



6500 River Place Boulevard  
Building 2, Suite 204  
Austin, Texas 78730  
Phone (512) 345-5200  
Toll Free (866) 480-RISK (7475)  
Fax (512) 346-1249  
www.actrisk.com

## Testimony for GHMSI Excess Surplus Hearing September 10, 2009

### Background

Good morning. My name is Corwin Zass, and I am a principal and consulting actuary of Actuarial Risk Management. I am an Associate of the Society of Actuaries (A.S.A.), a Member of the American Academy of Actuaries (M.A.A.A.), and a Fellow of the Conference of Consulting Actuaries (F.C.A.). I am the project leader for this engagement with DC Appleseed and represent our firm in these hearings. My colleague, Mark Shaw, who joins me here at these hearings, is a Fellow of the Society of Actuaries (F.S.A.), a Chartered Enterprise Risk Analyst through the Society of Actuaries (C.E.R.A.), and a Member of the American Academy of Actuaries (M.A.A.A.). Mr. Shaw is an instrumental team member for this engagement. His background includes the holding of top actuarial and risk management positions over his 30 plus years of working in the life and health insurance industry. In addition to the two of us, we used tenured ARM actuaries in the area of peer review and consultation throughout this engagement.

Both I and Mr. Shaw are actuaries in good standing with the American Academy of Actuaries and we conducted this assessment in a professional and ethical manner. We have followed Actuarial Standards of Practice in providing our August 31, 2009 report and honor our Code of Professional Conduct in which we conduct this expert testimony.

Next I like to give some brief insight on Actuarial Risk Management. Our firm is a global actuarial and risk management consulting firm and an independent member of the BDO Seidman Alliance program, and provides this 5<sup>th</sup> largest global accounting firm with audit and non-audit support across similar practice areas as Milliman; we also provide our customers with solutions from outside the traditional actuarial consulting firm focus. ARM's business model relies on a deep resource pool which currently consists of approximately 50 qualified actuaries, risk managers, and benefit specialists. Many of the ARM experts had previously held practice leader positions with accounting firms, other national firms and chief actuary roles across the insurance arena.

Specific to ARM's health actuarial practice, we focus on supplying providers and payers with unique risk mitigating solutions and program initiatives. Our practice area's objective is simple — to help our clients manage health care programs at affordable costs. Our associates are experts in assisting companies to optimize the risk/reward trade-off.

## Analysis

ARM, through DC Appleaseed, submitted a detailed request list to conduct a thorough review; however, we gained access only to GHMSI's NAIC filed statements for our assessment. We analyzed these public materials, which is far less than what Milliman had available to them, along with the reports filed by Milliman and CareFirst. Our approach was to determine if there were any areas within Milliman's hypothesis that were based on incorrect or unduly conservative methods and/or assumptions, or some combination thereof. Since we did not have the same information as Milliman nor access to their models or model details, our approach was to make appropriate adjustments to the Milliman calculations to determine what impact those adjustments would have on Milliman's conclusions.

The ARM report submitted on August 31<sup>st</sup> contained various observations based on our review of the Milliman report. Our observations varied from our identification of assumption differences with Milliman's input assumptions to exceptions with their process, such as their omission of certain GHMSI business. Some of our findings were technical in nature and may have little bearing on the surplus position of GHMSI. For a majority of our findings, some may choose to call Milliman's assumptions as "errors" or "oversight" – we simply label them as "unrealistic and unreasonable assumptions" used by Milliman. In addition, we would like the opportunity of "lifting the lid of Milliman's black box" to determine whether additional adjustments are warranted to lower our proposed range.

As described below, we corrected for four of Milliman's key assumptions that, taken together, significantly lowered the surplus range that we believe is appropriate for GHMSI. We believe that, if given the opportunity to fully review the content of Milliman's black box, our proposed optimal range of surplus for GHMSI could be even lower.

We were able to reach conclusions regarding the effects of the following four assumptions<sup>1</sup> that we believe most significantly bias the Milliman conclusions:

(1) the failure to recognize the different risk profiles of, both the Federal Employee Program (FEP) and other non-comprehensive insured parts of GHMSI's business, causing Milliman to overstate the riskiness of GHMSI's revenues. The earnings from these other lines are available to offset Milliman's insured medical Operating Loss Cycle costs; these lines provide a form of substantial diversity for the company. Ignoring them overstates GHMSI's need for surplus.

