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2 **DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION**
3 **BUREAU OF INSURANCE**
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6)
7 IN RE:)
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9 ANTHEM BLUE CROSS)
10 AND BLUE SHIELD 2008)
11 INDIVIDUAL RATE FILING)
12 FOR HEALTH CHOICE AND)
13 HEALTHCHOICE STANDARD)
14 AND BASIC PRODUCTS)

**PRE-FILED TESTIMONY OF
BETH R. FRITCHEN**

NON-CONFIDENTIAL

15)
16 Docket No. INS-07-1000)
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18

19 Q. What is your name?

20 A. Beth Fritchen

21 Q. Please describe your professional and educational background that qualifies you as a
22 witness in this matter.

23 A. I am a Fellow of the Society of Actuaries and a Member of the American Academy of
24 Actuaries. I am a Principal with the actuarial consulting firm Oliver Wyman Actuarial
25 Consulting, Inc. and specialize in health insurance management and actuarial services.

26 My qualifications that are relevant to this hearing are that I currently provide consulting
27 services to regulators in Kentucky, Vermont and Virginia. I review health insurance rate filings
28 in these states. I testified in last year's rate hearing for HealthChoice. In addition, I testified in
29 last year's rate hearing regarding the rate filing for the DirigoChoice rates. I have provided
30 consulting services to other regulators in Rhode Island, Massachusetts, Maryland and Maine. I
31 have been involved in approximately 15 rate hearings in Rhode Island regarding individual and

1 Medicare Supplement rate filings. In addition, I have participated in approximately 7 rate
2 hearings in Vermont.

3 I have co-authored several papers relating to the health insurance industry including
4 “Impact of Association Health Plan Legislation on Premium and Coverage for Small
5 Employers,” “Impact of Prior Approval Requirements for Rate Changes of Small Employers
6 Group and Individual Health Policies,” and the semi-annual Oliver Wyman Trend Survey.

7 I have a Bachelor of Science degree in mathematics from the University of Wisconsin –
8 Madison with an emphasis in actuarial science.

9 Q. What is the purpose of your testimony?

10 A. I am here to testify with respect to the Anthem Blue Cross and Blue Shield (“Anthem
11 BCBS”) HealthChoice rate filing for individual subscribers. My testimony will focus on the
12 reasonableness of the requested rates and demonstrate that the proposed HealthChoice rates do
13 not meet the statutory requirement to be “neither excessive, inadequate or unfairly
14 discriminatory.” Specifically, in my actuarial judgment, as discussed more fully below, the rates
15 are excessive and discriminatory.

16 In determining the reasonableness of the rates, the rates should be expected to cover the
17 claims costs associated with the benefit plan, the administrative expenses and provide for a
18 reasonable risk and profit charge to contribute to the surplus of the entire corporation. I will
19 discuss these three areas.

20 **Claim Costs**

21 **Base Claims Experience**

22 Q. Did you review the base claims experience used in this rate filing?

23 A. Yes.

1 Q. Do you believe that Anthem used appropriate base claims experience in projecting its
2 claim costs for the rating period?

3 A. No, I believe the projected claims should be based on more recent claims experience
4 than that used by Anthem. There appears to be an inconsistency in the filing between expected
5 claims for the rating period and the projected loss ratio for the rating period when compared to
6 the expected loss ratio for 2007. In Exhibit IX, Anthem has projected the loss ratio for calendar
7 year 2007 to be 87.6%, which is based on HealthChoice experience from January 2007 to June
8 2007. The target loss ratio for calendar year 2008 requested by Anthem is 87.4%. The current
9 rates, therefore, appear to be producing results consistent with the 2008 target loss ratio, so we
10 would expect the overall increase to be approximately trend, all other things equal. Anthem has
11 estimated trend to be 15.2% for the HealthChoice product. However, the overall increase
12 requested by Anthem is 18.6% which is more than 3 percentage points higher than trend.

13 Q. Has Anthem provided an explanation for the apparent inconsistency?

14 A. Yes. In responses to the Attorney General's and the Superintendent's questions, Anthem
15 has stated the reasons for this difference are 1) using a different time period in the development
16 of the 18.6% increase, as opposed to the financial projections, and 2) the inclusion of additional
17 mandated benefits.

