



ANALYSIS OF THE NEW JERSEY BUDGET

**DEPARTMENT OF
BANKING AND INSURANCE**

FISCAL YEAR

2009 - 2010

NEW JERSEY STATE LEGISLATURE

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DEPARTMENT OF BANKING AND INSURANCE

Budget Pages..... C-4, C-11, C-28, C-30, D-23 to D-29,
F-8, H-12

Fiscal Summary (\$000)

	Expended FY 2008	Adjusted Appropriation FY 2009	Recommended FY 2010	Percent Change 2009-10
State Budgeted	\$68,640	\$71,441	\$67,548	(5.4%)
Federal Funds	0	0	0	—
<u>Other</u>	<u>\$4,759</u>	<u>\$832</u>	<u>\$496</u>	<u>(40.4%)</u>
Grand Total	\$73,399	\$72,273	\$68,044	(5.9%)

Personnel Summary - Positions By Funding Source

	Actual FY 2008	Revised FY 2009	Funded FY 2010	Percent Change 2009-10
State	2	2	2	—
Federal	0	0	0	—
<u>Other</u>	<u>461</u>	<u>417</u>	<u>412</u>	<u>(1.2%)</u>
Total Positions	463	419	414	(1.2%)

FY 2008 (as of December) and revised FY 2009 (as of January) personnel data reflect actual payroll counts. FY 2010 data reflect the number of positions funded.

Key Points

- The proposed budget recommends a \$68 million appropriation for the Department of Banking and Insurance, a decrease of \$4.2 million (5.9%) from the FY2009 adjusted appropriation. The department's activities are entirely funded through revenue collected from assessments on the industries it regulates.
- The proposed budget anticipates \$119.6 million in revenue (page C-4) for the department, a \$20.3 million (14.5%) decrease from FY2009. The reductions are anticipated as follows: \$14 million (31.5%) from Insurance Licenses and Other Fees; \$2.5 million (19%) from the Insurance Special Purpose Assessment; \$2.5 million (25%) from the Real Estate Commission; \$860,000 (8.6%) from the Banking Assessment; and \$440,000 (1.3%) for Insurance Fraud Prevention.

Key Points (Cont'd)

- The proposed budget includes a \$3.8 million (10.9%) reduction in funding for salaries and wages. This decrease reflects the elimination of 49 funded positions since FY2008. Although the proposed budget suggests a reduction of five positions between the current and next fiscal year, from 419 filled FTE's in January 2009 to 414 funded positions for FY2010, budget data indicates 463 positions were funded in FY2008 and the funding for these positions was continued in the FY2009 budget. However, due to the early retirement initiative, attrition and hiring restrictions, these positions were eliminated during FY2009 and are not funded in the recommended FY2010 budget. The proposed reduction in salaries and wages for FY2010 will not result in savings to the General Fund, since as previously noted, the department is fully funded by fees imposed on the industries it regulates, and the budget further recommends that the department's decreased operating costs be reflected in reduced fees and assessments to banks, thrifts, and insurance companies.
- The proposed budget anticipates a \$400,000 (100%) reduction in appropriated receipts from Other Funds for the Supervision and Examination of Financial Institutions. These funds reflect revenue collected in excess of the amounts anticipated from examination and licensing fees, bank assessments, and fines and penalties imposed by the Division of Banking. While the department does not anticipate excess receipts in FY2010, as in prior years, language is included in the proposed budget which would authorize the appropriation of excess receipts, not to exceed \$400,000, which would be allocated to the division for operating expenditures, subject to the approval of the Director of the Division of Budget and Accounting. With the exception of \$22,000 in excess receipts which were appropriated in FY2008, the department has not appropriated excess receipts pursuant to this language for at least the last ten years.
- The proposed budget anticipates an increase of \$64,000 (14.8%) in revenue collected by the Small Employer Health Benefits Program established by P.L.1992, c.162. The Small Employer Health Benefits Program is responsible for the administration and oversight of small employer health benefits plans in the State. The program is administered by the Small Employer Health Benefits Board, which may assess participating health insurance carriers for the costs of the operating expenses of the program (N.J.S.A.17B:27A-32). According to budget data, the board is anticipating a \$64,000 increase in salaries and wages for the Small Employer Health Benefits program that will be assessed to the health insurance carriers.
- The proposed budget includes language in the General Provisions (page F-8) authorizing the transfer of \$20 million from the Workers' Compensation Security Fund (WCSF) to the General Fund as State revenue during FY2010. The WCSF was established pursuant to P.L.2004, c.179, to provide benefit payments for individuals entitled to receive workers' compensation benefits when a workers' compensation insurance carrier is insolvent. The WCSF is funded by assessments on all carriers writing workers' compensation business in the State. The proposed budget (page H-12) estimates an FY2010 year end balance of \$20.9 million as compared to a \$44.1 million year end balance in FY2009.
- The proposed budget includes language in the General Provisions (page F-8) authorizing the transfer of \$1.8 million from the Medical Malpractice Liability Insurance Premium Assistance Fund (MMLIPA) to the General Fund as State revenue. The "New Jersey Medical Care Access and Responsibility and Patients First Act," P.L. 2004, c.17

