GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE, SECURITIES, AND BANKING

IN THE MATTER OF:	)	
Surplus Review and Determination Regarding Group Hospitalization and Medical Services, Inc.	)	Order No: 09-MIE-007

FINAL DECISION AND ORDER

By reference, this Final Decision and Order hereby incorporates the Decision and Order in this above-captioned matter dated August 6, 2010 ("August Decision and Order"), Order No. 09-MIE-006.

Background

The August Decision and Order reopened the Commissioner's Hearing record "for the purpose of the Commissioner obtaining information regarding the financial impact of the Federal Health Care Reform Acts on GHMSI [Group Hospitalization and Medical Services, Inc. ("GHMSI")] from GHMSI, interested persons, the Commissioner's Experts, and members of the public."[1] August Decision and Order at 25, ¶ 1. The August Decision and Order directed GHMSI to submit:

> Comprehensive information regarding the financial impact of the Federal Health Care Reform Acts on GHMSI, including the appropriate level of GHMSI's surplus and GHMSI's financial obligations arising in connection with the conduct of its insurance business. . . . GHMSI shall include written justification of

[1] For reference, the August Decision and Order refers to the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, and the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, collectively as the "Federal Health Care Reform Acts." August Decision and Order at 8. The August Decision and Order further refers to Rector and Associates, Inc. as the Commissioner's Expert.

> GHMSI's costs, if any, to comply with and implement the provisions of the Federal Health Care Reform Acts.

Id. at 25-26, ¶ 2.

The August Decision and Order further allowed the Commissioner's Expert and members of the public to submit any information regarding the financial impact of the Federal Health Care Reform Acts on GHMSI or rebut any information provided by GHMSI pursuant to the August Decision and Order. *Id.* at 26, ¶ 3.

In response to the August Decision and Order, GHMSI submitted a supplemental report dated September 3, 2010 ("GHMSI Reform Report"), regarding the financial impact of recent federal health care reform, including the appropriate level of surplus for GHMSI to meet its financial obligations. The GHMSI Reform Report included a September 1, 2010 report from Milliman, Inc., entitled "Impact of Federal Health Care Reform on GHMSI's Risk Profile and Optimal Surplus Targets" ("Milliman Reform Report") as a supplemental attachment. GHMSI also included a report from the Lewin Group ("Lewin") regarding the financial impact of federal health care reform ("Lewin Reform Report").

In response to the GHMSI Reform Report, including the supplemental reports from Milliman and Lewin, the Commissioner's Expert submitted its rebuttal report dated September 20, 2010 ("Rector Reform Rebuttal").

Additionally, the D.C. Appleseed Center for Law and Justice, Inc. ("D.C. Appleseed") submitted a "Supplemental Report on the Effects of Federal Health Care Reform and Rebuttal Statement," dated September 20, 2010 ("D.C. Appleseed Reform Report"). On September 30, 2010, GHMSI submitted a rebuttal report ("GHMSI Reform Rebuttal Report") to the D.C. Appleseed Reform Report.

The Commissioner did not receive submissions from any other party.

Findings of Fact

After full consideration of all reports and other submissions in the record for this matter, the Commissioner makes the following findings of fact:

A. GHMSI's Federal Health Care Reform Acts Submissions

1. The GHMSI Reform Report stresses that before interpretive regulations and guidance are issued, the full financial impact of federal health care reform will remain unknown. However, the report emphasizes that the reforms will certainly have a negative financial impact on GHMSI and increase GHMSI's operating risks and costs. Accordingly, citing the supplemental Milliman Reform Report and Lewin Reform Report, the GHMSI Reform Report calls for increased surplus needs of an additional 100-200% Risk-Based Capital Authorized Control Level ("RBC-ACL"), at a minimum. GHMSI Reform Report at 4-5.

2. GHMSI anticipates that the most significant "downside risk" is the new minimum medical loss ratio requirement which requires GHMSI to achieve a minimum medical loss ratio of at least 85% for large group plans (100+ employees), and 80% for small group and individual plans. *Id.* at 2, 4. Any loss ratio below the prescribed amount requires GHMSI to issue rebates to policyholders. Additionally, GHMSI contends that failure to meet the minimum medical loss ratio may increase GHMSI's tax rate from the Alternative Minimum Tax level of 20% to the 35% corporate rate. *Id.* at 2. A further complication is that regulators have not indicated how community giving and charitable donations will be included in calculating the minimum medical loss ratio. *Id.* at 3. Thus, GHMSI does not know how it must account for the $5 million in annual grant monies it must contribute to the Healthy D.C. Fund, the $500,000 to an annual grant to cover senior wellness programs, or the losses it incurs from the mandated D.C. Open Enrollment program (estimated loss for 2010 is $3 million). *Id.* at 3.

