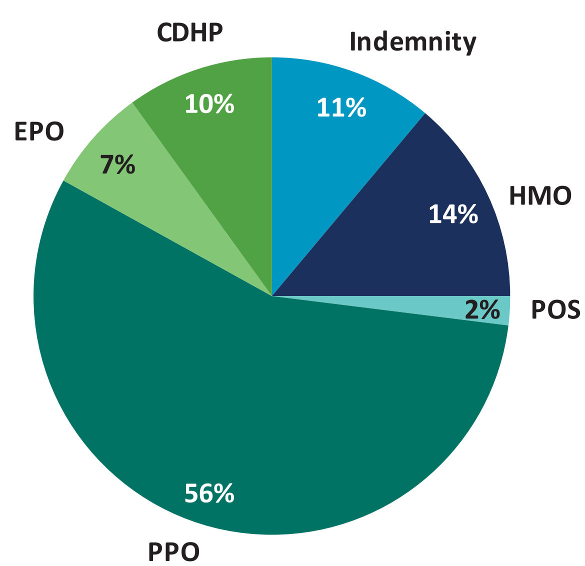
(1) Of the 300,000 members who reside in Delaware, approximately 200,000 purchase services directly from BCBSD and approximately 100,000 are BlueCard Host members.

F. Standard "f"

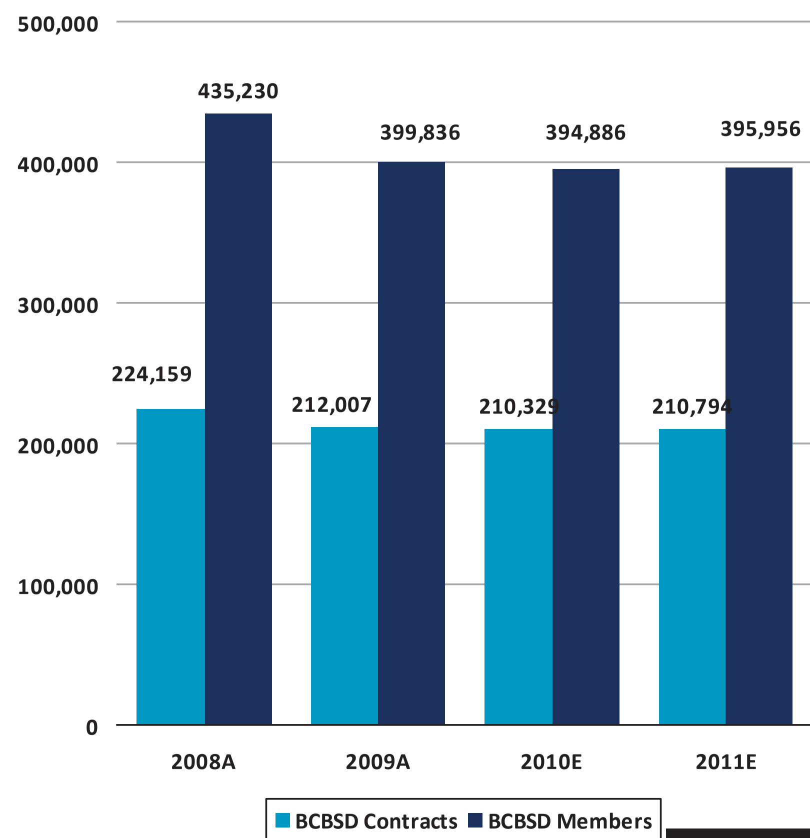
(i) BCBSD Market Position (cont'd)

BCBSD offers a wide range of commercial health products, which has helped the Company maintain a steady presence as the primary locally controlled non-profit carrier across most segments of the health insurance market in Delaware, but the overall number of members has declined by 9% since 2008.

2010 BCBSD Product Membership Distribution



BCBSD enrollment trends



Source: 2010 S+P Briefing Book Marketing Segments.

(ii) BSBSD’s Consideration of Strategic Alternatives

Beginning with the disaffiliation from CareFirst in September 2006, BCBSD began a comprehensive strategic review that culminated with the Company management and Board of Directors choosing to pursue an affiliation with Highmark in December of 2009.

