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July 10, 2019

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

Re: Solvency Impact of "2020 Vermont Individual and Small Group Rate Filing (SERFF # BCVT-131936226)" 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: "**2020 Vermont Individual and Small Group Plans Rate Filing**."[1]

The Department's two previous solvency opinions have had an increased sense of urgency regarding the impact of non-actuarially justified downward rate adjustments on BCBSVT's financial condition. We continue to maintain that sense of urgency in this opinion for the following reasons:

- BCBSVT's Risk Based Capital ("RBC") ratio is at its lowest point since the establishment of the Green Mountain Care Board ("GMCB");

- BCBSVT's RBC ratio is the lowest among comparative companies across the country, in fact, its current RBC ratio is approximately half of the average RBC ratio for comparative companies;

- BCBSVT's is the only RBC ratio that has trended downward for each of the last four years – falling a total of 171 points or approximately 26%.

- BCBSVT has fallen out of the Company's recently approved targeted RBC range – and would also be outside of its prior range; and

[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.

- Further, there is an elevated risk of nearer team solvency concerns when also considering recent and continued 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.

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 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

[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.

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, 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 2020 rate might have on BCBSVT's solvency, notably:

- **Premium inadequacy**: BCBSVT's RBC ratio has been in decline since 2014 and is now below 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 has grown 10.0% since 2014, while surplus has decreased 20.4% and membership has remained relatively flat – meaning BCBSVT's risk exposure has experienced a considerable increase over the past years, but its corresponding surplus safety net has decreased.

(numbers in thousands)	2018	2017	2016	2015	2014
Net Premiums Earned	$ 517,449	$ 578,277	$ 547,331	$ 539,867	$ 470,610
Member months (total)	2,385	2,557	2,509	2,517	2,440
Capital and Surplus	$ 110,155	$ 134,054	$ 135,264	$ 148,424	$ 138,363

  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**: At the federal level, healthcare policy continues to shift with the introduction of new policy positions that could have a potential negative impact on the ACA and thus BCBSVT's financial condition. For example: (i) just this week the U.S. Court of Appeals for the 5th Circuit heard oral arguments regarding the constitutionality of the ACA after the elimination of the individual mandate; (ii) the prospect remains that the federal government could disallow the "Vermont Silver Solution"; (iii) 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," limited short-term duration plans and the expanded use of HRAs to purchase healthcare insurance. It is important to be in a solid financial position during this continued time of uncertainty.

In connection with our solvency opinion, DFR asked our outside actuaries to provide an analysis of BCBSVT's financial condition compared to its peers (please find the Oliver Wyman

Report attached, the "Report"). As indicated in the Report, BCBSVT's RBC ratio is the lowest among comparative companies across the country and its current RBC ratio is approximately half of the average RBC ratio for comparative companies. Further, BCBSVT's is the only RBC ratio that has trended downward for each of the last four years – falling a total of 171 points or approximately 26%. [5]

DFR does not expect the proposed rate as filed will have a significant impact on our overall solvency assessment of BCBSVT. Any downward adjustments to the filing's rate components that are not actuarially supported, however, will reduce BCBSVT's surplus and continue to negatively impact its solvency, thus jeopardizing access to health insurance in Vermont. As noted above, BCBSVT's RBC is currently below its target range, and in an environment of unusual federal uncertainty, any departure from the filed rate should be made with great caution.

*   *   *

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

Sincerely,

Michael S. Pieciak
Commissioner

[5] BCBSVT is scheduled to receive a significant AMT tax refund, paid in five installments, beginning in late 2019/2020 due to the Tax Cuts and Jobs Act of 2017. This provides BCBSVT a unique opportunity to bring the Company's RBC ratio close to the bottom end of its targeted range and more in-line with its comparable companies without a significant increase to its contribution to reserves.

