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March 13, 2014

Mr. Alfred Gobeille, Chair
Green Mountain Care Board
89 Main Street, Third Floor, City Center
Montpelier, Vermont 05620

Re: Solvency Impact of "2014 BCBSVT Provision for Large Claims and Stop Loss Filing (SERFF # BCVT-129374060)" of Blue Cross and Blue Shield of Vermont

Dear Mr. Gobeille:

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 filing:"2014 BCBSVT Provision for Large Claims and Stop Loss Filing". Under 8 V.S.A. § 4062, DFR must provide to the Green Mountain Care Board ("GMCB") an analysis and opinion on the impact of the filing as proposed on the solvency of BCBSVT. The solvency of BCBSVT and how a particular filing or rate may affect that solvency are two separate questions. This letter first analyzes and provides DFR's opinion on the solvency of BCBSVT, the company. It then provides DFR's opinion and recommendation on the impact the filing could have on the solvency of BCBSVT.

Summary of Opinion

DFR is of the opinion that the filing as proposed will not have a material impact on the solvency and surplus of BCBSVT. This filing represents methods that would be used to develop rates. DFR recommends against any action on the filing that results in an increased likelihood of inadequate rates. Such an action could have a detrimental impact on BCBSVT's surplus and would likely change DFR's opinion regarding the filing's impact on BCBSVT's solvency.

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.[1] DFR has a unique responsibility with respect to BCBSVT, which was created under a specific statute

[1] 8 V.S.A. § 10.

and subject to careful regulation by DFR.[2] DFR is the primary, and for many purposes the only regulator of BCBSVT, which insures more Vermonters than any other health insurance company. DFR monitors the solvency of BCBSVT in many ways, including analyzing quarterly financial statements, performing routine examinations, reviewing transactions, and overseeing corporate governance.

Analysis of Solvency

DFR considers the solvency of insurers to be the most fundamental aspect of consumer protection. Whether an insurer is solvent is more complex than simply determining 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.

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 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 a number of tools to assess the adequacy of an insurer's surplus, including periodic financial examinations, review of corporate governance, and analyses of such areas as risk-based capital, claims reserve development, and risk mitigation strategies. The assessment of surplus, and whether that surplus is sufficient, is a dynamic prospective assessment.

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

Analysis of Threats to Solvency

The sufficiency of an insurer's surplus and its solvency generally is very sensitive to changes in circumstances and events. Some events that could place a health 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 may decrease as it is used to cover this shortfall.
- Adverse utilization: If consumers use more services than anticipated by the insurer, including because of a catastrophic event such as a pandemic flu, the insurer's surplus may decrease as it is used to cover this shortfall.
- Premium inadequacy: In addition to adverse utilization, various other factors can lead to claims and expenses exceeding premiums, including rate caps, disapproval by regulators of necessary rate increases; or administrative costs exceeding the insurer's projections. If claims and expenses exceed premiums, the insurer's surplus may be used to cover this shortfall.
- Membership growth: The sufficiency of an insurer's surplus is relative to the size of the population covered by the insurer. Thus, if an insurer doubles the number of people it covers, its existing surplus would only provide half of the protection against insolvency it previously did.

In Vermont's health insurance market, these risks are compounded because it takes up to two years from the time it is evident that a rate adjustment is necessary to the time those adjusted rates are approved and implemented. 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.

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. BCBSVT's current surplus is sufficient and does not justify a heightened level of regulatory concern. DFR believes that the level of surplus targeted and achieved by BCBSVT is reasonable and provides necessary protection to policyholders. Nonetheless, there is a significant risk that the sufficiency of BCBSVT's surplus will be steadily eroded by the medical trend growth and membership growth described above unless applicable premium rates are set at a level that provides an appropriate contribution to surplus in order to keep pace with those trends.

Impact of the Filing on Solvency

As noted, BCBSVT's current level of surplus is sufficient. The "2014 BCBSVT Provision for Large Claims and Stop Loss Filing" represents methods used to develop rates. GMCB's consulting actuary has issued a draft opinion that the filing does not produce rates that are excessive or inadequate.[3] DFR's opinion is that these methods as filed likely will not impact its assessment of BCBSVT's solvency. The filing would support the maintenance of surplus targets for BCBSVT that DFR deems reasonable and necessary.

However, if GMCB does not approve the filing as proposed, DFR recommends against any action or series of actions that would make it more likely that premium rates developed using these methods will be inadequate. An action by GMCB that increases the likelihood that the resulting rates are inadequate could make BCBSVT less able to withstand the occurrence of one or more of the risks discussed above. Therefore, any such action by GMCB will likely cause DFR to change its opinion on the impact of this filing to BCBSVT's solvency.

Sincerely,

Susan L. Donegan

Susan L. Donegan
Commissioner, Department of Financial Regulation

[3] Letter from Lewis & Ellis, Inc. to Green Mountain Care Board (February 27, 2014).