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April 26, 2017

Mrs. Susan Barrett, J.D.
Green Mountain Care Board
89 Main Street, Third Floor, City Center
Montpelier, Vermont 05620

Re: Solvency Impact of "3Q 2017 Large Group Rating Program Filing (SERFF # BCVT-130935776)" of The Vermont Health Plan, LLC

Dear Mrs. Barrett:

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 **3Q 2017 Large Group Rating Program 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. Below is a brief analysis and DFR's opinion regarding the solvency of BCBSVT, the company, followed by analysis and opinion regarding the impact this filing could have on the solvency of BCBSVT.

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 and BCBSVT is within the range determined to be necessary. There is a significant risk that the sufficiency of BCBSVT's surplus erodes due to factors described below unless applicable rates are adequate and set at a level that maintains adequate surplus to keep pace with those trends.

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 special responsibility with respect to BCBSVT, which was created under a special statute and subject to careful regulation by DFR.[2] In addition, DFR is the primary regulator of Health Maintenance Organizations, including TVHP, as well as the holding company consisting of BCBSVT and TVHP. DFR monitors the solvency of BCBSVT 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. Determining an insurer's solvency is more complex than 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 will move in the future. DFR is uniquely capable of assessing an insurer's solvency.

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 assets that are too low and liabilities that are too high, which presents 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 analysis of such areas as risk-based capital, claims reserve development, and risk mitigation strategies. The assessment of surplus, and whether that surplus is adequate, is a dynamic prospective assessment.

[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 an 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 will decrease as it is used to cover this gap.
- 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 will decrease as it is used to cover this gap.
- Premium inadequacy: In addition to adverse utilization, various other factors can lead to claims and expenses exceeding premiums, including rate caps, explicit disapproval of required rate increases; or administrative costs exceeding the insurer's projections. If claims and expenses exceed premiums, the insurer's surplus will be used to cover this shortfall.
- Membership growth: The sufficiency of an insurer's surplus is relative to the population of insureds covered by the insurer. Thus, the more people the insurer covers the more surplus it needs to provide sufficient protection against insolvency.

The occurrence of any one of these events, even on a small scale, can have a very detrimental effect on an insurer's solvency. In Vermont's health insurance market, these risks are compounded because it takes up to two years from the time enough data becomes available to make sound predictions about the appropriate rate to charge to the time insurance products with those rates are sold in the market. 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.

Impact of the Filing on Solvency

Unless GMCB's consulting actuary explicitly opines that this filing will produce rates that are inadequate or excessive, DFR's opinion is that these rates as filed likely will have the impact of sustaining the current level of solvency, which DFR has determined to be appropriate and necessary. Further, if rates are consistently reduced to the low end of a range of reasonableness, the likelihood of insufficient rates is increased. Therefore, DFR is also of the opinion that downward adjustments to rate components should not be made unless GMCB's consulting actuary explicitly opines that the filed rates, without any modification, are excessive.

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

Sincerely,

Michael S. Pieciak
Commissioner, Department of Financial Regulation