Key Points (Cont'd)

(C.2A:53A-37 et al.), established the MMLIPA, to provide medical malpractice liability insurance premium relief for certain specialized health care providers in the State. The fund, comprised of revenue derived from a \$3 annual surcharge paid on or by employees who are subject to the "unemployment compensation law" and a \$75 annual surcharge paid on the professional licenses of physicians, podiatrists, dentists, chiropractors, and attorneys, unless otherwise exempted, discontinued surcharges on June 30, 2007. In response to questions by the Office of Legislative Services in the FY2009 budget, the department stated that a balance of \$276,839 remained in the account at year end FY2008. Since that time, delinquent surcharge collections and investment income have increased the fund's available balances to approximately the amount proposed for transfer to the General Fund.

Background Papers:

- Horizon Blue Cross Blue Shield of New Jersey Conversion Opportunity p. 22

Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS (\$000)

	Expended FY 2008	Adj. Approp. FY 2009	Recom. FY 2010	Percent Change	
				2008-10	2009-10
General Fund					
Direct State Services	\$68,640	\$71,441	\$67,548	(1.6%)	(5.4%)
Grants-In-Aid	0	0	0	0.0%	0.0%
State Aid	0	0	0	0.0%	0.0%
Capital Construction	0	0	0	0.0%	0.0%
Debt Service	0	0	0	0.0%	0.0%
Sub-Total	\$68,640	\$71,441	\$67,548	(1.6%)	(5.4%)
Property Tax Relief Fund					
Direct State Services	\$0	\$0	\$0	0.0%	0.0%
Grants-In-Aid	0	0	0	0.0%	0.0%
State Aid	0	0	0	0.0%	0.0%
Sub-Total	\$0	\$0	\$0	0.0%	0.0%
Casino Revenue Fund	\$0	\$0	\$0	0.0%	0.0%
Casino Control Fund	\$0	\$0	\$0	0.0%	0.0%
State Total	\$68,640	\$71,441	\$67,548	(1.6%)	(5.4%)
Federal Funds	\$0	\$0	\$0	0.0%	0.0%
Other Funds	\$4,759	\$832	\$496	(89.6%)	(40.4%)
Grand Total	\$73,399	\$72,273	\$68,044	(7.3%)	(5.9%)

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 2008	Revised FY 2009	Funded FY 2010	Percent Change	
				2008-10	2009-10
State	2	2	2	0.0%	0.0%
Federal	0	0	0	0.0%	0.0%
All Other	461	417	412	(10.6%)	(1.2%)
Total Positions	463	419	414	(10.6%)	(1.2%)

FY 2008 (as of December) and revised FY 2009 (as of January) personnel data reflect actual payroll counts. FY 2010 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	32.2%	36.0%	37.2%	----	----
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Significant Changes/New Programs (\$000)

<u>Budget Item</u>	<u>Adj. Approp.</u> <u>FY 2009</u>	<u>Recomm.</u> <u>FY 2010</u>	<u>Dollar</u> <u>Change</u>	<u>Percent</u> <u>Change</u>	<u>Budget</u> <u>Page</u>
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ECONOMIC REGULATION

ANTICIPATED REVENUE

Total Anticipated Revenue	\$139,874	\$119,587	(\$20,287)	(14.5%)	C-4
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The proposed budget anticipates \$119.6 million in revenue (page C-4) for the department, a \$20.3 million (14.5%), decrease from FY2009. The anticipated decrease reflects the following reductions:

- \$14 million (31%) in reduced revenue from Insurance Licenses and Other Fees, \$13 million of which can be attributed to a one time fine paid in FY2009 by Health Net New Jersey to the department for sanctions related to under-reimbursements to consumers for out-of-network services for over a decade. The remaining \$1 million can be attributed to a one time fine paid in FY2009 by CIGNA Health Care of New Jersey, Inc. for sanctions in connection with consumer practices regarding nonrenewal of optional benefit riders for certain small employer health benefits plans;
- \$2.5 million (19%) in reduced revenue from the Insurance Special Purpose Assessment established pursuant to P.L.1995, c.156 and charged, on a proportional basis, to insurance carriers in the State for funding the activities of the Division of Insurance in regulating, monitoring and supervising these carriers. The anticipated revenue decrease is attributed to a similar decrease in the cost incurred by the State in regulating, monitoring and supervising the carriers;
- \$2.5 million (25%) in reduced revenue from the New Jersey Real Estate Commission which can be attributed to FY2010 being a non-renewal year of a two-year licensing schedule;
- \$860,000 (8.6%) in reduced revenue from the Banking Assessment established pursuant to P.L.2005, c.199 and charged to all financial entities the Division on Banking charters, licenses and registers for all services related to the division's financial regulation, supervision and monitoring of these entities. The anticipated revenue decrease is attributed to a similar decrease in the cost incurred by the State in regulating, monitoring and supervising these entities; and,
- \$440,000 (1.3%) in reduced revenue from the Insurance Fraud Prevention Assessment established pursuant to P.L.1983, c.320 and charged to all insurance carriers for all services related to the Office of Insurance Fraud located in the Department of Law and Public Safety. The anticipated revenue decrease is attributed to a similar decrease in the costs incurred by the State for these insurance fraud activities.