Zachary Smith, ASA, MAAA, CERA

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July 10, 2019

Mr. Michael S. Pieciak
Commissioner
Vermont Department of Financial Regulation
89 Main Street
Montpelier, VT 05620

Subject:
Analysis of Blue Cross Blue Shield of Vermont's Current Capital Position and Implications on their 2020 QHP Filing

Dear Commissioner Pieciak:

The Vermont Department of Financial Regulation (DFR) has engaged Oliver Wyman Actuarial Consulting, Inc. (Oliver Wyman) to perform an analysis of Blue Cross Blue Shield of Vermont's (BCBSVT) current financial position in support of your solvency opinion regarding BCBSVT's 2020 QHP filing with the Green Mountain Care Board (GMCB). The purpose of this letter is to provide you with our analysis with respect to BCBSVT's current financial position and solvency, and potential solvency implications if BCBSVT's requested rates are not approved in full. This letter is not intended for any other purposes.

Background

BCBSVT is requesting an average rate increase of 15.6% over their 2019 QHP premium rates in their 2020 QHP filing to the GMCB. The rate increase varies between 9.1% and 18.5% by plan. The rate increases by plan are shown in Table 1 on the following page. The Department is required to provide a solvency opinion to the GMCB with regard to BCBSVT's rate increase request. To support the Department's solvency opinion, Oliver Wyman is providing a limited update to some of the analysis performed from the report titled "Evaluation of BCBSVT Optimal Surplus Range Recommendation," (the Report) which was provided to the Department on January 25, 2019. The Report provided support for BCBSVT's proposed surplus range of a 590% to 745% RBC ratio, which was solidified in the Department's February 7, 2019 order.

Table 1
BCBSVT Proposed 2020 Rate Increases Over 2019 Rates

Product	Plan	Proposed Rate Increase[1]
BCBSVT EPO	BCBSVT Blue Rewards Catastrophic Plan	13.99%
BCBSVT EPO	BCBSVT Platinum Plan	17.34%
BCBSVT EPO	BCBSVT Gold Plan	18.47%
BCBSVT EPO	BCBSVT Silver Plan	15.24%
BCBSVT EPO	BCBSVT Silver Reflective Plan	16.25%
BCBSVT EPO	BCBSVT Bronze Plan	14.21%
BCBSVT EPO	BCBSVT Bronze Plan Integrated	12.78%
BCBSVT EPO CDH	BCBSVT Silver CDHP Plan	14.97%
BCBSVT EPO CDHP	BCBSVT Silver Reflective CDHP Plan	16.63%
BCBSVT EPO CDHP	BCBSVT Bronze CDHP Plan	13.69%
BCBSVT EPO Blue Rewards	BCBSVT Blue Rewards Gold Plan	9.30%
BCBSVT EPO Blue Rewards	BCBSVT Blue Rewards Silver Plan	9.13%
BCBSVT EPO Blue Rewards	BCBSVT Blue Rewards Silver Reflective Plan	10.03%
BCBSVT EPO Blue Rewards	Blue Rewards Bronze Plan	12.70%
BCBSVT EPO CDHP Blue Rewards	BCBSVT Blue Rewards Gold CDHP Plan	14.19%
BCBSVT EPO CDHP Blue Rewards	BCBSVT Blue Rewards Silver CDHP Plan	13.08%
BCBSVT EPO CDHP Blue Rewards	BCBSVT Blue Rewards Silver CDHP Reflective Plan	14.54%
BCBSVT EPO CDHP Blue Rewards	BCBSVT Blue Rewards Bronze CDHP Plan	11.68%

Analysis

Our analysis will focus on three aspects:

1. Analysis of BCBSVT's Current Financial Position as of December 31, 2018
2. Benchmarking - BCBSVT's Current RBC Ratio and Capital Range Amongst Comparative Companies
3. Limited Modelling of Capital Scenarios with Negative Adjustments to the Proposed Rates

Analysis of BCBSVT's Current Financial Position as of December 31, 2018

BCBSVT reported a statutory net loss of $6.7 million for the year-ended December 31, 2018, driven by a $15.5 million net underwriting loss. This loss, combined with a 2018 net unrealized loss, decrease in non-admitted assets, and an increase in their pension obligation, reduced BCBSVT's total adjusted capital by $23.9 million to $110.2 million at December 31, 2018. BCBSVT's RBC ratio decreased from 558% to 495%. BCBSVT's 2014 through 2018 reported statutory results are shown in Table 2.