Background of BCBSD Strategic Review Process

- BCBSD initially affiliated with CareFirst in 2000
  - The CareFirst affiliation was structured such that the BCBSD Board acted independently of CareFirst. However, BCBSD was partially integrated with CareFirst, and a number of BCBSD executives reported directly to counterparts at CareFirst
  - CareFirst provided certain IT functions (which are currently being provided by Highmark under an arms-length services agreement that is separate from the Affiliation Agreement) but did not provide comprehensive systems and technology support of the type to be provided under the proposed Affiliation
- The Delaware Insurance Commissioner ordered the disaffiliation of BCBSD and CareFirst in September 2006
  - Upon disaffiliating, BCBSD entered into a transition services agreement with CareFirst, which governed CareFirst’s continued provision of certain back office systems and support to BCBSD
    - This agreement did not have a defined end date
  - BCBSD entered into a replacement limited services agreement with Highmark that is separate from the Affiliation Agreement. As of July 2011, BCBSD has no ongoing contractual relationship with CareFirst
- Recognizing the challenges BCBSD was likely to face as a small, independent non-profit Blue plan, the BCBSD Board of Directors and senior management team engaged industry consultants Louis Pavia and Robert C. Cole, Jr. to conduct a comprehensive strategic review to address the Company’s long-term goal of continuing to provide benefit solutions that enable customers to access high quality, cost effective health services while remaining the leading provider of health insurance services in the markets the Company serves
- The strategic review began with a broad based initial stage focused on identifying potential corporate structures and operating models and included a multi-stage negotiating process involving several potential partners; the process culminated on December 3, 2009 with the Board’s decision to pursue an Affiliation Agreement with Highmark
  - Between December 1, 2006 and December 3, 2009, the BCBSD Board held over 25 meetings
  - The Board engaged in discussions with 6 parties at various stages, prior to choosing to pursue an affiliation with Highmark
  - The various stages of the process are discussed in further detail on the pages that follow

F. Standard "f"

(ii) BSBSD's Consideration of Strategic Alternatives (cont'd)

The Board's strategic review process encompassed four broad stages, as outlined below.

1 Assessment of Potential Strategies and Forms of Transactions

- Dates: 12/06 – 2/08
- Options Considered: Combinations of transaction types, including affiliations, mergers, conversions and asset sales, were assessed along with potential partner types, including multi-state Blues, regional Blues and single-state Blues
- Outcome: The Board decided to pursue a transaction in any form (although affiliation was preferred in order to maintain identity and local control) with either multi-state or regional Blues; single-state Blues were determined not to be an acceptable "end state" solution for BCBSD's long-term strategic needs

2 Discussions with Potential Partners

- Dates: 3/08 – 1/09
- Options Considered: The Board received interest from 5 organizations: REDACTED
- Outcome: The Board initially chose REDACTED as its finalists REDACTED); after further diligence, the Board chose REDACTED as an exclusive negotiating partner for a potential acquisition transaction

3 Exclusivity with REDACTED

- Dates: 2/09 – 8/09
- Options Considered: The Board negotiated with REDACTED for several months, but REDACTED valuation of BCBSD declined substantially from its initial indication (due in part to the deterioration of BCBSD's financial outlook and investment portfolio during the U.S. credit dislocation and subsequent recession that occurred at the time) and the parties remained relatively far apart on the terms of an agreement
- Outcome: The Board terminated exclusive discussions with REDACTED due to lack of progress toward an agreement

4 Reconsideration of Potential Partners

- Dates: 9/09 – 12/09
- Options Considered: The Board reached out to Highmark, REDACTED and REDACTED to assess interest in a transaction and remained in contact REDACTED REDACTED declined to move forward
- Outcome: The Board chose to pursue an affiliation with Highmark on an exclusive basis over REDACTED on December 3, 2009, due in part to the perceived strength of Highmark as a long-term partner and an operating model that would provide more local control than other potential partners

Final Outcome: After choosing to enter into exclusive negotiations with Highmark on December 3, 2009, the Affiliation Agreement was negotiated and executed on August 19, 2010.

(ii) BSBSD’s Consideration of Strategic Alternatives (cont’d)

Phase 1

BCBSD considered numerous strategic options to improve its competitive position. The timeline below highlights the key events that took place in BCBSD’s strategic review process, which ultimately led to the decision to propose an affiliation with Highmark.

REDACTED

(ii) BSBSD’s Consideration of Strategic Alternatives (cont’d)

REDACTED

(ii) BSBSD’s Consideration of Strategic Alternatives (cont’d)

REDACTED

(ii) BSBSD's Consideration of Strategic Alternatives (cont'd)

REDACTED

(ii) BSBSD's Consideration of Strategic Alternatives (cont'd)

BCBSD's strategic review process was driven by multiple factors and resulted in several conclusions which are outlined below. The process culminated in a decision to pursue an affiliation with Highmark.

