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

IN THE MATTER OF

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

D.C. APPLESEED'S MOTION FOR RECONSIDERATION

The Commissioner has issued a milestone decision in the implementation of MIEAA, and taken a very large step toward defining Group Hospitalization and Medical Services, Inc.'s ("GHMSI") proper role in the provision of health insurance and the advancement of community health in the District of Columbia. The decision finds that GHMSI's year-end 2011 surplus, built up over many years from generations of subscribers, is excessive. The decision clarifies key elements in the methodology to be employed in governing GHMSI's surplus under MIEAA. The decision should, therefore, enable GHMSI's management to avoid such large excesses in the future and greatly simplify regulatory review. Pursuant to the decision, GHMSI must now submit a "fair and equitable" plan to dedicate the excess to community health reinvestment.

The Commissioner's lengthy and complex decision, however, contains certain material errors. In this motion for reconsideration, the D.C. Appleseed Center for Law and Justice, Inc. ("DC Appleseed") respectfully brings to the Commissioner's attention several elements in the decision that warrant correction now, prior to any judicial review. These errors resulted in a significant undercounting both of GHMSI's excess surplus and of the portion of that excess that is allocable to the District of Columbia. The choices that led to the undercounting involved clear errors of law and/or were arbitrary and capricious. When those errors are corrected, GHMSI's

2011 allowable surplus is 615% RBC-ACL (or approximately $593.6 million); its excess surplus is $370 million; and 63.5% (or $235 million) of the excess is allocable to the District.

DC Appleseed accordingly requests that the Commissioner reconsider his Decision and Order of December 30, 2014, Order No. 14-MIE-012 ("Dec. 2014 Order") and require GHMSI to submit a plan to dedicate the revised excess 2011 surplus within 45 days of the date of his Decision and Order on Reconsideration.[1]

STATEMENT OF FACTS

With respect to the equity portfolio factor: (1) the Commissioner determined that GHMSI's permissible surplus must be measured by the level needed to meet reasonable risks and contingencies; (2) the Commissioner demonstrated that the method for ensuring that the model measures such risks is to require that the assumptions in the model be based on middle-of-the-fairway predictions; (3) this was not done in the case of the equity portfolio factor; and (4) as a result, GHMSI's surplus was increased to protect against potential shortfalls in its investment portfolio that unreasonably assumed a zero return on equity as the most likely outcome for the 2012–2014 period.

In calculating the portion of GHMSI's surplus allocable to the District, the Commissioner based the allocation, in relevant part, on (1) the relative profitability of FEP premiums compared to non-FEP premiums, but not the relative profitability of non-FEP premiums among the District, Maryland, and Virginia; (2) the situs of the contract with respect to non-FEP premiums, but not

[1] The Commissioner may act upon the motion of any person "for good cause shown, to promote the interests of justice." 26-A DCMR § 3800.2. The Commissioner therefore has the authority to entertain DC Appleseed's motion for reconsideration to promote the interests of justice, as set forth below. In the alternative, DC Appleseed requests the Commissioner's leave to file the present motion for reconsideration. The public interest in a proper outcome of this proceeding is measured in the hundreds of millions of dollars.

with respect to FEP premiums; (3) erroneous reliance on data solely from GHMSI's and CareFirst BlueChoice's ("BlueChoice") 2011 Annual Statements, but not from the preceding years in which the excess surplus was accumulated; and (4) erroneous consideration of 50% of BlueChoice premiums in his allocation.

LEGAL POINTS AND AUTHORITIES

Although MIEAA grants the Commissioner "discretion in light of [his] expertise in this subject matter" to establish a framework to review GHMSI's surplus and to determine the portion of the surplus allocable to the District, *D.C. Appleseed Ctr. for Law & Justice, Inc. v. District of Columbia Dep't of Insurance, Securities & Banking*, 54 A.3d 1188, 1215 (D.C. 2012), as an agency decisionmaker, he "must do so in a rational and consistent manner," *General Chem. Corp. v. United States*, 817 F.2d 844, 854 (D.C. Cir. 1987).[2] *See also Rapoport v. SEC*, 682 F.3d 98, 104 (D.C. Cir. 2012) ("[A]gencies must apply their rules consistently."); *Payne v. District of Columbia Dep't of Employment Servs.*, 99 A.3d 665, 671 (D.C. 2014) (explaining that agency conclusions must "flow rationally" from facts).

To meet its obligation to regulate with consistency, an agency must treat similar situations similarly, *see*, *e.g.*, *Independent Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996) ("An agency must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so."), and "follow the standards it . . . set[s] for itself," *Orion Communications Ltd. v. FCC*, 131 F.3d 176, 178 (D.C. Cir. 1998) (holding agency action arbitrary and capricious where it "failed to follow the standards it had set for itself" by

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[2] The District of Columbia Court of Appeals "look[s] to" the United States Supreme Court's and the United States Court of Appeals for the District of Columbia Circuit's administrative law decisions in applying the District's Administrative Procedure Act. *See Appleseed*, 54 A.3d at 1209 n.29, 1216.

regulation).[3] Agency reasoning that is "internally inconsistent" is likewise "arbitrary." *Business Roundtable v. SEC*, 647 F.3d 1144, 1153–54 (D.C. Cir. 2011).[4]

Moreover, an agency must effectuate the plain language and intent of the governing statute, and a reviewing court "will not affirm an administrative determination that reflects a misconception of the relevant law or a faulty application of the law." *Appleseed*, 54 A.3d at 1211 (quotation omitted).

As set forth below, the Commissioner erred as a matter of law in assessing the equity portfolio factor and allocating GHMSI's surplus in contravention of the standards for assessment and allocation articulated by the Commissioner in his Dec. 2014 Order, the appropriate data, and the plain terms and intent of the MIEAA.

I. The Commissioner Clearly Erred as a Matter of Law in Adopting Rector's Probability Distribution for the Equity Portfolio Factor.

The Commissioner interpreted the MIEAA "as requiring him to determine the level of surplus that maximizes GHMSI's community health reinvestment without undermining GHMSI's financial soundness and efficiency." Dec. 2014 Order at 15. This means, the Commissioner held, that he must "determine the amount of surplus that is large enough to be consistent with financial soundness and efficiency, but no larger." *Id*. at 15–16.

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[3] *See also Nat'l Rural Elec. Coop. Ass'n v. SEC*, 276 F.3d 609, 615 (D.C. Cir. 2002) (recognizing that Commission "failed to follow its own prior reasoning"). *Cf. Hensley v. District of Columbia Dep't of Employment Servs.*, 49 A.3d 1195, 1203 (D.C. 2012) (noting that an "unexplained inconsistency in an agency's interpretation of its governing statute can be a reason for holding an interpretation to be an arbitrary and capricious change from agency practice" (quotation omitted)).

[4] *See also Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (holding that an agency's decision was arbitrary and capricious where it "entirely failed to consider an important aspect of the problem"); *Dietrich v. Dist. of Columbia Bd. of Zoning Adjustment*, 293 A.2d 470, 473 (D.C. 1972) (holding that an agency may not offer "generalized, conclusory, or incomplete findings").

To determine that amount, the Commissioner concluded that the surplus should be designed to meet "all reasonable risks and contingencies." *Id.* at 20. He further concluded that, given his intention to rely on the Modified Milliman Model, the model must rely on "reasonable, 'middle-of-the-fairway' projections of surplus needs" in order to comply with MIEAA. *Id.* at 21. In the Commissioner's view, the purpose of Rector's review and use of the model was to ensure "that each individual assumption underlying the model was a reasonable, 'middle-of-the-fairway' assumption." *Id.* at 22. The Commissioner concluded that, except for the premium growth assumptions relied on by Rector, Rector's assumptions met the "middle-of-the-fairway" requirement. *Id.* at 23.