[1] 2020 BCBSVT QHP URRT Worksheet 2

Table 2
BCBSVT Statutory Financials (in Millions)[2]

	2014	2015	2016	2017	2018
Total Revenue	$470.6	$539.9	$547.3	$578.3	$517.4
Total Claims Expense	421.3	478.0	509.5	533.6	477.7
Administrative Expenses	44.2	53.0	56.0	46.1	55.3
Net Underwriting Gain/Loss	**5.1**	**8.8**	**(18.2)**	**(1.5)**	**(15.5)**
Change in Value of Affiliates	3.7	0.9	5.1	3.7	(0.9)
Other Investment Income	0.9	3.3	(0.9)	1.7	6.9
Total Investment Income Gain/(Loss)	**4.6**	**4.2**	**4.2**	**5.4**	**6.0**
Other Income	**3.2**	**2.6**	**2.6**	**2.7**	**1.9**
Pre-Tax Income	**13.0**	**15.6**	**(11.4)**	**6.7**	**(7.6)**
Federal Income Tax	3.1	3.4	(1.7)	(0.9)	(0.9)
Net Income/Loss	**9.9**	**12.2**	**(9.7)**	**7.6**	**(6.7)**
Member Months (millions)	2.4	2.5	2.5	2.6	2.4
Total Adjusted Capital	$138.4	$148.4	$135.3	$134.1	$110.2
Authorized Control Level RBC	$20.8	$22.4	$22.9	$24.0	$22.2
RBC Ratio	**666%**	**663%**	**591%**	**558%**	**495%**

Since 2014, BCBSVT's member months have remained relatively flat, but their RBC ratio has declined each year, from 666% in 2014 to 495% in 2018, driven by both a reduction in their total adjusted capital and an increase in their authorized control level RBC. As a result, BCBSVT's RBC ratio is 95 basis points below the low end of the approved surplus range.

Benchmarking - BCBSVT's Current RBC Ratio and Capital Range Amongst Comparative Companies

As discussed in the Report, because BCBSVT is a single-state Blue Cross and Blue Shield Association (BCBSA) licensee they are operating under unique circumstances compared to their competitors. Table 3 shows BCBSVT's RBC ratios from 2014 through 2018 along with their comparative BCBSA licensees, as were defined in the Report to be companies who derive at least 35% of their ultimate parent revenue from BCBSA entities and have 2017 Accidental and Health Policy Experience Exhibit premium between $0.3 and $4.0 billion.

[2] 2014-2018 Statutory Annual Statements

Table 3
Comparative Companies – 2014-2018 RBC Ratios[3]

Ultimate Parent Company	2014	2015	2016	2017	2018
BCBS of VT	666%	663%	591%	558%	495%
BCBS of WY	1402%	1426%	1142%	1162%	1201%
HealthyDakota Mutual Holdings (BCBS of ND)	388%	549%	793%	953%	801%
BCBS of MS	1735%	1687%	1618%	1700%	1708%
GoodLife Partners, Inc. (BCBS of NE)	1312%	1080%	811%	953%	1018%
Blue Cross of Idaho	938%	886%	1013%	1321%	1167%
BCBS of RI	466%	540%	459%	500%	520%
BCBS Of Kansas City (MO)	780%	828%	836%	968%	1057%
Capital BlueCross (PA)	837%	775%	725%	651%	704%
BCBS of KS	896%	848%	867%	843%	968%
BCBS of AZ	1114%	1028%	1047%	1226%	1251%
HealthNow Systems, Inc. (BCBS of Western NY)	556%	719%	678%	743%	727%
Louisiana Health Service & Indemnity Company (BCBS of LA)	1119%	953%	968%	1017%	1069%
Hawaii Medical Service Association (BCBS of HI)	398%	376%	421%	451%	504%
PREMERA (BCBS of WA)	1015%	915%	887%	1177%	1293%
Average with BCBSVT	**863%**	**840%**	**838%**	**937%**	**983%**
Average without BCBSVT	**866%**	**844%**	**843%**	**945%**	**992%**

