BlueCross BlueShield of Vermont
An Independent Licensee of the Blue Cross and Blue Shield Association

July 17, 2017

Mr. Noel Hudson
Hearing Officer
Green Mountain Care Board

Subject: Pre-Hearing Memorandum RE: Blue Cross and Blue Shield of Vermont 2018 Qualified Health Plan Filing (SERFF Tracking #: BCVT-131037743)

Dear Mr. Hudson:

In an effort to avoid some of the potentially time consuming technical testimony at the hearing in the above matter, BCBSVT provides this memorandum concerning findings alleged in a report submitted by the Office of the Health Care Advocate (HCA). It is our hope that clarifying these points in advance will make the hearing proceedings both more efficient and more targeted to material issues of interest to a broader audience.

Finding 1: IBNR Conservatism

In the report he produced for the HCA, Mr. Peter Horman suggests that experience period claims may be overstated due to excessive Incurred but Not Reported (IBNR) factors. IBNR is a means of estimating claims that occurred during the experience period, but have not yet been fully processed as paid claims. Mr. Horman agrees that BCBSVT's application of IBNR factors is "appropriate." However, Mr. Horman cites high November 2016 and December 2016 claims that may be indicative of "an actual trend increase," or, alternatively "extra assumed IBNR" as support for his assertion that BCBSVT IBNR may be overstated. He further cites favorable prior-year restatement reported in Underwriting Exhibits from BCBSVT annual statements to conclude that BCBSVT's application of IBNR may have "led to higher than necessary proposed rates."

It is standard practice in the industry to add margin to the calculation of IBNR for the purposes of statutory accounting. Because the year-end IBNR is intentionally conservative through the addition of this explicit margin (15 percent, in the case of BCBSVT medical claims), reserves will almost always restate downward as actual results become available. Consistent with its statutory obligations, however, BCBSVT does not file rates that are "higher than necessary." We therefore use "best estimates *before* margin" to complete experience period claims for purposes of setting rates. BCBSVT Actuarial Memorandum, section 3.1 (emphasis added), p. 16 of the binder. Furthermore, BCBSVT uses claims run out through February 2017, not through year-end 2016, providing more complete data with less variability than Mr. Horman's analysis would suggest. Mr. Horman's second and third pieces of "evidence" are in no way indicative of excessive IBNR factors.

As a standard part of the QHP rating process, BCBSVT reviews claims restated through March to assess whether there are material differences from the estimate of experience period claims through February. For 2016, differences from February to March were immaterial and it is not possible to incorporate runout through April into our calculations before the May 11 filing date, while adhering to high levels of quality control.

In response to this portion of Mr. Horman's report, BCBSVT assessed the change in experience period claims from February through April for each of the past four years for small group and individual products. The results are as follows:

Year	Incurred claims estimate as of February 28/29	Incurred claims estimate as of April 30	Restatement
2013	$267,846,123	$267,476,362	-0.14%
2014	$283,188,047	$284,020,896	+0.29%
2015	$324,272,831	$324,322,603	+0.02%
2016	$376,756,653	$376,298,867	-0.12%
Total	$1,252,063,654	$1,252,118,728	+0.00%

The data shows that BCBSVT IBNR assumptions have been neither excessive nor inadequate over the past four years. In fact, they have predicted actual runout almost perfectly.

While BCBSVT is committed to establishing the best possible rates, there is a practical limit to the data that can reasonably be included in a rate filing in advance of rate filing deadlines. This is the case in all rate development. This is not indicative of "failure to use the best data," as Mr. Horman incorrectly asserts, but rather results from the fact that better data was simply unavailable at time of filing.

Moreover, BCBSVT cautions the Green Mountain Care Board that ad hoc updates for new data that becomes available after the time of the filing can lead to market inequities unless applied consistently across years and across carriers. We have not objected to the use of updated risk adjustment data because it has been applied consistently from year to year and to all carriers on the Exchange. We would, however, object to including the impact of updates to the experience period restatement after the filing date *unless* such adjustments are ordered for all Exchange carriers and used in every year moving forward, irrespective of whether the adjustment has an upward or downward impact on rates.