Process Drivers

- Environmental Drivers:
  - Changes in the national healthcare environment are driving consolidation in the industry, and technological improvements and capability gains are achieved with larger scale
  - BCBSD competitors are large, national conglomerates with significant resources
- Capability Gaps:
  - BCBSD, with the help of consultants, undertook a full strategic review process to understand capabilities required for BCBSD to remain competitive
  - Review process revealed that a new strategic direction was necessary in order for BCBSD to continue to be successful
- Experience:
  - Prior experience as an affiliate of CareFirst provided evidence of the benefits of an affiliation with larger Blue organization, and current market environment places significant stress on BCBSD as a small, independent plan

Process Conclusions

- BCBSD desires to remain a non-profit corporation
  - Believes social mission is of paramount importance
  - Higher certainty to closing transaction and greater protection of local assets
- The Company prefers to retain decision-making authority in Delaware, among its constituents
  - Strong branded identity is important to the Delaware insurance buying community
- BCBSD is focused on finding an "end game" solution
  - The Company does not want to pursue a forward-looking strategy that necessitates large-scale change a second time in the near-term (i.e., unwinding an affiliation or beginning another partner search process)
  - In the face of mounting mandatory regulatory change, BCBSD desires a partner with significant financial stability
- BCBSD has identified capability gaps that ultimately must be met in order to ensure future success. Providing for those needed capabilities was a strong determinant in the affiliation search process

Factors Favoring a Highmark Affiliation

- Strong growth and retail orientation
- Proven technology platform
- Successful transition and integration experience
- Reserves remain in Delaware
- Local board with independent community directors
  - CareFirst and WellPoint options would have essentially resulted in the loss of local Delaware autonomy and branded identity
- Potential for additional regional relationships (multiple affiliation model)
- Interim administrative services agreement / good contingency option
- Straightforward Affiliation Agreement documents
- Clear, Delaware-only regulatory approval path

Source: BCBSD Board documents.

(iii) Public Feedback on the Proposed Affiliation

Blackstone participated both in public information sessions and private diligence meetings in order to identify public and private concerns about the proposed Affiliation.

	General Characteristics	Session / Meeting Details
Public Info Sessions	▶ Sessions were open to the public ▶ Advertised 20 days in advance in Delaware-based *News Journal* and *The Delaware State News* ▶ The applicants prepared opening and closing remarks ▶ Members of the public submitted written comments and verbal remarks; all comments and remarks transcribed and publicly available ▶ The Applicants provided written responses to all questions submitted, per DOI instruction	▶ May 16: Georgetown, Delaware ▶ May 17: Dover, Delaware ▶ May 19: Wilmington, Delaware
Private Diligence Meetings with Market Participants	▶ Blackstone, as well as the DOI and consultants to the Department of Justice, participated ▶ 30-60 minute telephonic discussions or in-person meetings ▶ Blackstone, generally, made the following inquiries • Market participant's view of BCBSD's current capabilities as a health insurance provider versus the capabilities of its competitors within Delaware • Whether having a sizeable non-profit provider of health insurance in the Delaware community is important to the market participant • Whether the market participant's organization has had any prior dealings with Highmark • The importance of BCBSD remaining locally managed • Whether the market participant's organization has any concerns about the potential impact on competition in the Delaware health insurance market resulting from the proposed Affiliation	▶ 14 total participants participated • 6 hospital providers • 2 physician providers • 1 homecare provider • 2 businesses in the Delaware community • 1 insurance broker • 2 consumers

(iii) Public Feedback on the Affiliation (cont'd)

Blackstone has focused on the following concerns voiced by members of the public during information sessions held in Delaware by the DOI.

