

HB917 HD1

Measure Title: RELATING TO INSURANCE.

Report Title: Mutual Benefit Societies; Minimum Net Worth Required

Description: Clarifies that a mutual benefit society shall maintain a minimum net worth calculated based on annual net premium revenues and net health care expenditures. Requires approval of reinsurer. (HB917 HD1)

Companion: SB1077

Package: None

Current Referral: CPH

Introducer(s): BELATTI, BROWER, EVANS, ING, JOHANSON, MCKELVEY, MIZUNO, MORIKAWA, NISHIMOTO, TAKUMI



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TO THE SENATE COMMITTEE ON
COMMERCE, CONSUMER PROTECTION, AND HEALTH

TWENTY-NINTH LEGISLATURE
Regular Session of 2017

Tuesday, March 14, 2017
9:00 a.m.

TESTIMONY ON HOUSE BILL NO. 917, H.D. 1 – RELATING TO INSURANCE.

TO THE HONORABLE ROSALYN H. BAKER, CHAIR, AND MEMBERS OF THE
COMMITTEE:

My name is Gordon Ito, State Insurance Commissioner (“Commissioner”), testifying on behalf of the Department of Commerce and Consumer Affairs (“Department”). The Department opposes this bill as written, which is a companion bill to S.B. 1077, and proposes amendments for clarification purposes.

The purpose of this bill is to change the calculation of a mutual benefit society’s (“MBS”) minimum net worth from a gross basis to a net basis under section 432:1-407(a) of the Hawaii Revised Statutes (“HRS”).

H.D. 1 amends this bill by adding the following language to page 2, lines 6 through 9 of the bill: “The net annual health care expenditures may be reduced by the amount ceded to reinsurers; provided that the reinsurer shall be approved by the commissioner.” By changing the calculation basis from gross to net and by allowing the minimum net worth to be reduced by the amount of ceded reinsurance, this amendment would fundamentally alter the intent of section 432:1-407(a), HRS, and significantly

weaken the efficacy of insurance solvency regulation. Calculating minimum net worth on a gross basis has long been an effective way to regulate solvency and has consistently been used in the health insurance industry for MBSs, health maintenance organizations, and other health insurers.

Furthermore, while approval of reinsurers by the Commissioner was added as a requirement to H.D. 1, all reinsurers must already be either authorized or accredited for the ceding insurer to recognize as admitted assets the recoverable losses it has incurred and has already paid. Thus, the amendment in H.D. 1 is unlikely to have the intended effect of adding an extra level of assurance (i.e., approval, authorization, accreditation, or otherwise) related to the recognition of recoverable losses. Even with this change, the recoverable amount from reinsurers remains a solvency concern until such amount is actually received and related transactions settled; this may present a regulatory challenge due to the timeliness of the recoverable and the verifiability of complex reinsurance transactions.

As stated in prior testimony submitted on this measure, section 432:1-407(a)(2), HRS, requires that every MBS maintain a minimum net worth equal to the greater of: \$2,000,000 under subparagraph (A); “[t]wo per cent of annual premium revenues . . . on the first \$150,000,000 of premium revenues and one per cent of annual premium revenues on the premium revenues in excess of \$150,000,000” under subparagraph (B); or “eight per cent of the sum of annual health care expenditures and operating expenses” under subparagraph (C). This statute intends a gross, rather than net, calculation of minimum net worth, as an MBS is ultimately responsible for all liabilities should its reinsurer fail, and the minimum net worth is easier to manipulate if reinsurance recoveries are included in the calculation.

In addition, section 432:1-407(a)(C), which considers annual health care expenditures and annual operating expenses in determining minimum net worth, intends calculation on a gross basis. “Operating expenses” is defined in section 432:1-406 as “claims adjustment, administrative, soliciting, and reinsurance allowances.” In contrast, “health care expenditures” is defined as “claims incurred,” which is a gross

amount, and makes no mention of reinsurance. This exclusion of reinsurance from “health care expenditures” indicates these expenditures are calculated on a gross basis.

The Department respectfully requests amending section 432:1-407(a)(2)(B) to read as follows: “Two per cent of gross annual premium revenues as reported on the most recent annual financial statement filed with the commissioner on the first \$150,000,000 of gross annual premium revenues and one per cent of gross annual premium revenues on the gross annual premium revenues in excess of \$150,000,000; or.” In addition, the Department requests amending section 432:1-407(a)(2)(C) to read as follows: “An amount equal to eight per cent of the sum of gross annual health care expenditures and operating expenses as reported on the most recent financial statement filed with the commissioner.” These amendments would clarify the basis used to calculate an MBS’ minimum net worth and maintain consistency with the Commissioner’s Order dated May 27, 2015 (IC-15-41, In the Matter of Hawaii Management Alliance Association), which addressed this very issue.