DIRECT STATE SERVICES

Salaries and Wages	\$34,846	\$31,059	(\$3,787)	(10.9%)	D-27
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The proposed budget includes a \$3.8 million (10.9%) reduction in funding for salaries and wages. This decrease reflects the elimination of 49 funded positions since FY2008. Although the proposed budget suggests a reduction of five positions between the current and next fiscal

Significant Changes/New Programs (\$000) (Cont'd)

<u>Budget Item</u>	<u>Adj. Approp. FY 2009</u>	<u>Recomm. FY 2010</u>	<u>Dollar Change</u>	<u>Percent Change</u>	<u>Budget Page</u>
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year, from 419 filled FTE's in January 2009 to 414 funded positions for FY2010, budget data indicates 463 positions were funded in FY2008 and funding for these positions was continued in the FY2009 budget. However, due to the early retirement initiative, attrition and hiring restrictions, these positions were eliminated during FY2009 and are not funded in the recommended FY2010 budget.

It is noted that the proposed reduction in salaries and wages for FY2010 will not result in savings to the General Fund, since the department is fully funded by fees imposed on the industries it regulates, and the budget further recommends that the department's decreased operating costs be reflected in reduced fees and assessments to banks, thrifts, and insurance companies. (See above: \$2.5 million reduction in the Insurance Special Purpose Assessment, \$860,000 in bank assessments and \$440,000 in the Insurance Fraud Assessment.)

As compared to the FY2008 position data and the FY 2009 adjusted appropriation levels, the reductions in salaries and wages are distributed to each program class as follows:

- Consumer Protection Services and Solvency Regulation - \$1.55 million (7.9%) and 21 positions;
- Actuarial Services - \$685,000 (10%) and 6 positions;
- Regulation of the Real Estate Industry - \$128,000 (3.9%) and 1 position;
- Public Affairs, Legislative and Regulatory Services - \$275,000 (11%) and 3 positions;
- Insurance Fraud Prevention - \$440,000 (1.4%) and 6 positions;
- Supervision and Examination of Financial Institutions - \$183,000 (5.5%) and 4 positions; and
- Administration and Support Services in the Office of the Commissioner - \$526,000 (12.6%) and 8 positions.

ALL OTHER FUNDS

**Consumer Protection
Services and Solvency
Regulation**

\$432	\$496	\$64	14.8%	D-28
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The FY2010 budget recommendation anticipates an increase of \$64,000 (14.8%) in revenue collected by the Small Employer Health Benefits Program established by P.L.1992, c.162 (C:17B:27A-17 et seq.).

The Small Employer Health Benefits Program is responsible for the administration and oversight of small employer health benefits plans in the State. The program is administered by the Small Employer Health Benefits Board, which may assess participating health insurance carriers for the costs of the operating expenses of the program (N.J.S.A.17B:27A-32). According to budget data, the board is anticipating a \$64,000 increase for salaries and wages for the Small Employer Health Benefits program that will be assessed to the industry.

Significant Changes/New Programs (\$000) (Cont'd)

<u>Budget Item</u>	<u>Adj. Approp. FY 2009</u>	<u>Recomm. FY 2010</u>	<u>Dollar Change</u>	<u>Percent Change</u>	<u>Budget Page</u>
Supervision and Examination of Financial Institutions	\$400	\$0	(\$400)	(100.0%)	D-28

The FY2010 Budget Recommendation anticipates a decrease of \$400,000 (100%) in appropriated receipts from Other Funds for the Supervision and Examination of Financial Institutions. These funds reflect revenue collected in excess of the amounts anticipated from examination and licensing fees, bank assessments, and fines and penalties imposed by the Division of Banking. While the department does not anticipate excess receipts in FY2010, as in prior years, language is included in the proposed budget which would authorize the appropriation of excess receipts, not to exceed \$400,000, which would be allocated to the division for operating expenditures, subject to the approval of the Director of the Division of Budget and Accounting. With the exception of \$22,000 in excess receipts which were appropriated in FY2008, the department has not appropriated excess receipts pursuant to this language for at least the last ten years.

Language Provisions

<u>2009 Appropriations Handbook</u>	<u>2010 Budget Recommendations</u>
No comparable language.	p. F-8 There is appropriated \$20,000,000 from the Workers Compensation Security Fund for transfer to the General Fund as State revenue.

