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March 25, 2015

The Honorable Chester A. McPherson, Acting Commissioner
D.C. Department of Insurance, Securities and Banking
810 First Street NE
Suite 701
Washington, D.C. 20002

Re: In the Matter of Surplus Review and Determination of Group Hospitalization and Medical Services, Inc., Order No. 14-MIE-012 (D.C. Dep't of Ins., Secs. & Banking Dec. 30, 2014)

Dear Acting Commissioner McPherson:

On December 30, 2014, the Commissioner of the D.C. Department of Insurance, Securities and Banking, acting pursuant to the Medical Insurance Empowerment Amendment Act of 2008 ("MIEAA"), determined that the District-based affiliate of CareFirst—Group Medical and Hospital Services, Inc. (GHMSI)—has excessive surplus of $268 million. He also determined that 21% of this excess—or $56 million—is attributable to the District of Columbia.

On January 22, 2015, GHMSI moved the Commissioner to reconsider his decision, arguing, among other things, that the Commissioner's method of attributing surplus to the District did not comply with MIEAA. On January 28, 2015, the Commissioner denied this motion, and ordered GHMSI to file a plan by March 16 that would spend down the $56 million. He also directed GHMSI to ensure that the plan spends the $56 million on programs or activities that qualify as community reinvestments under MIEAA.

GHMSI's March 16 response did not comply with the Commissioner's order; instead, GHMSI's response did two things. First, it told the Commissioner it disagrees with his order and contended again, as it had in its reconsideration motion, that the Commissioner's attribution method is not in compliance with MIEAA. Second, the company offered two alternative reasons why it had already spent down the $56 million and that it therefore need not comply with the order.

GHMSI's March 16 response inappropriately disregards the Commissioner's procedures for the conduct of this surplus review, the most basic principles of administrative finality, the Commissioner's December 30 decision, his order denying reconsideration of that decision, and his order to file a $56 million spend-down plan. Every argument GHMSI now makes to justify its failure to file the requisite plan has already been considered and rejected by the Commissioner, and/or is a reversal of the position previously taken by GHMSI in these proceedings, and/or is an argument GHMSI could have made

earlier but did not. For GHMSI to continue to make such arguments serves only to prolong these proceedings and undermine the implementation of MIEAA.

Below we address GHMSI's three asserted justifications for failing to comply with the Commissioner's order to submit a spend-down plan: (1) the Commissioner erred in his approach to attribution; (2) GHMSI has already spent down the $56 million to address underwriting losses in the District; and (3) GHMSI has already spent down the $56 through community reinvestments in the District.

Because none of these contentions can justify GHMSI's failure to file the spend-down plan contemplated by MIEAA and ordered by the Commissioner, the Commissioner should not delay these proceedings any longer. Instead, he should proceed to develop a fair and equitable spend-down plan himself and seek public input in doing so, as the statute authorizes.

1. THE COMMISSIONER SHOULD NOT RE-OPEN THESE PROCEEDINGS TO CONSIDER GHMSI'S NEW ATTRIBUTION METHOD.

GHMSI's first asserted justification for failing to file the $56 million spend-down plan ordered by the Commissioner is that it has computed what the RBC for the company would be "[i]f the District's portion of GHMSI's surplus were truly on its own." *Plan of Group Hospitalization and Medical Services, Inc. Filed with the Department of Insurance, Securities and Banking Pursuant to December 30, 2014 Order No. 14-MIE-012* 4 (Mar. 16, 2015) [hereinafter GHMSI Plan]. According to GHMSI, "[i]t is likely that an appropriate target for a District only RBC would exceed 1,400 %." *Id.* at 6. And according to GHMSI, this means that the District-only portion of GHMSI had only $15 million of excess surplus as of the end of 2011, not $56 million as determined by the Commissioner. *Id.* at tbl.3.

Apart from the fact that it is not at all clear how GHMSI has derived its claim of a 1,400% RBC and a $15 million excess for a "District-only" company, the Commissioner should reject this claim for at least three reasons.