While several of Rector's assumptions fail to meet the "middle-of-the-fairway" standard, the assumption underlying the equity portfolio factor so far departs from that standard as to make its adoption by the Commissioner a clear error of law, and/or arbitrary and capricious.[5] Moreover, as explained below, the Commissioner's treatment of the equity portfolio factor is in sharp contrast to his treatment of the premium growth factor, underscoring the Commissioner's error of law. The Commissioner, therefore, should reconsider his treatment of the equity portfolio factor and, upon doing so, reduce GHMSI's permissible surplus from 721% RBC to 615% RBC.

A. The Commissioner's Standard for Applying the "Middle-of-the-Fairway" Assumption.

In his examination of the factors relied on by Rector in the Modified Milliman Model, the Commissioner undertook to ensure that each factor reflects "reasonable, 'middle of the fairway'

[5] An agency has acted arbitrarily and capriciously, among other things, where it has "offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *State Farm*, 463 U.S. at 43.

assumptions." Dec. 2014 Order at 32. In determining whether the premium growth factor used by Rector met this standard, the Commissioner took into account three considerations: (1) historical premium growth experience; (2) future changes that might cause deviation from that experience; and (3) differing treatment for FEP and non-FEP business. *See id.*

Regarding the first consideration, Rector calculated an historical premium growth rate of 8.4%. Rector, however, selected a much higher growth rate (12.4%) for non-FEP premium growth as the most likely middle-of-the-fairway outcome for the years 2012–2014 based primarily on higher projected enrollments due to the Affordable Care Act. But the Commissioner concluded that the projected departure from the historical norm had not been justified and that the appropriate mid-point to use for non-FEP growth in the model was 8.0%. *Id.* at 35. The change lowered the permissible surplus under MIEAA from 795% RBC to 721% RBC.

As explained below, the Commissioner failed to take the same approach to arrive at middle-of-the-fairway assumptions regarding the equity portfolio factor. That unexplained departure from the Commissioner's articulated standard—and its application to the similar premium growth factor—was legal error. *See supra* pp. 3–4.

B. The Commissioner Failed to Apply the Middle-of-the-Fairway Standard to the Equity Portfolio Factor.

The Commissioner did not hold Rector to the middle-of-the-fairway standard in the case of the equity portfolio factor. Regarding that factor, the Commissioner first noted that "Rector found that . . . equity values have increased at an average rate of 7.3% over the last 50 years . . . ." Dec. 2014 Order at 37. He then noted that, "[b]y comparing the deviations in the S&P 500 over a 50-year period, Rector was able to validate the assumptions relating to the equity portfolio asset values" used in the Milliman Model. *Id.*

While it is appropriate to consider the deviations in the S&P 500 over the past 60 years[6] in constructing the probability distribution to use for the equity portfolio factor in the model, the probability distribution adopted by Rector is clearly not consistent with the historical record. Rector's most likely value in the distribution—*a minus 3% return*—indicates just how radically the distribution is skewed from the historical record toward underestimating equity returns. Milliman, *Milliman Response to June 10, 2014 Report by D.C. Appleseed and Mark E. Shaw, FSA, MAAA, CERA, FLMI* ch. B-1, at 16 (Nov. 6, 2014) [hereinafter Milliman Rebuttal]. As Mark Shaw has explained, given how Rector used the model, this translates into an assumption that the most likely actual return to GHMSI's equity portfolio during 2012–2014 would be *zero*. Mark Shaw Statement (attached hereto), 8.[7]

As the Commissioner's treatment of the premium growth factor establishes, the most likely outcome must be based on a validated middle-of-the-fairway assumption; and that middle-of-the-fairway assumption should be based on historical experience, unless some clear evidence is offered to explain why an outcome that differs from that experience should be expected in the future. None of that analysis was undertaken. The Commissioner did not mention, much less analyze, the percentage return used in the model as the most likely middle-of-the-fairway

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6 The historical period underlying Rector's assumption was actually 1/1/1950 to 4/1/2011. *See* Mark Shaw Statement, 8.

7 As Mr. Shaw explains, the reason the use of a negative 3% equity return produces a projected most likely outcome of zero equity return for three years is owing to how Rector used the equity return factor in the pro forma model. The pro forma model assumed a 3.75% total return to GHMSI's total investment portfolio for the period 2012–2014; this includes a 7% expected return to equities and a 3.5% return to bonds. Milliman Rebuttal at 15. However, because the equity portfolio factor is *not* used to reduce the equity return on the pro forma investment portfolio, but is actually used instead to reduce non-FEP premium revenue in that pro forma, and because non-FEP premium revenue is more than six times as large as the investment portfolio ($2.4 billion vs. $400 million), the result of using a negative 3% as the most likely outcome when applied to non-FEP premium revenue is to bring the expected equity return to the portfolio down to zero.

outcome for equities; nor did he address whether this percentage had been justified in light of the 60-year equity return average of 7.3%. No such justification is possible.

Even though average S&P 500 equity returns for the past 60 years were 7% per year and the average three-year return over the last 60 years was 22%, the most likely assumption Rector made about equity returns for GHMSI is that those returns *would be zero*. Rector provided no grounds to suppose that at the end of 2011 the most likely returns for the next three years would be zero. In fact, the S&P 500 return was 13% in 2012, 30% in 2013, and 12% in 2014—for a three-year return of over 63%. This outcome cannot be squared with the legal principles the Commissioner laid down in his decision requiring a middle-of-the-fairway assumption; nor can it be reconciled with how the Commissioner applied those principles to the premium growth assumption. The Commissioner's conclusion is thus legally erroneous.

Not surprisingly, this error caused an unjustified and very large increase in GHMSI's permissible surplus.

C. The Appropriate Adjustment to the Equity Portfolio Factor.

As Mr. Shaw has shown, the error in the equity portfolio factor should be corrected by adopting a probability distribution in which the most likely equity return would be 7% per year. This assumption is in keeping with historical averages—just as the Commissioner assumed that the most likely premium growth return would be in keeping with the approximate 8% historical average. Mark Shaw Statement, 9–10. No reason has been offered why reasonable expectations for equity returns in 2011 would have included a major departure from historical returns. There is no such reason.

By making this one change, GHMSI's permissible surplus would be adjusted from the 721% RBC found by the Commissioner, to 615% RBC, at the 95% confidence level. *See* Mark Shaw Statement, 12.

