INSURANCE
Antitrust Alert

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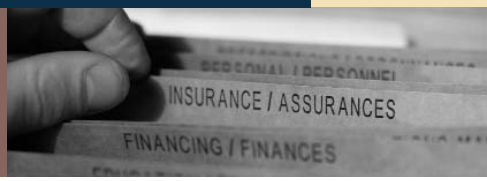

Pennsylvania Health Insurance Merger Faces Further Scrutiny

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On July 31, the Senate Judiciary Committee's Subcommittee on Antitrust, Competition Policy and Consumer Rights held a hearing to consider the proposed merger of Independence Blue Cross and Highmark Blue Shield, Pennsylvania's two largest health insurers. The transaction was announced over a year ago, but has been mired in regulatory review since that time while the Pennsylvania Insurance Department determines whether to approve the deal. The transaction would create one of the largest health insurers in the country (based on total premiums), but has already been approved by the DOJ Antitrust Division, principally because the insurers are not viewed as direct competitors (Independence operates predominantly in the Philadelphia area while Highmark is based in Pittsburgh). Now, with the parties still awaiting approval from the Pennsylvania Insurance Department, additional questions about the deal are being raised by, among others, Pennsylvania Senator and Senate Judiciary Committee member Arlen Spector.

Specifically, at the July 31 hearing, Senator Spector challenged the insurers' chief executive officers, Joseph Frick and Dr. Kenneth Melani, to provide further details on the efficiencies the parties claim would be achieved by the deal. In response, Melani stated that the largest insurers in the country have many millions more subscribers than do Independence and Highmark, separately or combined, and consequently those insurers can better spread their operating costs over more members. Melani also maintained that these larger insurers can leverage their large subscriber base to obtain better pricing from national suppliers of laboratory services, durable medical equipment, radiology services and pharmaceuticals, which neither Independence nor Highmark can currently do to any great degree. Accordingly, Melani asserted, the transaction would permit the parties to achieve these savings, which the parties value at approximately $1 billion over six years. Moreover, both executives noted that the insurers have committed to direct $650 million of this anticipated savings to expand health coverage for the uninsured in Pennsylvania.

The American Medical Association has opposed the transaction since its announcement, and took a leading role at the hearing in denouncing it. After first criticizing the Antitrust Division generally for challenging

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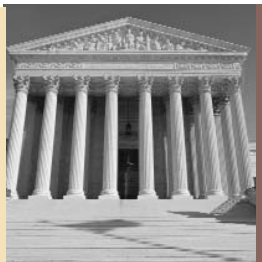

only three of the more than 400 mergers involving health insurers and managed care companies over the last twelve years, the AMA turned its attention to the merits of the specific transaction under review. The AMA asserted that the transaction would create a "merger to monopoly," and that national insurers have been largely incapable of penetrating the Pennsylvania market, despite significant market gains in many other regions of the country. Accordingly, the AMA told the subcommittee that the Antitrust Division's clearance of the deal "greatly concerns" the AMA, and called upon the subcommittee to urge DOJ to reconsider its position on the deal.

Given that the DOJ Antitrust Division has twice reviewed and cleared the deal (the initial approval lapsed after twelve months), a change in position by the DOJ is unlikely. However, all of the parties, both for and against the transaction, continue anxiously to await a ruling by the Pennsylvania Department of Insurance on the deal, and should the Department approve the deal, a court challenge to the decision similar to the challenge raised earlier this year in the United/Sierra merger, is certainly possible.

New York Insurance Department Holds Hearings on Broker Compensation

During July, the New York Insurance Department, in conjunction with the New York Attorney General's Office, held a series of public hearings to consider compensation arrangements for brokers and agents. The hearings addressed contingent and supplemental commissions, producer compensation disclosures, and deceptive and anti-competitive practices, and were designed to provide Insurance Superintendent Eric Dinallo and Attorney General Andrew Cuomo with additional information as they contemplate issuing new regulations on these subjects.

Specifically, the hearings were held so that the Insurance Department could assess how the insurance markets in New York have responded to the New York Attorney General's 2004 "contingent commission" investigation, and to determine whether the restrictions on contingent commissions imposed on the largest insurance brokers as a condition of settling all claims against them in the investigation should be extended to all brokers and agents.