Explanation

The recommended language provision authorizes the transfer of \$20 million from the Workers Compensation Security Fund (WCSF) to the General Fund as State revenue in FY2010.

According to data in the proposed budget (page H-12), the WCSF is estimated to collect \$21.8 million in total revenue in FY2010 for a total available balance of \$65.9 million. The year-end balance for the WCSF is estimated to be \$20.9 million in FY2010 inclusive of the recommended transfer, as compared to a year end balance of \$44.1 million in FY2009.

The WCSF (R.S.34:15-105) is a depository for monies received from assessments levied against mutual and stock insurance carriers writing workers' compensation insurance in the State. The revenue in the fund is disbursed to persons entitled to receive workers' compensation from a carrier when that mutual or stock carrier is determined to be insolvent.

<u>2009 Appropriations Handbook</u>	<u>2010 Budget Recommendations</u>
No comparable language.	p. F-8 Notwithstanding the provisions of any law or regulation to the contrary, there is appropriated from the Medical Malpractice Insurance Liability Premium Assistance Fund \$1,800,000 for transfer to the General Fund as State revenue.

Explanation

The recommended language provision authorizes the transfer of \$1.8 million from the Medical Malpractice Liability Insurance Premium Assistance Fund (MMLIPA) to the General Fund as State revenue in FY2010.

The proposed budget does not include a statement for the fund. However, in response to questions by the Office of Legislative Services during the FY2009 budget process, the department stated that a balance of \$276,839 remained in the account at year-end FY2008. Since that time, delinquent surcharge collections and investment income have increased the fund's available balances to approximately the amount proposed for transfer to the General Fund.

Language Provisions (Cont'd)

The MMLIPA (P.L.2004, c.17), which was authorized for a three year period, 2004 – 2007, was established to provide medical malpractice liability insurance premium relief for certain specialized health care providers in the State who experienced a liability insurance premium increase. Eligibility for relief was determined by class of practitioner, whose average medical malpractice premiums as a class were in excess of a particular amount per year, as established by the Commissioner of Banking and Insurance by regulation.

The MMLIPA was comprised of revenue collected from a \$3 annual surcharge paid on or by employees subject to the "unemployment compensation law" and a \$75 annual surcharge paid on the professional licenses of physicians, podiatrists, dentists, chiropractors, and attorneys, unless exempted under the law. The surcharges statutorily authorized to be deposited in the fund were discontinued on June 30, 2007.

Discussion Points

1. The Governor's budget incorporates an estimated \$5.183 billion over two fiscal years in federal stimulus funding provided by the American Recovery and Reinvestment Act (ARRA) of 2009. According to a table on page 42 of the Governor's abbreviated budget, the State will use \$3.074 billion (\$854 million in FY09 and \$2.220 billion in FY10) from ARRA for budget relief. In addition to these funds which will offset revenue shortfalls, \$2.109 billion will be used for new or expanded programs or initiatives. The ARRA allocates funds to states both by formula and by competitive grant awards. Most executive departments anticipate stimulus funding in either FY 2009, FY 2010 or both.

- **Question:** a. Please itemize the federal stimulus funding, if any, other than portions of the \$3.074 billion allocated for budget relief, included in the department's budget, by fiscal year and federal program, setting forth program goals and eligible uses, together with the amount for State administrative expenses and the amount for allocation to local public and private recipients, respectively. Please identify intended and actual recipients and the process by which the department determines recipients and funding awards. Are there ARRA funds that flow through your department for which the State has no discretion? Please also set forth the timetable for obtaining federal approval of funding, obligation and allocation of funding to recipients, and use by recipients. Could any of this funding be used to offset other State appropriations, and if so, what programs and in what amount? What additional positions, if any, have been and will be hired with these funds? If this money is being used for new or expanded activities, will the new or expanded activities be continued in FY 2011? If so, how will they be funded?

b. In addition to funding incorporated in the FY 2010 budget, what specific competitive grant opportunities has the department identified that it is eligible to pursue, has applied for, and has been awarded, respectively?

2a. Over the past several years, the overall staffing level in the Executive branch has been reduced through restrictions on hiring and an early retirement program. The proposed budget (page B-3) envisions continuation of the hiring restrictions coupled with possible furloughs or further reductions in positions. The Governor has proposed a schedule of once a month furloughs for State employees, beginning in May, 2009, resulting in an overall 5 percent wage reduction. The Treasurer, in his testimony to the Assembly Budget Committee on March 9, 2009, indicated that only select direct service and emergency responder employees would be exempt from the furlough requirements, regardless of funding source.

- **Question:** a. How has the reduction in staffing affected the department? What strategies has the department employed to adjust to staff reductions? What projects, work products or functions has the department discontinued or deferred because of staffing levels?
- b. Will the department be able to accommodate furloughs in FY2010 without increasing spending for overtime? What will be the effect of the furloughs on the assessments charged by the department to financial entities and insurers for services related to the department's regulation, supervision and monitoring of these entities?

