PRICEWATERHOUSECOOPERS

Executive Compensation Review: *Corrections and Clarifications to Exhibits S-27, S-28, and S-29*

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March 2004

Summary of Corrections and Clarifications

- Clarifications to S-27 -

- Page 4, Line 9.
  - $2.3 billion and 1.4 million members
- Page 6, Line 4
  - Premera has not disclosed the following information:
- Page 7, Line 5.
  - TDC provided to Premera's Top Five is above market practice approximating the 75th percentile
  - TDC provided to Premera's SVPs is between the median and 75th percentile
- Page 8, Line 2.
  - In aggregate, company-wide and officer voluntary turnover rates at Premera over the period 1999-2001 have been significantly lower than industry rates.

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Summary of Corrections and Clarifications

- Correction to S-27 -

⌖ Page 12.

Component	Below Market	At Market	Exceeds Market	Key Findings
Change in Control (CiC) Policy			✓*	▪ The level of CiC protection provided to the CEO, EVPs and SVPs within Premera's CiC policy is quite comparable, and, in some instances, better than that provided by publicly-held organizations and more competitive than practices found in not-for-profit organizations. The following policy provisions are above practices typically found at publicly-held organizations: ▪ The CEO, CFO and EVPs can terminate employment for any reason during a 30-day window period following the 1 year anniversary of a CiC event and collect 50% of the original CiC benefit. ▪ Payment of a prorated amount of a covered executive's annual and long-term incentive opportunity is protected in the event of a CiC. ▪ DB SERP benefits are enhanced in two ways: (i) additional years of service credit (equal to the Benefits Continuation Period) and (ii) Final Compensation, for purposes of determining the value of DB SERP benefits, **considers** severance benefits payable.
			✓*	▪ Estimated CiC benefits payable to the Top Five and SVPs upon a CiC are approximately $[ ] respectively.

*Reflects overall assessment of market position.

Proprietary Material Redacted

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Summary of Corrections and Clarifications

- Clarification/Correction to S-27 -

- Page 13 (Executive Benefits only).

Component	Below Market	At Market	Exceeds Market	Key Findings
Executive Benefits			✓	▪ The total number of supplemental retirement plans is above market practice.
Supplemental Retirement Plans				▪ Deferred Compensation: Matching contributions of 40% on mandatory incentive deferrals are above market practice. ▪ Defined Contribution SERP (DC SERP): The level of company contributions and the fact that these contributions are 100% vested at all times are above market practice. ▪ Defined Benefit SERP (DB SERP): Key plan provisions are in line with market practices and offset by the qualified pension plan **(i.e., PEP)** benefits only. There are no offsets for nonqualified company contributions (e.g., DC SERP and deferred compensation).
Annualized Benefit Value		✓		▪ Collectively, the value of supplemental retirement plans provide the CEO, EVPs and SVPs with an additional annualized benefit equal to approximately [**Proprietary Material Redacted**] (avg.) of base salary, respectively.
Perquisites		✓		▪ Perquisites are in line with competitive practices.

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Summary of Corrections and Clarifications

- Clarification to S-27 -

- Page 15 (Voluntary Turnover Rates only).

Component	Below Market	At Market	Exceeds Market	Key Findings
Voluntary Turnover Rates				
- Company-Wide			✓	• Company-wide turnover rates from 1999-2001 are lower than industry rates.
- Officer			✓	• Management turnover rates from 2000-2002 are lower than industry rates.

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Summary of Corrections and Clarifications

- Correction to S-27 -

- Page 36 (Summary table only)

Performance Measures	Weighting	Premera	
	Long-Term	%ile Rank	Relative Performance
Avg. Annual Net Written Premium Growth	40%	89%	36%
Cumulative Operating Income	30%	55%	16%
Avg. Annual Operating **Margin**	30%	8%	2%
Total:	***100%***		***54%***

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Summary of Corrections and Clarifications

- Clarification to S-27 -

- Page 42, Line 2.

  - Voluntary Turnover Rates -

  - Premera's company-wide and officer turnover rates (defined as voluntary separations) have been lower than the industry averages.

