Group Hospitalization and Medical Services, Inc.

REBUTTAL REPORT RESPONDING TO APPLESEED'S SUPPLEMENTAL REPORT

DISB Review of GHMSI Reserves Pursuant to the
Medical Insurance Empowerment Amendment Act,
D.C. Code § 31-3506 *et seq.*

September 30, 2010

INTRODUCTION

On August 6, 2010, the Commissioner of the Department of Insurance, Securities, and Banking ("DISB") issued an Order ("2010 Order") reopening the record in her review of the reserves of Group Hospitalization and Medical Services, Inc. ("GHMSI") for the express purpose of "obtaining information regarding the financial impact of the Federal Health Reform Acts on GHMSI." 2010 Order at 25, ¶ 1. On September 3, GHMSI submitted a Supplemental Report on Effects of Federal Health Care Reform ("2010 GHMSI Report").

On September 20, the D.C. Appleseed Center for Law and Justice, Inc. ("Appleseed") responded with a 45-page, single-spaced Supplemental Report on the Effects of Federal Health Care Reform and Rebuttal Statement ("2010 Appleseed Report") that is in large part non-responsive to the Commissioner's 2010 Order and, moreover, mischaracterizes the 2010 GHMSI Report and misstates critical facts regarding Federal Health Care Reform ("FHCR") and other issues. Indeed, less than half of the 2010 Appleseed Report actually addresses FHCR. The majority of the submission seeks to revisit a broad range of topics that already have been the subject of extensive briefing and testimony by the participants in this proceeding over the course of the last year. Rather than revisit every one of these topics, we limited our comments to addressing only the most serious of the errors and misstatements strewn throughout the 2010 Appleseed Report.

I. APPLESEED MISCONSTRUES GHMSI'S SUPPLEMENTAL REPORT AND MISINTERPRETS FHCR AND ITS ROLE IN THE EXPERTS' ANALYSIS.

A. GHMSI Seeks Neither To Raise Its Reserves Target Nor To Postpone The Reserves Inquiry.

Much of Appleseed's analysis of the impact of FHCR is based on a misunderstanding of the 2010 GHMSI Report. Appleseed mistakenly contends that "GHMSI has asked the Commissioner to raise the company's allowable surplus." 2010 Appleseed Report at 1. GHMSI has done no such thing. Rather, GHMSI has provided evidence that "while the precise upward shift in [its] risk profile and reserve requirements" due to FHCR "may not be calculable for some months or even several years," there will indeed be such an upward shift because FHCR will (i) create new expenses for insurers, (ii) limit their ability to recover costs, and (iii) create "massive" market uncertainty, which itself increases risk. 2010 GHMSI Report at ii, 1-10, 15. Thus, instead of calling for an immediate upward adjustment of GHMSI's reserve target above the levels the analysts previously calculated, the company has suggested – accurately – that the looming financial risks, and the likelihood that they have increased GHMSI's reserves needs, underscore the already overwhelming evidence that the company's reserves are not "excessive." *See id.* at 15.

To put the matter another way: GHMSI's reserves were not excessive even absent the new risks created by FHCR; these new risks simply are additional factors which demonstrate conclusively the GHMSI's reserves are not excessive. GHMSI therefore has suggested that the

Commissioner should conclude her present inquiry and undertake a new evaluation "once the financial impacts of reform are better understood and quantifiable." *Id.*

This suggestion bears little resemblance to the straw man against which Appleseed directs its argument. And GHMSI's fundamental point – that FHCR has introduced uncertainty and therefore risk – is far from controversial. The U.S. Secretary of Health and Human Services has described the FHCR as "the biggest expansion in health care coverage since Medicare . . . and the most ambitious health care innovation legislation I've ever seen, all rolled into one."[1] Appleseed itself acknowledges that "FHCR requires sweeping changes to the U.S. health care system." 2010 Appleseed Report a 3. Precisely right.

B. Appleseed's FHCR Analysis Appears To Misinterpret The New Laws And The Extent To Which They Have Been Accounted For In Milliman's Model.