(2) the assumption that GHMSI needs excess surplus sufficient to withstand a prolonged economic downturn of a magnitude that bears no relation to any of GHMSI's relevant experience. This assumption also has the effect of inflating GHMSI's current need for surplus.

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<sup>1</sup> See DC Appleaseed Pre-hearing Report, App. B – ARM Analysis at 13-14.

(3) the assumption that GHMSI would have annual premium growth rates of 12-14% during a prolonged economic downturn. This assumption likewise bears no relation to GHMSI's historic actual growth rates and again results in inflating the need for surplus.

(4) the assumption that the degree of certainty that is appropriate for avoiding the BCBSA reporting requirement, which is triggered at a 375% RBC ratio, needs to be at 95%. A 90% probability is more than ample for avoiding this reporting requirement to an association. We accepted Milliman's 98% standard for avoiding the Loss of Trademark threshold, which is set at a 200% RBC ratio.

As explained in our August 31 report, once we adjusted for these assumptions, ARM calculates that instead of needing to maintain surplus in the Milliman range of 750 -1050% RBC that a range of 400-525% provides near-certain protection against surplus dropping below minimum thresholds. This means that instead of GHMSI's current surplus of \$687 million, the company would have an efficient level of surplus at any level within the 400-525% range. The lower end of this sufficiency range equates to a surplus level of \$325 million, well more than \$300 million below the company's current level.

Again, I must stress we had access to more limited GHMSI information than Milliman. However, based on the information we have, we are confident that the current level of GHMSI surplus far exceeds any optimal range.

We wish to provide full transparency on any of our assumptions, analysis, and conclusions, whether previously published in our August 31, 2009 report or herein and welcome any questions. We also would welcome the opportunity to examine the data and calculations associated with Milliman's analysis.

Thank You.

## **“Black Box” Aspects of Milliman’s 12/4/08 report on GHMSI**

In Milliman’s above-referenced report, there were a number of assumptions, processes and results mentioned in the report that were not fully transparent, even to the expert reader. We identify these items (and references in the Milliman report) as follows:

- Pg 46 – A list of the risk and contingency categories considered in the Milliman model.
- Pg 46 – The range of possible values for each risk and contingency category.
- Pg 46 – The identification of risks and contingencies as dependent or independent.
- Pg 47 – The higher and lower range in assumptions with respect to the impact of fluctuation in rating parameter adequacy.
- Pgs 46-47 – The number of Monte Carlo simulations run.
- Pgs 46-49 – The complete range of Monte Carlo results before application of Pro Forma modeling.
- Pgs 48 – The range of simulated losses/gains related to interest rate and asset fluctuation risks.
- Pg 50 – The manner in which distribution of amounts of potential loss due to major risk and contingency categories were combined.
- Pg 50 – The provision for likelihood of distribution of amounts of potential loss due to major risk and contingency categories.
- Pg 50-52 – A comparison of results from the Monte Carlo methods against experience from 1992 and later (when RBC regulations were adopted) or against experience from 1995 and later (when GHMSI’s regulatory approach was changed).
- Pg 51 – The cumulative loss cycle results when FEP premium is considered.
- Pg 52 – The specific impact on modeling of the assumption that “GHMSI’s current pricing margins will be sustained in the future”.
- Pgs 52-53 – The specific length of the multi-year cumulative underwriting loss periods assumed in the modeling.
- Pgs 53-54 - The detailed assumptions as to investments (not just yield), expenses and other pro forma financial items.
- Pgs 53-54 – The assumptions in Pro Forma modeling relative to FEP premiums, their growth rate and their profitability or gains.
- Pgs 54-55 – The assumptions in Pro Forma modeling relative to the amount of non-insured business, their growth rate and their impact on expenses.
- Pg 54 – The impact on Pro Forma modeling of the elimination of GHMSI’s deferred tax asset.
- Pgs 54-56 – The impact on results of GHMSI’s 40% ownership of CareFirst Blue Choice.
- Pgs 55-57 – The impact on Pro Forma modeling of assuming 12-14% premium revenue growth rates as opposed to the 7-8% annual rates that GHMSI has experienced over the last 5 years.