	Premera	Market Rates (Average)
Company-Wide Turnover Rate	Average 1999-2001: [ ]%* **Proprietary Material Redacted**	Direct Life, Health, and Medical Insurance Carriers (NAICS: 52411): 14.1%
Officer Turnover Rate	Average 2000-2002: [ ]%** **Proprietary Material Redacted**	Direct Life, Health, and Medical Insurance Carriers (NAICS: 52411): 7.7%

*As reported in the Incentive Plans Report to Premera's Governan ce Committee dated February 12, 2002.

** As provided in E594, Bates Stamp # 0038684

Market Data Source: Saratoga Institute

Company-wide separation: The average voluntary separation rates for 1999, 2000, and 2001 are 13.4%, 17.0% and 11.8%, respectively.

Officer (vice-presidents and above) separation: The average separation rates for 2000, 2001, and 2002 are 10.9%, 6.7% and 5.4%, respectively.

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Summary of Corrections and Clarifications

- Clarification to S-27 -

- Page 56, Line 4.
  - Matched jobs based on title, description and reporting relationship. For the Top Five executive officers, we relied on job title, organization chart (as provided in WA #103), and executive contracts (as provided in WA #109).
- Page 58, Line 12.
  - Long Term Incentives - Competitive LTI percentages (consisting of stock options, restricted stock, and cash-based performance plans) were applied to the competitive median and 75th percentile base salary levels. These LTI percentages were adjusted using a discount rate of 40 percent to reflect Premera's private company status for the pre-conversion analyses only.

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Summary of Corrections and Clarifications

- Correction to S-27 -

- Page 104

CIC Provision	Premera	Leading Practices	Conclusions
CIC Period	[redacted] **Proprietary Material Redacted**	• 49 percent of companies with a CIC policy provide a protection period equal to 2 years following a CIC • Some companies, however, link CIC triggers to shareholder approval as opposed to consummation of a transaction. Hence, executives can collect severance benefits if employment is terminated after shareholder approval but before consummation. Approximately 40 percent of companies with a CIC policy link the CIC trigger to shareholder approval. Of those companies, the prevalence varies by transaction: ◆ 39 percent start the CIC period upon shareholder approval of a merger, consolidation, or reorganization. ◆ 43 percent start the CIC period upon shareholder approval of <u>a sale.</u> ◆ 68 percent start the CIC period upon shareholder approval of <u>a liquidation or dissolution.</u>	• The total period in which executive are protected from a CIC is more generous than leading practices • The protection period provided to Premera executives prior to the consummation of a transaction is more generous than leading practices

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Summary of Corrections and Clarifications

- Correction to S-27 -

- Page 107 (DB SERP only).

CIC Provisions	Premera	Leading Practices	Conclusions
Defined Benefit SERP (DB SERP)	[**Proprietary Material Redacted**]	• 26 percent provide pension enhancements as part of their CIC policy • 89 percent of the pension enhancements is in the form of additional age/service credit equal to the severance period (may also include accelerated vesting)	• The protection provided to pension benefits under the CiC policy is more generous than leading practices • The enhanced service credit equal to the benefits continuation period is consistent with leading practices. • <u>Considering severance benefits payable in defining Final Compensation is above market practices.</u>

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Summary of Corrections and Clarifications

- Correction to S-27 -

- Page 110

Benefit	Premera	Market Practice
Defined Benefit SERP	**Proprietary Material Redacted**	39% of organizations have a non-qualified retirement program Eligible Compensation: 72% of organizations include deferred compensation and 74% include bonuses as eligible compensation Final Compensation: For benefit determination, the most prevalent practices include final five-year period and final three-year period. Formula: The targeted income replacement ratio ranges between 50%-60% (avg. equals 54%) Vesting: Of those with a service requirement, both 1-5 and 6-10 years are prevalent (25% and 24%, respectively). Offsets: 85% of companies offset the target income replacement ratio by other benefits such as qualified plans, Social Security, company match to 401(k), company contributions to other nonqualified plans or former employer qualified plans.

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Summary of Corrections and Clarifications

- Clarifications to S-28 -

- Page 1.

