



1 From 1984 until 1994, I was employed in various capacities with Celtic Life Insurance  
2 Company of Chicago, Illinois, serving as Executive Vice President with overall profit and  
3 management responsibilities for its Small Group Division from 1988 to 1994. I was employed  
4 by Allstate Insurance Companies of Northbrook, Illinois, from 1972 until 1984 in various  
5 capacities involving the underwriting, pricing, reserve calculations, product development and  
6 other matters for their group life, health and disability insurance products. I began my career as  
7 an actuarial student for Montgomery Ward Life Insurance Company of Chicago, Illinois, where I  
8 was employed from 1970 to 1972.

9 Q. What actuarial activities are you involved in outside of your consulting  
10 responsibilities?

11 A. I have been an active member of the Society of Actuaries (SOA), and was elected  
12 in 2006 to a three-year term on the Health Section Council which I have just completed in 2009.  
13 I served as Chairperson for the SOA's 2010 Annual Health Meeting, where the SOA provided  
14 continuing education and networking opportunities for health actuaries. I have participated in  
15 the development of the syllabus and study materials for students seeking to become members of  
16 the SOA. I have also spoken at meetings, led seminars, and participated on the elections  
17 committee. Over the years, I have participated on various industry committees, especially in  
18 relation to the development of regulations affecting small group health insurance. I have also  
19 published articles and spoken in other insurance-related forums.

20 Q. Have you been qualified and been accepted as an expert on actuarial matters  
21 before?

22 A. I have served as an expert witness or expert consultant in the field of actuarial  
23 sciences in over 15 matters and have been accepted as an expert and testified both in federal

1 court and in arbitration hearings in the field of actuarial sciences. I have also been accepted and  
2 testified as an expert in the field of actuarial sciences at each of three prior hearings in Rhode  
3 Island regarding the Blue Cross Class DIR rates filings in 2006, 2007 and 2008. I submitted pre-  
4 filed testimony for last year's 2009 Class DIR rate hearing; however, my attendance at the  
5 hearing was not required.

6 Q. Please identify the document that has been marked as Attorney General Exhibit B  
7 for identification?

8 A. It is a copy of my Curriculum Vitae.

9

10 **Ms. Niehus is offered as an expert in the field of actuarial sciences.**

11

1 **II. MATERIAL REVIEWED**

2 Q. Ms. Niehus, did you review Blue Cross Exhibits 1-7 of the Filing of Subscription  
3 Rates for Class DIR submitted by Blue Cross Blue Shield of Rhode Island (“Blue Cross”) on or  
4 about November 19, 2010 for rates to become effective April 1, 2011 (“the Filing”) as well as  
5 the pre-filed testimony of Dr. Augustine Manocchia submitted by Blue Cross ?

6 A. Yes.

7 Q. Did you review any other materials that you used in reaching your conclusions  
8 and forming your opinions?

9 A. Yes, I reviewed all of the materials submitted in response to the Attorney  
10 General’s questions submitted on December 3, 2010 (1<sup>st</sup> Set), December 15, 2010 (2<sup>nd</sup> Set), and  
11 December 23, 2009 (3<sup>rd</sup> Set). In addition, I reviewed the Class DIR filings submitted by Blue  
12 Cross on November 15, 2007 (“2007 Class DIR filing”), November 21, 2008 (“2008 Class DIR  
13 filing”) and November 20, 2009 (“2009 Class DIR filing”) and related materials for each of these  
14 filings by Blue Cross, including data requests submitted by the Attorney General and the Office  
15 of the Health Insurance Commissioner (“OHIC”), responses to those data requests, pre-filed  
16 testimony, and the Final Orders.

17 **III. FINDINGS - General**

18 Q. Did you form any opinions to a reasonable degree of actuarial certainty regarding  
19 the Filing that affect the amount of the rates requested by Blue Cross?

20 A. Yes.

21 Q. Please state those opinions.

1           A.     I have determined that the rate increases requested in the Filing, in aggregate are  
2 excessive and are not consistent with the proper conduct of the business of Blue Cross or in the  
3 interests of the public.

4           Q.     Please explain.

5           A.     Blue Cross has requested rate increases averaging 8.1%. These rates include  
6 inappropriate charges which add to what would have been the appropriate premium increase.  
7 After removing these inappropriate charges, in my opinion a rate increase averaging 0.4% is  
8 appropriate.