18 Q. Did you review the impact of the new benefits?

19 A. Yes. The inclusion of new benefits is a valid reason for the requested rate increase
20 exceeding trend in this case. That, however, accounts for only a relatively small portion of the
21 difference. Anthem has incorporated two additional benefits in the rate increase development –
22 hearing aids for children and the expansion of coverage for dependent children to age 25.
23 Exhibit I of the rate filing shows the anticipated costs associated with the hearing aid to be \$0.34

1 PCPM or \$45, 357.70 ($\$0.34 \times 133,405$ anticipated 2008 contract months). The additional costs
2 due to the age expansion are \$231,938. The total additional cost is \$277,295.70. This represents
3 less than 0.5% of the anticipated claims prior to new benefits for 2008. Moreover, there is also a
4 claim *credit* for proton pump inhibitor of \$0.18 PCPM which would further reduce the impact of
5 changes in covered services.

6 Q. What about the different time periods for different projections?

7 A. The major difference between the requested increase and trend is the result of the
8 inconsistent time periods Anthem has used to generate the increase for the rating period, as
9 compared to its financial projections. In response to Question 7 of the Superintendent's first set
10 of questions, Anthem states the loss ratio for the experience period (May 2006 through April
11 2007) used in the rate development is 90%, while the experience for the six months ending June
12 2007, on which Anthem relied in making its financial projections for calendar year 2007, is
13 anticipated to produce a loss ratio of 87%. This roughly accounts for the three percentage point
14 difference.

15 Q. Do you have an opinion as to which of the two periods is more appropriate to use to
16 develop the expected rate increase?

17 A. Yes, in my opinion, the recent experience through June 2007 cannot be ignored or
18 discounted since Anthem found it credible enough to serve as the basis for projecting the
19 financial results for calendar year 2007, shown in Exhibit IX of the rate filing. Given the
20 significant difference between the two experience periods shown in Anthem's filing, we have
21 generated a revised rate increase using the experience base with data through June 2007. Our
22 analysis used the data provided by Anthem in the supplemental response to Question 3 of the
23 Advocacy Panel's first set of questions. This analysis, shown in Fritchen Exhibit A, generates a

1 rate increase of 15.5%, rather than the 18.6% proposed by Anthem. This data uses experience
2 incurred and paid through June 2007 and is generated using the identical approach Anthem
3 BCBS uses in Exhibit III of the filing to calculate the average rate increase. We also performed
4 the same analysis using data incurred through June 2007 with claims paid through September
5 2007 (available from the same Anthem response). That analysis generates a rate increase of
6 only 13%, as shown in Fritchen Exhibit B. This reinforces significant positive impact of using
7 the most recent experience period.

8 Q. Do you have any other observations regarding the rate development generally?

9 A. The analysis with the most recent claims experience demonstrates the conservatism built
10 into the Anthem rates. This inherent conservatism is reflected in other Anthem estimates as well.
11 For example, in the last two filings prior to this one, Anthem's estimates of the loss ratios found
12 in Exhibit IX of the filing have consistently decreased for all but one estimate. For example,
13 Anthem estimated the loss ratio for calendar year 2006 to be 105.4% in last year's filing. In the
14 current filing the expected loss ratio for calendar year 2006 is estimated to be 93%. This is a 13%
15 improvement in the expected financials and a significant change in the restatement.
16 A comparison of all of the years is shown on Fritchen Exhibit C.

17 Another area where Anthem has historically been conservative in its estimates is the
18 expected costs for the administrative expenses. This is demonstrated by the anticipated expenses
19 for calendar year 2007 for HealthChoice of \$20.91 PMPM which is approximately 7.6% lower
20 than what is included in the current HealthChoice rates.

21 Q. Does this pattern of conservatism affect your opinion of the reasonableness of Anthem's
22 claims projections?

1 Given that the financial estimates of the loss ratios shown on Exhibit IX of the filing are
2 historically conservative, it is highly likely that the 87.6% estimated loss ratio for calendar year
3 2007 is also conservative which would further justify a less-than-trend increase. The population
4 in this block of business is vulnerable and care should be taken when setting the premium rates.
5 Past testimony by policyholders has demonstrated how sensitive this population is to rising
6 premium costs. In many cases, members have testified that they struggle to retain coverage.
7 Inherent conservatism in the rate development process could adversely impact the viability of
8 this block. The 3% profit and risk charge built in to the requested rates eliminates any need for
9 inherent conservatism.