3. The GHMSI Reform Report also includes a "response" to the Commissioner's Expert's Report ("Rector Report") and makes "clarifying observations" regarding the findings in the August Decision and Order. *Id.* at 12-14.

4. GHMSI states that it intends to engage consultants to perform a new analysis of "optimal and appropriate surplus ranges" before the end of 2011 to update its target reserve range to reflect the impact of federal reform. *Id.* at 15.

5. The Milliman Reform Report limits its analysis to an approximately five-year horizon and does not account for the impact of anticipated reforms that are not scheduled to occur until after the next five years, i.e., the expansion of the definition of small group. However, its analysis takes into account current non-actuarially-based considerations, such as the Commissioner's four orders from March and April 2010 limiting premium rate increases. Milliman Reform Report at 1.

6. The Milliman Reform Report identifies five potential "upside impacts" of federal health care reform: (1) the potential for more customers beginning in 2014 due to the individual mandate; (2) potentially higher revenue per customer because of enhanced benefits due to the imposition of new benefit minimums, expanded coverage for preventive services, and the elimination of lifetime maximums; (3) growth opportunities resulting from changes in the competitive market and Medicaid expansion; (4) potentially simplified administration and distribution channels through exchanges; and (5) opportunities to benefit from reduced health care cost trends. *Id.* at 2-3.

7. Nevertheless, the Milliman Reform Report also identifies eight substantial "downside risks": (1) the financial impact of minimum loss ratio requirements; (2) additional rate reviews at both local and national levels with the potential for arbitrary caps; (3) increases in

rates for enhanced benefits that may result in additional lapsation and/or adverse selection; (4) required guaranteed issue in the individual market with no ability to exclude preexisting conditions; (5) restrictions and prohibitions on rating variations for individual and small group markets resulting in subsidization of higher cost risks; (6) adverse selection in decision making by individuals and groups choosing between current "grandfathered" plans and replacement plans subject to new benefit and pricing standards; (7) "likely" shift from employer-sponsored group to Medicaid and individual coverage, enrollment turnover with attendant adverse selection and unstable insurance risk pools; and (8) increased cost of compliance coupled with pressure to constrain administrative costs. *Id.* at 3.

8. The Milliman Reform Report notes that the reforms include reinsurance and risk adjustment provisions but concludes it is not clear how much relief those provisions will provide. *Id.*

9. The Milliman Reform Report concludes that federal health care reform results in an environment of "[u]ncertainty coupled with major limitations on how carriers are allowed to manage risk." *Id.* Consequently, Milliman contends that it would be imprudent to intentionally decrease GHMSI's surplus or target surplus. The Milliman Reform Report opines: "[w]hile it is impossible to quantify currently, it is our belief that surplus requirements have increased materially, at least 100 to 200% of RBC-ACL and quite possibly substantially more, as a result of the changes to the environment since we issued our report on an optimal surplus range for GHMSI (December, 2008)." *Id.* at 3-4.

10. The Lewin Reform Report responds to the Rector Report and findings and conclusions in the August Decision and Order. Lewin Reform Report at 2-3.

11. The Lewin Reform Report concludes that federal health care reform introduces more uncertainty in GHMSI's ability to maintain viable surplus levels while also adversely impacting its ability to react and recover. *Id.* at 3. Accordingly, the Lewin Reform Report contends that increased surplus holdings are necessary. *Id.* at 6.

12. The Lewin Reform Report identifies four risks adversely affected by federal health care reform and causing adverse RBC outcomes: (1) underwriting risk; (2) asset risk; (3) cost of capital and credit risk; and (4) operational and business risk. *Id.* at 3-5. The Lewin Reform Report emphasizes the importance of considering operational and infrastructure funding that will be necessary for GHMSI to remain a viable company. *Id.* at 5. Lewin argues that the other experts' failure to address this issue is an important shortcoming of their recommended RBC-ACL ranges. *Id.*

13. Similar to the Milliman Reform Report, the Lewin Reform Report concludes that while the exact quantification of the financial impact of federal health care reform is unknown, the need for additional surplus is certain. *Id.* at 5-6. Lewin estimates that GHMSI's required surplus will increase more than 10% (and perhaps significantly more) over the pre-reform levels previously modeled. *Id.* at 6.

