DC APPLESEED
Solving DC Problems

1111 Fourteenth Street, NW
Suite 510
Washington, DC 20005

Phone 202.289.8007
Fax 202.289.8009
www.dcappleseed.org

January 18, 2013

Ms. Sarah Schroeder
c/o District of Columbia Department of Insurance, Securities and Banking
810 First Street NE
Suite 701
Washington, D.C. 20002

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

Dear Ms. Schroeder:

We very much appreciate DISB hosting the meeting on January 10 among Rector & Associates, GHMSI, and DC Appleseed. We also appreciate the way Rector conducted the meeting, seeking input from both GHMSI and DC Appleseed and attempting to build as much consensus as possible concerning how a model should be constructed to assess GHMSI's permissible surplus under the MIEAA.

Our understanding is that Rector intends next to develop its own proposals for the model and then convene a second meeting with GHMSI and DC Appleseed to present those proposals. In hopes of making that next meeting as productive as possible, we are writing now to summarize and clarify our views on the key issues discussed at the January 10 meeting and to make certain requests concerning data we hope Rector will be able to share with us as the model is developed.

This letter presents our views and suggestions on the two central subjects we think DISB and Rector need to address in this process: (1) how to apply the "maximum feasible" standard; and (2) what assumptions to make in the model concerning five key issues discussed at the January 10 meeting: loss cycles; catastrophic events/unidentified growth and development; premium growth; impact of the Affordable Care Act ("ACA"); and confidence levels.

On the first of these issues, as we said at the January 10 meeting and further explain below, while we recognize that "maximum feasible" is a legal issue, we think that issue needs to be taken into account by Rector as it constructs the model. On the second issue – the five key components of the model – we attach a letter from Mark Shaw expressing his views on those components, and we briefly summarize those views below in this letter.

(1) Rector Should Account for the "Maximum Feasible" Standard in Developing Its Model.

The Court of Appeals' decision in this case makes clear that the "maximum feasible" standard was "the primary motivation behind the MIEAA."[1] Under that standard, GHMSI is obligated to commit as much of its surplus as possible to community health needs, limited by the need to avoid "undermining [its] 'soundness and efficiency.'"[2]

In our view, this means that the model for determining the company's surplus needs to be focused primarily on conserving surplus to address actual, present-day community health needs, rather than on conserving surplus to guard against remote future contingencies that are ungrounded in historical data. We believe Milliman's model has been primarily based on the latter approach; but we think the MIEAA should direct Rector to the former approach as it addresses the various technical issues presented by the construction of the model.

We also think the approach we recommend was the one generally adopted by the Pennsylvania Insurance Commissioner when she assessed the maximum permissible surplus for the Blues in that State. Her approach resisted increases in surplus that would bring about only "marginal reductions in risk," particularly as compared with "the benefits of using these same surplus funds in an alternative fashion."[3]

While in our view the technical issues raised by Rector at our January 10 meeting and addressed in the attached letter from Mark Shaw could potentially be resolved on the basis of sound actuarial judgment, we think that judgment should be informed by the primary goal of MIEAA – maximizing the amount of surplus available to address community healthcare needs. As a result, where more than one reasonable judgment could be made about the assumptions to include in the model, which by definition means that each is consistent with GHMSI's "financial soundness," the statute directs that the assumptions be made in favor of maximizing benefits, not maximizing surplus. And this is particularly so when the assumptions that would result in increasing surplus, would bring about only "marginal reductions in risk." Significant increases in surplus that achieve only "marginal reductions in risk" are not consistent with GHMSI's "financial . . . efficiency" and, therefore, are not in the interest of the GHMSI's subscribers, whose premiums typically pay for a large part or all of that surplus.

(2) The Five Key Issues to be Addressed in the Model

We have specific suggestions concerning how we think Rector should approach the five key issues raised at the January 10 meeting. Those five issues are addressed in the attached letter from Mr. Shaw.