2b. P.L.2008, c.21 (C.52:18A-248 et al) established an early retirement initiative (ERI) for certain State employees. The purpose of this legislation was to reduce the overall State payroll

Discussion Points (Cont'd)

and attain both short and long term savings through reduction of payroll and long term reduced pension costs. To maximize short and long term savings, the legislation imposed a limitation on hiring replacements for those who retire, limiting rehiring to 10 percent of the vacant positions Statewide. In response to the Office of Legislative Services' (OLS) questions during the review of the FY2009 budget, the department estimated that 64 department employees would accept the ERI. In fact, as of August 15, 2008, the Division of Pensions and Benefits in the Department of the Treasury reported that 35 persons employed by the department planned to retire under the ERI. The proposed budget indicates \$31.1 million dedicated to salaries and wages, a \$3.8 million reduction from FY2009. The majority of the Department of Banking and Insurance's budget is funded through assessments and fees.

- **Question:** How does the number of retirees in FY2008, FY2007 and FY2006 compare to the number of persons who retired under ERI in FY2009? How many positions is the department authorized to fill, under the State's 10 percent overall limit? What division and office in the department has experienced the highest number of retirees due to ERI? Have the corresponding assessments decreased by \$3.8 million to reflect the decrease in salary and wages?

2c. In response to OLS questions during the review of the FY2009 budget, the department stated that it planned to address any potential deficiencies created as a result of ERI that may affect the department's accreditation by national associations. In addition, the department stated that the ability of the Office of Consumer Finance, located within the department, to regulate mortgage lenders would be affected by the imposition of any early retirement initiatives. The department is currently accredited by the Conference of State Bank Supervisors and the National Association of Insurance Commissioners.

- **Question:** Please provide all current accreditations held by the department. Please detail the requirements for accreditations and how the department met these requirements in fiscal years 2007, 2008 and 2009. Are any of the department's accreditations currently at risk?

3. The FY 2009 appropriations act anticipated that \$25 million in procurement savings would be achieved by Executive departments. A chart on page 75 of the Budget in Brief categorizes those savings and indicates they will continue into FY 2010. The FY 2010 budget includes another \$25 million from procurement savings (Budget in Brief, Appendix I, page 8).

- **Question:** Please indicate the FY 2009 amount of procurement savings achieved by the department, by the categories set forth in the referenced table, and the sources of those savings by department program? What is the annual amount of these savings as continued into FY 2010? How have these reductions affected the department? What projects, work products or functions has the department discontinued or deferred in order to achieve these savings?

4. The proposed budget authorizes revenue solutions for FY2010, including the alternate use of other funds as detailed in the Budget in Brief (page 56). The proposed budget authorizes the transfer of \$20 million (page H-12) from the Workers' Compensation Security Fund (WCSF). The WCSF was established in the department to provide workers' compensation benefits to individuals in instances of a workers' compensation insurer becoming insolvent (R.S. 34:15-103 et seq.). The revenue for the fund is collected from an assessment applied to

Discussion Points (Cont'd)

all insurers writing workers' compensation business in the State equal to one per cent of each insurer's net written premiums.

- **Question:** Please provide an estimate for the revenue, expenditures and fund balance of the WCSF for FY2011 and FY2012. Does the department foresee any need to increase the assessment on workers' compensation insurers to ensure that the WCSF remains solvent?

5. The Troubled Asset Relief Program (TARP), which was signed into law on October 3, 2008, was created as part of the Emergency Economic Stabilization Act of 2008, Public Law No. 110-343, to address the nation's general economic downturn by injecting capital into and restoring consumer confidence in United States financial markets. Specifically, TARP which is administered by the newly created Office of Financial Stability (OFS), United States Department of the Treasury, was created to purchase assets and equity from financial institutions in order to strengthen that sector of the economy.

Originally, the primary focus of TARP was to purchase troubled mortgages and mortgage backed securities, but the U.S. Department of the Treasury determined that it needed to move more quickly to stabilize financial markets. Accordingly, on October 14, 2008, the Department of the Treasury announced it would make available \$250 billion of TARP funds, through a Capital Purchase Program, to inject capital directly into financial institutions by purchasing preferred stock in these institutions. TARP's Capital Purchase Program is intended to encourage financial institutions to increase lending to each other and to consumers and businesses. This increased lending or "loosening of credit" is part of a larger goal to restore order to financial markets and boost investor confidence.

Under the Capital Purchase Program, financial institutions were given the opportunity to apply for funds by the program's deadline of November 14, 2008. In order to participate in the program, financial institutions issued equity warrants or certain debt securities to the Treasury in exchange for the funds and agreed to certain conditions, largely concerning limits on executive compensation, designed to ensure proper use of the funds.

