

**July 18, 2017**

Chair Kevin Mullin  
Green Mountain Care Board  
89 Main Street, Third Floor, City Center  
Montpelier, Vermont 05620

**Re: Solvency Impact of “2018 Vermont Qualified Health Plans Rate Filing (SERFF # BCVT-131037743)” of Blue Cross Blue Shield of Vermont (Amended)**

Dear Chair Mullin:

This letter is to fulfill the Department of Financial Regulation’s (“DFR”) responsibility under 8 V.S.A. § 4062(a)(2)(B) regarding Blue Cross and Blue Shield of Vermont (“BCBSVT”) and its recent proposed rate filing: “**2018 Vermont Qualified Health Plans Rate Filing**”. Under 8 V.S.A. § 4062, DFR must provide to the Green Mountain Care Board an analysis and opinion on the impact of the filing as proposed on the solvency of BCBSVT.

DFR does not expect the proposed rate will have a significant impact on our overall solvency assessment of BCBSVT. However, as explained below, any downward adjustments to the filing’s rate components that are not actuarially supported will reduce BCBSVT’s surplus and over time could negatively impact its solvency.

### **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.<sup>1</sup> DFR has a special responsibility with respect to BCBSVT, which was created under a special statute and

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<sup>1</sup> 8 V.S.A. § 10.



subject to careful regulation by DFR.<sup>2</sup> DFR is the primary, and for many purposes the only regulator of BCBSVT, which insures more Vermonters than any other health insurance company.

### **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 several 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 ("RBC"), claims reserve development, and risk mitigation strategies. The assessment of surplus, and whether that surplus is adequate, is a dynamic prospective assessment.

### **Analysis of Threats to Solvency**

The sufficiency of an insurer's surplus and its solvency generally are 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.

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<sup>2</sup> 8 V.S.A. Chapters 123, 125.

- **Adverse utilization:** If consumers use more services than anticipated by the insurer, because of, for example, better economic conditions prompting increased access to care, or 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 affected by the size of 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 on Solvency of Proposed Rate**

The solvency events mentioned above factor into DFR's opinion regarding the potential impact the proposed rate might have on BCBSVT's solvency, notably:

- **Adverse Utilization:** BCBSVT experienced higher utilization in fiscal year 2016 than predicted, which resulted in a higher claims expense than originally estimated. If this trend continues, it would have a continued negative impact on BCBSVT's surplus and RBC ratio.
- **Premium Inadequacy:** BCBSVT recently sustained a decrease to its surplus and RBC ratio due to significant underwriting losses during its previous fiscal year ending December 31, 2016. The impact of these underwriting losses would have been lessened had BCBSVT's 2016 rates been approved as filed.

BCBSVT's current rate filing<sup>3</sup> contains a 2.0 percent contribution to reserves. If the proposed rate is approved as filed it will stabilize BCBSVT's RBC ratio, which has been trending downward over the last three years.

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<sup>3</sup> On July 17, 2017, BCBSVT filed a memorandum revising the contribution to reserves percentage necessary to maintain its RBC ratio from 3.2 percent to 1.9 percent. On July 18, 2017, DFR filed this amended opinion with the Green Mountain Care Board to reflect this change.

DFR does not expect the proposed rate will have a significant impact on our overall solvency assessment of BCBSVT. However, any downward adjustments to the filing's rate components that are not actuarially supported will reduce BCBSVT's surplus and over time could negatively impact its solvency, thus impacting access to health insurance in Vermont.

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

Sincerely,



Michael S. Pieciak  
Commissioner