10 Q. What is your overall opinion of Anthem's projected claim costs?

11 A. Based on our analysis, in my opinion the base claims used to generate the rate increase
12 are overstated and produce a rate increase that is excessive. Using the experience ending in June
13 2007 with claims paid through September 2007, our analysis generates a rate increase of 13%.
14 This calculation applies the 15.2% trend Anthem proposes to the base claims we have adjusted.
15 However, as shown below, we recommend a reduction of the trend to 14.7%, resulting in an even
16 lower overall rate increase (12.3%).

17 **Trend**

18 Q. Do you believe the 15.2% trend assumption used to project claims in the filing is
19 appropriate?

20 A. No. I believe the trend is overstated.

21 Q. Please explain.

22 A. Anthem did not adjust the underlying claims experience to account for the impact large
23 claims can have on the trend analysis. Significant variability occurs in large claims from year to

1 year and can cause trends to be overstated. If large claims happen to be at a random high near the
2 end of the period used for estimating trends, this can significantly overstate trends. This problem
3 can be exacerbated in a shrinking population where large claims become less predictable and
4 more random.

5 Q. Did you calculate an independent estimate of the trend?

6 A. Yes, in my opinion, in order to use the HealthChoice data to develop trends, the data
7 should be adjusted to reduce the variation caused by the large claims. Our recommended
8 methodology would include removing the large claims from the data and adding a pooling
9 charge to reflect the expected level of large claims for the block of business. By using this
10 approach, the data is smoothed to remove the large variations observed from year to year,
11 generating a more stable trend factor and one that is not skewed by a significant increase in large
12 claims in the earliest or latest periods.

13 Q. Please explain how you developed your pooling charge.

14 A. Anthem provided one-month rolling allowed claim costs for HealthChoice for the period
15 December 2003 through December 2006 in response to question 2 of the Attorney General's
16 Second Information Request. As requested, one column included all claims for all members for
17 each month. A second column was provided that excluded payments in excess of \$100,000 for
18 members that incurred claims of \$100,000 or more on an annual basis by calendar year (the
19 second column thus includes only "non-catastrophic" claims).

20 I calculated a pooling charge to add back to the rolling one-month non-catastrophic
21 claims a charge increased each month by a specified trend amount equal to the \$26,761,754, the
22 aggregate amount of claims that had been removed. The amount of the pooling charge used for
23 each individual month was calculated by selecting a trend rate at which the pooling charge

1 increased, and solving for the monthly pooling charges so the each month's charge was greater
 2 than the prior by a factor equal to one month of trend, and the sum product of the pooling
 3 charges and member months over the period December 2003 through December 2006 equaled
 4 \$26,761,754.

5 I calculated four different sets of pooling charge estimates, using 15%, 20%, 25%, and
 6 30% assumptions for the trend in the pooling charge. I added each of the resulting sets of pooling
 7 charge estimates to the non-catastrophic claim costs and further calculated 12-month moving
 8 averages. Using linear and exponential regression techniques, I calculated the trend for these four
 9 different assumptions of underlying pooling charge trend.

10 I then adjusted the results to add an estimate for deductible leveraging. I added 2
 11 percentage points for deductible leveraging which is consistent with the amount Anthem
 12 included in their calculations in the filing. The following table summarizes my results.

13

| Rate at which Claims Over \$100,000 Trend | Linear Trend w/o Deductible Leveraging Factor | Exponential Trend w/o Deductible Leveraging Factor | Linear Trend with Deductible Leverage Factor | Exponential Trend with Deductible Leveraging Factor |
|--------------------------------------------------|------------------------------------------------------|-----------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------------|
| 15% | 9.5% | 11.7% | 11.5% | 13.7% |
| 20% | 9.7% | 12.0% | 11.7% | 14.0% |
| 25% | 9.9% | 12.3% | 11.9% | 14.3% |
| 30% | 10.1% | 12.7% | 12.1% | 14.7% |

14

15 As discussed, this approach adds pooling charges which, in total, equal the amount of
 16 large claims removed in order to arrive at a more credible trend for overall claims.