9           Q.     Have you reached any other opinions regarding the Filing?

10          A.     Yes.

11          Q.     What are those opinions?

12          A.     As discussed further in my prefiled direct testimony, I have identified a number of  
13 areas that present opportunities for Blue Cross to better manage the Class DIR business to help  
14 assure its long-term viability and more appropriately serve its subscribers.

15 **IV.    FINDINGS – The Requested Rate Increase Is Too High**

16          Q.     You stated that it is your opinion that the requested rate increases in aggregate are  
17 excessive and not consistent with the proper conduct of the business of Blue Cross or in the  
18 interests of the public. What is the basis for your opinion?

19          A.     Blue Cross's calculation of required rates inappropriately inflates the required  
20 rates in four areas.

21          Q.     What are they?

22          A.     First, Blue Cross has selected trend factors for projection of health care costs  
23 which are higher than a review of all the facts would warrant, resulting in projected claim costs

1 that are too high. Second, Blue Cross is unfairly charging excessive administrative costs to Class  
2 DIR Subscribers related to Blue Cross's preliminary budget which fails to reflect certain cost-  
3 savings, its new building in Providence and its new system installation (the Blue TransIT  
4 project). Third, a provision for contribution to reserves has been added to the rates, which is  
5 inappropriate for reasons discussed later in my testimony. Fourth, Blue Cross has added a  
6 provision to Class DIR rates for state assessments and premium taxes, contrary to OHIC's order  
7 dated February 8, 2010.

8 Q. Let's take those one at a time. Can you first discuss the selection of trend factors  
9 and how that impacts the rates?

10 A. Yes. Blue Cross selects "utilization/mix trend factors" based on an analysis of  
11 prior years' experience. These trend factor selections and supporting analyses are provided in  
12 the Filing on Schedules 38 through 50 of Exhibit 2 of the Filing. The selection of trend factors is  
13 further described by Mr. Lynch in his pre-filed testimony on pages 36-47 of Blue Cross Exhibit  
14 4. To select these trend factors, Blue Cross looks at prior experience and fits a line (using a  
15 statistical method called least squares) to measure historical trends. As Mr. Lynch states in his  
16 prefiled testimony: "The annual trend indicated by the least squares line producing the best fit  
17 under this procedure is then selected as the basis for the trend assumption, provided the result is  
18 actuarially acceptable." (Blue Cross Exhibit 4, page 37) In some cases, Blue Cross selected  
19 trends different than those indicated by the least squares fit, and in three instances, I disagree  
20 with Blue Cross's choices.

21 Q. Please describe the first instance in which you disagree with Blue Cross's choice.

22 A. Schedule 42 of Blue Cross Exhibit 2 illustrates the least squares fit for Hospital  
23 Outpatient services for Pool I. The indicated trend is *negative* and approximately -7.6%, but

1 Blue Cross chose to use a trend factor of 0%. On pages 41-42 of Blue Cross Exhibit 4, Mr.  
2 Lynch describes his selection of trend and in support of his selection indicates his belief that a  
3 negative trend cannot be expected to continue and his partial reliance on trend factors observed  
4 under Blue Cross's Commercial Group experience. Because of the successful efforts that Blue  
5 Cross has made to attract relatively healthier lives into the Class DIR pool, contrary to Mr.  
6 Lynch's statements, it is not unreasonable to expect to observe negative utilization trends for  
7 some period of time, reflecting improvement in the "average health" of the subscribers. In fact,  
8 Mr. Lynch even acknowledges the possibility of such improvement on page 6 of Blue Cross  
9 Exhibit 4: "While it is too early to make a definitive judgment, it appears that [the introduction  
10 of age rating to Pool I] may be having the desired effect of improving the Pool I enrollment  
11 trajectory." Beyond the improving health of the subscribers, Blue Cross's affordability  
12 initiatives, if effective, can also have the impact of reducing observed trends. Consistent with  
13 these observations, I also note that 2010 cost trends for the six months ending 10/31/10 for both  
14 Pool I and Pool II ran favorably as compared to Blue Cross's pricing assumptions as shown in  
15 Blue Cross's response to Data Request AG2-1 (see AG Exhibit D ). In my opinion, it is  
16 appropriate to at least partially recognize the observed trend and select a trend factor of a  
17 *negative* 5%. Despite these observations supporting a negative trend, Mr. Lynch still decided to  
18 select a much higher, inappropriate trend factor of 0% in his calculations.