Finding 2: Reflection of Capitation

Mr. Horman asserts that "most capitation arrangements are designed to reduce claims costs below [fee for service] levels" and that "if BCBSVT has a risk contract in place which penalized providers for higher than necessary utilization, there would be reductions to the base experience to reflect capitation."

While these generalizations may often be true, BCBSVT has a different philosophy in establishing capitation schedules. BCBSVT supports primary care and believes that it is important to fund the efforts of primary care providers. BCBSVT's capitation schedules, which only impact a portion of services for a limited number of providers (capitated claims are less than one percent of total claims), are intended to support practice panel management. The monthly reimbursement can allow a practice to provide care coordination or non-billable services but with a fairly predictable revenue source. At times our capitated providers receive revenue in excess of fee for service projections, thereby supporting the overall panel management concept. Vermont stakeholders have been very vocal in their opposition to reducing overall primary care reimbursement, through capitation or otherwise. Reimbursing primary care providers less or putting them at large financial risk for care management is not a strategy that BCBSVT believes would benefit our members. BCBSVT performs an analysis at least biennially to assure that the capitation schedules continue to reflect as closely as possible 100 percent of fee for service

claims. The best estimate of projection period claims therefore begins with fee for service claims.

As the GMCB is aware, BCBSVT is extremely committed to the success of the All Payer Model and other payment reform initiatives. In fact, BCBSVT's vision is a transformed health delivery system in which every Vermonter has health care coverage, and receives timely, effective, affordable care. We will continue to strive toward this vision, and we look forward to incorporating savings from payment reform initiatives into our rates once those savings have materialized.

Finding 8: Net Cost of Reinsurance

Mr. Horman states that "it is a common practice for reinsurers to overestimate the cost of the reinsurance but then pay an experience refund to the insurance carrier. I believe that not including the anticipated experience rebate is an area of conservatism and when combined with other small areas of conservatism could be material and lead to an excessive rate." Mr. Horman goes on to recommend that "BCBSVT apply the terms of their actual reinsurance contract but no less than the minimum range presented." This "minimum range presented" represents a 40 percent rebate, or $0.66 per member per month (PMPM).

BCBSVT's reinsurance contract does not include such a rebate provision. It is clearly unreasonable to include an adjustment to pricing for a provision that doesn't exist.

BCBSVT has marketed our reinsurance twice in the last three years. We have achieved premium savings of 18 percent over these three years through the competitive bid process. We are extremely confident that our reinsurance contract is best-in-class. While others may see value in a large up-front premium with a back-end rebate, we believe that we have achieved the best possible contract with a lower initial premium and no potential rebate. Again, it is clearly unreasonable for pricing purposes to couple the low initial premium with an assumed rebate when a rebate provision is not part of our reinsurance contract. We reject Mr. Horman's recommendation on this item as simply unsupported by the facts.

Finding 11: BCBSVT Administrative Ratio

Mr. Horman asserts that "BCBSVT used misleading statistics" related to administrative costs in our May 11, 2017 presentation to the GMCB. He goes on to describe a number of reasons he thinks that our data may be suspect.

Mr. Horman appears to be unaware that the presentation cited the results of a formal benchmarking survey. In that survey, BCBSVT's PMPM administrative costs ranked within the best third of 16 Blues plans serving some 29 million members, despite being the smallest plan in the survey. This study very directly supports our statement that our administrative costs PMPM "compare well to benchmarks." We are very proud of what we have achieved for our members in reducing our PMPM administrative costs by over 24 percent from 2008 to 2016.

We would further note that our administrative costs PMPM are nearly 8 percent lower than MVP's, based on each company's respective SERFF filing.

Finding 13: Reduction of CTR

Mr. Horman asserts, "In my review of BCBSVT's [contribution to reserves (CTR)] approach, I was concerned that two components of the calculation were excessive." He goes on to describe three adjustments in BCBSVT's "CTR calculation" that he believes lead to an excessive rate increase.

