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TO THE HOUSE COMMITTEE ON FINANCE

TWENTY-NINTH LEGISLATURE
Regular Session of 2017

Tuesday, February 28, 2017
11:00 a.m.

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

TO THE HONORABLE SYLVIA LUKE, 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 an amendment 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 on 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, 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.” This amendment 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

HOUSE COMMITTEE ON FINANCE

Representative Sylvia Luke, Chair
Representative Ty J.K. Cullen, Vice Chair

HB 917 RELATING TO INSURANCE

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

February 28, 2017, 11:00 a.m.
State Capitol Conference Room 308

Chair Luke, Vice Chair Cullen, 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 HD1, as amended by the attached proposed HB 917, HD 2 (with proposed amendments highlighted in yellow). The attached HB 917, HD 2 seeks to clarify Hawaii Revised Statutes (“HRS”) Sections 431:1-406 and 432:1-407(a)(2) to require that small mutual benefit societies maintain minimum *net* worth amounts reflective of actual risks.

By way of background, HMAA is a non-profit mutual benefit society that provides health insurance to over 40,000 Hawai'i residents. HMAA occupies about three percent of Hawaii's health insurance market. As a small kama'aina insurer serving Hawai'i since 1989, HMAA takes special pride in providing health insurance to sole proprietors and small businesses, a segment of Hawaii's market that faces a difficult time obtaining affordable health-related insurance.

The intent of HRS Sections 431:1-406 and 432:1-407(a)(2) is 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 current language of the statute, however, permits differing interpretations on whether a mutual benefit society's minimum net worth requirements should be based on the annual net premiums or gross premiums it generates. 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. It further causes an avoidance of the use of industry-accepted risk mitigation tools to spread risk, increases financial uncertainty for a mutual benefit society, and diminishes economic growth.

HMAA has used reinsurance throughout its existence as an effective tool to best leverage its financial resources. Currently, HMAA shares its liability with Transatlantic Reinsurance Company (a.k.a. TransRe), a reinsurer with total assets of over \$16 billion as of September 2016, and General Reinsurance Corporation (a.k.a. GenRe), a wholly owned subsidiary of Berkshire Hathaway, with over \$35 billion of total assets. Both reinsurers are certified and/or accredited by the Insurance Division of the Department of Commerce and Consumer Affairs as of December 31, 2016, having met the certification or accreditation requirements for reinsurers as specified in HRS Chapter 431:4A.¹ HRS Chapter 431:4A provides adequate safeguards that empower the Insurance Division to protect against the insolvency of the reinsurer. These requirements include an obligation by the reinsurer to, among a variety of other things, (i) demonstrate to the satisfaction of the Insurance Commissioner the reinsurer's adequate financial capacity to meet its reinsurance obligations; and (ii) file annual statements with the Insurance Division that includes a copy of the reinsurer's most recent audited financial statement. The Insurance Division also has the ability to suspend or revoke a reinsurer's accreditation or certification if it fails to meet the requirements for accreditation or certification at any time.

For HMAA, the use of "gross" as opposed to "net" revenues and expenses reflects an overstatement of nearly \$3 million in reserves for risk insured by its reinsurers. To better illustrate the overstatement, consider a hypothetical where HMAA receives \$1 million in gross premiums. HMAA cedes 70% of the risk to TransRe and GenRe and retains only 30% of the risk. By using minimum net worth requirements based on HMAA's annual gross premiums as opposed to its net premiums, HMAA must base its net worth requirements on the total \$1 million in gross premiums collected—an amount well over and above the *actual* risk retained by HMAA, as 70% of that risk is not borne by HMAA but by the accredited or certified reinsurers.

The proposed HB 917, HD 2 solidifies the intent behind HRS Sections 431:1-406 and 432:1-407(a)(2) and clarifies that a mutual benefit society's minimum net worth requirements should be calculated on the annual *net* premiums generated. With the passage of the proposed HB 917, HD 2, mutual benefit societies will not be discouraged from ceding a portion of risk to reinsurers. Spreading risk among reinsurers mitigates the impact of insolvency of a single party and strengthens the financial stability of a mutual benefit society. By relying on reinsurers to bear the risk on its behalf, a mutual benefit society can then invest the additional capital in operations and wellness initiatives to lower the cost of insurance as opposed to letting the capital sit in a reserve account. For example, ceding risk to TransRe and GenRe has allowed HMAA to implement a new telehealth offering to its members and expanded upon Wellness initiatives. These Wellness initiatives include (i) the Hepatitis A vaccination campaign during this past summer in support of HMAA's members and the community in time of crisis and (ii) HMAA's Maternity Management program that has lowered the number of pre-term births experienced by our membership.

¹ See <https://cca.hawaii.gov/ins/files/2017/01/2016-Accredited-Reinsurers.pdf>

Without passage of HB 917, HD 2 hundreds of sole-proprietors, small businesses, and their families currently insured by HMAA may be forced to shop for more expensive policies with much less coverage. For these reasons, HMAA **strongly supports** proposed HB 917, HD 2 and respectfully urges the passage of this measure. Thank you for the opportunity to testify on this matter of critical importance.

A BILL FOR AN ACT

RELATING TO INSURANCE.

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

SECTION 1. Section 432:1-406, Hawaii Revised Statutes, is amended by amending to read as follows:

1. "Health care expenditures" means claims incurred net of reinsurance recoveries.

2. "Operating expenses" means net claims adjustment, administrative, and soliciting expenses being net of reinsurance allowances.

