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April 30, 2014

Mr. Alfred Gobeille, Chair
Green Mountain Care Board
89 Main Street, Third Floor, City Center
Montpelier, Vermont 05620

**Re: Solvency Impact of "Q4 2014 – Q3 2015 TVHP Admin Filing (SERFF # BCVT – 129486804)" of The Vermont Health Plan, LLC**

Dear Mr. Gobeille:

This letter is to fulfill the Department of Financial Regulation's ("DFR") responsibility under 8 V.S.A. § 4062(a)(2)(B) regarding The Vermont Health Plan, LLC ("TVHP") and its recent "Q4 2014 – Q3 2015 TVHP Admin Filing". Under 8 V.S.A. § 4062, DFR must provide to the Green Mountain Care Board ("GMCB") an analysis and opinion on the impact of the filing as proposed on the solvency of TVHP. TVHP is a wholly owned subsidiary of Blue Cross and Blue Shield of Vermont Inc. ("BCBSVT"). TVHP and BCBSVT are two insurers within an Insurance Holding Company System as defined by 8 V.S.A. § 3681(4). Under these circumstances, the solvency analysis of TVHP and BCBSVT concentrates on the financial position of the parent, BCBSVT. This opinion focuses on a discussion of BCBSVT and all references to the financial position, surplus, or solvency of BCBSVT are applicable to TVHP. The solvency of BCBSVT and how a particular filing or rate may affect that solvency are two separate questions. This letter first analyzes and provides DFR's opinion on the solvency of BCBSVT, the company. It then provides DFR's opinion and recommendation on the impact the filing could have on the solvency of BCBSVT.

## <u>Summary of Opinion</u>

DFR is of the opinion that the filing as proposed will sustain the current level of solvency, which DFR has determined to be appropriate and necessary. Additionally, the filing's proposed contribution to surplus would support the maintenance of surplus targets for BCBSVT within the range that DFR deems reasonable and necessary for the protection of policyholders. Downward adjustments to either the contribution to surplus or the administrative charges should not be made unless GMCB's consulting actuary has expressly opined that the administrative charges are excessive as filed and has therefore proposed adjustments.

## Background

Vermont law requires DFR to protect consumers by supervising insurance companies in a manner that assures the solvency, liquidity, stability, and efficiency of all such companies.[1] DFR has a specific responsibility with respect to BCBSVT, which was created under a unique statute and is subject to vigilant regulation by DFR.[2] DFR is the primary, and in most instances the sole regulator of BCBSVT and TVHP, which together insure more Vermonters than any other health insurance company. DFR monitors the solvency of BCBSVT and TVHP in many ways, including analyzing quarterly financial statements, performing rigorous risk based financial examinations, reviewing significant transactions, and monitoring corporate governance policy.

## Analysis of Solvency

DFR considers the solvency of insurers to be the most fundamental aspect of consumer protection. Whether an insurer is solvent is more complex than simply determining whether at any given moment the insurer has more assets than liabilities. Rather, it is an intricate analysis of many factors to discern how close or far away from insolvency the insurer is, and in what direction it is likely to move in the future.

The primary factor in an insurer's ability to maintain adequate solvency is whether the insurer consistently charges adequate premium rates. DFR considers a rate to be adequate if it is sufficient to cover expected claims, expenses, and to contribute to the insurer's surplus when appropriate. Over the long term, charging premium rates that are inadequate can result in a material and direct threat to the solvency of the insurer.

Rates are developed by predicting future behavior and future claims. Therefore, it is impossible to predict with certainty the "correct" rate to charge in a given year that will be both adequate and not excessive. Charging a higher or lower rate merely makes it more or less likely that the rate will be adequate. To protect against rates that turn out to be inadequate, whether due to unexpectedly high claims or some other factor, an insurer generally maintains a surplus. An insurer's surplus is the amount of assets remaining after accounting for all liabilities it must (or may have to) pay out. A sufficient level of surplus is a crucial piece of preserving an insurer's solvency.