19 Q. You mentioned that there were three instances where you disagreed with Blue  
20 Cross's selection of trend factor. What are the other two?

21 A. The other two trend factors which should be adjusted are the Pool I Surgical/  
22 Medical trend factor illustrated in Blue Cross Exhibit 2, Schedule 43 and the Pool II Hospital  
23 Inpatient trend factor illustrated in Blue Cross Exhibit 2, Schedule 45. In each of those cases

1 Blue Cross inappropriately chose to give partial weight to its Commercial Group results in  
2 selecting both of these trends. I again disagree with Blue Cross's selections.

3 Q. Why?

4 A. In the case of the Pool I Surgical/ Medical trend factor, I believe that Blue Cross's  
5 calculated value of 0.67% is more appropriate to use in the calculation of rates that should be  
6 approved for Class DIR than Blue Cross's arbitrary choice of 2%.

7 Q. What is your opinion regarding the Pool II Hospital Inpatient trend factor used by  
8 Blue Cross in the Filing?

9 A. In the case of the Pool II Hospital Inpatient trend factor used by Blue Cross, the  
10 calculated trend was *negative* 16%. (See Blue Cross Exhibit 4, p. 44.) In this instance, some  
11 weight should be given to that calculated trend rather than using Blue Cross's arbitrary choice of  
12 a 0% trend factor. In my opinion, a *negative* trend factor of 3% for the Pool II Hospital  
13 Inpatient utilization/mix is more appropriate.

14 Q. How do the changes in trend factors you recommend in place of those selected by  
15 Blue Cross impact Blue Cross's proposed rates?

16 A. The trend factors are used by Blue Cross in projecting incurred claims. A  
17 reduction in trend rates will result in lower expected claim costs, thereby reducing the required  
18 increase in premium rates. The overall impact of the change in these three trend factors, as  
19 shown in AG Exhibit C, Attachment AGBN-1, reduces the required premium increase by  
20 approximately 2 percentage points.

21 Q. Please explain your calculations.

22 A. In AG Exhibit C, Attachment AGBN-1, I have included all of the schedules from  
23 Blue Cross Exhibit 2 of the Filing that are affected by the recommended changes to trend factors.

1 This exhibit includes Blue Cross Schedules 22, 24, 27 through 35, 39, 40, 42, 43, and 45. Note  
2 that in AG Exhibit C, Attachment AGBN-1, numbers that are *shaded* represent my changes to  
3 input values on the corresponding Blue Cross Filing Schedule, while numbers in *bold* type  
4 represent my revised calculations based on my new inputs in Blue Cross's Filing Schedules. The  
5 adjustment of trend factors is reflected in Schedules 39 and 40 of AG Exhibit C, Attachment  
6 AGBN-1. These changes then carry through the other schedules of AG Exhibit C, Attachment  
7 AGBN-1, with the resulting required income amount calculated in Schedule 22 of this exhibit.  
8 This required income amount determines the total required premium, so any percentage change  
9 in this amount translates directly to a percentage change in the required rates. A comparison of  
10 required income of \$545.62 shown in column 10 of Schedule 22 in AG Exhibit C, Attachment  
11 AGBN-1 to the comparable number of \$556.22 shown in Schedule 22 of Exhibit 2 of the Filing  
12 indicates that the trend factor changes reduce required premium by approximately 2%. This  
13 comparison is highlighted in Schedule 22 in AG Exhibit C, Attachment AGBN-1.

14 Q. You mentioned several areas in which Blue Cross is unfairly charging excess  
15 administrative costs to Class DIR subscribers. What is your first area of concern?

16 A. I note that Blue Cross has provided updated, lower budgets for 2011 and 2012  
17 that compare to Exhibits 5 and 6 of the Filing (see AG Exhibit E, Blue Cross's initial and  
18 updated responses to AG1-56). As compared to the Filing, Blue Cross's budget for 2011 has  
19 been reduced by \$111,702 and its budget for 2012 has been reduced by \$106,271. These  
20 expense reductions reduce the required rate increase by approximately two-tenths of one percent.

21 Q. You also expressed an opinion that Blue Cross is unfairly charging excessive  
22 costs to Class DIR subscribers related to the new building in Providence. Please explain.

1           A.     I have reviewed the history of charges against Class DIR premiums related to  
2 facilities & occupancy over the past few years and have compiled it in AG Exhibit C,  
3 Attachment AGBN-2.