While much of Appleseed's analysis is non-responsive and reveals a fundamental misunderstanding of the thrust of the 2010 GHMSI Report, a few errors in particular bear notice:

First, Appleseed claims that Milliman's model "already accounts for potential risks associated with FHCR" and insists that adjusting GHMSI's reserves target to account for such risks would "double count" the effects of FHCR. 2010 Appleseed Report at 5, 9-10. Appleseed states, in part, "[a]s Invotex's analysis expressly confirms, Milliman's model, which Rector also adopts, already accounts for potential risks associated with FHCR." *Id.* This is inaccurate. Milliman's December 2008 report did not purport to incorporate the full range of potential risks associated with FHCR, but rather identified reform as a "[c]onsideration[] for the [f]uture," "warrant[ing] ongoing attention and vigilance with regard to GHMSI's need for surplus." Milliman December 2008 Report at 29.[2] The other analysts involved in this proceeding recognized as much. In its report issued in October 2009 ("Invotex Report"), Invotex expressly stated, "[Milliman] represented to us that if they were to update their studies today, they would include a greater provision for [FHCR] risk than they did when they performed their most recent studies . . . in late 2008." Invotex Report at 60.[3] Invotex ultimately found the outcome of FHCR "too

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[1] Speech by Secretary Kathleen Sebelius (Apr. 6, 2010), available at http://www.hhs.gov/secretary/about/speeches/sp20100406.html.

[2] Though Milliman indicated at the hearing that it took some account of the risk involved in "respon[ding] to legislation" generally, Sept. 10, 2009 Hearing Tr. at 58-59, Milliman did not claim to – and was in no position to – factor into its analysis the full implications of FHCR legislation in particular. That legislation was only in proposed form and remained in flux at the time of the September 2009 hearings. Even today, the effects of FHCR remain too uncertain to quantify. In its supplemental report provided to the Commissioner as part of the 2010 GHMSI Report, Milliman explicitly stated that it would be "impossible to quantify currently" the effect that FHCR will have on GHMSI's reserves requirements. 2010 GHMSI Report, Attachment A at 3.

[3] Appleseed quotes the Invotex Report out of context, claiming that the Milliman model provides for FHCR. In fact, the Invotex Report merely states that the Milliman model includes "*some* provision" for

unpredictable" to quantify and expressly cautioned that "depending on the ultimate outcome [of FHCR], CareFirst and the MIA may need to revisit the indicated targeted surplus ranges earlier than may have otherwise have been necessary." *Id.* The report issued by Rector & Associates, Inc. ("Rector Report"), which Appleseed adopts and describes as "careful analysis,"[4] echoed these points:

> [T]he analyses performed by all of the consultants, *including R&A*, sought to measure GHMSI's surplus needs as of December 31, 2008. However, there have been very significant changes in the District and US regulatory frameworks since that time that will have a significant impact on GHMSI's future operations and results. *The analysis performed by all of the consultants, including R&A, did not attempt to incorporate or measure the effect of such changes on GHMSI's surplus.*

Rector Report at 10 (emphasis added). The Commissioner herself acknowledged these facts in her 2010 Order. As she explained, "[t]he impact of the Federal Health Reform Acts and their implementing regulations on the health insurance market and on health insurers and all participants in the health insurance markets are expected to be unprecedented, extremely significant, and are not fully known." 2010 Order at 16, ¶ 30. She appropriately found that "the actuarial work included in all of the expert consultant analyses would need to be adjusted to accommodate the reform." 2010 Order at 24.

In sum, contrary to Appleseed's contentions, the unknown financial impacts of FHCR have not been – and indeed could not have been – fully incorporated into the ranges proposed by Milliman or any of the other experts.[5] The Commissioner is correct to take notice of the financial risks posed by FHCR and to proceed with caution in the face of these risks.

Second, Appleseed focuses on certain programs under FHCR that may result in "upside benefits" for GHMSI. 2010 Appleseed Report at 7-9. Appleseed misses the point. GHMSI has provided extensive evidence regarding potential downsides. It is impossible to know, at this early stage, the extent to which the downsides of FHCR will trump supposed benefits. Though many believe that the downsides ultimately will trump the benefits, the uncertainty itself creates risk. And risk is precisely what reserves are intended to guard against.

