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April 25, 2014

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

Re: Surplus Review and Determination for Group Hospitalization and Medical Services, Inc.

Dear Commissioner McPherson:

As you are aware, DC Appleseed has been attempting to access data necessary for the Commissioner, and for us, to understand exactly what Rector & Associates ("Rector") did to support the conclusions reached in its report. It is critical to understand what Rector did so that we and the Commissioner can determine if Rector properly applied the Medical Insurance Empowerment Amendment Act of 2008 ("MIEAA"). To date, we still have not received significant data that are crucial for the Commissioner's determination and necessary to our ability to contribute to that determination. We write today to summarize DC Appleseed's efforts to date to obtain those data and explain the further data that are still needed.

On January 29, 2014, DC Appleseed made several initial requests for data that would allow us to understand and assess Rector's work. However, despite several follow-up and clarification attempts, DC Appleseed has not received sufficient answers to these questions or to related follow-up questions. Moreover, DISB's April 18 letter—which we received a draft of on April 14, the day our pre-hearing report was then due—contained new information that raised additional questions.

As Rector noted during the 2009 surplus proceeding, an actuarial report that "does not contain sufficient actuarial detail to allow a reader to determine exactly what the [author] did or what its key assumptions were . . . in many ways . . . [is] a 'black box'" and is of limited use. Rector & Assocs., Inc., *Rebuttal to September 3, 2010 Supplemental Report on Effects of Federal Health Care Reform as Submitted by Group Hospitalization and Medical Services, Inc.* 5 (Sept. 20, 2010). Yet in this current proceeding, exactly what Rector did and what its key assumptions were remain, in important respects, a "black box," significantly compromising the Commissioner's and our ability to understand why and how it reached the conclusions that it did with regard to GHMSI's surplus.

Below, we provide a detailed history of our requests regarding these areas of concern. We also explain why some of Rector's answers are incomplete. We then explain why the missing information is crucial, not only to DC Appleseed's participation and to comport with the Actuarial Standards of Practice, but to the Commissioner's ability to fully analyze GHMSI's surplus and determine whether the company has invested in community health to the maximum feasible extent, as required by MIEAA. Finally, we summarize our requests for information that will address these concerns.

I. Critical Data Requests by DC Appleseed Remain Outstanding.

DC Appleseed has moved expeditiously to request data and review the responses provided by Rector. On January 9, 2014, DISB provided the December 9, 2013 Rector Report to DC Appleseed and informed us that DISB would be publishing a formal hearing notice for the surplus review. *See* Rector & Assocs., *Report to the D.C. Department of Insurance, Securities and Banking: Group Hospitalization and Medical Services, Inc.* 10 (Dec. 9, 2013) [hereinafter Rector Report]. We immediately reviewed the Rector Report and very soon realized that the report, as presented, did not include (1) sufficient information about the assumptions and methods Rector used to permit an understanding of exactly how Rector reached its conclusions; and (2) sufficient detail concerning the model and assumptions from Milliman, Inc., on which Rector relied.

On January 29, DC Appleseed submitted an initial request to DISB for data underlying Rector's analysis. To the extent that Rector or Milliman objected to disclosure on the basis of confidentiality, DC Appleseed expressly offered to enter into a confidentiality agreement. Letter from Walter Smith, Exec. Dir., DC Appleseed, et al., to the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking (Jan. 29, 2014) [hereinafter Smith Jan. 29, 2014, Letter].

On February 7, DISB responded to DC Appleseed with an "initial discussion" of most of the requests, and offered to convene a conference call to further discuss the requests. E-mail from the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking, to Walter Smith, Exec. Dir., DC Appleseed (Feb. 7, 2014, 04:43 PM EST) [hereinafter McPherson Feb. 7, 2014, E-mail]. Since this initial reply did not contain answers to each request, DISB resent the full answers on February 10. E-mail from Philip Barlow, to Walter Smith, Exec. Dir., DC Appleseed (Feb. 10, 2014 05:18 PM EST). DC Appleseed, Rector, DISB, and GHMSI conducted such a call on Friday, February 21. Ahead of that call, DC Appleseed sent a detailed letter on February 19 expounding on our initial requests, giving more detail and explaining the bases for our requests. Letter from Walter Smith, Exec. Dir., DC Appleseed, et al., to the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking attachment A 3–4 (Feb. 19, 2014) [hereinafter Smith Feb. 19, 2014, Letter].