According to data kept by the Office of Financial Stability, between November 14, 2008 and February 6, 2009, 15 financial institutions based in New Jersey received over \$600 million in TARP funds through the Capital Purchase Program. The amount of funding ranged from \$3.7 million to \$300 million. Of these 15, ten are State chartered institutions and five are federally chartered. One of these financial institutions repaid all, \$89.3 million, of the funds it originally received through TARP back to the federal government on March 13, 2009.

- **Question:**
 - a. Is the department aware of any increased lending or availability of credit to consumers or businesses in the State, due to the funding from TARP's Capital Purchase Program? Please elaborate on any indicators or metrics used by the department to ascertain any such effects on the credit market.
 - b. To the extent the department is aware of any increased lending activity or availability of credit attributable to the TARP funding, has the increase occurred in the residential mortgage market, consumer loan market, commercial mortgage market, or business loan market?

Discussion Points (Cont'd)

6. In March, 2009, Realty Trac, an online marketplace for foreclosed properties (residential and commercial), released its February, 2009 U.S. Foreclosure Market Report. Reversing what has been the trend for the past year, foreclosures in New Jersey in February, 2009 decreased 41.4% from February, 2008. The decrease contrasts with the 101% increase in the total number of foreclosures in 2008 as compared to the total number experienced in the State in 2007. Data released by Realty Trac in April, 2009, indicate that the decrease in foreclosures may have been a temporary change. In March, 2009, foreclosures once again increased in the State, approximately 10% higher than those reported in February, 2009.

Industry analysts are unsure what caused the recent decline in foreclosures. There has been speculation that the federal government's "Making Home Affordable" plan initiated in November 2008 is having the desired effect of encouraging lenders to renegotiate the terms of some mortgages and thus decreasing the number of foreclosures initiated. The "Making Home Affordable" plan was established to facilitate the renegotiation of mortgage terms for individuals who were living in their homes and had not yet experienced foreclosure, but were experiencing a financial emergency, or had the current value of their home decrease below the amount owed on the mortgage. Under the "Making Home Affordable" plan, the Federal National Mortgage Association (more commonly referred to as Fannie Mae) and the Federal Home Loan Mortgage Corporation (more commonly referred to as Freddie Mac), are required to renegotiate the terms of the mortgages they have issued to qualified participants. Additionally, many other lenders have chosen to participate in the federal program. Lenders who voluntarily renegotiate mortgages with qualified borrowers are eligible for financial incentives offered by the federal government under the program.

Many homeowners who are renegotiating their loans have chosen to do so because they were initially placed into the subprime residential loan market. In that market, mortgage loans typically have higher interest rates, and tend to contain loan features that enhance the borrower's chance of default. The features include adjustable interest rates and low initial rates that reset much higher. Additionally, subprime loans are often issued with lower qualification requirements that do not adequately assess the borrower's ability to repay the mortgage over the term of the loan.

- **Question:**
 - a. Please comment on possible causes for the recent decrease in foreclosures in the State. Please provide the department's estimate of the future number of foreclosures in the State. Please discuss the department's current and future plans to address this continuing crisis.
 - b. Please detail how many residential mortgages issued by mortgage lenders in the State are considered "subprime." What percentage of total mortgages issued in the State and the nation does this represent? Please provide this detail for the three most recent years available.

7. The Office for the Development, Implementation, and Deployment of Electronic Health Information Technology in New Jersey (Office for e-HIT) was established in the department pursuant to P.L.2007, c.330 (C.17:1D-1 et al). The Office for e-HIT, in collaboration with the Health Information Technology Commission (HIT Commission), established in the Department of Health and Senior Services pursuant to Section 5 of P.L.2007, c.330 (C.26:1A-136), is responsible for developing, implementing and overseeing the operation of a Statewide health information technology plan.

Discussion Points (Cont'd)

The enabling statute authorized \$1 million in funding for FY2009 for the HIT Commission's budget from revenue collected by the Department of Banking and Insurance in the form of fines, sanctions and civil penalties and transferred that revenue to the Department of Health and Senior Services. The proposed budget again authorizes \$1 million (page C-14) for the HIT Commission in FY2010. However, there are no funds specifically appropriated for the Office for e-HIT.

The American Recovery and Reinvestment Act (ARRA) of 2009 provides guidance and funding for the promotion of Health Information Technology. Included in ARRA are incentive grants for Medicaid and Medicare providers as well as hospitals. In addition, there are numerous opportunities for states to access federal funds to create, implement, and promote various health information technology programs on the state and local level through programs established through the ARRA.

- **Question:** Please provide an update on the status of the Office for eHIT's activities and its collaboration with the e-HIT Commission. Please provide the budget for the Office for e-HIT for FY2009 and anticipated for FY2010. Please provide the department's current plans for accessing the federal funds available through ARRA to create, implement and promote health information technology programs on the state and local level.