II. The Commissioner Erred As a Matter of Law in Allocating GHMSI's Surplus.

In his Dec. 2014 Order, the Commissioner agreed with DC Appleseed that "the location or 'situs' of the contract—as measured by the premiums reported and number of policies issued in each jurisdiction—is the most relevant consideration" in determining the portion of GHMSI's surplus that should be allocated to the District. *See* Dec. 2014 Order at 52–53. That was a legal determination under MIEAA—that either allocation by situs is compelled or is the most reasonable interpretation that best serves the statutory purpose. Further, the Commissioner properly weighted FEP and non-FEP premiums according to their relative profitability, recognizing that surplus arises not from premiums directly but from the gains after payment of medical claims and other expenses.[8]

But the Commissioner erred as a matter of law by failing to apply his own legal standard in two key instances: (1) he failed to consider the relative profitability of non-FEP premiums among the District, Maryland, and Virginia, and thus took into account relative profitability between FEP and non-FEP premiums, but not relative profitability geographically of non-FEP among the three jurisdictions; and (2) he failed to consider the situs of the contract with respect to FEP premiums. Separately, the Commissioner erred by relying solely on GHMSI's and BlueChoice's 2011 Annual Statements rather than the data for preceding years in which the excess surplus accumulated, and by considering 50% of BlueChoice premiums in his allocation;

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[8] In addition, the Commissioner properly gave the most weight to reported premiums, rather than the number of policies by jurisdiction, because the surplus gain is attributable to " 'premiums paid by or on behalf of [GHMSI's] subscribers.'" Dec. 2014 Order at 53 (quoting GHMSI Attribution Resp. at 2 and citing DC Appleseed Rebuttal Brief at 55 ("the surplus is produced by the premiums paid by individuals and small-group and medium-group employers and their employees.")). The number of policies says very little about the contribution of the policies to surplus; it reflects neither the amount of premiums paid under those policies nor their profitability after the premiums are applied to medical claims and other expenses. *See*, *e.g.*, *id.* at 56–57.

BlueChoice is not within the scope of the MIEAA (and its subscribers should not benefit from a reduction in GHMSI's surplus).

Under the Commissioner's articulated standard and the MIEAA's provisions, the portion of GHMSI's $964 million surplus attributable to the District of Columbia is 63.5%, not 21% as the Commissioner erroneously concluded.

A. The Commissioner Failed to Consider the Greater Profitability of Non-FEP Premiums Charged Under Contracts Whose Situs Is The District In Comparison With Non-FEP Premiums Charged Under Contracts Whose Situs Is Outside the District.

In establishing a method for allocating GHMSI's surplus, the Commissioner assessed the profitability of GHMSI's revenue streams. *See* Dec. 2014 Order at 55 (taking a "more nuanced approach" than simply allocating premiums, and noting that "[a]s a general rule, FEP business is less risky, and therefore less profitable and less likely to contribute to surplus"). This "more nuanced approach" is, in fact, by far the most accurate approach by which to identify the sources of accumulated surplus; ultimately, surplus arises not from premiums but from the net gains to the company after payment of medical claims and other expenses. Applying this principle, the Commissioner weighted the surplus allocation for FEP business lower than for non-FEP business. The Commissioner's profitability weighting, however, ended with the comparison of FEP and non-FEP business.

But major differences in the relative profitability of GHMSI's revenue streams do not end there. GHMSI's profits from 2003 to 2011 demonstrate that GHMSI's non-FEP revenue was consistently much more profitable in the District than in Maryland or Virginia, accounting for 65% of GHMSI's non-FEP profitability (as against 35% in Maryland and Virginia combined). *See* Mark Shaw Statement, 3, 7. Thus, GHMSI has consistently pocketed a much greater share of the premiums paid by District residents and businesses, and a much smaller share paid by

residents and businesses in Maryland or Virginia. For the period 2003-2011, 1.3% of every premium dollar for non-FEP in Virginia and Maryland was net underwriting gain to the company, whereas the percentage gain to the company from non-FEP premium dollars from the District was over four times as large: 5.3%. Mark Shaw Statement, 1 (Chart 1), 3. In turn, a greater share of District premiums have contributed to surplus than from the other jurisdictions. In fact, well over two-thirds of GHMSI's profitability arose from the District for the period 2003-2011. Therefore, the Commissioner erred in finding that only 21% of GHMSI's surplus "came from," Dec. 2014 Order at 55, the District.

Because the Commissioner did not assess the relative profitability of GHMSI's non-FEP business among the three jurisdictions, he failed to consistently apply his own articulated standards for allocation and thereby erred as a matter of law. The Commissioner should have placed greater weight on the District's non-FEP business than the non-FEP business in Virginia and Maryland. Under the Commissioner's "more nuanced" approach taking into account the greater profitability of premiums from contracts whose situs is the District, 63.5% of GHMSI's surplus should be allocated to the District. Mark Shaw Statement, 7.

B. The Commissioner Failed to Allocate GHMSI's FEP Premiums Based on the Situs of the Contract.

Consistent with his articulated standards, the Commissioner allocated GHMSI's non-FEP premiums based on the situs of the contract. However, in violation of the Commissioner's obligation to act rationally and consistently, he did not rely on the contract situs with respect to GHMSI's FEP premiums. Nor did the Commissioner offer any reasoned justification for the inconsistency, and there is none. The situs of the FEP contract is the District.

The Commissioner used GHSMI's 2011 Schedule T to determine the percentage of premiums reported for each jurisdiction. GHMSI no longer reports its FEP premiums on

Schedule T based on the location of the contract. *See* Dec. 2014 Order at 54 n.31. Rather, beginning in 2010, and without explanation, GHMSI allocates FEP premiums among the District, Maryland, and Virginia. *See* 2011 Annual Statement, Schedule T (as amended).[9] Had GHMSI allocated its FEP premiums based on the situs of the contract, the percentage of premiums allocated to the District would have been substantially higher—indeed, 100%. Mark Shaw Statement, 5.

Using GHMSI's chosen method of reporting violates the Commissioner's articulated allocation standard. Indeed, use of GHMSI's chosen reporting lends itself to inconsistent application, and, in effect, cedes the allocation decision to GHMSI. As the Commissioner acknowledged, *see* Dec. 2014 Order at 54 n.31; *see also* DC Appleseed Rebuttal Filing at 61, GHMSI recently changed the manner in which it reports FEP premiums on its Schedule T. Prior to 2010, GHMSI reported all of its FEP premiums to the District. In 2011 that figure dropped, without explanation by GHMSI to 19.03%. This unilateral alteration of the allocation of GHMSI's FEP premiums on its Schedule T—with the effect that GHMSI ultimately allocates surplus as it chooses rather than according to a verifiable objective standard—demonstrates why the Commissioner should adhere to his determination to base allocation on the situs of the contract. In other words, the Commissioner's situs standard is more capable of consistent application because it is beyond GMHSI's control.

In summary, under his articulated standard, the Commissioner must allocate FEP premiums based on the location of the contract, which GHMSI submitted in response to the Commissioner's request for current premium information. That GHMSI itself is "bound by its"

[9] Although we cannot be sure, this allocation appears to reflect the residence of the federal employee certificate holders.

Schedule T, Dec. 2014 Order at 54 n.30, is irrelevant. The absence of a "conventional" way to report FEP premiums, *see id.* at n.31, does not mean that GHMSI has free rein to choose an allocation method, nor does it relieve the Commissioner of his obligation to determine the basis that best implements MIEAA. The Commissioner has now determined that MIEAA is best implemented through allocation according to the situs of the contract. That basis must be applied to FEP premiums, just as the Commissioner has applied it to non-FEP premiums. This inconsistency was legal error, and is arbitrary and capricious.

C. The Commissioner Failed to Consider Financial Data From the Years In Which GHMSI's Excess Surplus Accumulated.

Throughout his calculations, the Commissioner relied solely on financial data from 2011 Annual Statements. But GHMSI's excess surplus has accumulated over a lengthy period of years. The excess surplus is not the product of activity in calendar year 2011 alone. To the contrary, in 2011 GHMSI experienced declines in both the dollar amount of its surplus (from $969 million to $963 million) and its RBC ratio (from 1098% to 998%). Mark Shaw Statement, 4. Reliance solely on 2011 is thus inconsistent with both the actual excess surplus under review and the MIEAA's provision that the Commissioner need not undertake a review of GHMSI's surplus each year; rather, a review is required (at least) every three years. *See* D.C. Code § 31-3506(e).