On March 5, DISB sent DC Appleseed a letter from Milliman to CareFirst that addressed some of the information DC Appleseed had requested. On March 7, DISB provided further information from Rector and FTI (Rector's actuarial firm) via e-mail. This information was sent again by formal letter from the Commissioner on March 14. Letter from the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking, to Walter Smith, Exec. Dir., DC Appleseed (Mar. 14, 2014) [hereinafter McPherson Mar. 14, 2014, Letter]. On March 14, DC Appleseed submitted a third letter to DISB asking for clarification of questions and inconsistencies based on the responses it had received as of that date. Letter from Walter Smith, Exec. Dir., DC Appleseed, et al., to the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking 3 (Mar. 14, 2014) [hereinafter McPherson Mar. 14, 2014, Letter]. On March 19, a second conference call took place to provide opportunity for Rector to confirm its understandings of DC Appleseed's requests.

DISB sent DC Appleseed further information from Rector on April 1, which again failed to address all of DC Appleseed's questions, and did not explain its failure to do so. E-mail from Philip Barlow, Assoc. Comm'r for Ins., D.C. Dep't of Ins., Secs. & Banking, to Walter Smith, Exec. Dir., DC Appleseed (Apr. 1, 2014, 4:44 PM EDT) [hereinafter Barlow Apr. 1, 2014, E-mail]. DC Appleseed sent a follow-up email directly to Rector on April 4, again seeking clarification of incomplete and unexplained assumptions and methodologies. E-mail from Walter Smith, Exec. Dir., DC Appleseed, to Sarah Schroeder, Rector & Assocs. (Apr. 4, 2014, 10:50 AM EDT) [hereinafter Smith April 4, 2014, E-mail]. DC Appleseed did not receive a response to this request until April 14, 2014 (the day our pre-hearing report was due to be filed), when DISB sent a draft response to DC Appleseed. DISB sent the final version of this letter to DC Appleseed on April 18. Letter from the Honorable Chester A. McPherson, Comm'r, D.C. Dep't of Ins., Secs. & Banking, to Walter Smith, Exec. Dir., DC Appleseed (Apr. 18, 2014) [hereinafter McPherson Apr. 18, 2014, Letter]. As we explain below, while this latest round of information answered some outstanding questions, it again failed to provide basic data needed to explain exactly what Rector did. At the same time, it raised new questions about what Rector did.

Below, we address four essential outstanding requests concerning information needed in this proceeding to understand (1) how Rector used the stochastic modeling process to estimate GHMSI's permissible surplus under MIEAA, (2) how Rector used the most significant factor in the stochastic model, the rating adequacy and fluctuation factor, (3) how Rector used the pro forma financial projections to estimate permissible surplus, and (4) why the level of permissible surplus estimated by Rector—the amount it says is required to avoid falling below 200% RBC—has grown by approximately $400 million (or approximately 67%) between the time of Rector's estimate in 2009 and now.

1. <u>Stochastic Modeling Process</u>

Milliman's model is based on a stochastic modeling process. The Rector Report indicates that the Milliman model generated "hundreds of thousands of potential gain or loss outcomes taking onto account a number of potential events and the probability of occurrence and relative severity of those outcomes." Rector Report at 10. We have several times sought access to the output results from the stochastic modeling, as well as a description of the multiple, simultaneous adverse events leading to the most extreme loss outcomes. Because the most extreme loss outcomes drive Milliman's and Rector's conclusions, those outputs and a description of the factors causing them are critical for the Commissioner and for DC Appleseed to fully assess Milliman's and Rector's conclusions. This information is also critical to assessing whether the proposed reliance on these particular extreme outcomes complies with MIEAA.

For this reason, on January 29, 2014, DC Appleseed wrote to the Commissioner seeking "a spreadsheet that includes in rank order all the potential gain or loss outcomes that were generated by the first component of the process and for each outcome a listing of the value of each of the 13 factors that help create that outcome." Smith Jan. 29, 2014, Letter attachment A at 1. We also requested that DISB "describe what events Milliman considered 'extremely adverse events' in the stochastic modeling." *Id.* attachment A at 4.

The Commissioner responded that Rector "was not provided with a spreadsheet listing the hundreds of thousands of potential gain or loss outcomes," and that it had asked GHMSI to inquire of Milliman whether this data was available. McPherson Feb. 7, 2014, E-mail. The Commissioner further responded that the Rector Report "describe[s] the specific adjustments to the . . . severity of events related to three factors to which R&A made adjustments," Barlow Feb. 10, 2014, E-mail, suggesting that Rector had not received or reviewed the range of potential outcomes that drive the results of the Milliman model.

In our February 19 letter clarifying our requests, we noted that the information regarding gain or loss outcomes "must exist in a readily available electronic format, even if they were not provided in that format to Rector," since the Rector Report indicates that gain or loss outcomes were ranked by Milliman and input into the pro forma financial projections. Smith Feb. 19, 2014, Letter attachment A at 2. We therefore requested the outcomes, and, if Rector used only certain outcomes, we requested "those outcomes used by Rector for the financial projections component." *Id.* We also again "asked for a description of the multiple extremely adverse events that the model assumes could occur in order that we (and the Commissioner) would have an opportunity to assess whether it is appropriate under MIEAA to increase surplus . . . to guard against such events." *Id.* attachment A at 6.