First, GHMSI made this same claim in its motion for reconsideration and the Commissioner denied the motion. GHMSI's insistence that the Commissioner reconsider his denial is simply out of order. And GHMSI in any event offers no reason why the Commissioner should reconsider the denial, much less that the company should be entitled to defy the Commissioner's order to file a spend-down plan by simply repeating an argument the Commissioner has already rejected.

Second, the claim GHMSI is now making for a "D.C.-specific" RBC is the complete opposite of the position it has consistently taken throughout these proceedings. As the Commissioner noted in his December 30 decision, all parties have recognized that as practical matter "in the first instance the surplus must be examined in its totality." *In the Matter of Surplus Review and Determination for Group Hospitalization and Medical Services, Inc.*, Decision and Order, Order No. 14-MIE-012 50 (D.C. Dep't of Ins., Secs. & Banking Dec. 30, 2014) [hereinafter December 30 Decision].

Indeed, as late as its October 10, 2014, response to the Commissioner's August 7, 2014, Third Scheduling Order requesting information, GHMSI took a completely different view of the attribution issue from what it is taking now, and it nowhere suggested that attribution should be based on a District-specific RBC. The first question the Commissioner posed in his August 7, 2014,

request was: "Please provide your recommendations regarding how the Commissioner should determine the amount of GHMSI's surplus that is attributable to the District." GHMSI's response was that "surplus cannot be subdivided by jurisdiction," and it attached as an exhibit a previous filing from Milliman explaining how the attribution would occur if one were done. *Group Hospitalization and Medical Services, Inc.'s Further Response to Questions in the Third Scheduling Order* 1 (Oct. 10, 2014).

That exhibit states that attribution to the District should be based on "a percentage" of the excess surplus determined for GHMSI as a whole, and that the percentage should be based on premiums attributable to the District, *id.* at exh. G at 1, which is of course precisely the method the Commissioner followed and is the exact opposite of what GHMSI now proposes.[1] It was therefore completely understandable and appropriate that, when GHMSI offered its new District-specific RBC argument for the first time in its reconsideration motion, the Commissioner rejected it saying: "The Commissioner does not believe it is the public interest, or an efficient use of public resources, to delay the filing of GHMSI's plan so that these proceedings may be reopened to hear new arguments that could have been briefed and argued previously." *In the Matter of: Surplus Review and Determination for Group Hospitalization and Medical Services, Inc.*, Order on GHMSI's Motion for Reconsideration and Coordinated Proceedings with Maryland and Virginia, and on D.C. Appleseed's Request for Briefing Schedule 2 (D.C. Dep't of Ins., Secs. & Banking Jan. 28, 2015). The same is true now, except it is two months later and GHMSI is further delaying the proceedings by repeating an argument that was untimely when made and that the Commission has already rejected.

Finally, we note that the entire premise of GHMSI's new argument is inconsistent with MIEAA itself and is contradicted by GHMSI's own March 16 filing. MIEAA provides that "In determining whether the surplus of the corporation that is attributable to the District is excessive, *the Commissioner shall take into account all of the corporation's financial obligations arising in connection with the conduct of the corporation's insurance business*[] . . . ." D.C. Code § 31-3506(f) (emphasis added). Moreover, not only does MIEAA itself recognize that the surplus attributable to the District must be assessed in the context of the financial condition of the company as a whole, but GHMSI itself acknowledges that that context will lower its surplus needs. As GHMSI says: "the District benefits from being incorporated into the far larger business operations of GHMSI in Virginia and Maryland because their larger size contributes to a relatively more stable and predictable risk environment *on which it is possible to hold a lower RBC level*." GHMSI Plan at 4 (emphasis added). Exactly so.[2]

GHMSI's belated argument that the District-based portion of GHMSI must be evaluated on a stand-alone basis is inconsistent with its previous positions, inconsistent with the statute, inconsistent with the Commissioner's rulings, and inconsistent with the actual facts, and it cannot justify its failure to file the spend-down plan ordered by the Commissioner. The argument should be summarily rejected.

2. GHMSI'S CLAIM THAT IT HAS ALREADY SPENT DOWN THE $56 MILLION IS COMPLETELY WITHOUT MERIT.

[1] Milliman and GHMSI both contended that the percentage of premiums should be based on residency, not site of the contract as the Commissioner determined, but neither Milliman nor GHMSI ever proposed that attribution should be based on a District-specific RBC.