Looking at the historical record, GHMSI's year-end surplus has remained above a 721% RBC ratio since the end of 2002. GHMSI therefore generated any excess surplus above this level in the 9-year period from 2003 to 2011. Mark Shaw Statement, 4. Considering these years

of actual excess surplus accumulation, the District's allocation of FEP premiums increases markedly. Mark Shaw Statement, 4–5.[10]

D. The Commissioner Failed to Exclude BlueChoice From the Allocation.

Finally, the Commissioner erred in concluding that BlueChoice "should be factored into the determination of what portion of the surplus is attributable to the District" because it "was factored into the determination of whether the surplus was excessive." Dec. 2014 Order at 54 n.28. The resulting inclusion of 50% of BlueChoice's business to calculate the allocation of GHMSI's surplus is inconsistent with MIEAA, inconsistent with the Commissioner's recognition that it is the profits on premiums and not simply the premiums themselves that contribute to surplus, and inconsistent with the treatment of other GHMSI assets.

Contrary to the Commissioner's reasoning, inclusion of BlueChoice premiums in the calculation of the premium growth factor, solely for technical reasons,[11] does not justify use of BlueChoice's premiums to allocate GHMSI's excess surplus. BlueChoice is an invested asset of GHMSI and, indeed, the sole assumption relating to BlueChoice's premiums in the pro forma projections of the Modified Milliman Model related to premium growth. *See* Mark Shaw Statement, 5. But BlueChoice has its own surplus that protects its own subscribers; GHMSI's surplus would not appropriately be distributed to BlueChoice's subscribers. *See* Mark Shaw Statement, 5. For that reason, BlueChoice's projected risks, expenses, etc. did not enter into the model, and its premiums and profitability do not properly play any role in allocation of GHMSI's excess surplus. *See* Mark Shaw Statement, 5. As elsewhere discussed, and as the

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[10] The District's allocation of non-FEP premiums is similar whether 2011 data or 2003-2011 data is used. Mark Shaw Statement, 4–5.

[11] The formulas for determining baseline RBC for GHMSI takes into account insurance premiums in a subsidiary such as BlueChoice. Mark Shaw Statement, 5.

Commissioner elsewhere recognizes, it is the profitability of premiums and not simply the premiums themselves that generate surplus.

Moreover, as a legal matter, under MIEAA the Commissioner is authorized to review "the portion of the surplus of the corporation that is attributable to the District." MIEAA § 2(e); D.C. Code § 31-3506(e). And any spend-down is of the excess portion of the surplus under review. *Id.*, § 31-3506(g)(1). In short, the surplus that is to be allocated is the surplus under review in this proceeding. BlueChoice's surplus is of course not under review in this proceeding.

Nor could it be. MIEAA's legislative history confirms that GHMSI was the sole intended target of the law.[12] Accordingly, GHMSI is the only entity that meets the statutory definition of a "corporation"—"a nonstock, nonprofit corporation which is subject to regulation and licensing under this chapter and which offers subscriber contracts as part of a hospital service plan, a medical service plan, or both"). D.C. Code § 31-3501(2). By contrast, BlueChoice is a for-profit health maintenance organization owned by CareFirst Holdings, LLC ("CFH"), which in turn is jointly owned by GHMSI and CareFirst of Maryland, Inc. It is a separate corporate entity, independently regulated by DISB, and not subject to MIEAA.

Thus, under MIEAA's plain terms and intent, the "corporation" whose surplus is under the jurisdiction and review of MIEAA is GHMSI, not BlueChoice. And it is only "the surplus of the corporation" (GHMSI) under MIEAA that is allocable. D.C. Code § 3103506(e). The

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[12] *See* Council of the District of Columbia Committee on Public Services and Consumer Affairs Report (Oct. 17, 2008) at 3 (explaining that GHMSI is "the only non-profit hospital and medical services corporation in the District"). The report also notes that the CareFirst corporate family includes "a substantial number of CareFirst companies, including CareFirst BlueChoice, a for-profit health maintenance organization ("HMO") and subsidiary of [CareFirst of Maryland, Inc.]"). *See also Appleseed*, 54 A.3d at 1214–15 (relying on legislative history in determining meaning of MIEAA provision).

Commissioner's decision to factor BlueChoice's premiums into his allocation therefore violates MIEAA.

Finally, as a matter of consistency, the Commissioner should not have included BlueChoice—an asset of GHMSI—in calculating the proportion of GHMSI's surplus attributable to the District. The Commissioner did not consider the location of other assets that GHMSI owns in calculating allocation, and the Commissioner's inconsistent treatment of BlueChoice was thus erroneous, arbitrary, and capricious.

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In summary, if the Commissioner bases his allocation on Schedule T returns for 2003-2011, rather than on 2011 alone, but makes no other change, it raises the District's allocation to 30.3%. If the Commissioner in addition weights non-FEP premium revenue according to its profitability, it raises the District's allocation to 45.0%. If he also takes account of the District's share of FEP premium revenue as reported on Schedule T for the years 2003-2011, it increases the District's allocation to 54.6%. If he further treats all FEP revenue as allocable to the District based on the situs of the contract, it raises the District's allocation to 58.3%. And finally, if he also omits BlueChoice from the allocation calculations, it produces a District allocation of 63.5%.

CONCLUSION

DC Appleseed urges the Commissioner to reconsider and amend the December 30 Decision and Order as set forth above.

Respectfully submitted,

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CERTIFICATE OF FILING

I certify that on this 9th day of January, 2015, I caused one copy of the foregoing Motion to be sent by hand delivery and electronic mail to the following:

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Mark Shaw Statement

January 9, 2015

Purpose of this Statement

In calculating the portion of GHMSI's surplus allocable to the District, the Commissioner based the allocation, in relevant part, on (1) the relative profitability of FEP premiums compared to non-FEP premiums, but not the relative profitability of non-FEP premiums among the District, Maryland, and Virginia; (2) the situs of the contract with respect to non-FEP premiums, but not FEP premiums; and (3) on data from the 2011 Annual Statements of Group Hospitalization and Medical Services, Inc.'s ("GHMSI") and CareFirst Blue Choice ("CFBC"), rather than data from the years that the excess surplus was accumulated. The Commissioner also considered 50% of CFBC premiums in his allocation, rather than relying solely on the premiums arising from GHMSI subscribers. This statement will discuss and quantify the impact of these issues on the allocation of GHMSI's excess surplus.

In addition to the allocation issues, the Commissioner's decision relied on EPAV factors selected by Milliman which are not consistent with the historical record that Milliman states it relied upon and which are not "middle of the fairway" as the Commissioner states he intended the surplus model assumptions to be. This statement will discuss and quantify the impact of the inappropriate EPAV factors on the determination of the amount of GHMSI's excess surplus.