When we did not receive a response to these specific requests after several weeks, we again renewed them. Specifically, we requested (1) rank-ordered gain/loss outcomes of the stochastic modeling process, (2) gain/loss outcomes from the stochastic modeling that were put through the pro forma financial projections, (3) gain/loss outcomes from the stochastic modeling that were provided by Milliman to Rector, and (4) gain/loss outcomes that Rector requested Milliman to put through the pro forma financial projections. Smith Mar. 14, 2014, Letter at 3. In addition, we renewed our request for "[a] description of the extremely adverse events that were assumed to occur" in the stochastic modeling. *Id.* at 4. That same day, the Commissioner subsequently responded to our inquiry concerning the stochastic modeling outcomes by providing us an "Illustration of Milliman Stochastic Modeling Process." McPherson Mar. 14, 2014, Letter at 2. The Commissioner also again responded that the Rector Report "describe[s] the specific adjustments to the . . . severity of events related to three factors to which R&A made adjustments." *Id.* at 4.

Subsequently, DISB staff advised that Rector "never sought nor was provided with a spreadsheet of rank-ordered gain/loss outcomes" from the stochastic modeling. Barlow April 1, 2014, E-mail. DISB also stated for the first time that Rector instead "instructed Milliman to input certain outcomes from the stochastic modeling for selected RBC thresholds and confidence levels into its financial projections" and that it was "in the process of determining whether Milliman can provide this information and, if so, whether it is willing to do so." *Id.* DISB further responded by referring us to Attachment A of the February 27 letter from Milliman providing charts identifying "Probability Distribution Assumptions Reflected in Milliman Evaluation of GHMSI Surplus Requirements," and Section IV.B of the Rector Report identifying Rector's "revisions to the assumptions for various risk and contingency categories." *Id.* However, this did not address our January 29, 2014, request for a description of "what events Milliman considered 'extremely adverse events' in the stochastic modeling," nor did it address which gain/loss outcomes actually were put into the pro forma model. In response, we again renewed our request for "[t]he amount of the gain/loss outcome that was input into the Pro Forma model." Smith Apr. 4, 2014, E-mail. In addition, since we had just learned that Rector received only certain gain/loss outcomes from the stochastic modeling process, we requested for each outcome, "the value of each of the 12 factors leading to that gain/loss outcome." *Id.*

DISB's April 18 letter to DC Appleseed provided additional information on "[t]he four loss outcomes R&A asked Milliman to input into the pro forma financial statements and the confidence levels on which those loss outcomes were based." McPherson Apr. 18, 2014 Letter at 10. According to this response, the largest negative outcome entered into the financial model was a loss of 23.3% at a 98% confidence level. Our actuarial expert, Mark Shaw of United Health Actuarial Services, calculates that this is a loss of approximately $313 million.[1] It is not explained how such a loss could lead to a reduction in surplus of $760 million over a three-year period, which according to Rector is the amount of loss that a 98% confidence level protects against. This response thus raises additional questions. DISB also stated in its response that "[t]he values of the 12 factors that led to each of the selected outcomes were not retained by the Milliman modeling software and were not provided to R&A. Accordingly, the requested information does not exist." *Id.* at 28.

As a result, neither the Commissioner nor DC Appleseed currently has access to sufficient data to allow understanding of the stochastic modeling results that Rector used or to analyze whether the results from that modeling are in accord with MIEAA.

2. Rating Adequacy and Fluctuation Factor

Rector states that its changes to the rating adequacy and fluctuation risk and contingency category "had the most significant impact on the modeling results." Rector Report at 21. FTI indicates that this factor was the single largest driver of increased surplus since the 2009 review. Memorandum from Jim Toole, FTI Consulting, to Rector & Assocs. 3 (Mar. 6, 2014) [hereinafter Toole Mar. 6, 2014, Memorandum]. The Rector Report specifies seven reasons for making adjustments to this factor in Milliman's model. Rector Report at 21–23. Rector states that four of these reasons are related to the effects of health care reform, and three of these reasons are not related to the effects of healthcare reform. *Id.* We have several times sought information necessary to understand the effect of this significant factor on Rector's recommended surplus for GHMSI.