Concern	Stakeholder(s) Concerned	Highmark / BCBSD Response	Blackstone Comments
Loss of local control / autonomy	Consumer	▶ Highmark has an established track record of working with companies (most recently MSBCBS in W.V.) in order to maintain a strong local presence and provide better service to the local community	▶ BCBSD President retains operational flexibility and a majority of the Board of Directors must be Delawareans (as currently planned, this means that the post-Affiliation Board of Directors must have 5 seats occupied by Delawareans)
Rate increases and requirement to "re-apply" for benefits to affiliated company	Consumer	▶ Customer premiums will continue to be developed based upon Delaware laws and regulations and there are no plans to institute coverage changes to any current customers that could result in the need to re-apply for other plans	▶ Highmark has stated that re-application will not be necessary
Possible pecuniary incentives for the board of BCBSD to go through with the Affiliation	Consumer	▶ Neither BCBSD Board members nor executives have any pecuniary incentives tied to the approval of the Affiliation	▶ Blackstone reviewed the Affiliation Agreement and notes the Affiliation does not confer any pecuniary incentives on the BCBSD Board or executives
Changes to current business model	Physician	▶ N/A	▶ BCBSD appears at a technological disadvantage to larger peers and the Company is attempting to pursue a viable forward strategy
Loss of jobs	Delaware resident	▶ Highmark has stated that it will not proportionally eliminate any more jobs in Delaware than at its other locations	▶ Highmark has stated its intention to maintain total full-time employment levels consistent with pre-Affiliation levels
Affiliation may cause the un-insured rate to increase	Physician	▶ The Applicants cannot control the un-insured rate, but the Affiliation will enable BCBSD to be more efficient, which may help improve affordability	▶ Pro forma premiums under the Affiliation case are 3% lower than premiums under the standalone case
Right to lower health insurance rates if Affiliation goes through	Physician provider/ Consumer	▶ N/A	▶ Pro forma premiums under the Affiliation case are 3% lower than premiums under the standalone case
Affiliation's possible negative impact on mental health benefits	Physician provider	▶ Should not have any effect on mental health benefits	▶ The Applicants have no plans to change mental health benefits in Delaware as a result of the Affiliation

Source: Highmark and BCBSD responses to hearings held on May 16, 17 and 19 in Delaware released on June 24 and 27.

(iii) Public Feedback on the Affiliation (cont'd)

Concern	Stakeholder(s) Concerned	Highmark / BCBSD Response	Blackstone Comments
Necessity of Affiliation given BCBSD's large reserves	Consumer	▸ Though BCSBD does have large reserves that make it a "financially sound" company today, it must look to the future to maintain itself. Given the shifting environment in the Healthcare industry in terms of increased regulations as well as rising medical care costs, small Health Insurance firms like BCBSD are at risk and the current competition that BCBSD faces in Delaware makes the need for a larger partner strong. BCBSD's next smallest competitor is over 12 times BCBSD's size. During the recession, BCBSD's reserves fell by 30% making it that much more imperative that BCBSD find a partner who can make BCBSD financially stable in the future	▸ Although BCBSD currently has the financial resources to obtain IT upgrades without the Affiliation, the IT upgrades can likely be obtained at lower cost in connection with the Affiliation, thereby preserving the Company's claims-paying ability and resources for future corporate initiatives ▸ In addition to IT upgrades, BCBSD will also receive non-system related corporate and strategic services from Highmark of the type that are generally not available among unrelated parties ▸ Maintenance of strong reserves will help BCBSD retain flexibility with regard to potential future strategic alternatives
Lack of consideration for alternative solutions to BCBSD's problems	Consumer	▸ BCBSD conducted an extensive four-year corporate strategic planning process and searched for many alternatives with the help of consultants	▸ BCBSD undertook a lengthy, thorough strategic planning process
Lack of oversight to hold both BCBSD and Highmark accountable to promises made in order to get the Affiliation approved	Physician	▸ BCBSD will operate as a separate legal entity headquartered in Delaware and will remain under the regulatory oversight of the Delaware Department of Insurance	▸ Under Chapters 3, 50 and 63 of Title 18, the Delaware Insurance Code, and regulations promulgated thereunder, the DOI has continuing regulatory authority over BCBSD post-affiliation to ensure that the Applicants remain accountable to commitments made and any conditions imposed during the review of the proposed Affiliation
The Affiliation will have an anti-competitive effect in the Delaware health insurance market	Competitor	▸ Highmark is not currently a significant competitor in the Delaware health insurance market ▸ The Affiliation will help to ensure BCBSD's continued viability as the only significant non-profit carrier in the Delaware market	▸ The evidence discussed in Standard "b" of this report does not lead to the conclusion that the Affiliation will result in a lessening of competition in the Delaware market
BCBSD will have the ability to engage in predatory pricing practices due to having increased financial resources as a result of the Affiliation	Competitor	▸ BCBSD's ability to take aggressive pricing actions are impeded by regulatory oversight on price increases and federally mandated minimum MLR ratios[(1)]	▸ BCBSD's primary competitors have financial resources that are generally comparable to, if not greater than, Highmark ▸ Recent federal regulations concerning MLR and rate increases will constrain BCBSD's ability to engage in predatory pricing

Source: Highmark and BCBSD responses to hearings held on May 16, 17 and 19 in Delaware released on June 24 and 27.
(1) BCBSD management statement on 8/30/2009.