Allocation Issues

1) The Commissioner correctly states that excess surplus should be distributed based on where the profits generating that excess came from. In this regard the Commissioner differentiated the profitability of FEP premium from that of all other premium. This differentiation is appropriate, but does not address a similar differentiation in profitability that is plainly seen in the historical record – that non-FEP premium generated from the District has been consistently and substantially more profitable than non-FEP premium arising from other jurisdiction in which GHMSI does business. Here is a summary of the historical record arising from the last nine years[1] (2003-2011):

CHART 1

	DC Total Non-FEP	VA, MD Non-FEP	All Non-FEP
2003-2011 Total Revenue (Excludes Investment Income)	3,310,018,886	7,337,127,216	10,647,146,102
2003-2011incurred for Health Care Services	2,591,503,735	6,015,398,160	8,606,901,895
Loss Ratio	78.3%	82.0%	80.8%
2003-2011 Claims Adjustment expenses	132,235,327	319,741,547	451,976,874
2003-2011 General Administrative expenses	405,755,016	912,787,190	1,318,542,206
Net Underwriting gain or loss	176,444,861	93,280,266	269,725,127
Net Underwriting % gain or loss	5.3%	1.3%	2.5%

[1] As described later in this section, the rationale for using nine years (2003 – 2011) to present the historical record rests on the fact that the last time that GHMSI's year-end surplus was below a 721% RBC ratio was at 12/31/2002. It follow that the entire excess surplus above 721% RBC was generated in the 9-year period from 2003 to 2011.

CHART 1 (continued)

	DC Total Non-FEP	VA, MD Non-FEP	All Non-FEP
2011 Total Revenue (Excludes Investment Income)	467,645,209	915,791,566	1,314,362,445
2011 incurred for Health Care Services	363,886,653	762,060,814	1,067,936,948
Loss Ratio	77.8%	83.2%	
2011 Claims Adjustment expenses	17,588,599	43,155,540	60,744,139
2011 General Administrative expenses	61,776,349	121,284,107	183,060,456
Net Underwriting gain or loss	24,393,608	(10,708,895)	13,684,713
Net Underwriting % gain or loss	5.2%	-1.2%	1.0%
2010 Total Revenue (Excludes Investment Income)	461,784,940	908,210,664	1,339,247,601
2010 incurred for Health Care Services	345,483,838	711,909,494	1,033,648,595
Loss Ratio	74.8%	78.4%	
2010 Claims Adjustment expenses	22,244,415	46,712,635	68,957,050
2010 General Administrative expenses	63,109,505	125,843,760	188,953,265
Net Underwriting gain or loss	30,947,182	23,744,775	54,691,957
Net Underwriting % gain or loss	6.7%	2.6%	4.1%
2009 Total Revenue (Excludes Investment Income)	454,481,964	904,205,067	1,293,559,088
2009 incurred for Health Care Services	371,301,359	754,718,652	1,074,924,897
Loss Ratio	81.7%	83.5%	
2009 Claims Adjustment expenses	17,205,582	41,528,944	51,947,323
2009 General Administrative expenses	58,081,423	130,335,196	175,358,962
Net Underwriting gain or loss	3,813,652	(18,297,777)	(14,484,125)
Net Underwriting % gain or loss	0.8%	-2.0%	-1.1%
2008 Total Revenue (Excludes Investment Income)	415,103,408	848,614,575	1,263,717,983
2008 incurred for Health Care Services	343,897,879	715,642,960	1,059,540,839
Loss Ratio	82.8%	84.3%	83.8%
2008 Claims Adjustment expenses	17,543,965	36,087,981	53,631,946
2008 General Administrative expenses	53,031,792	108,319,414	161,351,206
Net Underwriting gain or loss	629,772	(11,435,780)	(10,806,008)
Net Underwriting % gain or loss	0.2%	-1.3%	-0.9%
2007 Total Revenue (Excludes Investment Income)	368,790,524	1,020,210,784	1,389,001,308
2007 incurred for Health Care Services	289,836,457	843,906,212	1,133,742,669
Loss Ratio	78.6%	82.7%	81.6%
2007 Claims Adjustment expenses	12,254,840	36,082,701	48,337,541
2007 General Administrative expenses	47,422,673	128,529,516	175,952,189
Net Underwriting gain or loss	19,276,554	11,692,355	30,968,909
Net Underwriting % gain or loss	5.2%	1.1%	2.2%
2006 Total Revenue (Excludes Investment Income)	316,915,474	844,921,017	1,161,836,491
2006 incurred for Health Care Services	258,861,298	687,107,733	945,969,031
Loss Ratio	81.7%	81.3%	81.4%
2006 Claims Adjustment expenses	11,258,453	30,363,128	41,621,581
2006 General Administrative expenses	37,184,341	99,188,408	136,372,749
Net Underwriting gain or loss	9,611,382	28,261,748	37,873,130
Net Underwriting % gain or loss	3.0%	3.3%	3.3%

CHART 1 (continued)

	DC Total Non-FEP	VA, MD Non-FEP	All Non-FEP
2005 Total Revenue (Excludes Investment Income)	292,483,946	714,021,348	1,006,505,294
2005 incurred for Health Care Services	227,466,091	600,391,471	827,857,562
Loss Ratio	77.8%	84.1%	82.3%
2005 Claims Adjustment expenses	10,543,061	28,101,402	38,644,463
2005 General Administrative expenses	33,692,650	84,264,569	117,957,219
Net Underwriting gain or loss	20,782,144	1,263,906	22,046,050
Net Underwriting % gain or loss	7.1%	0.2%	2.2%
2004 Total Revenue (Excludes Investment Income)	277,810,041	593,045,939	870,855,980
2004 incurred for Health Care Services	199,599,877	459,255,889	658,855,766
Loss Ratio	71.8%	77.4%	75.7%
2004 Claims Adjustment expenses	9,774,563	22,904,846	32,679,409
2004 General Administrative expenses	29,794,036	65,016,725	94,810,761
Net Underwriting gain or loss	38,641,565	45,868,479	84,510,044
Net Underwriting % gain or loss	13.9%	7.7%	9.7%
2003 Total Revenue (Excludes Investment Income)	255,003,380	588,106,256	843,109,636
2003 incurred for Health Care Services	191,170,283	480,404,935	671,575,218
Loss Ratio	75.0%	81.7%	79.7%
2003 Claims Adjustment expenses	13,821,849	34,804,370	48,626,219
2003 General Administrative expenses	21,662,247	50,005,495	71,667,742
Net Underwriting gain or loss	28,349,002	22,891,455	51,240,457
Net Underwriting % gain or loss	11.1%	3.9%	6.1%

Notes: Total non-FEP premiums, incurred claims and expenses are from the Statement of Operations by Line of Business exhibits in GHMSI's Annual Statements. By jurisdiction earned premiums and incurred claims are from the Exhibit of Premiums, Enrollment and Utilization in GHMSI's State Pages to their Annual Statements. By jurisdiction claim adjustment expenses are overall expenses allocated by claim dollars. By jurisdiction general administrative expenses are overall expenses allocated by earned premiums.

It can be seen over this 9-year period (2003 – 2011) that while about 30% of GHMSI's non-FEP premium revenue arose from the District, District residents and businesses accounted for more than 65% of the profits. Moreover, if only the 2011 experience is used as the basis for allocating based on profitability, then 100% of non-FEP profit arises from the District. For the entire 9-year period the ratio of profitability for each dollar of District non-FEP premium to each dollar of profitability per non-FEP premium dollar from other jurisdictions is 4.2 to 1. This profitability differentiation is almost as large as the 4.5 to 1 distinction that the Commissioner gave to non-FEP premium vs. FEP premium.