In our January 29 letter, we requested "[d]etails on how much, if any, each of the[se] reasons impacted the probabilities and charges" for this factor. Smith Jan. 29, 2014 Letter Attachment A at 1. In response, DISB stated that Rector was "in the process of attempting to determine if it is feasible to separate the various factors in such a way that the impact of each of the revisions" to this factor "can be quantified separately." McPherson Feb. 7, 2014, E-mail. DISB further stated that Rector was "in the process of attempting to determine if it is feasible to separate the various factors in such a way that the impact of each of the revisions" to this factor "can be quantified separately." *Id.*

On February 19, we renewed our request for a detailed explanation for how Rector accounted for each of its reasons for adjusting the rating adequacy and fluctuation factor, including probability distributions, impact, and time periods assumed. Smith Feb. 19, 2014, Letter attachment A at 1–2. We explained that it was important to understand these reasons fully because Rector itself in its report states that

> modeling choices relating to the rating and adequacy factor are *crucial* in the methodology used to select a loss outcomes. . . . Of the assumption changes that we made in the Milliman model, the changes made to the rating adequacy and fluctuation factor had the *most significant impact* on the modeling results.

[1] This is derived from 23.3% of GHMSI's 2013 non-FEP premium revenue of $1.344 billion.

Id. attachment A at 1 (quoting Rector Report at 21 (emphasis added)).

When we did not receive a response to our initial requests after several weeks, we again requested "the probability distributions for each of" the seven reasons Rector cited for modifying this factor, "and their separate impacts on Rector's modification of the rating adequacy and fluctuation factor." Smith Mar. 14, 2014, Letter at 5. Since the FTI Memorandum's discussion appeared to be limited to the impact of healthcare reform on the rating adequacy and fluctuation factor, we noted that four of Rector's stated reasons appeared related to health care reform, while three did not. *Id.* That same day, the Commissioner subsequently responded to the inquiry by referring us to the March 6, 2014, FTI memorandum stating that "[w]e estimate our rating adequacy assumption is between 100% to 150% higher than the previous rating adequacy assumption as a result of healthcare reform." Toole Mar. 6, 2014, Memorandum at 3. DISB also stated that the two identified documents Rector used in connection with this factor were confidential. Mar. 14, 2014, Letter at 2.

Subsequently, Rector responded through DISB on April 1 by again referring to the FTI memorandum and stating that "[o]ur response to this question remains the same." Apr. 1, 2014, E-mail. Rector further noted that

> the values and probabilities for the model's risk and contingency categories were based on a number of factors that required R&A to exercise actuarial judgment in its review of the values and probabilities chosen by Milliman. Accordingly, it is not feasible or appropriate to quantify our reasons behind our revisions to the rating adequacy and fluctuation factor.

Apr. 1, 2014 E-mail. Rector repeated this response through DISB's April 18 letter. McPherson Apr. 18, 2014, Letter at 26–27.

Thus, DC Appleseed still does not have access to sufficient data for it to evaluate how Rector used this important factor and to determine whether the results from this factor comport with MIEAA. We know only that Rector apparently used this factor to increase its recommended surplus for GHMSI by 100 to 150 percentage points, but we do not know how or why it did that.

3. Pro Forma Financial Projections

The pro forma financial projections are also an integral part of the Milliman model used by Rector to produce its recommended surplus. We have several times sought access to information to understand the impact of running the results of the stochastic modeling through the pro forma financial projections. As noted above, Rector has indicated that the largest loss outcome entered into the pro forma financial projections is approximately $313 million, yet its target surplus protects against a loss of approximately $760 million. Thus, it appears that the pro forma financial projections account for less than half of the estimated surplus need that Rector recommends. For a complete assessment of Rector's conclusion, either by the Commissioner or by us, it is critical to understand this discrepancy.

On January 29, we requested "a spreadsheet that provides . . . the projected impact on GHMSI's surplus after pro-forma financial projections were made." Smith Jan. 29, 2014, Letter attachment A at 1. The Commissioner responded that Rector "did not believe it is possible to generate such a spreadsheet." McPherson Feb. 7, 2014, E-mail.

In our February 19 letter clarifying our requests, we requested "the projected impacts on GHMSI's surplus after the loss outcomes were applied to the pro-forma financial projections." Smith Feb. 19, 2014, Letter attachment A at 3.

When we did not receive a response to this specific request after several weeks, we again renewed it, requesting "[a] statement as to whether Rector adjusted any of the pro forma financial projections" and "[t]he pro forma financial results for all gain/loss outcomes that were put through the pro forma model by Milliman at Rector's request." Smith Mar. 14, 2014, Letter at 3. That same day, the Commissioner subsequently responded to our initial request that Rector "did not believe it was possible to generate such a spreadsheet." McPherson Mar. 14, 2014, Letter at 2.