- General Conclusions -

- Premera's total share reserve (7% of total outstanding shares or "TSO") approximates the median of market practice.
  - The total initial stock option grant to employees, management and outside directors of 3.2% of total shares outstanding falls between the 25th percentile and median of competitive practice.
    - The initial equity grant to the Top Five officers of .6% falls between the 25th percentile and median of competitive practice.
  - Premera proposes a reserve pool of 1.46% of TSO for the initial two year period following the conversion. However, the company cannot grant more than 1.1% of TSO from its reserve pool during the initial year if it wishes to remain within the maximum percent allowable under Form A.
  - The median share usage reported by the Compensation Peer Group ranges from 1.8% (1-year) and 3.2% (3-year average) of total shares outstanding. Following the first two years of an IPO, we would expect share usage to fall within this range. The OIC should inquire as to Premera's planned share usage practices following the IPO date.
- The Form A requires management and outside directors to wait 3 months following the conversion to receive stock options. The OIC should extend this restriction period to a minimum of 6 months to 1 year following the conversion in order to be consistent with competitive practices. We also suggest that during the restriction period, management and outside directors are precluded from receiving other types of equity awards (e.g., restricted stock, performance shares).

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Summary of Corrections and Clarifications

- Clarifications to S-28 -

- Page 12.
- Premera's proposed Stock Ownership Plan expressly prohibits grants of stock to any employee, officer or outside director during the initial 12 months following the conversion, but it does retain discretion to make grants of stock options during that same period. Management and outside directors are subject to a 3-month restriction period before they can receive a stock option grant.
- Summary of competitive findings:
  - Five of the fourteen companies either did not disclose or were silent regarding restrictions on equity ownership. Of the nine that have disclosed restrictive guidelines,
    - The majority of the guidelines were self-imposed or negotiated by management. Two of the companies indicated that equity grants were restricted by state statute.
    - Virtually all of the restrictive guidelines prevent executives and outside directors from:
      - Receiving stock-based grants (e.g., restricted stock, stock options) during the restriction period
      - Purchasing the company's common stock during the restriction period (which, presumably, would include the exercise of a stock option)
    - <u>Executive and outside directors are restricted from receiving any stock-based grants for a period of 6 months to 1 year following the IPO date.</u>
    - <u>Executive and outside directors are restricted from purchasing stock for a period of 6 months to 2 years following the IPO date.</u>
    - One company conditioned the extent of the restriction (i.e., how long, type of transaction) on the class of employee; less restrictive for non-officers or non-directors.

Note: These type of restrictions differ from "lock-up" agreements, which are a legally binding contracts between the underwriters and insiders of the company undergoing an initial public offering (IPO). These agreements prevent insiders from selling any shares of stock for a specified period of time.

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Summary of Corrections and Clarifications

- Correction/Clarification to S-29 -

- Page 5 (Issues No. 6 and No. 8 only)

Issue No.	Issue	Premera's Response	Status
6)Defined Contribution (DC SERP) and Defined Benefit SERP (DB SERP) Programs	▪ Executives participate in a number of different nonqualified executive retirement **and deferred compensation** plans. **Only the DB SERP benefit is subject to an offset for benefits accrued under the Pension Equity Plan.** ▪ Market practice is to provide benefit offsets on company contributions to participants from other qualified, non-qualified or statutory plans, **as well as social security**.	▪ Clarifications provided in the October 16 facsimile from Premera (i.e., labeled Exhibit 4).	▪ *Potential Mitigating Action(s):* **Establish a maximum retirement benefit limit per participant on the aggregate benefit received from all qualified and non-qualified plans (excluding employee contributions and deferrals).**
8)Change in Control: Enhanced DB SERP	▪In the event of a change in control, **Final Compensation considers the value of severance benefits payable in determining the enhanced DB SERP benefit.**	▪Clarifications provided in the October 16 facsimile from Premera (Exhibit 4).	▪*Potential Mitigating Action(s):* **Limit future base salary growth for covered officers to dampen above market benefit triggered by a change in control (or amend the change in control policy).**

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