[2] It is also of course true that GHMSI's Maryland and Virginia operations benefit for the same reason from their affiliation with the District. Scale economies and spreading of risk run both ways.

GHMSI offers two contradictory justifications for its claim that it has already spent down the $56 million ordered by the Commissioner. First, it says that it spent $56 million from surplus in 2012–2014 to cover significant losses GHMSI experienced in the District of Columbia. Alternatively, it says it voluntarily spent $56 million from surplus in the form of community reinvestments.

If GHMSI contended and had evidence to show that during 2012–2014 it had in fact spent down significant sums in the District devoted to community reinvestment, it could have made and supported that contention during the Commissioner's June 2014 hearing and/or in the company's post-hearing submissions to the Commissioner. But it did not do so. It should not be permitted do so now.

In any case, neither of GHMSI's claims that it already spent down the $56 million is correct; in fact, both claims are contradicted by GHMSI's own data and by its previous positions in this proceeding. Moreover, the claims are out of keeping with the Court of Appeals' decision. And both claims are based on arguments the Commissioner has already rejected. The Commissioner should reject these claims again and move forward with a spend-down proceeding.

A. GHMSI Did Not Spend Down $56 Million in Surplus to Cover Losses in the District.

GHMSI's first justification for failing to submit the $56 million spend down plan ordered by the Commissioner is the claim that the company already spent down that amount of surplus to cover losses attributable to the District of Columbia. GHMSI's own data show that this is not the case. Furthermore, GHSMI's data are not computed in a manner that is consistent with the Commissioner's December 30 decision. Moreover, the entire premise of GHMSI's argument is that the Commissioner should update his analysis to take into account of whether GHMSI's surplus has risen or fallen since the end of 2011, but without updating the permissible RBC and allocation he determined to be appropriate as of that date. We assess each of these points below.

First, as the Commissioner knows, and as GHMSI's own Table 1 in its March 16 submission shows, the total amount by which GHMSI's company-wide surplus declined between the end of 2011 and the end of 2014 was *only $30 million*; it is therefore hard to understand how GHMSI can now claim that this decline somehow meets the company's obligation to spend down $56 million in community benefits in the District. The claim is misconceived even on the unfounded assumption that all of the $30 million in losses is attributable to the District—which GHMSI has not and cannot show is the case.

GHMSI implies, however, that even though its company-wide surplus reduction was only $30 million, all of that $30 million and more should be treated as surplus reductions attributable to the District because the losses in the District were "offset by more favorable results in Maryland and Virginia." GHMSI Plan at 4. In fact, GHMSI's own Tables 1 and 2 refute this contention.

According to those Tables, while the District had underwriting losses in 2012–2014 of $62 million, Maryland and Virginia had *even higher losses*—$67 million. These Tables therefore do not show that Maryland and Virginia were offsetting the District's losses. Nor do they show that the whole $30 million reduction in surplus should be attributed to District losses—much less do they show that the losses constituted a spend down on community reinvestment.

In fact, GHMSI's determination to allocate the whole of the $30 million decline to the District is completely out of keeping with the allocation methodology the Commissioner established in his December 30 decision. In that decision, the Commissioner made clear that surplus should be allocated according to which jurisdiction actually produced the surplus—based on premiums earned in that jurisdiction. December 30 Decision at 52–58.

This means that if GHMSI wished now to determine the amount of the $30 million surplus decline between 2011 and 2014 that should be allocated to the District, it should determine what the allocation percentage should be as the end of 2014, using the Commissioner's allocation methodology. But it has not done so.

Instead, without even referring to the allocation methodology established by the Commissioner or the District allocation percentage that that methodology produced (21%), GHMSI has allocated the entirety of the $30 million surplus reduction to the District; and it then claims that by adding another $7 million to the $30 million due to investment income it attributes to Virginia and Maryland, that the result is "the District attributable surplus was $37 million lower at year-end 2014 than it had been at year-end 2011." GHMSI Plan at 4. For several reasons this cannot possibly be correct, much less be sufficient to justify GHMSI's claim that it has already spent down the $56 million ordered by the Commissioner.