The level of surplus considered to be adequate is necessarily different for every insurer, since it depends heavily on both the volume and type of the insurance business conducted, as well as the quality and nature of the insurer's underlying assets and the environment in which the insurer operates. DFR uses a number of tools to assess the adequacy of an insurer's surplus, including periodic financial examinations, review of corporate governance, and analyses of such areas as risk-based capital, claims reserve development, and risk mitigation strategies. The assessment of surplus, and whether that surplus is sufficient, is a dynamic prospective assessment.

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[1] 8 V.S.A. § 10.
[2] 8 V.S.A. Chapters 123, 125.

**Analysis of Threats to Solvency**

The sufficiency of an insurer's surplus and its solvency generally is very sensitive to changes in circumstances and events. Some events that could place a health insurer's surplus and solvency at risk are:

- Adverse medical cost trends: If the actual cost of medical services grows at a faster rate than anticipated by the insurer, the insurer's surplus may decrease as it is used to cover this shortfall.
- Adverse utilization: If consumers use more services than anticipated by the insurer, including because of a catastrophic event such as a pandemic flu, the insurer's surplus may decrease as it is used to cover this shortfall.
- Premium inadequacy: In addition to adverse utilization, various other factors can lead to claims and expenses exceeding premiums, including rate caps, disapproval by regulators of necessary rate increases, or administrative costs exceeding the insurer's projections. If claims and expenses exceed premiums, the insurer's surplus may be used to cover this shortfall.
- Membership growth: The sufficiency of an insurer's surplus is relative to the size of the population covered by the insurer. Thus, if an insurer doubles the number of people it covers, its existing surplus would only provide half of the protection against insolvency it previously did.

In Vermont's health insurance market, these risks are compounded because it takes up to two years from the time it is evident that a rate adjustment is necessary to the time those adjusted rates are approved and implemented. Each of these events can decrease an insurer's surplus. To ensure a sufficient level of surplus is maintained despite these threats, it is often appropriate for a premium rate to include a contribution to surplus.

**BCBSVT Solvency Opinion**

DFR has and will continue to monitor BCBSVT's surplus and its solvency, as well as potential threats to surplus and solvency, using all available tools. DFR believes that the range of surplus targeted by BCBSVT is reasonable and necessary for the protection of policyholders. While BCBSVT's current surplus is sufficient and does not justify a heightened level of regulatory concern, BCBSVT is currently below the mid-point of the range determined to be necessary. There is a significant risk that the sufficiency of BCBSVT's surplus erodes due to continued medical trend growth and membership growth unless applicable rates are adequate and set at a level that maintains adequate surplus to keep pace with those trends.

**Impact of the Filing on Solvency**

This filing for Q4 2014 – Q3 2015 TVHP Admin Filing represents administrative charges to be used in developing rates for large groups. Unless GMCB's consulting actuary explicitly opines that this filing will produce rates that are inadequate or excessive, DFR's opinion is that these administrative charges as filed likely will have the impact of sustaining the current level of solvency, which DFR has determined to be appropriate and necessary. Further, DFR is of the opinion that downward adjustments to these administrative charges should not be made unless absolutely necessary to prevent the resulting rate from being excessive (i.e., only if GMCB's consulting actuary has expressly opined that the filing will produce rates that are excessive and has therefore proposed adjustments).

Because of the many threats to solvency, the strength of a company's surplus may erode even when its rates are adequate. Consequently, analysis of a contribution to surplus is equally as important as rate analysis when determining solvency. BCBSVT's current surplus level is appropriate and necessary. This filing includes a contribution of 2% of premium to BCBSVT's surplus. DFR has reviewed and analyzed the filing's proposed contribution to surplus, and is of the opinion that it would support and maintain the surplus targets of BCBSVT within the range that DFR deems reasonable and necessary for the protection of policyholders. If GMCB reduces the proposed contribution to surplus, the reduction will contribute to an erosion of the sufficiency of BCBSVT's surplus, which could threaten BCBSVT's solvency.

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Please do not hesitate to contact me if you have any questions.

Sincerely,

/s/ Susan L. Donegan

Susan L. Donegan
Commissioner, Department of Financial Regulation