(iii) Public Feedback on the Affiliation (cont'd)

Blackstone conducted private interviews with market participants in an effort to reach a broader spectrum of Delaware-based interested parties beyond those who attended the public sessions.

Concern	Stakeholder(s) Concerned	Blackstone Comments
Loss of local control	Hospitals, Non-physician provider, Self-insured consumer, Broker, Homecare provider, Physician provider	▶ BCBSD's president will retain operational flexibility, and the Board of Directors must have at least a majority of seats occupied by Delawareans
Protection of BCBSD's reserves	Hospital, Community / business	▶ The Affiliation does not provide Highmark with the means to access or control BCBSD's reserves ▶ Statutory protections require Department of Insurance approval for any reserve transfers from BCBSD to Highmark greater than \$500k and review of administrative charges, 18 *Del. C.* §6311.
No strong history with Highmark	Hospital	▶ Many industry participants have spoken positively of interaction with Highmark
Change in ease of communication with BCBSD	Hospital	▶ BCBSD is clearly a customer service market leader, and both BCBSD and Highmark have stated a commitment to maintaining to this standard of service
Increase in prices	Community / business, Homecare provider	▶ Blackstone has reviewed pro forma projections and Affiliation case premium rates are 3% lower than projected rates in BCBSD's standalone case
Loss of jobs	Community / business	▶ Highmark has made various job-related commitments, see p. 72.
Loss of accessibility	Consumer	▶ Highmark has stated its commitment to maintaining BCBSD's "local touch" with clients, and the West Virginia experience appears consistent with Highmark's commitment to that end
Change in compensation arrangements	Broker	▶ Both BCBSD and Highmark have stated there are no pending changes to compensation arrangements
Highmark's ability to influence public policy	Hospital	▶ Highmark has a strong presence in Pennsylvania and may be capable of exerting some pressure on PA governing / regulatory authorities
Dynamics of Pittsburgh's "competitive insurance market" will be forced on Delaware, causing the diversion of funds away from patients	Hospital	▶ Depending on Highmark's future business plans, this may be a concern for BCBSD. However, the retention of operational flexibility by BCBSD president after any affiliation is as a mitigating factor
Potential consolidation of local providers	Homecare provider	▶ Highmark has given no indication that such an outcome will result from the Affiliation. This concern would remain subject to changes in Highmark's ongoing business plan

Source: Highmark and BCBSD responses to hearings held on May 16, 17 and 19 in Delaware released on June 24 and 27.

Standard "f": Conclusion

Blackstone believes the proposed Affiliation would not violate standard "f".

Standard "f" : The affiliation is likely to be hazardous or prejudicial to the insurance buying public

Standard "f" Summary Conclusions:

- BCBSD maintains a leading position in the Delaware health insurance market and offers a unique presence as the only locally-controlled, non-profit health insurance carrier in Delaware
- The Board's determination that BCBSD's strategic position was jeopardized subsequent to the CareFirst disaffiliation was reasonable, given industry trends that included consolidation among competitors, cost pressure from providers, increasing needs for significant IT investments and the increasing scope and uncertainty of federal and state health care regulations
- The Board's review of strategic alternatives and search for a partner was reasonable
- The primary concern of BCBSD's customers and the general insurance buying public related to BCBSD's maintenance of a strong local presence and decision-making ability in key market-facing functions
- Given the Company's current strategic position and options available to remain a viable health insurance carrier as identified during the Board's strategic review process, the Board's opinion that an affiliation with Highmark will balance the Company's achievement of long-term strategic goals with the Company's ability to maintain a local presence and fulfill its social mission is reasonable
- **Based on the above analysis, conditions regarding preserving BCBSD's local presence and autonomy would be appropriate to bring the affiliation into compliance with the statutory criteria. The specifics of those conditions are within the purview of the Department of Insurance. Based on Blackstone's analysis and the above conditions, Blackstone believes that the Affiliation is not likely to be hazardous or prejudicial to the insurance buying public of Delaware**