4           Q.     What is the purpose of this exhibit?

5           A.     A review of this exhibit shows that charges for these expenses for Class DIR  
6 subscribers have increased substantially with the 2009 Filing, at the same time that Blue Cross  
7 was moving into its new building. In the current economy, I believe it is inappropriate to ask  
8 Class DIR subscribers to bear additional costs related to Blue Cross's new building. In order to  
9 make charges for facilities and occupancy more consistent with prior years, I believe that the  
10 expenses charged to Class DIR in the approved rates should be reduced by an annual amount of  
11 \$100,000. This adjustment would reduce rates by approximately two-tenths of one percent.

12          Q.     You also expressed an opinion that Blue Cross is unfairly charging excessive  
13 costs to Class DIR subscribers related to the Blue TransIT project. Please explain.

14          A.     With respect to the Blue TransIT project, Blue Cross appears to have done a poor  
15 job of estimating and controlling its costs. When Blue Cross first proposed charging Class DIR  
16 subscribers for this project in 2007, Blue Cross estimated a total cost of \$140 million (see AG  
17 Exhibit F, Blue Cross's response to AG1-21 for the 2007 Filing). The estimate this year is now  
18 almost \$100 million higher than the original estimate at \$238 million (see AG Exhibit G, Blue  
19 Cross's response to AG1-14). This year's estimate is a significant increase from last year's  
20 estimate of \$205 million (see AG Exhibit H, Blue Cross's response to AG1-15 for the 2009  
21 filing). In my experience, I would expect that the Class DIR business is less likely to demand the  
22 types of system flexibility that the other Blue Cross lines of business might require and therefore  
23 may be receiving less benefit from the system implementation than other Blue Cross lines of

1 business. For example, only 5 different plan options are available to Class DIR subscribers,  
2 limiting the plan design flexibility that the system needs to accommodate. In addition, it seems  
3 inappropriate for Blue Cross to ask Class DIR subscribers to shoulder the burden for an effort  
4 that has been poorly managed by Blue Cross. As a result, I recommend that Blue Cross not be  
5 allowed to include its proposed charge of 0.34% in the Class DIR premium rates to become  
6 effective April 1, 2011.

7 Q. You also stated that Blue Cross's rates include an inappropriate charge for  
8 contribution to reserves. Can you please explain?

9 A. Yes. Blue Cross has included a contribution to reserves equal to 1.25%  
10 (including federal income tax) in its rate calculations. This component is included in the  
11 calculations shown on Schedule 22 of Blue Cross Exhibit 2 of the Filing. Mr. Lynch discusses  
12 this rating component on pages 16 and 17 as well as pages 58-60 of his pre-filed testimony (Blue  
13 Cross Exhibit 4 of the Filing).

14 Q. What is meant by "reserves"?

15 A. Blue Cross must hold reserves, more commonly referred to as "surplus" to protect  
16 itself against extreme fluctuations in its business. Surplus is funded through "profits" on  
17 premiums. Premium dollars not used to pay claims or cover other costs are contributed to  
18 surplus (or "reserves" in the case of Blue Cross). All insurance companies, including Blue  
19 Cross, are regulated by state insurance departments. One requirement of the insurance regulators  
20 is that the company be financially strong enough to assure that all financial obligations can be  
21 met, even when claims exceed expected levels. Therefore, a certain amount of surplus must be  
22 held by the company to meet the regulators' test of surplus adequacy for solvency protection.  
23 However, Class DIR subscriber premiums are a small percentage of Blue Cross's total premiums

1 and any contribution requested from Class DIR subscribers by Blue Cross to add to its surplus in  
2 any one year needs to be balanced in each instance against the need to maintain affordable rates.

3 Q. Why is it inappropriate for Class DIR to contribute to reserves this year?

4 A. For the past few years, in its decisions regarding Blue Cross's requested rate  
5 increase for Class DIR plans, the Attorney General has recommended this component not be  
6 approved, a recommendation that the OHIC has adopted. Reasons for not including such a  
7 charge have included the fact that the Direct Pay class is particularly vulnerable to the high cost  
8 of health care and that Direct Pay subscribers should be afforded reasonable aid in their efforts to  
9 purchase affordable health insurance.