Without any other changes, below is the impact that weighting non-FEP premium dollars with profitability makes:

CHART 2

Impact of Weighting Non-FEP Premium with Profitability				
		Unweighted by Profit	Profit Weights	Weighted Share
GHMSI + 50% CF Blue Choice	DC Share	22.3%	4.2	54.7%
	VA/MD Share	77.7%	1.0	45.3%
GHMSI Only	DC Share	27.8%	4.2	61.8%
	VA/MD Share	72.2%	1.0	38.2%

2) The Commissioner's decision on how to allocate excess surplus relies solely on the 2011 Annual Statements of GHMSI and CFBC. There are significant issues with this approach:
   a. The excess surplus to be distributed has accumulated over a long period of time, not just in one calendar year.
   b. **<u>None</u>** of the excess surplus was accumulated in 2011 as GHMSI's experienced a decline in the dollar amount of surplus (from $969 million to $963 million) and Risk Based Capital – Authorized Control Level ("RBC") ratio (from 1098% to 998%) in 2011.

Looking at the historical record, the last time that GHMSI's year-end surplus was below a 721% RBC ratio was at 12/31/2002. It follows then that all of the excess surplus above 721% RBC was generated in the 9-year period from 2003 to 2011. Using this time period as the basis rather than 2011 alone has the following impact on allocation:

CHART 3

As Reported in Schedule T of Annual Statement Filings

GHMSI	Total Non-FEP Premium	DC Non-FEP Premium	DC % of Non-FEP	FEP Premium	DC FEP Premium	DC % of FEP
2011	1,700,261,589	473,305,211	27.8%	1,730,368,058	331,882,869	19.2%
2003 - 2011	11,936,130,690	3,322,401,535	27.8%	12,560,554,331	9,816,674,342	78.2%

CF Blue Choice	Total Non-FEP Premium	DC Non-FEP Premium	DC % of Non-FEP	FEP Premium	DC FEP Premium	DC % of FEP
2011	1,871,635,759	231,586,264	12.4%	174,470,124	-	0.0%
2003 - 2011	13,057,505,334	1,401,207,736	10.7%	697,278,227	410,765,112	58.9%

GHMSI + 50% of CF Blue Choice	Total Non-FEP Premium	DC Non-FEP Premium	DC % of Non-FEP	FEP Premium	DC FEP Premium	DC % of FEP
2011	2,636,079,469	589,098,343	22.3%	1,817,603,120	331,882,869	18.3%
2003 - 2011	18,464,883,357	4,023,005,403	21.8%	12,909,193,445	10,022,056,898	77.6%

The impact of using this 9-year period is minimal with regard to non-FEP premium, but is very significant with regard to the allocation of FEP premium. Moreover, as discussed in allocation issue #1, using the 9-year period 65% of non-FEP profitability is in the District as opposed to 2011 non-FEP profitability being 100% from the District.

3) The Commissioner specifically states in his decision that premium is appropriately allocated by situs of contract. He then proceeds in practice to contradict that decision by adopting premium allocation exactly as reported in Schedule T in GHMSI's Annual Statements. While GHMSI's Schedule T's are consistent with the situs of contract approach with regard to non-FEP premium, GHMSI's recent such schedules are inconsistent with contact situs in regard to FEP premiums whose situs is solely in the District.

   The Commissioner's approach using only the GHMSI 2011 Annual Statement for FEP premium allocation has only 19% of FEP premium allocated to the District. If the Commissioner adopts the recommended 9-year approach and continues to use filed Schedule T's for premium allocation, the GHMSI FEP premium percentage in the District rises to almost 78% as shown in the discussion of allocation issue #2. If the Commissioner fully adopts the situs of contract approach embraced in his decision, the GHMSI FEP premium percentage in the District rises to 100%.

4) The Commissioner reasons in a footnote on page 55 of his decision that because CFBC premium was considered in parts of the actuarial modeling used to determine the appropriate level of GHMSI's surplus that such premiums also ought to be considered in the allocation of GHMSI's excess surplus. This reasoning is faulty for the following reasons:
   a. CFBC is an invested asset of GHMSI. CFBC has its own surplus that protects its subscribers and which will not be distributed. Any distribution of GHMSI's excess surplus would not be appropriately returned to CFBC subscribers.
   b. The reason to include CFBC's premium in certain aspects of the modified Milliman model used to determine the appropriate level of GHMSI surplus is technical: the formulas for determining the baseline RBC for GHMSI are affected by insurance premiums in a subsidiary such as CFBC. By including CFBC's impact on premium growth, the model produced a relatively high estimate of surplus need and, therefore, a conservative (low) estimate of GHMSI's excess surplus.
   c. In the Pro Forma projections of the model the only assumption related to CFBC as an insurer was that of premium growth. CFBC's projected risks, expenses, etc. did not enter directly in the model – only CFBC's impact on GHMSI's overall premium growth and its expected profitability as an investment were considered.

I have presented four criticisms of the Commissioner's proposed allocation approach. Here is a summary of the impact on the premium weights of adopting the various alternative approaches suggested.

CHART 4

	Schedule T 2003-2011 vs. 2011 alone					
	Years(s)	Non-FEP Weight	DC Share of Non-FEP	FEP Weight	DC Share of FEP	Weighted Avg DC Share
GHMSI + 50% CF Blue Choice	2011	82%	22.3%	18%	18.3%	21.6%
	2003 - 2011	82%	21.8%	18%	77.6%	31.8%
GHMSI Only	2011	82%	27.8%	18%	19.2%	26.3%
	2003 - 2011	82%	27.8%	18%	78.2%	36.9%

	Schedule T 2003-2011 vs. 2011 and Non-FEP Profit Weights					
	Years(s)	Non-FEP Weight	DC Share of Non-FEP	FEP Weight	DC Share of FEP	Weighted Avg DC Share
GHMSI + 50% CF Blue Choice	2011	82%	100.0%	18%	18.3%	85.3%
	2003 - 2011	82%	54.7%	18%	77.6%	58.8%
GHMSI Only	2011	82%	100.0%	18%	19.2%	85.5%
	2003 - 2011	82%	61.8%	18%	78.2%	64.7%

	Sched T 2003-2011 vs. 2011, Non-FEP Profit Weights, Comm's FEP Weights					
	Years(s)	Non-FEP Weight	DC Share of Non-FEP	FEP Weight	DC Share of FEP	Weighted Avg DC Share
GHMSI + 50% CF Blue Choice	2011	82%	100.0%	18%	18.3%	85.3%
	2003 - 2011	82%	54.7%	18%	18.3%	48.1%
GHMSI Only	2011	82%	100.0%	18%	19.2%	85.5%
	2003 - 2011	82%	61.8%	18%	19.2%	54.1%

	Sched T 2003-2011 vs. 2011, Non-FEP Profit Weights, FEP Contract Situs					
	Years(s)	Non-FEP Weight	DC Share of Non-FEP	FEP Weight	DC Share of FEP	Weighted Avg DC Share
GHMSI + 50% CF Blue Choice	2011	82%	100.0%	18%	100.0%	100.0%
	2003 - 2011	82%	54.7%	18%	100.0%	62.9%
GHMSI Only	2011	82%	100.0%	18%	100.0%	100.0%
	2003 - 2011	82%	61.8%	18%	100.0%	68.7%

The above premium weights then translate to the following allocation percentages when the other weights and values of the Commissioner's allocation formula are adopted:

CHART 5

Premium Allocated To District							
		GHMSI + CFBC	GHMSI Only	GHMSI + CFBC	GHMSI Only	GHMSI + CFBC	GHMSI + CFBC
		Comm's Unmodified		Sched T		Non-FEP Profit, Comm FEP Wt	
Factor	**Weight**	**2011**	**2011**	**2003-2011**	**2003-2011**	**2011**	**2003-2011**
Weighted Premiums	90%	21.6%	26.3%	31.8%	36.9%	48.1%	54.1%
Policies by Jurisdiction	5%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Providers	5%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Weighted Average:		**21.1%**	**25.4%**	**30.3%**	**34.9%**	**45.0%**	**50.4%**