17 Q. In your opinion, what is the appropriate trend rate to use in calculating the pooling
 18 charge?

1 A. In my opinion, the appropriate trend rate to assume for the large claims is the underlying
2 trend rate of the claims under \$100,000, adjusted for leveraging that occurs at the \$100,000 level.
3 Using linear and exponential regression techniques, I calculated the trend rate for claims under
4 \$100,000. The linear trend was approximately 9.4% and the exponential trend was 10.4%. I
5 chose to use the 10.4% exponential trend.

6 I then used a standard claim probability distribution from Oliver Wyman's proprietary
7 pricing model to estimate the cost of claims over \$100,000 for a population with an underlying
8 claim cost of \$352 per member per month, consistent with the base period claims cost of the
9 HealthChoice population as shown in Exhibit I of Anthem's filing. The expected cost of claims
10 over \$100,000 is \$332 per member per year. I then trended the underlying distribution at 10.4%
11 to reflect an underlying claim cost of \$389pmpm and re-calculated the expected cost of claims
12 over \$100,000. In this case the expected cost of claims over \$100,000 is \$397 per member per
13 year, or an increase of 19.5% ($=397/332 - 1$). This shows that if claims under \$100,000 trend at
14 10.4%, claims over \$100,000 are expected to trend at 19.5% due to the impact of leveraging all
15 other things being equal. This established one end of the range. This approach does not take into
16 account any increases for new technology and treatment that generally impact large claims on a
17 more predominant basis. As such, a higher trend number should be utilized. I recommend using
18 the 30% assumption for several reasons. It adds margin to the trend to take into account the new
19 technology component. It is also consistent with the trend we recommended last year for the
20 Dirigo Choice filing. Finally, it is more reflective of the large claims trends in the HealthChoice
21 product for the most recent period ($\$31.09/23.67 - 1 = 31.3\%$).

1 Therefore, using 30% as the trend assumption underlying the pooling charge for claims
2 over \$100,000, the chart above shows that the total trend with 2 percentage points for leveraging
3 results in an 11.9 % linear trend and a 14.7% exponential trend.

4 Q. Is the 30% assumption for the underlying trend of claims over \$100,000 consistent with
5 the observed trend in claims over \$100,000 for the entire period provided? If not, please explain
6 why your assumption is reasonable.

7 A. No. Claims over \$100,000 were \$13.79 in 2004, \$23.67 in 2005, and \$31.09 in 2006.
8 This results in an annual trend of 50% ($= (31.09/13.79)^{0.5} - 1$) over the three-year period.
9 However, using a 50% trend assumption to develop the pooling charge as a proxy for claims
10 over \$100,000 would be contradictory to the argument for smoothing them in the first place, that
11 being the extremely volatile nature of claims at this level. The premise for removing the large
12 claims and smoothing them is that an unusually low or high catastrophic claim level at the
13 beginning or end of a period used to measure trends would place upward or downward pressure
14 on the resulting trend analysis. In this case, the large claims for calendar year 2004 appear
15 abnormally low resulting in an overstatement of the calculated increase of 50%. Removing the
16 actual claims and smoothing them through the use of a pooling charge adds credibility to the
17 trend results. By using the observed trend of 50%, this non-credible uptick would leak back into
18 the analysis. This is why we instead recommend using the underlying trend on claims under
19 \$100,000, a credible base, and adjusting it for the impact of leveraging based on the population's
20 underlying costs to determine the appropriate trend rate to use in developing the pooling charge.

21 Q. What is your conclusion as to the appropriate trend after smoothing for large claims? We
22 recommend utilizing a 14.7% annual trend rather than the 15.2% trend requested by Anthem

1 BCBS. This is the result of the exponential trend after leveraging with a 30% expected trend for
2 large claims.

3 **Rate Relativities**

4 **Rule 940 Compliance**

5 Q. Do all of the proposed rates shown in the rate filing meet the requirements of Rule 940?

6 A. No.

7 Q. Please explain which rates in the current rate filing do not meet these requirements.

8 A. The rates for ages 55 to 64 and 65+ do not meet the requirements of rule 940. Fritchen
9 Exhibit D illustrates this. This analysis uses the same methodology to test rule 940 as shown on
10 Exhibit IV of the filing. There are two issues. The first relates to an apparent oversight in
11 application of the new contract type factors. The second relates to 65+ rates even after the
12 correction.