In response to our March 14 letter, on April 1, DISB for the first time stated that the pro forma projection model incorporates premiums, losses, investment income, other income and taxes over a three-year period. Barlow Apr. 1, 2014 E-mail. It also stated for the first time that Rector "reviewed the pro forma financial model and the assumptions underlying [it]" and concluded that it "did not believe it was necessary or appropriate to make modifications" to those assumptions, which it said were described in the February 13, 2013, "Presentation of Technical Materials Related to the Milliman Report." *Id.* In response to this new information, on April 4, we requested "[d]isclosure of *all* assumptions that impact surplus that were used in the Pro Forma model, including" average expected investment yield, tax carryback assumptions, other income assumptions, other tax assumptions, premium growth assumptions, and pro forma projection time period. Smith Apr. 1, 2014 E-mail (emphasis added).

On April 18, DISB responded by providing only part of the assumptions Rector relied on in the pro forma financial modeling. McPherson Apr. 18, 2014, Letter at 13–14. Specifically, the April 18 letter states that "[t]he pro forma financial model includes additional assumptions that Milliman presented in its 'Presentation of Technical Materials Related to Milliman Report of May 31, 2011,' dated February 13, 2013, as well as assumptions that Milliman discussed with R&A, all of which Milliman states are confidential information." *Id.* No information was provided about these additional assumptions, why Milliman considers them confidential, or whether DISB agrees they should be considered confidential. Neither was any response offered to DC Appleseed's offer to enter a confidentiality agreement in the case of information DISB considers confidential.

Thus, as with the information concerning the stochastic model, neither the Commissioner nor DC Appleseed has sufficient information either to understand exactly how Rector used the pro forma financial projections or to assess whether that use meets the requirements of MIEAA.

4. <u>Change in Target Surplus Ratio</u>

We have several times requested an explanation of why Rector's target surplus ratio changed from 600% (to avoid 200% RBC at a 99% confidence level) in its 2009 report to 958% RBC (to avoid 200% RBC at a 98% confidence level) in the latest report filed in 2013. We estimate, based on normal distributions, that a 98% certainty would lower the 600% calculated in 2009 to 553%, in which case the increase is actually 405 percentage points. In the April 18 response, DISB states that Rector considers that estimate to be "reasonable." McPherson Apr. 18, 2014, Letter at 5. Since Rector is essentially recommending that the Commissioner approve a level of surplus that equates to 958% RBC, and since Rector's comparable calculation in its 2009 report was 405 points (or approximately $400 million) lower, it is important that this substantial increase be justified and explained.

In response to our initial request on January 29 for an explanation of the change, the Commissioner initially stated that Rector "was in the process of further analyzing the causes" of this change. Barlow Feb. 10, 2014, E-mail. The Commissioner subsequently provided to us a document identifying material changes that Rector made between 2009 and 2013; however, this document accounted for an RBC increase of only 250 percentage points. Toole Mar. 6, 2014, Memorandum. Noting this apparent discrepancy, we renewed our request for a detailed explanation of the difference. Smith Mar. 14, 2014, Letter at 2. In response, DISB stated only that the answer to this request was "[p]ending." Barlow Apr. 1, 2014, E-mail.

On April 18, Rector indicated for the first time that the change is due, in part, to a different approach to accounting for potential management intervention actions. Rector said that in 2009 it made adjustments to the loss curve to account for those actions, resulting in a 190-percentage-point reduction in the required surplus. For 2013, however, Rector said that it made no adjustment to the loss curve, but instead "performed a detailed analysis of each of the 12 factors that are used in Milliman's stochastic modeling process." McPherson Apr. 18, 2014, Letter at 6. Rector previously had considered three types of potential management interventions. DISB apparently told Rector not to take into account one of the three types of interventions—reducing margins in claim reserves. However, it is not clear how if at all Rector took into account the other two types of interventions. And no information was given concerning how the analysis of the 12 factors accounted for such interventions or the impact, if any, on required surplus. In addition, while in the March 6 memorandum from Jim Toole it is explained that a 180-percentage-point upward adjustment was made in the rating and adequacy fluctuation factor, in the April 18 letter, this adjustment is said to be 150 percentage points. McPherson Apr. 18, 2014, Letter at 7. Thus, our request that Rector explain the increase in its recommended surplus from 553% in 2009 to 958% now (in both cases the amount Rector says is needed to avoid falling to 200% RBC with 98% confidence) has not yet been met. A full explanation of this approximately $400 million increase is needed, both to verify the reliability of the recommended 958%, as well as to verify the reliability of the model and the assumptions that produced these widely varying results.