First, and most obviously, even if GHMSI's claim that it spent down $37 million in the District in 2012–2014 were correct—which it is not—$37 million is not $56 million.[3] Nor is the alleged $37 million a spend-down for community reinvestment.

Second, GHMSI's contention is that the Commissioner should update his analysis concerning the company's compliance with MIEAA by taking into account that its surplus is lower in 2015 than it was at the end of 2011. But the Commissioner cannot know the extent to which the update of GHMSI's surplus would bring the company into compliance with MIEAA unless he also updates the permissible RBC ratio under MIEAA and the appropriate allocation of surplus to the District. It would be inconsistent to update the state of the surplus to the present, without also updating the permissible level of the surplus.

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[3] Beyond the fact that GHMSI has not explained how or why it has allocated all of the $30 million surplus reduction to the District, it is obvious on the face of GHMSI's Tables 1 and 2 that it has miscalculated the federal tax implications of the losses that occurred both in the District and Virginia/Maryland during 2012–2014. Table 1 says that the net loss of $30 million for GHMSI produced a federal tax credit of 50%—or $15 million. But on Table 2 the net loss of $42 million in the District produced a federal tax credit of only 19%—or $8 million.

But the Commissioner should not use this spend-down proceeding to update his analysis under MIEAA. If he does that, these proceedings will never end. And we say that even though our preliminary analysis of the allocation percentage (using the Commissioner's methodology) is that the District's allocation percentage would be higher and the permissible RBC ratio would be lower (owing to the resolution of uncertainties under ACA during the last three years)—meaning that the current level of the needed spend-down would be much higher than $56 million.

The circumstances now presented to the Commissioner are analogous to those faced by the Court of Appeals. In that appeal, the Court addressed GHMSI's permissible surplus as of the end of 2008. By the time the Commissioner issued her determination of the permissible RBC level for that date, it was already 2010 and it was apparent that the company's RBC ratio had risen above the maximum set by the Commissioner. DC Appleseed contended that the Commissioner should therefore take the new higher level into account

But the Court rejected that view, noting that it was likely that the next three-year review would produce a different maximum RBC ratio due to changed circumstances under the ACA, and it would be appropriate for the Commissioner to take the changed circumstances into account in that next review. *D.C. Appleseed Ctr. for Law & Justice v. D.C. Dep't of Ins., Secs., & Banking*, 54 A.3d 1188, 1219–20 (D.C. 2012).

The same analysis should apply here. The Commissioner should conclude that GHMSI has certainly not shown that it has already spent down the $56 million and he should leave to the next review a consideration of changed circumstances affecting the state of the current surplus or the permissible RBC ratio.

In sum, GHMSI's first rationale for failing to comply with the Commissioner's order—that it already spent down the $56 million to cover losses in the District—has not been justified.

B. GHMSI Did Not Spend Down $56 Million in Surplus for District Community Reinvestment.

GHMSI's second rationale for failing to comply is even less grounded in fact. GHMSI says that it spent $80 million of its surplus on community reinvestment for the District during 2012–2014—and argues that this prior spending satisfied the current order to spend down $56 million on those benefits. Like the first rationale, GHMSI's argument contradicts GHSMI's own data and its previous positions, and also contradicts prior determinations by the Commissioner.

First, even if it were true that GHMSI spent $80 million on community benefits in the District during 2012–2014, it would not follow that this $80 million came from *a spend down of surplus*, as opposed to spending from excess operating revenues after GHMSI met all expenses.

Under MIEAA, GHMSI has an obligation to commit the "maximum feasible" amount to community reinvestment both from its current revenues as well as from its surplus. And the vast majority (if not all) of the claimed $80 million did in fact come from operating revenues, not from surplus.

This cannot meet the requirement of the Commissioner's spend down order. MIEAA states that, if the Commissioner finds that there is excess surplus, "the Commissioner shall order the corporation to submit a plan for dedication of *the excess* to community health reinvestment in a fair and equitable manner." D.C. Code § 31-3506(g) (1) (emphasis added). By the plain language of the statute, spend-down is to come from excess surplus, not operating revenues.