While virtually all of those testifying at the hearings endorsed the need for greater transparency in the disclosure of broker and agent commissions, the views on contingent commissions were markedly different. For example, Willis Group, which was one of the brokers that agreed to eliminate contingent commissions as a condition of its settlement of the State's investigation (along with Marsh and Aon), urged regulators to extend the bar to all brokers. Don Bailey, CEO of Willis North America, stated that "the practice of contingent commission payments is fundamentally at odds with the best interests of clients," and that "former Attorney General Spitzer missed a great opportunity to do the right thing by banning all brokers from accepting contingents. The result is the largest brokers now work within new boundaries, but the rest of the industry does not work within these same boundaries." Similarly, Janice Ochenkowski, president of the Risk and Insurance Management Society (RIMS), testified that "it is an inherent conflict of interest for brokers and independent agents to accept contingent fees in transactions which are make on behalf of the buyer."

However, Peter Resnick, president of the Council of Insurance Brokers of Greater New York, aggressively staked out the opposite view, stating, "It is ironic that some of the selfsame mega-brokers that were forced to sign settlement agreements to avoid prosecution for their criminal acts, have now testified at these very public hearings that the sanctions they agreed to should now be applied to all insurance pro-

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ducers. It is laughable when a mega-broker such as the Willis Group says that the insurance brokerage field is not level; if it now operates at a competitive disadvantage, it is solely due to its own misdeeds." Similarly, Gary Ricker Jr., president of the Professional Insurance Wholesalers Association, another association of smaller entities, maintained that contingent commissions do not create irreconcilable conflicts of interests and that instead "the problem was that large brokers used their economic leverage to obtain the best deal for themselves, not necessarily their clients. Contingent commissions provide opportunities for brokers to share in the success of placements and should not be discouraged."

Given the strongly-held and diametrically opposed views of those testifying at the hearings, it is impossible to predict what direction the Superintendent of Insurance is likely to take on this issue. A decision will likely be announced later this year.

House Financial Services Subcommittee Takes Favorable Action on Legislation that would Create Federal Office of Insurance Information

On July 9, the House Financial Service Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises acted favorably on H.R. 5840, "The Insurance Information Act of 2008," approving the legislation by a voice vote and sending it on to the full House Financial Services Committee for further action. The legislation creates an "Office of Insurance Information" in the Department of Treasury, which would collect and analyze insurance data and act as a liaison between state insurance regulators and the federal government. The legislation is also viewed by many as an "intermediate step" towards the creation of a National Insurance Office.

Notably, the Subcommittee's action came one day after the National Association of Insurance Commissioners apprised the Subcommittee of its conditional support for the legislation. In a July 8 letter to the Subcommittee, NAIC President Sandy Praeger stated that amendments to the legislation making clear that the Office of Insurance Information would not have regulatory authority over the "business of insurance" or any insurer (thus reserving that role to the states) helped sway the NAIC towards a more favorable view of the legislation. However, the NAIC advised the Subcommittee that if it views H.R. 5840 as the first step to an Optional Federal Charter for insurance, it will face strong opposition from the NAIC. Taking on the issue head-on, Praeger stated that "every Insurance Commissioner strongly believes that an OFC is the worst possible public policy choice for insurance" and that "The NAIC unequivocally opposes any attempts to use this bill as a vehicle for such a misguided policy." The legislation now moves forward to the House Financial Services Committee for further action.

UK Insurance Buyer Trade Association Supports Insurers' Block Exemption

In Europe, insurers currently enjoy a partial exemption from the antitrust laws pursuant to a "Block Exemption" that has been in effect for many years. The exemption operates in much the same way that the McCarran-Ferguson Act exemption operates in the United States but, like the McCarran-Ferguson Act in the United States, the European Block Exemption is also under attack. In fact, the Block Exemption is scheduled to sunset in 2010 if not renewed. Accordingly, the EC's Directorate General for Competition has

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solicited industry comments regarding the advisability of renewing the exemption.

Not surprisingly, insurer trade associations, including the International Underwriting Association and the Lloyd's Market Association, have announced their support for the exemption. Specifically, these associations have asserted that the exemption provides significant benefits by, among other things, permitting standard policy wordings and increasing insurer efficiency. However, support for the Block Exemption has recently come from a somewhat unexpected source – the Association of Insurance Risk Managers. Strongly advocating the renewal of the exemption, this insurance buyer association maintained that "the block exemption encourages competition by making it easier for new players to enter the market," which "acts in the interests of commercial insurance buyers, who would otherwise have less choice."

The EC's Directorate General for Competition will now take these comments, and the others it has received, and prepare a report and recommendation for the European Council of Ministers no later than March of 2009. How it will come out is currently uncertain so, at least for now, the future of the Block Exemption remains very much in doubt.

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