II. The Commissioner must have the requested data in order to reach a determination.

To the extent the Commissioner intends to rely in whole or in part on the Rector Report to determine whether GHMSI's surplus is excessive, further information concerning the Report is essential. Without the disclosure of the additional information requested by DC Appleseed, the Commissioner will be unable to rely on the Rector Report to support a conclusion concerning the maximum amount of surplus permitted under MIEAA; furthermore, without the information, the Commissioner will be unable to satisfy either the general requirements applicable to decisions in contested cases or the heavy burden of explanation imposed by the Court of Appeals in this case; moreover, without the needed information, Rector's report will not meet the actuarial standards governing such a report.

1. <u>The Court Imposed A Heavy Burden Of Explanation On The Commissioner.</u>

In order to determine the maximum permitted surplus under MIEAA by relying on the Rector Report, DISB must be fully informed of the assumptions Rector used in its model, the proffered bases for those assumptions, and how the model employs those assumptions to produce the recommended surplus levels. Neither the Rector Report alone nor the information released by Rector since publication of its Report contains the information needed by the agency to do this.

The Court of Appeals imposed a heavy burden of explanation on the Commissioner precisely because of the highly technical nature of the issues and the millions of dollars at stake. The complexity of the subject matter, far from justifying unexplained exercises of actuarial judgment, actually *heightens* the legal requirement that the agency's evidence, findings and reasoning be set out in detail. As the Court said in reversing the prior Commissioner's decision, "the technical nature of the actuarial reports requires a far more detailed discussion of a decision in which even a small variance can implicate millions of dollars." *D.C. Appleseed Ctr. for Law & Justice v. D.C. Dep't of Ins., Secs., & Banking,* 54 A.3d 1188, 1219 (D.C. 2012). "The more technical and complex the subject matter, the more explanation the agency ought to provide for this decision." *Id.* at 1217. This burden to explain includes the need to "'explain the assumptions . . . used in preparing the model. . . .'" *Id.* at 1217 n.38 (quoting *Sierra Club v. Costle*, 657 F.2d 298, 333 (D.C. Cir. 1981)). Moreover, the Commissioner's factual findings must "be supported by substantial evidence on the record, and the conclusions must rationally flow from the findings." *Id.* at 1216; *see also* D.C. Mun. Reg. tit. 3, § 423.8 (requiring that, in a contested case hearing, "[t]here shall be substantial evidence adequate to support pertinent and necessary findings of fact.").

As described above, the current report is insufficient standing alone: it lacks the data necessary to allow the Commissioner, the parties, and members of the public to independently test its conclusions. Without further data showing exactly what Rector did and what its assumptions were, the report will remain what Rector itself called a "black box," and it will not support the high burden the Court of Appeals placed on the Commissioner to justify his determination.

2. <u>DC Appleseed has a right to the data under the Court's decision.</u>

In addition to needing additional data for his own determination, the Commissioner must also ensure that DC Appleseed has sufficient information to allow it to respond to Rector's Report during the surplus hearing. Specifically, because MIEAA is a contested case proceeding, *D.C. Appleseed*, 54 A.3d at 1199, the Commissioner must maintain an "official record" of the proceeding. As part of the record, the Commissioner must "make factual findings on all material contested issues, the findings must be supported by substantial evidence on the record, and the conclusions must rationally flow from the findings." *Id.* at 1216.

The "official record" requirement "has 'the fundamental purpose . . . to assure the parties an adequate opportunity, *at the administrative proceeding, to challenge and respond to the evidence which forms the basis of the agency's decision*.'" *Fair Care Found., A.G. v. District of Columbia Dep't of Ins. and Secs. Reg'n*, 716 A.2d 987, 996 (D.C. 1998) (emphasis added). It is "basic to the notion of fairness in administrative proceedings that 'the mind of the decider should not be swayed by evidence which is not communicated to both parties and which they are not given an opportunity to controvert.'" *Id.*

Furthermore, the Court of Appeals decision in *D.C. Appleseed* entitles DC Appleseed to receive information necessary to understand what Rector did to reach the conclusions in its report. The Court emphasized that the Commissioner should "ensur[e] . . . that the regulated entity discloses information . . . necessary to the development of analyses by participants that contribute to the Commissioner's determination." *D.C. Appleseed,* 54 A.3d at 1218 n.41. Confidentiality is not a reason to withhold this information; the Court specifically contemplated disclosures to DC Appleseed "subject to appropriate agreements and limitations on use." *Id.*[2]

In short, the contested case requirements of the D.C. APA, as well as explicit pronouncements by the Court of Appeals and generally accepted administrative practice, all require that DISB disclose to DC Appleseed sufficient data to allow it to understand and respond to the Rector Report during the surplus review hearing. Taking into account DC Appleseed's contributions to a fully developed record, the Commissioner will be able to determine the surplus level that satisfies each of the MIEAA standards.