---

[1] D.C. Appleseed Ctr. for Law & Justice v. D.C. Dep't of Ins., Secs. & Banking, No. 10-11-1461, at 51 (D.C. Sept. 13, 2012).
[2] *Id.* at 50.
[3] *In re: Applications of Capital BlueCross, Highmark Inc., Hospital Service Association of Northeastern Pennsylvania d/b/a Blue Cross of Northeastern Pennsylvania and Independence Blue Cross for Approval of Reserves and Surplus*, Misc. Dkt. No. MS05-02-00615, Insurance Dep't of the Commonwealth of Pennsylvania (Feb. 9, 2005) at 15.

Generally, Mr. Shaw's suggestions emphasize that the model Rector uses should be grounded as much as possible in the actual experience of GHMSI and its peers, rather than on remote contingencies that are not based on historical data and that drive up surplus at the expense of maximizing the amount available to address actual community health needs. Mr. Shaw also requests in his letter that once Rector determines which assumptions to make concerning these five issues, sufficient data be shared so that he and DC Appleseed will have an opportunity to assess the reasonableness of the assumptions.

In summary, Mr. Shaw's recommendations are as follows:

Loss Cycle. Our understanding is that the Milliman model aggregates a number of adverse potential events to create a "loss cycle." Yet this "loss cycle" appears not to reflect the actual performance of GHMSI or similar companies over the last 15 years. This is the most relevant period to validate the model, because older results do not reflect the modern realities of the industry. The Milliman model also appears based on other data and its own "experience and judgment." Once Rector determines how, if at all, to use "loss cycles" in the model, we request that sufficient information about those cycles be shared so that we will have an independent opportunity to assess their reasonableness and their consistency with the MIEAA standard.

Catastrophic Events/Unidentified Growth and Development. The Milliman model includes additional charges for catastrophic events and unidentified growth and development in every scenario. We believe, essentially for the reasons stated in Rector's 2009 report, that additional increases in surplus for these items are not warranted and should not be included in the model.

Premium Growth. The premium growth that the Milliman model assumes is too high and does not reflect actual experience. Mr. Shaw and Milliman offered different methods of calculating actual, prior premium growth, ranging from Mr. Shaw's position of 2% or 2.6% to Milliman's position of 4.8%. The Milliman model, however, assumes growth of 7% to 11%. An assumption of 2% to 6% would fairly reflect actual experience by any measure.

Affordable Care Act. The Milliman model makes two unrealistic assumptions about the impact of the ACA. First, it attaches dramatic risk to ACA provisions that have already been implemented, even though these have already been incorporated into the market and experience without any noticeable impact. Second, the model also attaches dramatic risk to ACA provisions that will be implemented in the future, even though there are indications that these provisions will have a positive impact on GHMSI. As with the loss cycle issue, once Rector determines how, if at all, to account for the ACA in the model, we request that sufficient information be provided for us to make an independent assessment of the assumptions' reasonableness and their consistency with the MIEAA standard.

Confidence Levels. There appears to be agreement that the primary element the model should measure is the amount of GHMSI surplus needed to avoid falling below 200% RBC/ACL with 98% confidence. We think, as Rector appeared to suggest at our meeting, that the model does not need to also estimate the surplus needed to avoid falling below 375%. In any case, however, as Mr. Shaw points out, a surplus that avoids falling below 200% RBC with 98% confidence can be expected to be sufficient avoid falling below 375% RBC with 75% confidence. It seems to us that this is sufficient to protect soundness and efficiency, both as a matter of actuarial soundness, as well as under the MIEAA standard

Thank you again for inviting us to participate in this surplus review process. As Mr. Shaw has noted in his letter, he is willing to sign an appropriate confidentiality agreement if that is needed to facilitate review of the information we are requesting from Rector. We look forward to the remainder of this process and hope it will help reach consensus concerning the appropriate level of GHMSI's surplus.

Sincerely,

Walter Smith, Executive Director
DC Appleseed Center

Deborah Chollet, Ph.D.

Richard B. Herzog
Harkins Cunningham LLP

Marialuisa S. Gallozzi
Covington & Burling LLP

cc: The Honorable William P. White, Commissioner, D.C. Department of Insurance, Securities and Banking
Mr. Philip Barlow, Associate Commissioner for Insurance, D.C. Department of Insurance, Securities and Banking
Mr. Thomas M. Glassic, General Counsel, D.C. Department of Insurance, Securities and Banking