14. GHMSI's Reform Report also attached Milliman's response to the Rector Report, which disputes several conclusions in the Rector Report.

B. Rector Reform Rebuttal

15. The Rector Reform Rebuttal discounts the comments and arguments in the GHMSI Reform Report, the Milliman Reform Report response to the Rector Report, and the Lewin Reform Report that are critical of the Rector Report. Rector Reform Rebuttal at 3-11.

16. The GHMSI Reform Report was critical of the Rector Report's assertion that the impact of federal health care reform on payers for health care is unclear. GHMSI Reform Report at 9. Instead, GHMSI contends that the effect, while unclear, is decidedly adverse to its financials and risk profile. *Id.* Rector's Reform Rebuttal clarified that it was not asked to analyze how federal health care reform might impact GHMSI and thus merely pointed out that the reform would alter the industry's operations in a way that could not be fully determined at this time and believed it was prudent not to speculate. Rector Reform Rebuttal at 12.

C. D.C. Appleseed Reform Report

17. The D.C. Appleseed Reform Report argues that federal health care reforms should not affect the determination of GHMSI's permitted surplus as of December 31, 2008, because reforms include provisions to help offset an insurer's increased risk profile and Milliman's original recommended range already accounted for any remaining risks. D.C. Appleseed Reform Report at 6-10.

18. D.C. Appleseed contends that the financial impact of reform is properly addressed through rate review and not surplus accumulation, especially because the most far-reaching and potentially costly reforms will not take effect until 2014. *Id.* at 10-17.

19. D.C. Appleseed further argues that GHMSI has not substantiated its request for a significant increase in surplus and that such request contradicts GHMSI's admission that it cannot quantify the impact of federal health care reform until the end of 2011 and that it has not made any attempt to adjust its surplus or rates in light of the reforms. *Id.* at 17-18.

20. Given the uncertainties and amount of time before significant measures of federal health care reform take effect, D.C. Appleseed contends that the Commissioner will have ample opportunity to review GHMSI's surplus in future rate and surplus review proceedings. *Id.* at 19.

21. GHMSI disputes D.C. Appleseed's contention that Milliman and other actuarial experts have already accounted for the impact of federal health care reform in their recommended surplus values. GHMSI Reform Rebuttal Report at 2-3.

22. Additionally, GHMSI dismisses the relevance of potential "upsides" of reform because it is not certain if those upsides will outweigh the downsides, and reserves are intended to guard against that very uncertainty. *Id.* at 3.

23. GHMSI also disputes D.C. Appleseed's arguments that the most far-reaching reforms will not go into effect until 2014 and the Department of Health and Human Services has yet to issue implementing regulations. *Id.* at 3-4. On the contrary, GHMSI cites several provisions that go into effect in 2010 and 2011, and notes that a number of regulations regarding pre-existing conditions, internal claims and appeals, external review processes, and dependent coverage for children up to the age of 26 have been issued. *Id.* at 3-4.

Conclusions of Law

In accordance with all applicable laws within the context of GHMSI's obligations under its Congressional charter, and based on a comprehensive record, including expert opinions, submissions, and testimony from GHMSI, D.C. Appleseed, and various other community members, in addition to the conclusions of law from the August Decision and Order which are incorporated herein by reference and made a part hereof, the Commissioner hereby concludes as follows:

1. The Parties Submitted Reports Beyond the Scope of the August Decision and Order.

The substance of GHMSI's, Milliman's, and Lewin's responses to the Rector Report and GHMSI's "clarifying observations" regarding the August Decision and Order are, to a great extent, outside the scope of the Commissioner's Order. *See* August Decision and Order at 25-26,

¶ 2. Although the August Decision and Order permits other parties, including the Commissioner's Expert and D.C. Appleseed, to respond to any materials GHMSI submitted pursuant to the August Decision and Order, the Commissioner's Expert and Appleseed submissions directly responding to non-federal health care reform matters are outside the intended scope of the August Decision and Order and its inquiry. *Id.*

The Commissioner had weighed the credibility of the various expert reports and within her statutory and regulatory discretion, as described in the August Decision and Order, made findings and conclusions on all issues raised by the GHMSI Reform Report except the impact of federal health care reform. The Commissioner's findings and conclusions in the August Decision and Order are supported by applicable laws and this matter's record, including all submissions received from experts, interested parties, and the public.

