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April 21, 2021

Mr. Kevin Ruggeberg, FSA, MAAA
Vice President & Consulting Actuary
Consulting Actuary

Subject: Your 3/30/2021 Questions re: Blue Cross and Blue Shield of Vermont 2022 AHP Rating Program Filing (SERFF Tracking #: BCVT-132760913)

Dear Mr. Kevin Ruggeberg:

In response to your request dated April 12, 2021, here are *your questions* and our answers:

1. *The following questions relate to BCBSVT's risk-based capital (RBC) position, BCBSVT's requested contribution to reserve (CTR), and the statements made in Attachment A (Ruthe Greene Letter) supporting BCBSVT's CTR request in the present matter. These questions are based on the information that BCBSVT reported in its 2020 Annual Statement.*

   a. *From 2019 to 2020, BCBSVT's "aggregate health policy reserves, including the liability of $......... for medical loss ratio rebate per the Public Health Service Act" increased by $31,171,463 (150.8%). Please describe the reason(s) for this increase.*

      The primary driver of the change in aggregate health policy reserves in 2020 was a $24.5 million increase in the liability for premium and administrative fee deficiency reserves (PDR). Statutory reporting guidance requires a PDR liability to be recorded for expected future losses when there are contracts in place where revenue is inadequate to cover projected costs during the contract period. The 2020 PDR liability relates to both insured and ASO business. The component of the PDR related to fully insured segments is driven by a combination of GMCB rate cuts below levels found to be actuarially reasonable, expected increased claims utilization in 2021 due to COVID-related treatment costs and delayed care from 2020, and membership losses that create an administrative cost gap. The ASO component is driven by administrative expenditures that on a PMPM basis exceed the fees that will be received under multi-year rate guarantees that were necessary to retain our largest ASO customers. Market conditions and competitive pressures prevented BCBSVT from increasing rates for those customers, and in fact drove the rates lower. Over time, management will take actions to grow membership, reduce expenses and be responsive to customer needs to bolster retention in order to reduce the future losses that are currently projected in the year-end 2020 PDR calculation.

   b. *From 2019 to 2020, BCBSVT's "general expenses due or incurred" increased by $12,051,661 (29.9%). It appears that one driver was an increase of $33,382,973 in BCBSVT's "accrued postretirement benefit obligation." Is it correct that this increase in the "accrued postretirement benefit obligation" impacted the numerator used in the RBC calculation in a way that reduces BCBSVT's RBC number?*

      General expenses due or accrued that are reported on page 3, line 9 of the annual statement are unrelated to the accrued postretirement benefit obligation that is reported on line 23. The balance of general expenses due or accrued fluctuates based on the timing of the accounts payable process and payment to various vendors, and it has no direct impact on the RBC calculation. The liability for accrued postretirement benefit obligation relates to the annual actuarial valuation of BCBSVT's employee retirement benefit programs, the most significant of which is a defined benefit pension plan. When this liability increases, it results in a corresponding reduction in policyholder reserves that decreases the RBC numerator and therefore reduces BCBSVT's RBC calculation.

A portion of the increase in the postretirement benefit liability in 2020 was due to the movement of certain assumptions for the year-end actuarial valuation of the pension plan, the most significant of which was a 62 basis point decline in the discount rate used to calculate pension liabilities. A lower discount rate, which is an actuarial factor that is determined based on statutory accounting guidance, results in a higher calculated liability.

The remainder of the increase in the postretirement benefit liability in 2020 was due to losses in asset value during the year. BCBSVT participates in the National Retirement Trust (NRT) administered by the National Employee Benefits Committee (NEBC) of the Blue Cross and Blue Shield Association (BCBSA). The NRT holds funds from separate pension benefit programs of several Blues organizations, and it invests assets according to investment policies adopted by the NEBC based on the recommendation of the Committee's investment advisors. As a participant in the NRT, BCBSVT is allowed to specify its pension asset allocation between generalized asset classes, but it is not able to choose specific investments or asset managers within the asset classes. The NRT experienced a substantial decline in value in February and March of 2020 due at least in part to the poor performance of assets invested in funds managed by Allianz Global Investors. These losses are distinct from the general market losses that occurred at the onset of the COVID-19 pandemic. The NEBC has filed a lawsuit against Allianz Global Investors U.S. LLC and Aon Investments USA Inc. seeking damages for participating plans, including BCBSVT. While BCBSVT hopes for a successful resolution of this litigation, the defendants strongly dispute any responsibility for the losses, and it is anticipated that the process could take several years. In the meantime, management is committed to steadily restoring the funded status of the pension plan to a level that ensures no restrictions or limitations on the benefit plan options offered to participants.

c. *From 2019 to 2020, BCBSVT's "general administrative expenses" increased by $7,831,114 (33.7%). Is it correct that one driver of this growth was an increase of $9,630,603 (469.3%) in BCBSVT's "regulatory authority licenses or fees?" Please describe the source of the increase in the "regulatory authority licenses or fees" line item.*