8. The "New Jersey Home Ownership Security Act of 2002," P.L.2003, c.64 (C.46:10B-22 et seq.) (HOSA) directed the department to enforce prohibitions against certain predatory lending practices in the residential mortgage market. The act categorizes residential mortgage loans as "home loans" or "high-cost home loans," depending on the loan terms, and applies certain restrictions on lending practices to each category of loans. Generally, these restrictions are designed to prevent loan terms that present an unreasonable risk of the homeowner's ultimate default and resulting loss of equity in the home through foreclosure. In addition, the department was directed to implement, in consultation with the Divisions of Consumer Affairs and Civil Rights in the Department of Law and Public Safety, a program of consumer protection to protect vulnerable individuals from predatory lending practices. In its response to the OLS discussion points in the analysis of the FY2009 budget, the department reported on its activities under the HOSA consumer education program, including public education, partnering with community groups and in-school financial education presentations.

However, since the adoption of HOSA, there has been a Supreme Court decision and new federal legislation affecting the licensing and regulation of mortgage lenders, solicitors and bankers in the State and the nation. In the decision of Watters v. Wachovia Bank, N.A. the United States Supreme Court held that states are preempted from using their inspection and regulatory powers with respect to national banks and their operating subsidiaries. On the basis of this decision and prior opinion letters issued by federal regulatory agencies, it appears that any financial institution that is chartered on the federal level is exempt from HOSA regulation.

- **Question:** a. Please outline the status of the HOSA consumer education program established by the department, including: (1) a general description of the activities conducted through the program; (2) private sector partners in the program (3) the number of staff positions involved in implementing the program; (4) the average

Discussion Points (Cont'd)

number of public outreach efforts conducted annually as part of the program; and (5) funds dedicated to the program by department.

b. Please detail the number of financial institutions, including banks, mortgage lenders, solicitors and bankers that are licensed by the State for FY2007, FY2008 and thus far in FY2009. Please comment on the affect Watters v. Wachovia Bank, N.A. may be having on the State's regulation of banks and other financial institutions.

9. The federal "Housing and Economic Recovery Act of 2008" (Pub.L.110-289) was signed into law in July, 2008. Among other initiatives, the act included the "Secure and Fair Enforcement for Mortgage Licensing Act of 2008" (S.A.F.E. Act). The S.A.F.E. Act defines a loan originator as an individual who takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain. The act requires the states to participate in a nationwide mortgage licensing system and registry that will be established by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators. Each state's system must include, at a minimum, requirements that meet the established national standards for licensing loan originators. These requirements include, among other things, minimum education requirements, ethics training, background checks, proof of financial responsibility, bonding requirements and the successful completion of a written exam. In addition, the act establishes a mandatory nationwide registry of loan originators to provide for increased accountability and tracking of loan originators. The proposed "New Jersey Residential Mortgage Lending Act" (Senate Committee Substitute for S-470 approved by the Senate Commerce Committee on February 26, 2009 and A-3816, approved by the Assembly Financial Institutions and Insurance Committee on March 9, 2009) would require New Jersey's current regulatory scheme to conform to the requirements of the federal S.A.F.E. Act.

Pursuant to the current "New Jersey Licensed Lenders Act," N.J.S.A.17:11C-1 et seq., and the pending "New Jersey Residential Mortgage Lending Act" those persons engaged in the business of making, acquiring or selling mortgage loans are required to pay an application fee to the State for a new license or license renewal. In addition, pursuant to the S.A.F.E. Act, loan originators are required to pay a fee to be included in the nationwide system. Loan originators who are included in the nationwide system are not required to also be licensed by the State.

In addition to the S.A.F.E. Act's effect on the State licensing of loan originators, some reports indicate that the decision in Watters v. Wachovia Bank, N.A. has led to a decrease in the number of State licensed loan originators under the current Licensed Lenders Act which will continue under the pending "New Jersey Residential Mortgage Lending Act." The department currently collects revenue from loan originators through licensing fees established under the "New Jersey Licensed Lenders Act" that will be adjusted and continued in the pending "New Jersey Residential Mortgage Lending Act."

• **Question:** a. Please provide the number of individual loan originators and businesses which have been regulated, registered, and licensed by the State in FY2007, FY2008 and thus far in FY2009.

b. Please indicate how much the department anticipates collecting from each type of fee authorized under the "New Jersey Residential Mortgage Lending Act." Please indicate how much the department collected from each type of fee established under

Discussion Points (Cont'd)

the "Licensed Lenders Act," since its inception, reported by fiscal year. For each category of lender, please explain the differences between the fees collected in the past under the "Licensed Lenders Act" as compared to those anticipated to be collected under the "New Jersey Residential Mortgage Lending Act."

c. Please comment on the effect of Watters v. Wachovia Bank, N.A and the S.A.F.E. Act on the number of State licensed loan originators.

d. Please comment on any changes the department anticipates in regard to the assessment charged by the department to loan originators and businesses pursuant to P.L.2005, c.199 (C. 17:1C-33 et seq.) and the fees paid by loan originators and businesses to be included in the nationwide system.