3. <u>The standards of actuarial practice require disclosure of the data.</u>

Accepted standards of actuarial practice also require that Rector disclose additional detail regarding the basis for its Report. Actuarial Standard of Practice No. 41 provides that, in an actuarial report, "the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area *could make an objective appraisal of the reasonableness of the actuary's work* as presented in the actuarial report." Actuarial Standard of Practice No. 41, Actuarial Communications, at 3–4 (Rev. ed., December 2010), *available at* http://www.actuarialstandardsboard.org/pdf/asops/asop041_120.pdf (emphasis added).

Rector has failed to disclose key information that would allow other actuaries to make an objective appraisal of the reasonableness of its Report. For example, in several Rector and Milliman documents regarding the Rating Adequacy and Fluctuation factor—the largest single driver of surplus—there was no disclosure or detailed description of how probabilities and associated factors were derived. Rector Report at 21–23; *see also* Letter from Phyllis A. Doran, Principal & Consulting Actuary, Milliman, to Jeanne Kennedy, Vice Pres. & Treasurer, CareFirst BlueCross BlueShield attachment A chart 1 (Feb. 27, 2014); Memorandum from Jim Toole to Rector & Assocs. 6 tbl.1 (Sept. 12, 2013). This is clearly inconsistent with the Actuarial Standards of Practice quoted above. Yet when pressed for details, Rector stated that "*it is not feasible or appropriate to quantify the reasons behind our revisions to the rating adequacy and fluctuation factor*." Barlow Apr. 1, 2014, E-mail (emphasis added). Similarly, with regard to key assumptions relied on by Rector in the pro forma modeling, Rector said that there were assumptions it would not disclose, due to assertions of confidentiality from Milliman. McPherson Apr. 18, 2014, Letter at 13–14.

These assertions are squarely contrary to the Standards, which ***require*** that there be disclosure of the methods, procedures, assumptions, and data used. Rector must spell out the specifics of and the basis for its actuarial judgments and not merely assert that it is not feasible to do so, or that confidentiality concerns preclude it from doing so. The Commissioner and the Court must know exactly what Rector did and whether it complies with MIEAA, and Rector therefore must explain its analysis. And as we have said before, to the extent there are legitimate

[2] Accepted practices in federal government are also instructive. For example, to the extent that federal agencies consider or rely on scientific research, the Administrative Conference of the United States "encourages the disclosure of data underlying" that research. ACUS Recommendation 2013-3, Science in the Administrative Process 4–5 (June 14, 2013), *available at* http://www.acus.gov/sites/default/files/documents/Science%20Recommendation%20APPROVED-FINAL_1.pdf.

confidentiality concerns shown, DC Appleseed is prepared to sign an appropriate confidentiality agreement.

III. Follow-Up Data Requests

We appreciate that responding to these requests has required a significant investment of time and thought. We think this process has been useful in assisting the Commissioner and DC Appleseed in understanding Rector's work, and we believe it is necessary to comport with the Court's decision and Actuarial Standards of Practice. As described above, however, we have not been provided with all the information that we think is necessary to an informed decision by the Commissioner in this case. Therefore, we request the following in response to DISB's April 18, 2014, letter.

1. <u>Stochastic Modeling</u>

DISB states that Rector "performed a detailed analysis of each of the [13] factors[3] used in Milliman's stochastic modeling process." McPherson Apr. 18, 2014, Letter at 6. DISB has also provided us the specific gain/loss outcomes produced by the stochastic modeling process that Rector then put through the pro forma modeling. But we have not received two important things that are necessary to understand how Rector used the stochastic model to estimate GHMSI's permissible surplus.

(a) We have asked for information showing the exact values of the factors Rector relied on as to each of the four selected loss outcomes that Rector used in the pro forma modeling. We have been advised that Milliman no longer has "[t]he values of the [13] factors that led to each of the selected outcomes." Because we believe the Commissioner needs to know whether the values of those factors are sufficiently plausible to meet the requirements of MIEAA, we ask that Rector request Milliman to re-run the model and provide the values of the 13 factors that led to each of the four particular loss outcomes that Rector relied on: a 200% RBC threshold at a 98% confidence level; a 375% RBC threshold at a 75% confidence level; a 375% RBC threshold at an 85% confidence level; and a 375% RBC threshold at a 95% confidence level.

(b) We were informed in the April 18 letter that the most severe loss outcome relied on by Rector was 23.3% of non-FEP premium. *Id.* at 9. Yet when that loss is applied to GHMSI's non-FEP premium revenue, as reported at the end of 2013, it produces a loss of only $313 million, whereas Rector's proposed 958% RBC is designed to protect against a loss of $760 million (i.e., falling from approximately $961 million (958% RBC) to $201 million (200% RBC)). Please explain this apparent discrepancy. It may be that the additional loss is caused by assumptions used by Rector in the pro forma modeling, but as mentioned earlier and as discussed below, we do not yet know what those assumptions are.