Third, Appleseed states that "[i]t is premature to adjust GHMSI's surplus level in this proceeding for changes not yet scheduled to take effect until 2014 or later." 2010 Appleseed

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events such as FHCR that could "produce losses to the companies." Invotex Report at 52 (emphasis added).

[4] 2010 Appleseed Report at 2.

[5] As the Lewin Group explained, "[t]he exact quantification of the impact [of FHCR] is obviously a complex problem and will not be fully known in the timeframe established by the DISB order." 2010 GHMSI Report, Attachment B at 5.

Report at 5. Of course, as already discussed, GHMSI has not suggested that its reserves level be "adjust[ed] . . . in this proceeding" to account for FHCR. *Id.* But in fact, several significant provisions of FHCR go into effect in this year and next:

- Patient Protection and Affordable Care Act ("PPACA") § 1001 (prohibiting lifetime coverage limits, restricting annual limits, prohibiting rescissions in many circumstances, requiring coverage of preventive services without cost-sharing, and extending dependent coverage).
- PPACA § 1201 (prohibiting certain pre-existing condition exclusions).[6]
- PPACA § 1251 (guaranteeing certain members continued existing coverage).
- PPACA § 2718 (requiring health insurers to meet Medical Loss Ratio thresholds of 80% in the small group and individual market and 85% in the large group market and contemplating rebates of premiums to members if those thresholds are not met).

Fourth, Appleseed claims that the "the U.S. Department of Health and Human Services (HHS) has yet to issue implementing regulations . . . ." 2010 Appleseed Report at 3. To the contrary, HHS already has promulgated a number of implementing regulations, including regulations regarding pre-existing conditions, internal claims and appeals and external review processes for group health plans and health insurance coverage in the group and individual markets, and dependent coverage for children up to the age of 26.[7]

C. Premium Rate Increases Cannot Substitute For Adequate Reserves.

Appleseed argues that any "cost increases owing to FHCR can and will be fairly addressed through premium adjustment," rather than through the use of reserves. 2010 Appleseed Report at 17; *see also id.* at 10. Appleseed further suggests that any rate increases would be modest and cites a recent statement by GHMSI for the proposition that FHCR may result in "rate increases of 2% to 6%." *Id.* at 3.

As an initial matter, Appleseed's "facts" are misleading. For example, Appleseed refers to anticipated rate increases of 2% to 6%. But Appleseed fails to mention that GHMSI's rough estimate was limited to accounting only for the predicted "short run" effects of FHCR.[8] In any event, Appleseed's analysis is flawed for several important reasons.

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[6] At one point in its submission, Appleseed states that a prohibition on pre-existing exclusions will not go into effect until 2014. 2010 Appleseed Report at 13. But as Appleseed elsewhere seems to acknowledge, some aspects of that prohibition already have taken effect. *See* PPACA § 1255; 2010 Appleseed Report at 11.

[7] *See* http://www.healthcare.gov/center/regulations/index.html.

[8] *Health care reform? Not the costs*, Baltimore Business Journal, Sept. 9, 2010, available at http://www.bizjournals.com/washington/blog/2010/09/health_care_reform_not_the_costs.html.

Most importantly, Appleseed repeats the fallacy that only cost increases driven by FHCR are relevant to the reserve question. That is not accurate. The primary reason that FHCR is overwhelmingly likely to drive reserve needs upward, at least in the short and medium term, is not that the legislation creates known new costs but rather that it creates massive *uncertainty*. Some costs may be recouped through premium adjustments – at least in theory. Uncertainty cannot; it is exactly what reserves are designed to protect against.