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



BEFORE THE

SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, AND HEALTH

Senator Rosalyn H. Baker, Chair
Senator Clarence K. Nishihara, Vice Chair

HB917 HD1 RELATING TO INSURANCE

**TESTIMONY OF
WILLIAM C. McCORRISTON
President and Chief Executive Officer,
Hawaii Medical Assurance Association**

March 14, 2017, 9:00 a.m.
State Capitol Conference Room 229

Chair Baker, Vice Chair Nishihara, and Committee Members:

My name is William C. McCorriston, President and Chief Executive Officer of Hawaii Medical Assurance Association (HMAA). HMAA **strongly supports** HB 917, as amended by the attached proposed HB917, HD2 (with proposed amendments highlighted in yellow). The attached HB917, HD2 proposes a compromise between the bills respectively advanced by HMAA and the Insurance Division of the Department of Commerce and Consumer Affairs ("Insurance Division") to clarify Hawaii Revised Statutes ("HRS") Section 432:1-407(a)(2).

Prior testimony by HMAA concentrated on the intent behind HRS Section 432:1-407(a)(2) to protect against the insolvency of a mutual benefit society by ensuring that it maintains minimum net worth amounts reflective of the actual risk it retains. The financial condition and net worth requirements for a mutual benefit society should be based on its *net* risk, after consideration of risk that it has transferred to acceptable reinsurers. The use of gross premiums to calculate minimum net worth requirements does not reflect the actual risk retained by a mutual benefit society, thereby (i) removing a key incentive for a mutual benefit society to enter into a reinsurance agreement and (ii) reducing the benefits of ceding risk.

Reinsurance (insurance for insurance companies) serves a number of benefits for insurers, allowing them to (a) limit its liability to a level commensurate with its assets and net worth, (b) stabilize its loss and financial performance by transferring the risk of volatility to the reinsurer, (c) protect against catastrophic loss, and (d) increase its capacity to write additional insurance policies without having to raise additional capital.

Hawaii has already adopted the National Association of Insurance Commissioners' recommended standards in HRS Section 431:4A-101 to permit **for-profit insurers** to reduce its liabilities and costs for premium amounts transferred to reinsurers by contract if the reinsurer meets certain strict qualifications for accreditation by the Insurance Commissioner.¹ The for-profit insurer's transfer of risk is ultimately reflected on its financial statement by presenting its obligations net of the liabilities and other obligations transferred to the reinsurer. The evaluation of the insurer's solvency and required capital is also based upon its net financial condition. An insurer identifies its total/gross liabilities and obligations, the amount of those obligations that it has transferred to acceptable reinsurers, and the net liabilities and obligations that it must pay from its own resources.

Although all classes of for-profit insurers may use risk ceded to reinsurers as a credit under HRS Chapter 431:4A, **this chapter does not apply to mutual benefit societies.**² HB 917 HD 2 would clarify that mutual benefit societies (governed by HRS Chapter 432) would be treated no differently than for-profit insurers (governed by HRS Chapter 431) if the mutual benefit societies cedes risk to an accredited reinsurer. There is no basis to treat mutual benefit societies differently than other health insurers. In fact, up until 2015, the Insurance Division acknowledged the benefit of reinsurance to mutual benefit societies by relying on the annual *net* premium revenues generated by a mutual benefit society to calculate its minimum net worth. Moreover, any concern as to the potential insolvency of a reinsurer is alleviated by the strict accreditation requirements set forth in HRS Chapter 431:4A.

The proposed HB917 HD2 is sound public policy that will enable mutual benefit societies to increase the number of insurance policies issued in a financially-prudent manner to the benefit of Hawaii's insurance consumers. HD917 HD2 will further allow HMAA to take excess funds sitting in a reserve account to strengthen its wellness and preventative care initiatives for its members, the small local kama'aina companies of Hawai'i.

For these reasons, HMAA **strongly supports** proposed HB917 HD2 and respectfully urges the passage of this measure. Thank you for the opportunity to testify on this matter of critical importance.

¹ The Insurance Commissioner may accredit reinsurers if the reinsurers: are from an acceptable state or jurisdiction, maintain trusts to support their obligations and potential obligations to their insurance counterparties, and/or otherwise post collateral with the insurer to ensure the payment of such obligations.

² The statute governing mutual benefit societies specifically note that "[n]o law [of the Insurance Code] enacted after July 1, 1988, shall apply to mutual benefit societies unless such societies are expressly designated therein."

A BILL FOR AN ACT

RELATING TO INSURANCE.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. Section 432:1-407, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) Net worth requirements are as follows:

(1) Before issuing a certificate of authority pursuant to section 432:1-301, the commissioner shall require that the mutual benefit society has an initial net worth of \$2,000,000 and the society shall thereafter maintain the minimum net worth required under paragraph (2); and

(2) Every mutual benefit society shall maintain a minimum net worth equal to the greater of:

(A) \$2,000,000;

(B) Two per cent of annual gross premium revenues as reported on the most recent annual financial statement filed with the commissioner on the first \$150,000,000 of premium revenues and one per cent of annual gross premium revenues on the premium revenues in excess of \$150,000,000; or

(C) An amount equal to eight per cent of the sum of gross annual health care expenditures and operating expenses as reported on the most recent financial statement filed with the commissioner.

(3) The annual gross premium revenues and gross annual health care expenditures shall be reduced by the total amount thereof ceded to reinsurers by the mutual

benefit society, provided the reinsurance credit taken
complies with HRS §§ 431:4A-101 through 431:4A-104 and
the administrative rules established by the
commissioner thereunder."

SECTION 2. New statutory material is underscored.

SECTION 3. This Act shall take effect upon its approval.