10 Further support for the Attorney General's recommendation can be found in the Filing.  
11 As discussed in Mr. Lynch's testimony (Blue Cross Exhibit 4, p. 59), Blue Cross's surplus  
12 position as shown in its September 30, 2010 financial reports was approximately \$247 million.  
13 This amount still exceeds the minimum threshold required to avoid triggering monitoring by  
14 either state regulators or by the Blue Cross Blue Shield Association ("BCBS" which controls  
15 Blue Cross's use of the Blue Cross Blue Shield trademarks). Triggers used by both state  
16 regulators and BCBS are based on the authorized control level risk-based capital ("ACL"), as  
17 defined by the National Association of Insurance Commissioners. BCBS will first get involved  
18 when the ratio of surplus to ACL falls to 375% or less; for state insurance regulators that  
19 threshold is 200% (see AG Exhibit I, March 7, 2006 report from The Lewin Group, pp. 15-16).  
20 Based on Blue Cross's 2009 year-end financial statement, its ratio of surplus to ACL is 531%  
21 after reducing surplus for premium deficiency reserves of \$101.6 million. (see AG Exhibit C,  
22 Attachment AGBN-3) Without considering premium deficiency reserves, that ratio would have  
23 been 711%.

1 Q. What are premium deficiency reserves?

2 A. A premium deficiency reserve (“PDR”) is a reserve that is established when  
3 premium rates which are guaranteed for some period of time are not sufficient to cover future  
4 claim payments and expenses during the period for which rates remain in effect. The reserve is  
5 released over time as the guarantee period elapses and actual results materialize. Blue Cross has  
6 provided information regarding the PDR as it relates to Class DIR business which, at 12/31/09,  
7 was only \$3.9 million of the total Blue Cross deficiency reserve of \$101.6 million (see AG  
8 Exhibit J, Blue Cross’s response to AG1-18). Based on my review of the information provided  
9 by Blue Cross regarding the portion of PDR attributable to Class DIR, I have reason to believe  
10 that Blue Cross may have overstated this reserve.

11 Q. Why do you believe this to be the case?

12 A. In Blue Cross’s response to Data Request AG1-18 (AG Exhibit J), Blue Cross  
13 indicates that at 9/30/10, it held PDR amounts of \$2.5 million to cover anticipated Class DIR  
14 losses for the period 10/1/10-3/31/11. At the same time, in its response to Data Request AG1-17  
15 (AG Exhibit K), Blue Cross showed its expected losses for that same period of time to be only  
16 \$706,000, approximately \$1.8 million less than the PDR, meaning that this portion of the PDR  
17 may have been overstated by that amount of approximately \$1.8 million.

18 Blue Cross’s provision for PDR is also influenced by Blue Cross’s charges to Class DIR  
19 subscribers for premium taxes and state assessments as proposed in its Filing. Despite OHIC’s  
20 concerns it expressed in its order regarding the 2009 Filing, Blue Cross continues to charge  
21 premium tax and state assessments to the Class DIR business (as shown in Blue Cross’s  
22 responses to Data Requests AG1-17 and AG1-18, AG Exhibits K and J respectively) and appears

1 to be making a provision for them in the portion of PDR attributable to Class DIR business. This  
2 could also result in overstatement of the PDR.

3 This analysis leads me to believe that the PDR attributable to Class DIR may be too  
4 conservative. As mentioned above, the PDR at 12/31/09 was only \$3.9 million of the total PDR  
5 of \$101.6 million that Blue Cross held to cover all of its lines of business. My review of the  
6 Class DIR portion leads to concerns that the PDR on other lines of business may also be  
7 overstated.

8 Q. Why is this important?

9 A. If the PDR is set too conservatively (too high), then Blue Cross's surplus position  
10 would actually be more favorable than shown in its reported financials, supporting the Attorney  
11 General's recommendation that no contribution to reserves be made by Class DIR subscribers in  
12 connection with this Filing.

13 Q. Do you have other concerns related to Blue Cross's request to include an amount  
14 for contribution to reserves in the Class DIR premium rates?

15 A. Yes, another issue that has unfavorably impacted Blue Cross's financial position  
16 is the excessive costs incurred related to the Blue TRANSIT project as I discussed earlier in my  
17 testimony.

18 Q. How does this cost impact the contribution to reserves Blue Cross is asking of its  
19 Class DIR subscribers in the Filing?

20 A. The cost overruns on this project of almost \$100 million will have the direct effect  
21 of reducing Blue Cross's surplus. Both the PDR concerns and the expense overruns provide  
22 additional reasons why it would be inappropriate at this time to ask Class DIR subscribers to pay  
23 additional premiums to contribute to Blue Cross's reserves.