Mr. Horman is mischaracterizing filing exhibit 7B and BCBSVT's approach to selection of CTR. As described in our actuarial memorandum at page 37 of the binder:

> "BCBSVT believes that CTR should be managed to an adequate long-term level, rather than fluctuating significantly from year to year with changes in membership and health care cost trend. For this reason, we have continued to file a CTR of 2.0 percent for 2018. It is our expectation that our future filings will also include a 2.0 percent contribution to reserves. While the long-term CTR target may exceed or fall below that required to maintain [Risk Based Capital (RBC)] in any given year, maintaining an adequate long-term assumption will allow us to avoid rate shocks in years of high growth in projected claims costs."

Our CTR selection is not a calculation. It is the long-term requirement that is needed to maintain RBC within our target range. Exhibit 7B was provided at the request of Lewis & Ellis for illustrative purposes. It is not relied upon to support the 2 percent CTR selection. Because Vermont law prohibits carriers from publicly disclosing or discussing the details of RBC levels, we must select a point from our range to demonstrate the CTR that "would be required to maintain RBC levels in light of projected increases in total claims costs in QHP products during 2018." Binder p. 37.

Nonetheless, as the exhibit is part of our filing, we of course intend for it to be accurate. Mr. Horman asserts correctly that the RBC calculation is driven by claims rather than premium. However, he errs in estimating the claims increase as being equivalent to the medical trend assumption. Rather, claims costs are also affected by demographic changes, among other factors. The formula in row J of the original Exhibit 7B included a factor that adjusted for the difference between premium and claims. Unfortunately, in attempting to condense the highly complex RBC calculation into a single formula so that reviewers could work with a live model, we failed to recognize that this factor should not be hardcoded, but would instead change with the claims-to-premium ratio within the 2018 QHP filing.

We have provided an updated spreadsheet (please see attached "*Revised CTR Illustration.xlsx*") showing the result of including the total claims from our filing directly within our RBC calculation software (which is the source of the dollar amount shown in row J). Our revised calculation shows that the CTR required to maintain RBC in light of projected increases in total claims costs is 1.9 percent at the high end of our target RBC range.

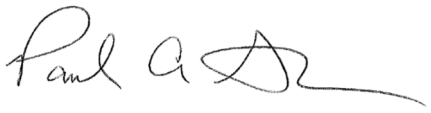
While we regret the error in our illustration, we reiterate that CTR is neither a precise calculation nor is our selection of CTR for this filing based in any way on the illustration. DFR states in their solvency opinion that "DFR believes that the range of surplus targeted by BCBSVT is reasonable and necessary for the protection of policyholders and BCBSVT is within the range determined to be necessary." As we have and will testify, our intention is to continue to file for a 2 percent CTR while that statement remains true. If we fall outside our target range, we will adjust our CTR pick accordingly; that is, we will request a CTR higher than 2 percent if RBC falls below our target range, and we will request a CTR below 2 percent if RBC exceeds our target range.

Mr. Horman also suggests that no investment income should be allocated to lines of business other than QHP and insured large group. This is an unreasonable methodology. Lines of business not reviewed by the GMCB, such as Medicare Supplement and the Federal Employees' Plan, quite obviously require an allocation of surplus as well; therefore, a fair allocation of investment income is also reasonable. It should be noted that BCBSVT allocates investment income within this illustration as aggressively as possible toward QHP: premium for other lines of business is not projected forward to 2018 in the illustration, which uses share of capital requirement as the means of allocation. Other reasonable selections of allocation method, such as membership or contribution to surplus, would allocate far less investment income toward QHP. Less investment income would also be allocated to QHP if we had trended the other lines of business. This illustration, therefore, could correctly be seen as demonstrating the *lowest* CTR that would maintain a particular RBC level in light of projected increases in total claims costs.

Based upon the revised illustration, it is clear that a 2 percent CTR remains an amount that reasonably allows us to maintain RBC within the target range in light of the impact of projected claims costs increases and potential adverse events.

Please let us know if we can provide additional clarity on any of the items above in advance of the hearing.

Sincerely,



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Paul Schultz, F.S.A., M.A.A.A.