		GHMSI + CFBC	GHMSI Only	GHMSI + CFBC	GHMSI Only
		Sched T, NF Profit, Comm FEP		Sched T, NF Prof, FEP Situs	
Factor	**Weight**	**2003-2011**	**2003-2011**	**2003-2011**	**2003-2011**
Weighted Premiums	90%	58.8%	64.7%	62.9%	68.7%
Policies by Jurisdiction	5%	19.0%	19.0%	19.0%	19.0%
Providers	5%	15.0%	15.0%	15.0%	15.0%
Weighted Average:		**54.6%**	**59.9%**	**58.3%**	**63.5%**

EPAV Factors Adopted by Commissioner Are Inappropriate

Milliman stated for the first time in its November 7th rebuttal statement that it assumed "underlying average rates of return of 7.0% for equities, and 3.5% for the bond portfolio, consistent with [an] overall 3.75% rate of return." Not only is the arithmetic of this statement mystifying, but at long last Milliman went on to make transparent the source of Milliman's EPAV factors and how significantly Milliman's use of the EPAV factor inflates the amount of surplus that GHMSI purports to need. The Commissioner's December 30, 2014 order adopted the Milliman EPAV Factors without apparently knowing of their inconsistency with historical experience.

1) A summary of how much of the GHMSI's invested assets have been invested in equities in recent years is as follows:

CHART 6

GHMSI Investments in Stock as % of Non-FEP Premium						
			% of Pension	Total		Stock as %
	Assets in	Pension	Assets	Invested	Non-FEP	of Non-FEP
Year	**Stocks**	**Assets**	**in Stocks**	**in Stocks**	**Premium**	**Premium**
2008	$ 289,187,387	$ 219,384,000	51%	$401,073,227	$ 1,263,603,449	31.7%
2009	$ 271,267,146	$ 264,791,000	63%	$438,085,476	$ 1,358,626,250	32.2%
2010	$ 118,844,948	$ 289,120,000	66%	$309,664,148	$ 1,369,920,355	22.6%
2011	$ 172,513,788	$ 304,005,000	60%	$354,916,788	$ 1,383,316,013	25.7%
2012	$ 179,646,805	$ 334,907,000	56%	$367,194,725	$ 1,385,008,996	26.5%
2013	$ 121,819,719	$ 367,650,000	59%	$338,733,219	$ 1,344,078,347	25.2%

If CFBC equity investments are considered then the charts look like this:

CHART 7

CFBC Investments in Stock as % of Non-FEP Premium						
			% of Pension	Total		Stock as %
	Assets in	Pension	Assets	Invested	Non-FEP	of Non-FEP
Year	Stocks	Assets	in Stocks	in Stocks	Premium	Premium
2008	$ 64,923,424			$ 64,923,424	$ 1,667,377,185	3.9%
2009	$ 40,687,683			$ 40,687,683	$ 1,763,840,303	2.3%
2010	$ 78,365,074			$ 78,365,074	$ 1,853,609,597	4.2%
2011	$ 157,000,481			$157,000,481	$ 1,845,964,987	8.5%
2012	$ 180,498,934			$180,498,934	$ 1,940,926,592	9.3%
2013	$ 137,438,765			$137,438,765	$ 2,132,957,651	6.4%

GHMSI+50% of CFBC Investments in Stock as % of Non-FEP Premium						
			% of Pension	Total		Stock as %
	Assets in	Pension	Assets	Invested	Non-FEP	of Non-FEP
Year	Stocks	Assets	in Stocks	in Stocks	Premium	Premium
2008	$ 321,649,099	$ 219,384,000	51%	$433,534,939	$ 2,097,292,042	20.7%
2009	$ 291,610,988	$ 264,791,000	63%	$458,429,318	$ 2,240,546,402	20.5%
2010	$ 158,027,485	$ 289,120,000	66%	$348,846,685	$ 2,296,725,154	15.2%
2011	$ 251,014,029	$ 304,005,000	60%	$433,417,029	$ 2,306,298,507	18.8%
2012	$ 269,896,272	$ 334,907,000	56%	$457,444,192	$ 2,355,472,292	19.4%
2013	$ 190,539,102	$ 367,650,000	59%	$407,452,602	$ 2,410,557,173	16.9%

As used in the modified Milliman Model, the EPAV factor is one component of the total loss that comes out of the stochastic model (other sources of loss from the stochastic model include the RAAF factors, Bond Portfolio Impairment, etc.). The Pro Forma model then applies the total loss from the stochastic model to all non-FEP premiums—*in effect greatly magnifying the impact of stochastic model investment losses*. Since the amount of stock investment for GHMSI totals 16.9% of non-FEP premium (see above table), the effect of applying a 1% stochastic model EPAV loss to all non-FEP premiums is to multiply it by a factor of 6 (1/.169)—compared with the relatively small impact that would occur if the pro forma model separately applied a 1% loss only to equity investment returns. In short, the pro forma model translates the most likely result for the EPAV factor in the stochastic model (a loss of 3% of non-FEP premium) *to an equities 3-year loss of 18%*. When added to the 7% equity annual rate of return assumption in the Pro Forma model (that Milliman now says stocks are assumed to earn), this translation produces a most likely equities 3-year return of 0%.

2) The source behind Milliman's EPAV factors is revealed for the first time on page 16 of the Milliman Rebuttal as "the distribution of three-year price changes in the Standard & Poor's (S&P) 500 Index for the period from 1/1/1950 to 4/1/2011". With this source of information we are able to present the actual 3-year changes in equity prices from the S&P 500 index for the period from 1950 to 2011:

CHART 8

Probability	Actual S&P 500 3-year Return
10.0%	88.0%
11.7%	50.4%
25.0%	37.5%
30.0%	18.0%
13.3%	-1.2%
10.0%	-26.9%

Using data from 1/1/1950 through 12/31/2011 there are 60 actual 3-year periods. The above probability percentages used by Milliman do not appear to be the most logical groupings of the data to me, but I have used those percentages because I have tried to replicate the Milliman probability distribution using the 60 available observations.

Using this actual probability and loss distribution and the newly revealed 7% annual return on equities in the Pro Forma model and the newly revealed assumption that 16% of investments are assumed to be in equities, we are able to derive what historically justified EPAV factors should be as follows:

> Historically Justified EPAV = (Actual S&P 500 3-year return / Pro Forma Assumed stock return for a 3-year period (i.e. 7%/year compounded)) x Stocks as % of non-FEP premiums

These calculations result in the following chart that shows what true "middle of the fairway" assumptions for the EPAV factor should look like:

CHART 9

Probability	Actual S&P 500 3-year Return	Pro Forma Assumed Stock Return	Stocks as % of non-FEP Premium	S&P 500 EPAV Factor
10.0%	88.0%	7.0%	16.0%	8.6%
11.7%	50.4%	7.0%	16.0%	3.6%
25.0%	37.5%	7.0%	16.0%	2.0%
30.0%	18.0%	7.0%	16.0%	-0.6%
13.3%	-1.2%	7.0%	16.0%	-3.1%
10.0%	-26.9%	7.0%	16.0%	-6.5%

These numbers derived from Milliman's newly stated sources, when compared to the EPAV factors Milliman/Rector actually used, clearly show that the EPAV factors that Milliman and Rector actually used

significantly overstate the magnitude of equity loss. As a result, Milliman's and Rector's EPAV factors significantly overstate the need for surplus.