The net increase in general administrative expenses in 2020 was driven by the increase in regulatory authority licenses and fees, which in turn was almost entirely driven by the "Annual Fee on Health Insurance Providers," also referred to as the "Health Insurer Tax" (HIT). The HIT fee was created as part of the Affordable Care Act (ACA), and it was intended to be assessed on an annual basis to all health insurers. However, in certain years Congress has suspended the HIT, including in 2019. Thus, consistent with all other health insurers in the U.S., BCBSVT was not assessed a HIT fee in 2019. In 2020, when Congress reinstated the HIT fee, BCBSVT was assessed a HIT fee of $9,633,791, of which $9,455,936 is included in the regulatory authority licenses and fees total of $11,682,611 that is reported on page 14, line 23.3, column 3 of the annual statement (the remaining $177,855 balance of the 2020 HIT fee was incurred by BCBSVT's HMO subsidiary, The Vermont Health Plan, LLC). As of now, the HIT fee has been repealed and will not be assessed after 2020.

d. *From 2019 to 2020, BCBSVT reported a reduction of $2,731,567 (46.3%) in "net investment gains." Is it correct that this is not due to poor investment performance in 2020 but rather the fact that BCBSVT's did not realize investment gains experienced in 2020? If so, please explain the reason(s) for not realizing investment gains in 2020 and how you incorporated this dynamic into your assessment of your need for additional reserves. If this is not true, please explain the drivers of the experienced reduction in reported "net investment gain."*

   Approximately $2.2 million of the reduction in BCBSVT's statutory basis net investment income from 2019 to 2020 was due to lower net "realized" capital gains in 2020. The recognition of realized gains is in accordance with statutory accounting and reporting guidance, but it has virtually no net impact on policyholder reserves.

   Generally, realized capital gains are created when assets are sold at a price that is higher than what was originally paid for them; the difference between the amount received from the sale and the amount paid when purchased is recorded as a realized gain. The higher sale price typically reflects that the asset has appreciated in value since the time it was acquired. For equity securities, which comprise the vast majority of realized gains reported in BCBSVT investment income, the appreciation in value is recorded in policyholder reserves as it occurs based on stock market prices that are known each day. While an equity security is being held in the portfolio, the appreciation in value is recorded as an "unrealized" gain that directly increases policyholder reserves. The sale of the equity security turns the unrealized gain into a "realized" cash gain that is reported in the income statement; however, because the unrealized gain was previously recorded, the transaction to "realize" the gain has virtually no net impact on policyholder reserves (except to the extent that the sale price is slightly different from the most recently recorded unrealized amount). The amount of gains (or losses, in some instances) realized from the investment portfolio can fluctuate greatly from year to year based on operating cash needs and the related transfer of assets back and forth between cash and the investment portfolio.

2. *In last year's Association Health Plan (AHP) filing (GMCB0-004-20rr), BCBSVT estimated that approximately 50% of its administrative costs were fixed. In its current filing, BCBSVT estimates that approximately 70% of administrative costs are fixed.*

   a. *Is the above-detailed increase in BCBSVT's estimated percent of administrative costs that are fixed driven solely by enterprise-level enrollment changes? Are there other drivers of the estimated change in fixed versus variable administrative costs?*

      The percentage of administrative costs that are fixed is immaterially impacted by enrollment changes. The difference from the previous filing in the estimated proportion of fixed administrative costs is the result of a new study performed by the actuarial department with input from the finance department. The study was conducted specifically in order to refine this assumption for filing, financial statement and market strategy purposes. The revised approximation of 30 percent variable cost is better aligned with historically observed changes associated with onboarding or offboarding jumbo group customers.

b. *In its actuarial memorandum, BCBSVT notes a correlation between the enterprise total number of covered lives and the percent of administrative costs that are fixed versus variable. Please describe the extent of this correlation. For example, the correlation might be that, on average, a 1% decrease in covered lives is correlated with a 10% increase in the percentage of total administrative costs that are fixed. Also, what is the approximate lag between enrollment changes and BCBSVT's ability to "right size" its workforce?*

The actuarial memorandum notes a correlation between enterprise membership and the portion of fixed costs that are borne by a given block of business, not the overall proportion of fixed vs. variable costs. The proportion of variable cost is measured by assessing the increase in administrative costs required by an increase in membership. This proportion, about a 3 percent increase in administrative expense for every 10 percent increase in membership, is immaterially correlated with baseline enterprise membership.

The lag between enrollment changes and BCBSVT's ability to "right size" its workforce can vary greatly depending on a variety of factors, including but not limited to the magnitude of the enrollment change, enrollment projections for the following year, the status of the labor market and success in recruiting efforts, known retirements or other attrition within the existing workforce, and other efficiency and/or investment initiatives in progress that may impact the size of the workforce in either direction. BCBSVT manages the size of its workforce based on long term enrollment expectations and does not overreact to enrollment changes that are projected to be temporary or short-term. It is often not cost effective overall to contract the workforce when enrollment declines if it is expected that enrollment will rebound the following year; similarly, it may not be prudent to increase the workforce in response to enrollment gains if offsetting losses are projected to follow.

For material enrollment losses that are not projected to be replaced within 12 – 24 months, right sizing is a thoughtful and deliberate exercise that is accomplished through attrition and managing out low performers whenever possible. This process can take several months to complete.

Please let us know if you have any further questions, or if we can provide additional clarity on any of the items above.

Sincerely,

Paul A. Schultz

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