Indeed, the rough estimates ("2% to 6%") to which Appleseed misleadingly refers were predicated on GHMSI's *current* reserve levels. But as GHMSI has explained repeatedly, the company uses earnings from its reserves to help moderate the need for premium increases for its individual and small group plans. Sept. 10, 2009 Hearing Tr. 33:15-22; GHMSI Post-Hearing Brief, Attachment 2 at 3, 13-14. Thus, it is incorrect to say that GHMSI's reserves could be set to a low target and that the company could still expect only small premium increases due to "short run" FHCR effects. A reduction in GHMSI's reserves would leave less income-generating capital available, GHMSI Post-Hearing Brief, Attachment 2 at 14, and the need for premium increases would accelerate accordingly.

Most importantly, there is no guarantee that GHMSI will be able to obtain the rate increases it needs to maintain stability. Appleseed argues that recent rate-review reform at the local and federal levels should not affect insurers' ability to obtain the necessary approvals,[9] but experts in the field believe otherwise. The Rector Report, for example, expressly acknowledged that recent rate-review legislation in the District will have a tangible impact on GHMSI's future financial position:

> It is clear that these reductions in, and caps on, GHMSI's allowable rate increases will impact GHMSI's future financial position. Such reductions and caps were not factored into the actuarial analysis work performed and reviewed in connection with our Report. Accordingly, the actuarial analysis work performed by all of the consulting firms involved, including the work performed by Milliman and R&A, would need to be adjusted to reflect the fact that these limits now exist.

Rector Report at 10. As the Lewin Group explained, "[s]urplus is needed" to offset the impact of pricing errors that may result from these rate caps or restrictions. Lewin FHCR Report at 4.

GHMSI's reserves play a crucial role in helping the company to moderate rate increases and recover from pricing errors. A reduction in reserves at this time – particularly in the face of the financial uncertainty posed by FHCR and rate-review reform – could have significant, undesirable consequences down the road. And such consequences would fall on the backs of the company's current and prospective subscribers.

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[9] *See* 2010 Appleseed Report at 14-17.

II. APPLESEED'S PROPOSED RBC-ACL MAXIMUM IS AT ODDS WITH THE MIEAA AND THE EXPECTATIONS OF CONSUMERS.

Appleseed's proposed maximum RBC-ACL of 600% is also flawed. Appleseed argues that 600% – the *low*-end target as determined by Rector – must be the *maximum* permissible level of reserves because the Medical Insurance Empowerment Amendment Act's ("MIEAA's") "community health reinvestment" language requires that result. The argument is erroneous. The overwhelming weight of the evidence supports a bottom point of the RBC-ACL target range *higher* than the 600% identified by Rector. For example, the Maryland Insurance Administration ("MIA") adopted the Invotex range (700% to 950% RBC-ACL) as the "appropriate surplus range[]" for GHMSI, and the Commissioner herself noted that the ranges calculated by the four experts whose reports she considered all included "750% to 850% as a subset." 2010 MIA Order at 8-9; 2010 Order at 20.[10] But even if Rector's range were adopted by the Commissioner, there is no reason in law or logic to ignore its conclusion that 850% is a reasonable RBC-ACL target. Rector Report at 4-5.

Appleseed bases its argument on the notion that MIEAA requires the adoption of an RBC-ACL range's low end. The MIEAA provides that after the hearing, the Commissioner can only find GHMSI's reserves to be "excessive" if (i) she finds that the reserves are "unreasonably large" ***and*** (ii) she determines that the reserves are "inconsistent with the corporation's obligation" to engage in statutorily-defined community health reinvestment. D.C. Code § 31-3506(e). As in its past submissions, Appleseed misconstrues the statute, focusing almost exclusively on the second prong of the inquiry and arguing that the "unreasonably large" finding should be driven by and should reflect the "overarching obligation" to engage in community health reinvestment. 2010 Appleseed Report at 37 & n.172. This is impermissible. The Commissioner must separately address each of the two inquiries required under the statute: First, are GHMSI's reserves "unreasonably large"? Second, are they also "inconsistent with the corporation's obligation" to engage in statutorily-defined community health reinvestment? Only if the evidence demonstrates that the answers to both questions is "yes" could GHMSI's reserves be deemed excessive. It is well-established that when "two requisites are joined by the conjunctive 'and', . . . both are necessary." Orlans v. Orlans, 238 F.2d 31, 32 (D.C. Cir. 1956). Appleseed's approach would "read . . . language out of [the] statute," and "[a]n