BCBSVT's RBC ratio has declined every year since 2014, resulting in a 2018 RBC ratio that is the lowest of all of their comparative companies. They are the only company within their peer group to experience a decline in RBC ratio every year since 2014, and they have done so without any large 100 basis point or more decreases like some of the comparative companies. The average of the comparative companies' RBC ratios excluding BCBSVT has increased 126 basis points since 2014, largely driven by a 149 basis point increase in the RBC ratio from 2016 to 2018. In that period, BCBSVT's RBC ratio declined by 96 basis points.

Limited Modelling of Capital Scenarios with Negative Adjustments to the Proposed Rates

In BCBSVT's 2020 QHP filing with the GMCB, they are requesting rates that, should the proposed rates be approved in full and realized experience matches the assumptions, would reduce their 2020 RBC ratio by 4 basis points. The rates include a 1.5% contribution to surplus assumption, which is intended to counteract the ACL RBC increase that typically occurs with increased premiums.

Due to the Tax Cuts and Jobs Act, BCBSVT is expecting to receive roughly $26.6 million in refundable tax credits in 2019 and 2020 that will increase their surplus. BCBSVT estimates that these credits will increase their RBC ratio from 495% at December 31, 2018 to slightly above the 590% bottom end of the target range, excluding the impact of 2020 operating results.

[3] 2014-2018 Statutory Annual Statements

However, operating results in 2019 and 2020 could significantly impact BCBSVT's RBC ratio. Table 4 shows the potential impact on BCBSVT's RBC ratio at various negative adjustments to their proposed premium rates, with no offsetting decrease to projected claims, other non-benefit expenses, and no changes in legislation or rate filing requirements, based on the December 31, 2018 TAC and ACL amounts adjusted for the aforementioned tax credits and the proposed premium rates.

Table 4
Projected Impact on BCBSVT RBC Ratio

Adjustment to Overall Requested Premium (%)	**0%**	**-1%**	**-2%**	**-3%**	**-4%**	**-5%**	**-10%**
Resulting Average Increase on 2019 Rates (%)	15.6%	14.4%	13.3%	12.1%	11.0%	9.8%	4.0%
Contribution to Surplus (%)	1.5%	0.5%	-0.5%	-1.5%	-2.5%	-3.5%	-8.5%
Contribution to Surplus ($ millions)	$5.0	$1.7	($1.7)	($5.0)	($8.3)	($11.6)	($28.2)
Impact on 2020 RBC Ratio	-4%	-19%	-34%	-49%	-64%	-79%	-153%

As shown in Table 4, even a moderate 1% reduction in BCBSVT's proposed premium level, which would result in a 14.4% increase on their 2019 premium rates, with no offsetting decrease to projected claims or other non-benefit expenses could push their projected December 31, 2020 RBC ratio back below their target RBC range.

Conclusion

BCBSVT is projecting that their proposed 2020 QHP rates, including a 1.5% contribution to surplus assumption, will be capital neutral assuming all of their assumptions are experienced. Their RBC ratios have declined every year since 2014 to 495% at December 31, 2018. The 495% 2018 RBC ratio is the lowest of all of the comparative companies. Lastly, any negative adjustment to the proposed premium levels could cause the December 31, 2020 RBC ratio to fall below the target RBC range.

We have relied on information provided in publicly available financial statements and BCBSVT's 2020 QHP rate filing without independent investigation or verification. If this information is inaccurate, incomplete, or out of date, our findings and conclusions may need to be revised.

If you have any questions regarding this filing, please feel free to contact me. I can be reached at 215 246 1045.

Sincerely,

Zachary Smith

Zachary Smith, ASA, MAAA, CERA
Senior Consultant

Copy: Gavin Boyles, Vermont Department of Financial Regulation
Jesse Lussier, Vermont Department of Financial Regulation
Tammy Tomczyk, Oliver Wyman Actuarial Consulting, Inc.
Marc Lambright, Oliver Wyman Actuarial Consulting, Inc.