1 Q. The fourth category of inappropriate charges that you identified was state  
2 assessments and premium taxes. Can you please explain why you believe these charges are  
3 inappropriately assessed by Blue Cross against its Class DIR subscribers?

4 A. In response to the 2009 Filing, Commissioner Koller's final order prohibited Blue  
5 Cross from including state assessments and premium taxes in the Class DIR rates. In his final  
6 order dated February 8, 2010, Commissioner Koller included the following: "11. The cost  
7 allocations to Direct Pay of state assessments for medical services are not based on the historical  
8 consumption of these services by Direct Pay enrollees. Direct Pay enrollees should not be  
9 subject to the risk that estimated medical costs allocated to them are greater than the costs they  
10 actually incurred. Blue Cross can and should develop a more accurate method of allocating these  
11 costs to Direct Pay subscribers. Until it does so, these costs should not be allocated to Direct Pay  
12 products." Blue Cross had the opportunity to present a "more accurate method" in both the  
13 Filing and in its response to Data Request AG1-43 (AG Exhibit L), but it failed to do so. As a  
14 result, consistent with last year's decision, the charges are inappropriate to include in the rates to  
15 become effective April 1, 2011 and should be excluded from any approved rates for Class DIR.

16 Q. What is the impact on Blue Cross's proposed rate increase if these charges are not  
17 included?

18 A. If state assessments and premium taxes are excluded, the rate increase is reduced  
19 by approximately 3.6 percentage points.

20 Q. You've talked about four inappropriate charges included in Blue Cross's proposed  
21 rates, including the overstated trend factors, excessive administrative costs, contribution to  
22 reserves, the state assessments and premium taxes. Have you reached an opinion, to a reasonable

1 degree of actuarial certainty, as to what rates are appropriate for the April 1, 2011 Billing Cycle  
2 if all of these corrections are made?

3 A. Yes.

4 Q. What is that opinion?

5 A. AG Exhibit C, Attachment AGBN-4 presents the Attorney General's proposed  
6 rates, and also displays the current rates as well as Blue Cross's proposed rates. In every case,  
7 the Attorney General's proposed rates are lower than Blue Cross's. For Pool II subscribers, the  
8 Attorney General proposes a 0.4% increase, as compared to Blue Cross's proposed increase of  
9 approximately 8.1%. Pool I subscribers on average would receive an increase of approximately  
10 0.4%, rather than an average increase of 8.1% as proposed by Blue Cross. The Pool I increases  
11 vary by age as shown in AG Exhibit C, Attachment AGBN-4, from a high of a 4.2% increase, to  
12 a low which reflects a *decrease* of 7.1% (reflecting Blue Cross's proposed age rating described  
13 by Mr. Lynch on pages 6 and 61 of Exhibit 4 of the Filing).

14 Q. Please explain how you calculated those rates.

15 A. That calculation is presented in AG Exhibit C, Attachment AGBN-5. In that  
16 Attachment, I have included all of the schedules from Blue Cross Exhibit 2 of the Filing that are  
17 affected by the Attorney General's proposed changes. That includes Blue Cross Schedules 5  
18 through 9, 12 through 16, 19 through 22, 24, 27 through 35, 37, 39, 40, 42, 43, and 45. Note that  
19 in AG Exhibit C, Attachment AGBN-5, numbers that are *shaded* represent my changes to input  
20 values on the corresponding Blue Cross Filing Schedule, while numbers in *bold* type represent  
21 my revised calculations based on my new inputs in Blue Cross's Filing Schedules. The  
22 adjustment of trend factors is reflected in Schedules 39 and 40 of AG Exhibit C, Attachment  
23 AGBN-5. The adjustments for expenses related to the updated budget and the new building are

1 reflected in Schedule 37 of AG Exhibit C, Attachment AGBN-5 while state assessments are  
2 reflected in Schedule 24 of AG Exhibit C, Attachment AGBN-5. The reduction of Blue TransIT  
3 charges, premium taxes and contribution to reserves are reflected in Schedule 22 of AG Exhibit  
4 C, Attachment AGBN-5. These changes then carry through the other schedules of AG Exhibit  
5 C, Attachment AGBN-5.

