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TO THE HOUSE COMMITTEE ON
CONSUMER PROTECTION AND COMMERCE

TWENTY-NINTH LEGISLATURE
Regular Session of 2017

Tuesday, February 7, 2017
2:00 p.m.

TESTIMONY ON HOUSE BILL NO. 917 – RELATING TO INSURANCE.

TO THE HONORABLE ANGUS L.K. McKELVEY, 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 require calculation of a mutual benefit society’s
(“MBS”) annual premium revenues, annual health care expenditures, and annual
operating expenses on a net basis when determining the MBS’ minimum net worth
under section 432:1-407(a) of the Hawaii Revised Statutes.

Section 432:1-407(a) requires that every MBS maintain a minimum net worth
equal to the greater of: \$2,000,000 under paragraph (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 paragraph (B); or “eight per cent of the sum of annual health care expenditures
and operating expenses” under paragraph (C). This statute intends a gross, rather than

net, calculation of minimum net worth, as the 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~~] earned as reported on the most recent annual statement filed with the commissioner on the first \$150,000,000 of premium [~~revenues~~] earned and one per cent of gross annual premium [~~revenues~~] earned on the premium [~~revenues~~] earned 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 CONSUMER PROTECTION & COMMERCE

Representative Angus L.K. McKelvey, Chair
Representative Linda Ichiyama, Vice Chair

HB 917 RELATING TO INSURANCE

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

February 7, 2017, 2:00 p.m.
State Capitol Conference Room 329

Chair McKelvey, 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 supports** HB 917, as amended by the attached proposed HB 917, HD 1 (with proposed amendments to HB 917 highlighted in yellow). The attached HB 917, HD1 seeks to clarify a portion of the law to require that 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 30,000 Hawai'i residents. HMAA occupies about three percent of Hawaii's health insurance market. As a small kama'aina insurer, HMAA takes special pride in providing health insurance to sole-proprietors and small businesses, a segment of Hawaii's market that has a difficult time obtaining affordable health-related insurance.

The proposed HB 917, HD 1 would amend Hawaii Revised Statutes ("HRS") Section 432:1-407(a)(2) to add the word "net" before "premium revenues" and before "annual health care expenditures and operating expenses." The intent of HRS Section 432:1-407(a)(2) is to ensure that Hawaii's mutual benefit societies maintain minimum net worth amounts reflective of the actual risk retained by the mutual benefit society. The current language of the statute, however, permits differing interpretations on whether a mutual benefit society's minimum net worth requirements should be calculated based on the annual net premiums or gross premiums generated by the mutual benefit society. The use of gross premiums to calculate minimum net worth requirements does not reflect the actual risk retained by a mutual benefit society, thereby removing all incentives to enter into a reinsurance agreement and eliminating the benefits of ceding risk. This adversely results in the 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. For HMAA, the use of “gross” as opposed to “net” revenues and expenses reflects an overstatement of over \$2.5 million in reserves for risk insured by our reinsurers.

The proposed HB 917, HD 1, will solidify the intent behind Hawaii Revised Statutes Section 432:1-407(a)(2) and clarify that a mutual benefit society’s minimum net worth requirements should be calculated based on the annual net premiums generated. Mutual benefit societies are owned by its members who benefit from consistent interpretation of the law as the members institute measures to best manage the risk profiles of their population. Subjective interpretation of statutes creates uncertainty and additional costs that must then be borne by the membership.

With the passage of the proposed HB 917, HD 1, mutual benefit societies will not be discouraged from ceding a portion of risk to reinsurers. Spreading risk among numerous organizations mitigates the impact of insolvency of a single party and strengthens the financial stability of a mutual benefit society. This enables smaller mutual benefit societies to not only successfully compete in the State of Hawai’i with the financial backing of multiple entities but also provide valuable options to employers in their compliance with the Prepaid law. Mutual benefit societies 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.

HMAA has served Hawaii’s insurance marketplace since 1989 and has used reinsurance as an effective tool throughout its existence to best leverage its financial resources. Currently, HMAA shares its liability with TransRe, a reinsurer with total assets of over \$16 billion as of September 2016 and GenRe, a wholly owned subsidiary of Berkshire Hathaway, with over \$35 billion in total assets. By relying on its reinsurers to bear risk on behalf of the mutual benefit society, HMAA has implemented a new telehealth offering to its members and expanded upon new Wellness initiatives. Examples of the latter include the organization and payment of on-site Hepatitis A vaccinations during this past summer in support of HMAA’s members and the community in time of crisis. In addition, HMAA’s Maternity Management program has successfully lowered the number of pre-term births experienced by our membership. These are just a couple examples of how HMAA can better invest in its members’ health by utilizing financial resources effectively.

Without passage of HB 917, 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 1 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."

SECTION 2. New statutory material is underscored.

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

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SUPPORT: Hawaii HB 917
Mutual Benefit Societies and Reinsurance

The Reinsurance Association of America (“RAA”) submits the following comments in support HB 917, 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 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.

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 prudential behavior generally.

Summary

The RAA supports 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 benefiting Hawaii's insurance consumers by enabling insurers to issue more policies in a financially prudent, risk appropriate manner.

Dennis C. Burke
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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.