2. The Federal Health Care Reform Acts May Have a Financial Impact on GHMSI.

Although all submissions concede that the precise financial impact of Federal Health Care Reform Acts is not fully known at this time, the majority of expert opinions agree that the enacted legislation and forthcoming regulatory rules are likely to require GHMSI to maintain additional surplus. Milliman Reform Report at 3-4; Lewin Reform Report at 5-6. Milliman, Lewin, and D.C. Appleseed all identified potential financial benefits for GHMSI as a result of the Federal Health Care Reform Acts, but the experts also cautioned that the potential fiscal liabilities are significant. Milliman Reform Report at 2-3; Lewin Reform Report at 3-5; D.C. Appleseed Reform Report at 6-9.

Accordingly, the Commissioner concludes that the Federal Health Care Reform Acts may have a financial impact on GHMSI in the short term that warrants a higher level of surplus than would have been anticipated as of December 31, 2008.

3. GHMSI's Surplus is Not Excessive as of December 31, 2008.

GHMSI's surplus may only be "excessive" if the Commissioner determines that the surplus is "unreasonably large." *See* D.C. Official Code § 31-3506(e). According to Chapter 46, Title 26A of the District of Columbia Municipal Regulations, "unreasonably large surplus" is the amount in excess of the amount of surplus needed by the corporation to meet its expected and unanticipated contingencies. 216A D.C.M.R. § 4699.4.

As discussed in the August Decision and Order, in order for GHMSI to avoid a statutory action level event in the District, it must maintain an RBC-ACL ratio above 200%. *See* D.C. Official Code § 31-3506(d). If GHMSI falls below that same 200% level, GHMSI would lose its trademark rights associated with the Blue Cross and Blue Shield Association. Additionally, falling below the Blue Cross Blue Shield "Early Warning Monitoring" threshold (375% RBC-ACL ratio) triggers restrictions on GHMSI's operations and oversight by the Blue Cross and Blue Shield Association. While triggering the "Early Warning Monitoring" threshold for additional oversight and restrictions would not be immediately detrimental, the Commissioner finds that GHMSI's surplus as of December 31, 2008 must be sufficient to remain above the 375% RBC-ACL ratio threshold with a very high, but not extremely high, degree of likelihood. The Commissioner finds that it is important for GHMSI to maintain a 375% RBC-ACL ratio with a very high confidence level as of December 31, 2008. At the same time, the Commissioner also believes that other benchmarks could be considered for use in surplus reviews as of subsequent year-end periods that are performed when the impact of health care reform is more certain.

The Commissioner has taken into account all expert reports and submissions accepted into the record. Given the inherently subjective nature of some of the analyses, it is expected

that the experts disagree regarding certain assumptions and calculations. However, the experts are unanimous in using actuarial modeling methods, albeit with variations, for predicting future surplus needs. Further, the experts' findings have significant overlap with regard to the surplus necessary for GHMSI's operations, and to maintain an RBC-ACL ratio above 200% and 375% with the appropriate confidence levels as of December 31, 2008.

According to Milliman's calculations, an "optimal surplus target range" for GHMSI as of December 31, 2008 is a 750-1050% RBC-ACL ratio. The other expert reports corroborate that maintaining an 850% RBC-ACL ratio would result in an extremely high degree of likelihood that GHMSI would not fall below a 200% RBC-ACL ratio as of December 31, 2008. Thus, all four experts—including the two experts engaged by GHMSI—agree that an 850% RBC-ACL ratio would give GHMSI an extremely high degree of likelihood of not dropping below a 200% RBC-ACL ratio as of December 31, 2008. The work performed by Milliman and the Commissioner's Experts also leads to the conclusion that an 850% RBC-ACL would provide a very high degree of likelihood that GHMSI would not drop below a 375% RBC-ACL ratio as of December 31, 2008. Further, the work performed by Lewin and Invotex Group does not contradict this conclusion.

Although the initial expert reports did not account for the financial impact of the Federal Health Care Reform Acts, the supplemental reports received from Milliman and Lewin indicate that there is a large amount of uncertainty regarding the quantification of the financial impact of the reforms. While the experts and the Commissioner agree that health care reform may financially impact GHMSI on a short-term basis based on what is currently known about the reform requirements that impact GHMSI, the suggested increases in optimal RBC-ACL ratio levels made by Milliman and Lewin appear to be arbitrary and unsupported by actuarial data.

Accordingly, the Commissioner concludes that it would be inappropriate at this time to increase the RBC-ACL ratio level she has determined to be necessary for GHMSI as of December 31, 2008 (850% RBC-ACL). Rather, the Commissioner concludes that any adjustment to the RBC-ACL ratio level necessary for GHMSI should be made in conjunction with any subsequent surplus review of GHMSI that incorporates a more precise analysis of the financial impact of Federal Health Care Reform Acts.