[10] Contrary to Appleseed's contentions, in determining whether GHMSI's reserves are "unreasonably large," it is essential that the Commissioner select an RBC-ACL *range* rather than a single target. As GHMSI and the experts have explained throughout this proceeding, reserves swing up and down as claims are incurred, as expenses (both planned and unforeseen) arise, and as investment markets fluctuate. GHSMI Post-Hearing Report, Attachment 2 at 6; *see also* GHMSI Post-Hearing Report, Attachment 3 at 20 (Lewin Group: "Observations of most health care insurers suggest that surplus levels can be quite volatile."). If the Commissioner were to follow Appleseed's suggestion, requiring GHMSI to set its reserves at 600% RBC-ACL, GHSMI could find itself well below that ratio within a matter of months or even weeks – raising the probability of regulatory intervention to an unacceptable level.

interpretation of the statute that nullifies some of its language is neither reasonable nor permissible." Goba v. District of Columbia Dep't of Employment Servs., 960 A.2d 591, 594 & n.8 (D.C. 2008); *see also* GHMSI Post-Hearing Brief, Attachment 2 at 4-6.

III. RESERVES WERE CREATED BY AND BELONG TO GHMSI'S SUBSCRIBERS AND SHOULD NOT BE ALLOCATED BASED ON THE LOCATION OF THEIR EMPLOYERS.

Finally, Appleseed contends that GHMSI's "surplus should be attributed based on the jurisdiction in which the insurance policy was written." 2010 Appleseed Report at 41. This argument already has been addressed and refuted at length in the 2010 GHMSI Report and GHMSI's prior submissions in this proceeding. But a few points merit brief discussion.

First, contrary to Appleseed's claim,[11] GHMSI's reserves *are* "caused by" and *do* "belong to" GHMSI's subscribers, rather than their employers. Individual subscribers, of course, pay their premiums themselves; thus to the extent GHMSI's reserves derive from those premiums, they are completely "caused by" the subscribers. Even in group policies, employees contribute close to 50% of the premiums out of pocket, on average, and the other 50% represents an employment benefit that is provided to employees as part of their compensation for work they do. GHMSI Post-Hearing Brief, Attachment 4, Ex. B. It is just fundamentally wrong to suggest that premium payments are not "caused by" GHMSI's subscribers. And in any event, as the Kansas Supreme Court has recognized, reserves derived from group policies belong to the subscribers rather than to their employers because the subscribers created the reserves by "filing fewer and/or smaller claims than were anticipated" when the insurer set the premiums:

> Regardless of whether the teachers [i.e., the subscribers] or the District [i.e, their employer] actually paid for the group health insurance, there is no dispute that the divisible surplus was created by the actions of the subscriber-teachers in filing fewer and/or smaller claims than were anticipated when BCBS set the premiums. The divisible surplus is wholly a product of their actions rather than anything that may be attributed to the District. . . . We conclude that in the absence of a contract provision addressing the rights of the parties in this situation, those whose conduct generated the refund, the teachers, are entitled to the refund [of surplus].

NEA-Coffeyville v. *Unified School District No. 445*, 996 P.2d 821, 832 (Kan. 2000).

Second, as discussed in the 2010 GHMSI Report and contrary to Appleseed's contention,[12] the Commissioner has *not* determined that 69% of GHMSI's reserves are

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[11] 2010 Appleseed Report at 43-44.

[12] 2010 Appleseed Report at 41.

attributable to the District. Her 2010 Order merely recounts certain findings in the Rector Report. 2010 GHMSI Report at 12.

