VERMONT

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April 19, 2019

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

Re: Solvency Impact of "3Q 2019 Large Group Rating Program Filing (SERFF # BCVT-131835151)" 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: "**3Q 2019 Large Group Rating Program 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, has fallen out of the Company's targeted range (both its current range and its prior 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 continue to erode BCBSVT's surplus and continue to negatively impact its financial position and ultimately its solvency.

Further, there is an elevated risk of nearer team solvency concerns when also considering the unpredictability surrounding federal health care policy (and its corresponding impact on Vermont's health insurance market).

With this background, 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 below this range.[2] There is a significant risk that BCBSVT's surplus will further 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.[3] DFR has a special responsibility with respect to BCBSVT, which was created by statute and is subject to comprehensive DFR regulation.[4] 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.

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[2] The Department recently approved an updated RBC ratio range of 590% - 745%. A copy of the order can be found at https://dfr.vermont.gov/sites/finreg/files/regbul/dfr-order-19-07-i-bcbsvt-rbc.pdf.
[3] 8 V.S.A. § 10.
[4] 8 V.S.A. Chapters 123, 125.

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, 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

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 further reduce BCBSVT's surplus and will negatively impact its solvency over time, thus impacting access to health insurance in Vermont. As noted above, BCBSVT's RBC has fallen below its target range and any departure from the filed rate that is not actuarially justified 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