VERMONT

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July 10, 2018

Chair Kevin Mullin
Green Mountain Care Board
144 State Street
Montpelier, Vermont 05620

Re: Solvency Impact of "2019 Vermont Qualified Health Plans Rate Filing (SERFF # BCVT-131497882)" of Blue Cross Blue Shield of Vermont

Dear Chair Mullin:

The Department of Financial Regulation ("DFR") respectfully submits the following solvency opinion regarding Blue Cross and Blue Shield of Vermont ("BCBSVT" or the "Company") and its recent proposed rate filing: "**2019 Vermont Qualified Health Plans Rate Filing**."[1]

This opinion is delivered in a context that bears explaining: BCBSVT's Risk Based Capital ("RBC") ratio has been in decline since 2014, is approaching the bottom of the Company's targeted range, and is at its lowest point since the establishment of the Green Mountain Care Board ("GMCB"). Further, any downward adjustments to the filing's rate components that are not actuarially supported will likely erode BCBSVT's surplus and negatively impact its solvency over time.

When coupled with the unpredictability surrounding federal health care policy (and its corresponding impact on Vermont's health insurance market), however, there is an elevated risk of nearer term solvency concerns for BCBSVT.

Bearing this in mind, however, DFR does not expect the rate, as filed and unmodified, would have a significant impact on our overall solvency assessment of BCBSVT.

[1] Under 8 V.S.A. § 4062, DFR must provide to the Green Mountain Care Board an analysis and opinion on the filing's impact on BCBSVT's 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. BCBSVT is currently at the low end of that range. There is a significant risk that BCBSVT's surplus will erode due to factors described below unless applicable rates are adequate and set at a level that maintains adequate surplus.

Background

Vermont law requires DFR to protect consumers by supervising insurance companies to ensure their solvency, liquidity, stability, and efficiency.[2] DFR has a special responsibility with respect to BCBSVT, which was created by statute and is subject to comprehensive DFR regulation.[3] BCBSVT insures more Vermonters than any other health insurance company and DFR is BCBSVT's primary regulator and, for many purposes, its sole regulator.

Analysis of Solvency

DFR considers insurer solvency 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 the insurer is to insolvency now, and in what direction it will move in the future. DFR is uniquely capable of assessing insurer 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 and expenses, and to contribute to the insurer's surplus when appropriate. Over the long term, charging inadequate premium rates 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, insurers must maintain a surplus of funds. 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 surplus is crucial to an insurer's solvency.

The adequate level of surplus 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 surplus adequacy, including periodic financial examinations,

[2] 8 V.S.A. § 10.
[3] 8 V.S.A. Chapters 123, 125.

corporate governance review, and analysis of such areas as RBC, claims reserve development, and risk mitigation strategies. This surplus assessment is dynamic and prospective.

Analysis of Threats to Solvency

The sufficiency of an insurer's surplus and its solvency generally are very sensitive to changed circumstances. 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 faster than the insurer anticipated, the insurer's surplus will decrease as it is used to cover this gap.

- **Adverse utilization**: If consumers use more services than the insurer anticipated, 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 more people the insurer covers, the more surplus it needs to protect against insolvency. Thus, an increase in covered lives would increase an insurer's surplus requirements. An increase in covered lives can be the result of new lines of business, additions to current business, or conversion of a group from administrative services to fully insured business.

- **Regulatory uncertainty**: The changing federal landscape regarding the Affordable Care Act and tax law can have unexpected and continuing consequences, as evidenced by recent changes in law.

Any one of these events, even on a small scale, can have a very detrimental effect on 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. To ensure a sufficient surplus level 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 specifically into DFR's opinion regarding the potential impact the proposed 2019 rate might have on BCBSVT's solvency, notably:

- **Premium inadequacy**: BCBSVT's RBC ratio has been in decline since 2014 and is now approaching the bottom of the approved range. BCBSVT's RBC currently sits at its lowest point since the establishment of the GMCB.

  Downward adjustments to Qualified Health Plan filings for previous plan years that were not necessarily actuarially supported have contributed to the decline in RBC.

  As illustrated in the table below, BCBSVT's net premiums earned and member months have grown 37.4% and 36.6% percent, respectively – meaning BCBSVT's risk exposure has experienced a considerable increase over the past years, but its corresponding surplus safety net has remained stagnant.

(numbers in thousands)	2017	2016	2015	2014	2013
Net Premiums Earned	$ 578,277	$ 547,331	$ 539,867	$ 470,610	$ 420,770
Member months (total)	2,557	2,509	2,517	2,440	1,872
Capital and Surplus	$ 134,054	$ 135,264	$ 148,424	$ 138,363	$ 132,369

  Any downward adjustments to BCBSVT's filed rate components that are not actuarially supported will likely erode BCBSVT's surplus and negatively impact its solvency over time.

- **Regulatory Uncertainty**:[4]

  - **CSR Defunding**: BCBSVT was unfavorably impacted due to the federal government defunding Cost Share Reduction (CSR) payments in late 2017. BCBSVT had to bear the costs of participating in the program but did not receive corresponding reimbursements for the months October, November and December in 2017. Further, BCBSVT will be affected in the same way in 2018, but for the entire year as 2018 rates were filed and approved by the GMCB prior to the defunding announcement. This has and will continue to impact the Company's surplus and RBC throughout the current plan year.

  - **Possible Disallowance of Silver Loading**: The current filing addresses the CSR defunding issue for 2019 by "loading" On Exchange silver plans to adjust for the defunding. Many other states implemented similar measures to protect their health insurance marketplaces and Health and Human Services Secretary Alex Azar indicated these solutions will not be disallowed for plan year 2019. Secretary Azar, however, would not commit to such measures being disallowed in future

[4] In addition to the items articulated in this section, the federal government has also introduced changes to short-term limited duration health plans and eliminated the federal individual mandate. The Vermont legislature took steps to mitigate the impact of these actions on the Vermont health insurance marketplace; however, it is still possible these federal actions will still negatively impact BCBSVT surplus and RBC.

years. BCBSVT would face considerable downward pressure on its surplus and RBC should the federal government disallow the "Vermont Silver Solution" in plan year 2020, or thereafter.

- **Introduction of ACA Alternatives**: The federal government has also taken steps to introduce alternatives to ACA plans, or to make such alternatives more widely available, as in the case of "association health plans." Federal rules will allow association health plans to be operational for plan year 2019 and such plans may appear favorable to small businesses and sole proprietors. These entities and individuals tend to have a better risk profile, and their departure from the exchange market might cause disruption that could ultimately impact BCBSVT's surplus and RBC.

- **Risk Adjustment Program Payment Freeze**: Even as this opinion is delivered, the full impact of the Centers for Medicare and Medicaid Services' recent announcement that it would suspend the collection and distribution of monies under the Federal Risk Adjustment Program is uncertain. However, in the event there is an unfavorable change to the payment formula, BCBSVT could be negatively impacted along with its surplus and RBC.

- **Federal Tax Changes**: It should be noted that one recent change to the federal tax code is scheduled to positively impact BCBSVT beginning in late 2019/2020 and will continue to benefit BCBSVT through 2022. DFR cautions, however, that any tax benefit to BCBSVT will not be realized for approximately 18 months and is contingent on no further action by the federal government to eliminate, reduce or prevent such payments.

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. As noted above, BCBSVT's RBC is currently close to the bottom of its target range, and in an environment of unusual federal uncertainty, any departure from the filed rate should be made with great caution.

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

Sincerely,

Michael S. Pieciak
Commissioner