SECTION 2. 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 premium net 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 net 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 net annual health care expenditures and operating expenses as reported on the most recent financial statement filed with the commissioner. The net annual health care expenditures may be reduced by the amount ceded to reinsurers, provided the reinsurance credit taken complies with the credit for reinsurance administrative rules established by the commissioner pursuant to HRS §§ 431:4A-101 through 431:4A-104."

SECTION 2. New statutory material is underscored.

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

SUPPORT: Hawaii HB 917 (Original Version)
Mutual Benefit Societies and Reinsurance

The Reinsurance Association of America (“RAA”) submits the following comments in support HB 917 as originally drafted, and particularly the reinsurance and net worth calculation provisions contained therein. The Reinsurance Association of America is the leading trade association of property and casualty reinsurers doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. The RAA represents its members before state, federal and international bodies.

The RAA supports the original draft of HB 917 as it clarifies that the financial condition and net worth requirements for a mutual benefit society are based upon its net risk, after consideration of risk that it has transferred to acceptable reinsurers. It is sound public policy that will enable insurers to increase the number of insurance policies issued in a financially prudent manner to the benefit of Hawaii’s insurance consumers.

We do not support the language in HB 917, HD 1, which authorizes the appropriate net accounting only if the commissioner approves of the reinsurer. It is our view that the credit for reinsurance laws and regulations appropriately set the standards for reinsurer acceptability and requirements for an additional approval of the specific reinsurers supporting a mutual benefit society are redundant and could complicate and limit the society's reinsurance options at key renewal dates.

Alternative suggested language is set forth below.

Reinsurance – Background, Credit for Reinsurance and Net Accounting

Reinsurance, which is insurance for insurance companies, serves a number of beneficial roles for insurers and other insurance entities, such as mutual benefit societies (individually and collectively, “insurer”). The decision to purchase reinsurance is a voluntary decision, typically made by the insurer 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. ¹

Consistent with achieving these objectives, an insurer’s financial condition is evaluated in light of the reinsurance protection that an insurer has in place. The National Association of Insurance Commissioners (NAIC) has an established financial accounting framework for the consideration of reinsurance as an asset or as an offset to liabilities otherwise required to be maintained by the insurer.

Hawaii has adopted the recommended standards that allow financial statement credit for reinsurance through HI Rev Stat § 431:4A-101, et seq. (Hawaii's Credit for Reinsurance Law) and its adoption of the NAIC accounting practices and procedures.²

Credit for reinsurance laws and related accounting practices and procedures permit an insurer to reduce its liabilities and costs for amounts that it has transferred to the reinsurer by contract, if the reinsurer qualifies under Hawaii's Credit for Reinsurance Law. The law and related regulation set for legal framework for evaluating reinsurers to determine if they: are from an acceptable state or jurisdiction, maintain trusts to support their obligations and potential obligations to their insurance counterparties, and/or if they otherwise post collateral with the insurer to ensure the payment of such obligations.

If the reinsurer meets the applicable standards, the 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.

Examining an insurer's solvency on a net of reinsurance basis encourages an insurer to transfer risk to acceptable reinsurers and is important from a solvency and public policy perspective. By encouraging appropriate utilization of reinsurance to (a) limit an insurer's 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 enhances the solvency of its insurers, attracts reinsurance capital, and encourages prudent behavior generally.

Reinsurance – A Key Claims Paying Resource

Reinsurance is a key component of many companies' financial resources. It is the RAA position that the proper analysis of a ceding company looks at the company's ability to pay claims in consideration of all of its claims paying resources, including reinsurance. It is for that reason that the NAIC regulators, Hawaii's legislature, and the insurance department have adopted credit for reinsurance laws and regulations to establish the standards for reinsurance accounting for reinsurance and provide ceding insurers with appropriate guidance before they enter a proposed reinsurance transaction.

When a qualifying, claims paying reinsurer provides inuring reinsurance, the insurer or mutual benefit society should be able to reflect that coverage in its financial statements. Its net retained risk is the appropriate measure for determining the net worth it is required to maintain to complement its other financial resources to ensure that the ceding insurer's claims obligations can and will be met.

Suggestions for Amendments:

While the RAA supports HB 917 as originally drafted, we believe that clarifying amendments referring to the Hawaii credit for reinsurance law and amendments would improve the law. Accordingly, the RAA supports language substantially similar to the following proposal:

(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 premium net 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 net 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 net annual health care expenditures and operating expenses as reported on the most recent financial statement filed with the commissioner. **The net annual health care expenditures may be reduced by the amount ceded to reinsurers, provided the reinsurance credit taken complies with the credit for reinsurance administrative rules established by the commissioner pursuant to HRS §§431:4A-101 through 431:4A-104.**

Alternatively, we have reviewed and support the approach taken in a draft of proposed SB 1077, SD 1, which maintains much of the original bill's language while clarifying the definitions of "health care expenditures" and "operating expenses" are net of inuring reinsurance.

Summary

The RAA supports HB 917, as originally drafted or with our suggested amendments, as it clarifies that the financial condition and net worth requirements for a mutual benefit society are based upon its net risk, after consideration of risk that it has transferred to acceptable reinsurers. It is sound public policy benefiting Hawaii's insurance consumers by enabling insurers to issue more policies in a financially prudent, risk appropriate manner.

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¹ Support for this general statement is reflected in any number of documents, including the [RAA Fundamentals of Reinsurance](#), page 5, the [Reinsurance: A Basic Guide to Facultative and Treaty Reinsurance](#) by Munich Re, page 15, et seq., and the International Accounting and Systems Association, Incorporated (IASA) presentation entitled [Reinsurance 101 and Overview](#).

² NAIC Accounting Practices and Procedures Manual, Statement(s) of Statutory Accounting Principles 61R and 62R.