We know that the company did not spend down $80 million from excess surplus on community reinvestment for a reason already mentioned—GHMSI's surplus declined only $30 million during 2012–2014 (from $964 million to $934 million). So the proposition that GHMSI spent down $80 million from surplus during that period is not only mathematically impossible, but it assumes, as we have already noted, that GHMSI spent down surplus *solely* for the District, and none for Maryland or Virginia.

GHMSI implies that it could theoretically have spent down $80 million in surplus in the District, even though its surplus declined only $30 million—because Maryland and Virginia were so profitable that they together added $50 million to surplus during that period. But as we have already mentioned, GHMSI's own March 16 filing shows that that did not even remotely happen.

In fact, the mathematical error is apparent from Tables 1 and 2 of GHMSI's filing, which present GHMSI's new calculations designed to show losses in the District and "gains" in Maryland and Virginia during 2012–2014. Even by GHMSI's own calculations, the net surplus gains for Maryland and Virginia combined during those years were only $7 million (not $50 million)—completely refuting the proposition that GHMSI could have spent down $80 million in community benefits for the District from surplus during 2012–2014, given that its company-wide surplus declined only $30 million.

Furthermore, when the particulars of the $80 million that GHMSI claims to have spent on community reinvestments are examined, it is quite clear that GHMSI has not justified the claim.

By far the largest community reinvestment claim that GHMSI made for the years 2012–2014 was "nearly $30 million in premium reductions and moderation in the District." GHMSI Plan at 5. But the Commissioner has already determined that such a claim is insufficient to show a community reinvestment. As the Commissioner said in his decision, rate actions taken for competitive reasons do not benefit subscribers because the lower rates are available elsewhere in the market; there is no practical way to distinguish rate reductions taken for competitive reasons from those designed to benefit subscribers; and, accordingly, *rate reductions are not community reinvestments within the meaning of the statute.* December 30 Decision at 60–61.

The remaining $50 million that GHMSI now claims to have spent from surplus in 2012–2014 consists of expenditures for community healthcare programs. But the data before the Commissioner make clear that those expenditures came from operating revenue, not surplus. Indeed, the one thing that GHMSI and Mr. Burrell have made clear throughout these proceedings—including in their March 16 filing with the Commissioner—is that they have never spent, and will never voluntarily spend down *surplus* on community reinvestment programs; rather, they will spend down surplus only on premium reductions for current subscribers. The suggestion that they spent $50 million on such programs not only has no support in the record before the Commissioner, but it is completely refuted by the company's own steadfast assertions to the contrary.

In sum, as with GHMSI's claim that it has spent down $56 million of surplus to cover District losses, its claim that it has spent down $56 million of surplus to bestow community reinvestments on the District has not been explained or justified. Indeed, both claims are refuted by GHMSI's own data and by the Commissioner's December 30 decision.

3. THE COMMISSIONER SHOULD PROCEED TO A SPEND-DOWN PLAN.

The law requiring a spend-down of GHMSI's excess surplus was passed more than six years ago. The Court of Appeals interpreted the law and remanded this issue to the DISB for prompt implementation more than two years ago. The Commissioner has said throughout these remand proceedings that he intends to move expeditiously. He ordered GHMSI to file a spend-down plan by March 16. GHMSI has not done so.

The governing statute provides a remedy for GHMSI's failure to submit a spend-down plan. The statute authorizes the Commissioner to deny rate increases due to the failure. It also authorizes him to "issue such orders as are necessary to enforce the purposes of this chapter." D.C. Code § 31-3506(i) (emphasis added). The core purpose of MIEAA is to ensure that excess surplus is directed to community health reinvestment. The Commissioner should exercise his statutory authority to meet that core purpose by inviting public comment on the content of an appropriate spend down plan, determining a plan that is fair and equitable, and ordering GHMSI to comply with that plan.

Sincerely,

Walter Smith, Executive Director
DC Appleseed Center

Richard B. Herzog
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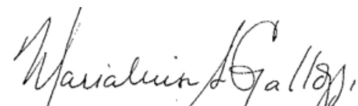

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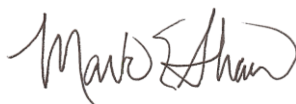

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cc: Mr. Philip Barlow, Associate Commissioner for Insurance
D.C. Department of Insurance, Securities and Banking

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