2. <u>Rating Adequacy and Fluctuation Factor</u>

[3] Milliman had 12 risk and contingency factors that Rector analyzed, but Rector directed Milliman to add a 13th factor for premium growth.

As described above, we have been seeking information regarding the rating adequacy and fluctuation risk factor, changes to which the Rector Report states "had the most significant impact on the modeling results." Rector Report at 21. The March 6 FTI memorandum indicates that this factor was the single largest driver in the increase in Rector's estimated surplus needs from 2009 to 2013. Toole Mar. 6, 2014 Memorandum at 3. According to that memorandum, the rating adequacy and fluctuation factor accounted for a 180-percentage-point increase in Rector's estimated surplus need from 2009 to 2013. *Id.* However, the April 18 letter from DISB states that Rector estimates that this factor accounted for only a 150-percentage-point increase. McPherson Apr. 18, 2014, Letter at 7. In addition, while we were told in the April 18 letter that Rector could not quantify how it derived the increase to this factor, it did say that it estimated that 100 to 150 percentage points of the increase was due to health reform. *Id.* at 5. This leads to two requests:

(a) Please state whether Rector estimates that its changes to the rating adequacy and fluctuation factor increased surplus from 2009 to 2013 by 150 percentage points or by 180 percentage points.

(b) Other than the 100- to 150-percentage-point increase attributable to health reform, please state which other factors account for the remainder of the increase and the amount you estimate is attributable to each of those factors.

3. Pro Forma Financial Projections

We have sought information necessary to explain exactly how Rector used the pro forma financial projections to estimate permissible surplus under MIEAA. As just noted, Rector appears to have indicated that the largest loss outcome entered into the pro forma financial projections is approximately $313 million, yet its target surplus protects against a loss of approximately $760 million. Thus, it appears that the assumptions used in the pro forma modeling account for well over half of the projected loss assumed in Rector's calculations. Yet as explained earlier, we have not received information about all those assumptions, even though Rector specifically reviewed and relied on them. We therefore request the following information:

(a) Please explain of all assumptions underlying the pro forma financial projections, including those that were not disclosed in the April 18 letter.

(b) If any undisclosed assumptions are considered confidential, please explain why they are confidential.

(c) Please provide a statement indicating whether the undisclosed assumptions will be made available if DC Appleseed enters a confidentiality agreement.

4. Change in Target Surplus Ratio

As described above, we have received inconsistent and incomplete explanations regarding the reasons that Rector's target surplus for avoiding 200% RBC increased from 600% RBC (at 99% confidence) in 2009 to 958% RBC (at 98% confidence) in 2013. We estimate, based on normal distributions, that a 98% certainty would lower the 600% calculated in 2009 to 553%, in which case the increase is actually 405 percentage points. In the April 18 response, DISB states that Rector considers that estimate to be "reasonable." *Id.* at 5. Through that response, Rector indicated that in 2009, it accounted for potential management interventions in the loss curve, resulting in a 190-percentage-point reduction in estimated surplus need. *Id.* at 9. The April 18 letter further indicated that in its recent surplus analysis, Rector instead "performed a detailed analysis of each of the 12 factors that are used in Milliman's stochastic modeling process." *Id.* This leaves unexplained how Rector's analysis of the 12 factors took account of potential management intervention, what impact this analysis had on surplus, and what the precise adjustments were that account for Rector's $400 million increase in recommended surplus. We therefore request the following information:

(a) Please explain how Rector's "detailed analysis of the [13] factors that are used in Millman's stochastic modeling process" accounted for the two elements of management intervention described in the 2010 Rector Report as "Pricing Margins and Underwriting Standards" and "Infrastructure Investments."[4] Please answer separately with respect to each of the 13 factors.

(b) Please quantify how much reduction in surplus this analysis produced, in comparison with the 190-point reduction the analysis produced in 2009.

(c) Please quantify the various adjustments Rector made that account for the difference between the 553% RBC that Rector calculated was needed in 2009 as compared with the 958% RBC needed now (in each case the calculation being surplus needed to avoiding falling to 200% RBC with 98% confidence).

Given the time we expect it to take between the time we receive this requested data and our ability to take it into account for purposes of preparing a pre-hearing report that will be due 15 days before the hearing, we ask that the data be provided to us by Friday, May 2.

We look forward to continuing our work with you to ensure a surplus review process that complies with the requirements of MIEAA. If you have any questions, please do not hesitate to contact us.

Sincerely,

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[4] Rector & Assocs., *Report to the D.C. Department of Insurance, Securities and Banking: Group Hospitalization and Medical Services, Inc.* 8 (July 21, 2010).