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**TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE**

**TWENTY-NINTH LEGISLATURE
Regular Session of 2017**

Wednesday, March 22, 2017
2:00 p.m.

TESTIMONY ON SENATE BILL NO. 1077, S.D. 1 – RELATING TO INSURANCE.

TO THE HONORABLE ROY M. TAKUMI, 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 supports this bill as amended and provides the following comments.

This bill has been amended to clarify that a mutual benefit society’s (“MBS”) minimum net worth shall be based on gross annual premium revenues, gross annual health care expenditures, and gross annual operating expenses under section 432:1-407(a) of the Hawaii Revised Statutes.

Section 432:1-407(a)(2) 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.

We thank the Committee for the opportunity to present testimony on this matter.



BEFORE THE

HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

Representative Roy M. Takumi, Chair
Representative Linda Ichiyama, Vice Chair

SD1077 SD1 RELATING TO INSURANCE

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

March 22, 2017, 2:00 p.m.
State Capitol Conference Room 229

Chair Takumi, Vice Chair Ichiyama, and Committee Members:

My name is William C. McCorriston, President and Chief Executive Officer of Hawaii Medical Assurance Association (HMAA). HMAA **strongly opposes** SB1077 SD 1 as currently drafted and proposes the attached SD1077, SD2 (with amendments highlighted in yellow). The attached SD1077, SD2 sets forth 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). HMAA and the Insurance Division have engaged—and continue to engage—in dialogue to reach a compromise on this bill.

SD1077 is a companion bill to HB917, which came before this Committee earlier in this session. Prior testimony by HMAA on HB917 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 SB1077 SD2 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 SB1077 SD2 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. SB1077 SD2 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 SB1077 SD2 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.