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TO THE HOUSE COMMITTEE ON CONSUMER
PROTECTION & COMMERCE

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Monday, February 4, 2008
2 p.m.

TESTIMONY ON HOUSE BILL NO. 3089 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES, CHAIR, AND MEMBERS OF THE
COMMITTEE:

My name is J. P. Schmidt, State Insurance Commissioner (“Commissioner”),
testifying on behalf of the Department of Commerce and Consumer Affairs
(“Department”). The Department strongly supports this Administration bill.

The purpose of this bill is to amend the formula used to determine the
assessment amount to the compliance resolution fund (“CRF”) that should be made by
insurers regulated under the Insurance Code.

The CRF is used to fund, among other things, the operations of the Insurance
Division. Amended by Act 1, Special Session Laws of 2005 (“Act 1”), the current
formula in HRS § 431:2-215(d) authorizes the Commissioner to assess insurers to the
extent the proposed fiscal year budget exceeds the cash balance at the end of the prior
fiscal year after deducting other anticipated revenues. This entails that the Insurance
Division manage its budget to achieve zero funds in reserve at the end of the fiscal
year. The current statute also requires a minimum 60-day notice to insurers.

Although the fiscal year closes on June 30, the prior fiscal year’s ending cash
balance is not known until a few months later, after allowing for fourth quarter

encumbrances and closing of the books by the Department of Accounting and General Services.

Under the current formula, the likelihood of a cash shortfall in the first quarter of the fiscal year is an annual certainty, given the 60-day notice requirement and the closing which usually takes up to two months.

In the late 1990s and early years of this decade, assessments were increased significantly resulting in a large reserve, which the legislature then transferred to the general fund. Act 1 was enacted in 2005 to provide reasonable limits on assessments and to prevent transfer of funds intended for the regulation of insurance to the general fund.

In 2003, the Insurance Division began reducing the reserves by cutting assessments by 60%. In 2004 and 2005, no assessments were made. An assessment was made in Fall 2006 for FY 2007, in accordance with the new formula in Act 1. In FY 2008, the Insurance Division has not made an assessment. The ending cash balance on June 30, 2008 is projected at \$259,361. The Insurance Division is closing out contracts and looking at services and expenditures that can be delayed in order to have sufficient funds on June 30 so that we can continue operations on July 1, 2008.

It is impossible for the Insurance Division to continue operations if it is unable to assess until there is a zero cash balance on June 30. The Insurance Division requires cash on hand on July 1 of the next fiscal year to fund payroll and on-going expenses.

Basing the assessment calculation on 125% of the proposed fiscal budget will allow for sufficient reserve to fund operational needs during the first quarter of the fiscal year. This will provide funds for continued operation of the Division until fees and assessments for the new fiscal year are received. This also maintains a reasonable safeguard to prevent large increases in assessments or transfers of assessment funds for other purposes.

Without this adjustment to recognize government accounting and budget requirements, the Insurance Division will continually head into the end of each fiscal year with funds approaching zero, creating an untenable situation for the Insurance Division's operation.

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We thank this Committee for the opportunity to present testimony on this matter and ask for your favorable consideration.

**HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE**

February 4, 2008

House Bill 3089 Relating to Insurance

Chair Herkes and members of the House Committee on Consumer Protection and Commerce, I am Rick Tsujimura, representing State Farm Insurance Companies, a mutual company owned by its policyholders.

State Farm supports the intent of House Bill 3089 Relating to Insurance and the Insurance Division's need for funds to operate the Division. We recommend that the committee keep this measure alive by defecting the date to allow continued dialogue between the industry and the Division on the level of funds necessary to adequately and sufficiently run the Division.

Thank you for the opportunity to present this testimony.



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Alison Powers
Executive Director

TESTIMONY OF ALISON POWERS

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE
Representative Robert N. Herkes, Chair
Representative Angus L.K. McKelvey, Vice Chair

Monday, February 4, 2008
2:00 p.m.

HB 3089

Chair Herkes, Vice Chair McKelvey, and members of the committee, my name is Alison Powers, Executive Director of Hawaii Insurers Council. Hawaii Insurers Council is a non-profit trade association of property and casualty insurance companies licensed to do business in Hawaii. Member companies underwrite approximately 60% of all property and casualty insurance premiums in the state.

Hawaii Insurers Council **opposes** HB 3089. This bill allows the Insurance Commissioner to assess the insurance industry 25% more than the budget ceiling approved by the Legislature.

The insurance sub-account, which is part of the Compliance Resolution Fund, is 100% funded by the insurance industry for the purpose of its own regulation.

In 2006, Hawaii Insurers Council won in Circuit Court its lawsuit filed in 2004 against the State. In relevant part, on Count IX of the Declaratory Judgment, granting in part Hawaii Insurers Council's motion for summary judgment, the Court stated "the methods of calculation and amounts of at least a portion of the insurance division's assessments, including those related to reserve margins, overhead of the DCCA and

overhead of the DBF [Department of Budget and Finance], run afoul of the requirements of *Medeiros*¹.”

In addition to the Declaratory Judgment from First Circuit Court, Judge Ahn went further and issued a stay as requested by the State so as not to change the status quo. In her order dated January 23, 2006, she outlined certain requirements of the Insurance Division pending this case’s appeal. In relevant part, the Judge required the Insurance Division to “inform the Plaintiff (Hawaii Insurers Council) thirty days prior to any future assessment of:

- a. The amount in the insurance regulation sub-account of the Compliance Resolution Fund on June 30th of the prior fiscal year;
- b. How much money they project to receive for the insurance sub-account of the Compliance Resolution Fund from non-assessment sources for the fiscal year of that assessment; and
- c. What the Insurance Division proposes its budget to be for the fiscal year of that assessment.”

HB 3089 clearly violates the spirit of the Judge’s order in that requiring an accounting to the Hawaii Insurers Council by the Insurance Division is to ensure the assessments in their aggregate are not excessive.

This bill also attempts to overturn Count IX of the Declaratory Judgment, which says in part that the Insurance Division’s assessments for reserves runs afoul of the *Medeiros* case.

This bill usurps the Legislature’s authority to approve the budget ceiling, lends itself further to abuse, and violates Judge Ahn’s order while this case is pending a decision by the Intermediate Court of Appeals. In addition, we are awaiting the State

¹ *State v. Medeiros*, 89 Hawaii 361, 973 P.2d 736 (1999). Under *Medeiros*, the assessment must (1) apply to the direct beneficiary of a particular service, (2) be allocated directly to defraying the costs of providing the service, and (3) be reasonably proportionate to the benefit received. The Circuit Court ruled that the Insurance Division’s assessment did not meet this test.

Auditor's report, mandated by Act 1, SSLH 2005, which requires the Auditor to conduct a financial and management audit of the insurance regulation sub-account of the Compliance Resolution Fund. This audit report was due prior to the convening of the 2008 legislative session.

Therefore, we ask that this bill be held.

Thank you for the opportunity to testify.