13 Q. Please explain the first issue relating to the contract type factors.

14 Anthem has requested the contract type factor for Two Adults/Child(ren) change from
15 2.65 to 2.53. However, in the development of the test to determine if the rates meet the
16 requirement of Rule 940, Anthem did not adjust their methodology to account for the new factor.
17 As such, the rates for ages 55 to 64 are slightly outside the rules. Anthem has stated they will
18 correct this calculation. However, we have not received the adjustment to date.

19 Q. Please explain your concerns about the proposed 65+ rates.

20 While the filed age factor in the historical rate filings for the HealthChoice product for
21 the 65+ age band has been 1.50, Anthem has historically chosen not to utilize this factor but
22 rather keep the rates for this age band identical to those for the 55-64 year old age band.
23 Therefore, the rates have always been in compliance with Rule 940. This year, however, Anthem

1 has chosen to implement the rates that utilize the 1.50 age band factor. As such, the rates do not
2 meet the requirements of Rule 940 as shown in Fritchen Exhibit D.

3 In response to Question 8 of the Attorney General's second set of questions, Anthem has
4 suggested that the rates for the 65+ age band are not subject to the rating restriction of plus or
5 minus 20% from the community rate. While the rates may not be subject to the rating rules, in
6 my opinion there is no language in Rule 940 that would exempt them from this separate
7 requirement. Rule 940 is meant to apply to all individual rates in Maine, which would include
8 those in the 65+ age band. Further, we do not understand why this class of members would not
9 be afforded the same protection from the benefit relativity relationships as members in other age
10 bands. If they were not afforded this same protection, it would appear that those members could
11 be considered to be discriminated against due to their age.

12 Q. Do you have any other observations regarding Rule 940?

13 A. Yes. We have reviewed the proposed rate increases by benefit plan and the corresponding
14 membership distribution. Almost 70% of the contracts are enrolled in the \$5,000 deductible plan.
15 These plans on average are receiving increases well in excess of the overall requested increase of
16 18.6%. Given that the average deductible inherent in the experience is over \$8,000 as provided in
17 the Anthem response to the Attorney General's question 2 of the first set, we would have
18 expected the increase to be lower than the average due to deductible leveraging. Rule 940 has
19 limited the maximum rate increase that can be applied to the lower deductibles resulting in a
20 subsidization by members in the higher deductible plans.

21 **Administrative Expenses**

22 Q. Did you review the administrative expenses proposed in the filing?

23 A. Yes.

1 Q. Do you have an opinion as to whether this component of the proposed rates is
2 reasonable?

3 A. Yes, I believe the projected administrative expenses are reasonable.

4 **Risk and Profit Charges**

5 Q. Do you have an opinion about the risk and profit charges of 3% in the proposed rates?

6 A. Yes. In my opinion, the risk and profit charge for the HealthChoice product is reasonable
7 under the circumstances of this particular rating year.

8 **Independent Calculation**

9 Q. Have you calculated an independent estimate of the needed premium increase?

10 A. Yes.

11 Q. How did you calculate your independent estimate?

12 A. We used the format that Anthem BCBS used to generate their estimate of the required
13 rate increase found in Exhibit I and made two adjustments.

14 ▪ We used incurred claims for the period July 2006 through June 2007 as the base claims. This
15 reflects the improvement in the emerging experience Anthem has observed through June and
16 reflected in Exhibit IX of the rate filing.

17 ▪ We revised the trend to 14.7%

18 Each of these adjustments has been previously discussed in my testimony in detail.

19 Q. Please state the needed premium increase you have calculated and explain how it
20 compares with the increase calculated by Anthem BCBS in the filing?

21 A. Attached as Fritchen Exhibit E is my independent calculation. I have calculated needed
22 premium for this period of \$59,650,453. Applying Anthem BCBS's approach on Exhibit III
23 generates an increase of 12.3% over the current premium rates. Anthem's initial requested

- 1 increase to the base claims is 18.6% as shown on Exhibit III of the filing. The increase I have
- 2 calculated is approximately 5.3% lower than the increase calculated by Anthem BCBS.