The 1st and last columns of Chart 9 above represent a historically accurate equivalent to Chart B-1 in the Milliman rebuttal. Accordingly, Chart 9A below repeats just the 1st and last columns of Chart 9:

CHART 9A

	S&P 500
	EPAV
Probability	**Factor**
10.0%	8.6%
11.7%	3.6%
25.0%	2.0%
30.0%	-0.6%
13.3%	-3.1%
10.0%	-6.5%

3) The mystifying arithmetic of Milliman's November 7th rebuttal statement derives from the following statements: "In our modeling we have reflected underlying average rates of return of 7.0% for equities, and 3.5% for the bond portfolio, consistent with [an] overall 3.75% rate of return", coupled with having noted that equities represent 16% of GHMSI investments[2]. However, a 7% return on 16% of invested equity assets and a 3.5% return on the remaining 84% of invested assets yields an overall investment return of 4.06%, not the 3.75% overall rate of return Milliman has stated the Pro Forma Model uses. Given that cash and invested assets are $1.23 billion at 12/31/2011 per GHMSI's annual statement, this understatement of expected investment return is worth approximately $3.8 million per year for 3 years or a total investment return understatement of $11.4 million. As a result, Milliman's own calculation of required surplus is inflated by $11.4 million due only to Milliman's own arithmetic error.

   Note: using the actual mix of investments at 12/31/2011 (see Chart 7) which consisted of 18.8% equities, the Milliman assumption of a 7% return on invested equity assets and a 3.5% return on the remaining 81.2% of invested assets yields an overall investment return of 4.16% which is worth an additional approximately $5.0 million per year for 3 years or a total investment return understatement of $15 million that would correspondingly reduce the required surplus calculated by the modified Milliman model.

4) As compared to Milliman's most likely expectation of a 1% equities investment gain over three years, Chart 8's most likely equities investment gain is 18.0%. Given that the actual average annual historical gain for the S&P 500 over the 1950 – 2011 period is 7.35%, or 22.0% over a three-year period, it is clear that the values in Chart 8 are much more true to historical experience. Furthermore, the S&P 500's actual gain over the recently completed three year period from 12/31/2011 to 12/31/2014 is 63.7%.

[2] See page 16 of the Milliman Rebuttal.

5) Phyllis A. Doran's rebuttal statement presents as Chart B-1 the probabilities of Equity Portfolio Asset Values and the surplus change as a % of non-FEP Insured Premium. Based on the information that Miliman reported for the first time in its November 7 rebuttal, we can now restate that chart as follows, adding a column that shows the surplus change as a % of amounts invested in equities[3]; another column that shows the annual Pro Forma Equities return; and a final column that shows the assumed Effective 3-year Pro Forma Equity Return based on the combined assumptions. Restated, the chart is:

CHART 10

Probability	3-year Surplus Change as % of non-FEP Insured Premium	3-year Surplus Change as % of assets based on 16% Equities	Annual Pro Forma Equity Return	Effective 3-year Pro Forma Equity Return
10%	11.5%	71.9%	7%	111%
12%	3.8%	23.8%	7%	52%
25%	0.9%	5.6%	7%	29%
29%	-3.0%	-18.8%	7%	0%
14%	-6.9%	-43.1%	7%	-30%
10%	-10.7%	-66.9%	7%	-59%

The final column in Chart 10 is a reverse calculation of Chart 9. For example, at the most common probability (29%), the -3.0% EPAV factor is divided by 16% (the percent of assets in equities) to get the surplus change based on equity investments rather than non-FEP premium. The result (-18.8%) is then increased by the assumed annual pro forma yield of 7% for 3 years (I.e., (1 – 18.8%) x (1 + 7%) x (1 + 7%) x (1 + 7%) = a 0% return).

This chart shows that the modified Milliman Model expects that 53% of the time (29% +14% +10%) that the rate of return on equities (the last column) – after accounting for the yields in both the stochastic model and the pro forma model – will be a 3-year return of 0% or less. This differs greatly from the actual historical experience that Milliman states it used, which shows that actual S&P 500 Index 3-year returns have been 0% or less only 18% of the time since 1950!

Moreover, the modified Milliman model is driven by results in the tail probabilities, and in this case Milliman and Rector use a 10% tail probability of a 59% 3-year equity loss. In contrast, actual historical data (see Chart 8) show that the average loss for the 10% worst 3-year returns is only 26.9%. This means the modeled average loss on equities in the 10% worst scenarios for EPAV as used by Milliman and Rector is more than double (219% = 59% / 26.9%) what actual experience shows it should be, and the 10% worst scenarios average a return that is almost 50% worse (59%/40.1%) than the single largest historical 3-year loss.

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[3] Based on 16.0% of GHMSI invested assets being invested in equities as of 12/31/2013 as Milliman indicates they assumed in their rebuttal statement.

In my June 2014 report, I concluded that, excluding the RAAF factor, the impact of the EPAV factor is greater than all other risk factors combined in the Stochastic Model. I reached this conclusion by replicating the modified Milliman model as used by Rector and then changing the EPAV factor without changing any of the other factors used by Rector.

Using the revised EPAV factors of Chart 9A, which were derived from the additional information that Milliman provided on November 7, I have rerun the stochastic model. It should be no surprise that the resulting Chart E below confirms that Milliman's EPAV factor assumption dramatically overstates the likelihood and magnitude of loss and increases the need for surplus significantly above what historically accurate factors would require.

CHART 11

Rector Assum.	Stochastic Model Loss @ Confidence Level				Prem		Permissible Surplus (Using Given Confidence Levels of Avoiding 200%			
Changed	**98%**	**95%**	**93%**	**90%**	**Growth**		**98%**	**95%**	**93%**	**90%**
None	-23.2%	-17.6%	-15.1%	-12.5%	12.4% Rector		958%	795%	723%	647%
S&P EPAV	-20.5%	-14.8%	-12.5%	-10.1%	12.4% Rector		880%	714%	647%	578%
None	-23.2%	-17.6%	-15.1%	-12.5%	8% DISB		880%	721%	653%	575%
S&P EPAV	-20.5%	-14.8%	-12.5%	-10.1%	8% DISB		774%	615%	553%	482%
None	-23.2%	-17.6%	-15.1%	-12.5%	5.4% UHAS		818%	670%	607%	534%
S&P EPAV	-20.5%	-14.8%	-12.5%	-10.1%	5.4% UHAS		747%	590%	529%	459%

Note: The above corrections are before correcting for the investment income error by Milliman cited in point #3 above.

Thus, it can be seen that by correctly using the actual historical experience that Milliman cites as the support for their assumption, using the premium growth assumption chosen by the Commissioner, using a 95% confidence level and leaving all other assumptions unchanged, the appropriate surplus for GHMSI drops from the 721% stated in the Commissioner's order to 615%.

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

IN THE MATTER OF

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

[PROPOSED] ORDER

The Acting Commissioner of the District of Columbia Department of Insurance, Securities and Banking ("Commissioner"), having considered the motion for reconsideration of the D.C. Appleseed Center for Law and Justice, Inc. ("DC Appleseed") and all supporting documents, hereby:

(1) **GRANTS** the motion for reconsideration, and

(2) **AMENDS** the Commissioner's Decision and Order of December 30, 2014, Order No. 14-MIE-012 in accordance with DC Appleseed's motion for reconsideration and the supporting statement of Mark Shaw.

Dated: ________________

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Chester A. McPherson, Acting Commissioner