6

7 **V. FINDINGS – Management Opportunities**

8 Q. You stated earlier that you have identified a number of areas that present  
9 opportunities for Blue Cross to better manage the Class DIR business to help assure its long-term  
10 viability and more appropriately serve its subscribers. Will you identify those opportunities?

11 A. Yes. After reviewing Blue Cross's calculations and methodology, I noted certain  
12 issues that, although not affecting this year's recommendations, may become important in the  
13 future.

14 Q. What is the first area of opportunity for Blue Cross to better manage the Class  
15 DIR business you have identified?

16 A. In general, as has been stated by the Attorney General in previous years, Blue  
17 Cross needs to make sure that administrative costs are properly managed and allocated on a basis  
18 that is fair to Class DIR subscribers. I have already noted concerns about charges related to  
19 facilities & occupancy as well as the Blue TransIT system. Blue Cross needs to be vigilant in  
20 identifying all expense saving opportunities to better serve its subscribers. For example, on the  
21 surface, Blue Cross's employee benefit plans seem to be rich as compared to many private sector  
22 plans and may present some opportunities for savings.

23 Q. Can you provide an example of a possible benefit plan savings?

1           A.     Yes, as noted in its response to Data Request AG1-52 (AG Exhibit M), Blue  
2 Cross indicates it provides long-term disability insurance to full-time employees at no cost to the  
3 employee after one year of service. Long-term disability plans are frequently offered as an  
4 employee-paid, rather than employer-paid benefit. If the plan were offered on an employee-paid  
5 basis, Blue Cross would save the premium costs. The employees would then be required to pay  
6 the premiums. From a federal income tax perspective, disability benefits are taxable to the  
7 employee if the employer paid the premium, but are not taxable if the employee paid the  
8 premium. Because of this differing tax treatment, a less generous (and less expensive) benefit  
9 formula could be offered to employees on an employee-paid basis that would provide equivalent  
10 after-tax protection of income during disability.

11           Q.     Do you have another example of possible benefit plan savings?

12           A.     Another area of potential savings is related to the portion of the employees'  
13 Health Insurance that is paid for by employee contributions. In its response to Data Request  
14 AG3-3 (AG Exhibit N) Blue Cross indicates that employees contribute an average of 4% of total  
15 Health Insurance costs. In my experience, it is not uncommon for private-sector employers to  
16 expect their employees to pay as much as 20% or more of costs. By increasing employee  
17 contributions to their Health Insurance, Blue Cross would save some costs. These are but two  
18 examples where Blue Cross could require its employees to shoulder some of the costs of  
19 employee benefits as Blue Cross asks its subscribers to tighten their belts.

20           Q.     What is the next area of opportunity that you have identified?

21           A.     The next area I have identified is related to the prescription drug formulary.

22           Q.     Please explain.

1           A.     Blue Cross is making major changes to its prescription drug benefits by  
2 introducing a formulary beginning in 2011, which it further described and explained in its  
3 response to Data Request AG1-27 (AG Exhibit O). We understand that Blue Cross has  
4 introduced this formulary for its large group and small group business, and have heard that the  
5 changes have created some concerns with Blue Cross subscribers and some plan sponsors.  
6 Limited information is available related to the impact of these recent changes on subscribers.  
7 Class DIR subscribers are particularly vulnerable since no carriers other than Blue Cross offer  
8 coverage in Rhode Island. For this reason, we recommend that OHIC disapprove Blue Cross  
9 proposed benefit changes related to the introduction of the new formulary and require Blue Cross  
10 to continue its previous prescription coverage for Class DIR. This decision could be re-  
11 evaluated next year, when more information is available.

12           Alternatively, if OHIC chooses to approve the benefit changes despite the Attorney  
13 General's recommendations, because these changes will impact many Class DIR subscribers,  
14 Blue Cross needs to monitor consumer feedback to determine whether modifications to the  
15 formulary are appropriate, whether communications can be improved, and whether Blue Cross  
16 needs to offer an appeals process that would allow subscribers to obtain payment of non-  
17 formulary pharmacy costs where medical necessity has been documented by the subscriber's  
18 treating physician.

19           Q.     What is the next area of opportunity for Blue Cross to better manage the Class  
20 DIR business you have identified?

21           A.     In July, 2010 OHIC established certain conditions related to health plans'  
22 contracting with hospitals. The implied intent of those conditions is to better align incentives  
23 with the hospitals to encourage effective, efficient care. Blue Cross has indicated that the

1 recently negotiated contract with Lifespan complies with those conditions and results in some  
2 savings to Class DIR subscribers. We encourage Blue Cross to continue its efforts to benefit its  
3 subscribers.