For the reasons stated above, the Commissioner finds that the amount of surplus necessary for GHMSI to meet its expected and unanticipated contingencies as of December 31, 2008 is the surplus necessary to maintain an 850% RBC-ACL ratio.

Because GHMSI's RBC-ACL ratio at the end of 2008 was 845%, GHMSI's surplus is not in excess of the 850% RBC-ACL ratio required to meet its expected and unanticipated contingences. Therefore, the Commissioner concludes that GHMSI's surplus as of December 31, 2008 is neither unreasonably large nor excessive.

While GHMSI's surplus is not excessive as of December 31, 2008, the Commissioner observes that GHMSI's surplus as of December 31, 2009, as reported by GHMSI on March 3, 2010, was $761 million, which resulted in a 902% RBC-ACL ratio as of December 31, 2009. The $761 million surplus amount that resulted in a 902% RBC-ACL ratio would exceed the surplus necessary for an 850% RBC-ACL ratio that is required to meet GHMSI's expected and unanticipated contingences, as determined in this review. Accordingly, the Commissioner notes that there could be a finding of unreasonably large surplus as of December 31, 2009 or 2010 if all the assumptions underlying this review were to remain the same. However, the Commissioner concludes that a subsequent review of GHMSI's surplus will be required since many of the underlying assumptions of this review are expected to change, given the anticipated

impact of the Federal Health Care Reform Acts on GHMSI's operations. Moreover, the Commissioner expects federal agency rulemaking related to the Federal Health Care Reform Acts to continue to occur over the coming years, and accordingly, will undertake a *de novo* review of GHMSI's surplus in the future, at which time the assumptions and analyses used in the review can be adjusted, as appropriate.

4. The Commissioner Need Not Decide the Issue of Attribution at This Time.

Because the Commissioner finds that GHMSI's overall surplus as of December 31, 2008, is not excessive, the portion of GHMSI's surplus "attributable" to the District is also not excessive, regardless of how attribution is calculated. Accordingly, the Commissioner need not conclude which portion of GHMSI's surplus is attributable to the District at this time.

Order

Based upon the foregoing Findings of Fact and Conclusions of Law and the August Decision and Order, it is hereby ORDERED:

1. The amount of surplus determined hereunder as necessary for GHMSI to meet its expected and unanticipated contingencies is 850% RBC-ACL, as of December 31, 2008.

2. GHMSI's surplus of approximately $687 million, as of December 31, 2008, is not unreasonably large or inconsistent with the corporation's obligation under section 6a of the HMSCR Act (D.C. Official Code § 31-3505.01), and thus, is not excessive under the HMSCR Act.

3. Although GHMSI's surplus of approximately $761 million, as of December 31, 2009, exceeds the surplus necessary to maintain an 850% RBC-ACL ratio as of December 31, 2008, a *de novo* review of GHMSI's surplus will be necessary to determine if GHMSI's surplus as of any future year-end period is excessive since the conclusions drawn in the expert

consultants' reports regarding GHMSI's December 31, 2008, surplus do not accurately reflect the current regulatory environment and financial obligations of GHMSI.

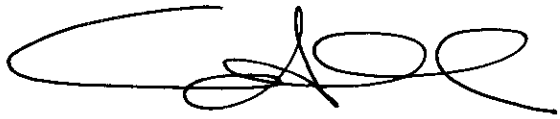
4. That in accordance with its obligation under Section 2 of the Medical Insurance Empowerment Amendment Act of 2008 (D.C. Official Code § 31-3506(e)), by July 31, 2012, with the benefit of the ongoing implementation of the Federal Health Care Reform Acts and the enactment and implementation of companion legislation in the District, the Commissioner will again review and reexamine GHMSI's surplus and determine whether its surplus is excessive.

5. The amount of surplus determined to be necessary for GHMSI in paragraph 1 of this section, expressed as an RBC-ACL ratio level, is based on the corporate structure of GHMSI as of December 31, 2008. Any change in GHMSI's surplus or its RBC-ACL ratio resulting from organizational changes after December 31, 2008, shall be recognized in any future review of GHMSI's surplus, and the Commissioner may adjust the RBC-ACL ratio level determined to be necessary for GHMSI under the HMSCR Act as a result of those organizational changes.

SO ORDERED:

This 29th day of October, 2010.

Approved and so Ordered:
In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department in the District of Columbia, this 29th day of October, 2010.



Gennet Purcell
Commissioner