Third, while Appleseed's situs-based analysis relies on determining the jurisdiction in which a "policy is issued," 2010 Appleseed Report at 41, that statistic is utterly irrelevant to the attribution procedure *required* by the regulations governing this proceeding. As explained in the 2010 GHMSI Report,[13] under the MIEAA's implementing regulations, reserves "attributable to the District" are derived by looking to: "(a) The number of policies by geographic area; (b) The number of health care providers under contract with the company by geographic area; and (c) Any other factor that the Commissioner deems to be relevant based on the record of a public hearing held pursuant to section 4602." D.C. Mun. Regs. Subt. 26-A, § 4699.2. According to Rector's findings, the two enumerated factors, averaged together, produce an attribution percentage of 21.6%.[14] (Notably, even this figure is higher than the 11.6% derived by the statutorily-mandated pure residency analysis.[15]) The Commissioner simply cannot allow data points expressly identified in the DISB's regulations to be trumped by irrelevant situs-related factors.[16]

In any event, Appleseed misconstrues the very factor upon which it purports to rely. Appleseed insists that an insurance policy is "issued or delivered" in the jurisdiction in which employers are located. 2010 Appleseed Report at 41-42. But the Commonwealth of Virginia recently reached the opposite conclusion, passing a statute that defined the jurisdiction in which polices are "issued or delivered" as the jurisdiction in which the individuals covered by those policies reside: "surplus attributable to residents of the Commonwealth . . . covered by policies *issued or delivered* either in the Commonwealth or in any other state [(which, in this context, includes the District of Columbia)] shall be based upon the *number of residents* in the Commonwealth compared with the number of residents in other states *covered by the policies*

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[13] 2010 GHMSI Report at 10-12.

[14] We derive this figure by adding Rector's "policies by jurisdiction" and "providers by jurisdiction" figures together and dividing by two. *See* Rector Report at 18.

[15] *See* GHMSI Prehearing Report Exhibit A (p. 37 of PDF).

[16] The third factor identified in the regulation – "[a]ny other factor" – is a traditional "catchall" phrase. And "[u]nder the venerable interpretive canons of *noscitur a sociis* and *ejusdem generis*, the meaning of a catchall phrase is given precise content by the specific terms that precede it." *United States* v. *Phillips*, 543 F.3d 1197, 1206 (10th Cir. 2008) (citing, *inter alia*, *Norton* v. *South Utah Wilderness Alliance*, 542 U.S. 55, 62 (2004)); *accord Santa Fe Pacific R. Co.* v. *Secretary of Interior*, 830 F.2d 1168, 1175 (D.C. Cir. 1987) (under the canon of *ejusdem generis*, "the catchall provision should be read to include only rights similar in character to those conferred by the statutes enumerated"). Applied here, those canons forbid an interpreter to import, through the catchall phrase, a factor that would cause the result to deviate wildly from that produced by the enumerated factors. Such a factor would not be "similar in character" to those that the DISB explicitly enumerated in the regulation. *Santa Fe Pacific R. Co.*, 830 F.2d at 1175.

of the health services plan." Va. Code § 38.2-4229.2(C) (emphasis added). Once again, the residence of the subscribers rather than the location of their employers governs the attribution inquiry.[17]

Ultimately, for all of the reasons indicated in GHMSI's previous submissions, attribution should be determined based on the residency of the subscribers covered by GHMSI's policies. Appleseed's arguments to the contrary are at odds with the plain language of the MIEAA and its implementing regulations.

CONCLUSION

The Commissioner now has before her a mountain of data on GHMSI's reserves. This data points directly to the conclusion that GHMSI's reserves are not excessive. In its recent submission, GHMSI has established that the company's reserve needs almost certainly have increased as a result of FHCR. Appleseed has failed to introduce any evidence to the contrary.

[17] Appleseed also misleadingly suggests that a new Maryland law, Md. Code, Ins. § 14-124, reinforces its situs-based approach to attribution. 2010 Appleseed Report at 42. In fact, the new Maryland law expressly authorizes the Maryland Insurance Commissioner to "determine whether the impact [of another jurisdiction's laws] on the nonprofit health service plan is harmful to the interests of *subscribers covered by policies* issued or delivered in [Maryland]." Md. Code, Ins. § 14-124(a)(4) (emphasis added). Regardless of the definition of "policies issued," the focus, once more, is on the subscribers, not on their employers.