4 Q. Have you identified any other area of opportunity for Blue Cross to better manage  
5 the Class DIR business?

6 A. Blue Cross set forth numerous Affordability Initiatives in a 2006 Report that it  
7 submitted to the Office of the Health Insurance Commissioner (“OHIC”) on April 21, 2006.  
8 When this report was initially released, the Attorney General expressed significant concerns  
9 regarding these proposed initiatives, particularly raising concerns that there was no  
10 accountability for any expenditures made to implement these initiatives, no measures for  
11 determining whether the initiative had been achieved, and no triggers to cease unsuccessful  
12 initiatives. These concerns have continued to be expressed by the Attorney General during  
13 OHIC’s consideration of subsequent rate filings by Blue Cross. Since 2006, OHIC and Blue  
14 Cross have modified the approach to reporting on these initiatives. Despite some concerns I  
15 expressed last year, information provided with the 2009 Filing regarding those initiatives better  
16 highlighted major priorities. This year, the reporting appears to have taken some steps  
17 backward, in that the reporting is less informative than last year.

18 Q. What are your concerns with regard to this year’s reporting?

19 A. Affordability initiatives were addressed as part of the Filing only in Blue Cross  
20 Exhibit 3 and in the pre-filed testimony of Dr. Manocchia. The Filing does not provide sufficient  
21 information to determine whether Blue Cross properly followed through on commitments made  
22 last year as summarized in Exhibit 4 to Blue Cross’s 2009 Filing. For example, last year’s  
23 priority number 3 was “best practices in clinical care (Evidence Based Medicine).” Blue Cross

1 indicated last year that a strategy was to “engage appropriate providers in development of  
2 standards of care.” This particular initiative did not receive any significant commentary in this  
3 year’s Filing, and it is unclear whether this has now become a low priority.

4 Blue Cross Exhibit 3 of the Filing, which replaced previous Affordability Initiative  
5 reporting, provides very little useful information. It itemizes a variety of Blue Cross  
6 contributions without providing any explanation of why the activity is a good investment and  
7 without any measures as to the effectiveness of efforts that are being supported. It merely  
8 focuses on expenditures without any ability to determine whether it represents an effective use of  
9 subscribers’ premium dollars.

10 Q. Do you have suggestions as to how Blue Cross’s reporting of Affordability  
11 Initiatives can be improved to demonstrate better accountability to its subscribers?

12 A. Yes, information such as that provided in Exhibit 4 to Blue Cross’s 2009 Filing  
13 including identification of top priorities is important to know. Blue Cross should be required to  
14 provide additional information regarding the nature of the investment in an initiative, an  
15 approximation of the magnitude of the investment, a description of the expected benefit, as well  
16 as an expected pay-back period. We also ask that in each year’s report Blue Cross be required to  
17 include a look-back at the prior year’s priorities, including current status, progress made, updates  
18 on investments and investment returns, and any major modifications to strategy. This increased  
19 reporting and analysis will also provide an opportunity to determine which initiatives should be  
20 continued or discontinued to better serve Blue Cross’s subscribers.

21 Q. In the course of your review of the Filing, did you also review the progress of the  
22 AccessBlue Program?

23 A. Yes.

1 Q. Do you have any opinions regarding this Program?

2 A. Yes.

3 Q. What are they?

4 A. I note that the AccessBlue Program has continued to grow and is a very  
5 meaningful and successful effort. It benefits those subscribers in financial need, but it also  
6 appears to benefit all subscribers by encouraging more healthy people to join the program,  
7 helping to keep rates lower for everyone. Blue Cross should continue to offer this important  
8 program to its subscribers.

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12 Q. Is it your opinion, to a reasonable degree of actuarial certainty, that the Attorney  
13 General's proposed rates in AG Exhibit C Attachment AGBN-4 to become effective April 1,  
14 2011 (representing an 0.4% average increase rather than Blue Cross's proposed rates averaging  
15 an 8.1% increase) are within the proper conduct of the business of Blue Cross and in the interests  
16 of the public?

17 A. Yes.

18 Q. Are all of the opinions you have expressed in your prefiled testimony and  
19 attached schedules made to a reasonable degree of actuarial certainty?

20 A. Yes.

21 Q. Does this conclude your testimony at this time?

22 A. Yes.