10. P.L.2008, c.38 (C.30:4J-11 et al) implemented several reforms to the individual health insurance market to make these plans more affordable to individuals in the State. The law amended the New Jersey Individual Health Coverage Program (IHCP), P.L.1992, c.161 (C.17B:27A-2 et seq.), initially established to provide access to a broad choice of private health insurance products to any New Jersey resident who does not have access to employer-based or other group health coverage. The IHCP requires all carriers, as a condition of issuing health insurance in the State, to offer individual health benefits plans through the IHCP or pay a share of losses incurred by other carriers in that market. Pursuant to the 1992 act, the IHCP board created five standardized health benefits plans, which were guaranteed-issue and guaranteed-renewable. The 1992 act required all plans to be community rated, meaning that carriers cannot vary rates for the same policy based on health status, age, claims history, geographic location, or any other risk factor. However, since the mid-1990's, the IHCP market has experienced a steady increase in premium and a change in participation toward older and potentially higher risk insureds.

The reforms implemented through P.L.2008, c.38 are intended to make IHCP more affordable and therefore attractive to younger uninsured persons, by revising the rating system for individual plans for new policies and contracts. Under the changes, the IHCP premium rate can be set using a "modified community rating," which allows for a rating differential based on the age of the person covered under the plan. To protect consumers who are currently covered through IHCP, the act limits increases to premiums for the next four years and only allows a premium rate differential of 3.5 to 1 ratio between the lowest and highest rated plans. The act also allows carriers to offer a minimum of three plans, as opposed to the previously mandated five plans, and allows carriers to offer riders offering expanded coverage at an additional cost. Additionally, the reforms included a change in the loss ratio allowed for carriers from 75 percent to 80 percent, among several other changes. While the reforms eliminate the current cost sharing aspect of the individual market as of FY2008, the reforms require that a carrier must offer, and make a good faith effort to market, individual policies as a condition of participation in the small employer market.

- **Question:** a. Please update the Legislature on the IHCP program and what effect, if any, the changes implemented under P.L.2008, c.38 have had on the premium rates and participation levels of carriers under the IHCP. Please be specific as to the impact of "modified community rating;" the reduction in the number of mandated plans; the

Discussion Points (Cont'd)

ability to offer riders; the elimination of the cost sharing mechanism; and the increase in the loss ratio.

b. Please describe the details of the riders that have been developed and offered under the modified IHCP, including cost structure.

11. P.L.2001, c.368 (C.17B:27A-4.4 et seq.) requires health insurance carriers to offer a limited health care services plan through the IHCP. The Legislature's intent in establishing this plan, known as the Basic and Essential Health Care Services Plan (the "B&E Plan") was to create a plan that was more affordable, even though it is not as generous in coverage as the three "standard" plans. The act permits carriers to rate the B&E Plan by using factors for age, gender, and geographic location, but by no more than a 3.5 to 1 ratio between the highest and lowest rated plans.

- **Question:** Please comment on the effectiveness of the Basic and Essential Health Care Services Plan in providing affordable individual health insurance coverage and reducing the number of uninsured New Jersey residents. Is the B&E plan successful in attracting younger, lower risk individuals to purchase health insurance? How many of those that choose coverage with the B&E plan also choose to select a rider to that plan? Please describe the details of the riders that have been developed and offered under the modified B&E Plan, including cost structure.

12. Ten years ago, pursuant to the "Automobile Insurance Cost Reduction Act," (AICRA) P.L.1998, c.21, (C.17:29A-48) the commissioner was directed to establish standards, through regulation, for redrawing the (now) almost 60-year-old territorial rating plan used in determining automobile insurance premiums throughout the State, no later than January 1, 2000. In addition, the commissioner was to provide for a new system that would create an equalization system for automobile insurers to encourage them to write in all areas of the State, and replace the existing rate "caps."

In 2008, the department established the Territorial Rating Equalization Exchange (TREE) as an unincorporated association with a 12 member governing committee. The TREE governing committee developed a "Plan of Operation" approved by the commissioner in 2008. Pursuant to statute, the "Plan of Operation" must include a methodology for determination of the zip codes eligible for TREE reimbursement, methods and means for the collection, investment and disbursement of funds and a methodology for determination of the amount of the equalization charge.

The new territorial rating map was developed by the department in December 2007 and the department is currently reviewing the resulting rate filings from insurers providing automobile insurance in the State. The new rates will be evaluated as established in the "Plan of Operation" and be used by the department to ascertain the equalization system needed to maintain equitable access to insurance throughout the State.

- **Question:** Please provide the new territory map. Please provide the current status of the rate filing and approval process. Please provide the number of policies eligible for the equalization plan. Please provide a list of the current members of the TREE governing committee and the "Plan of Operation." Please discuss how the

Discussion Points (Cont'd)

department foresees the implementation of the TREE plan in the future, including the methodology for determining the average equalization charge.

13. The "Fair Automobile Insurance Reform Act of 1990," P.L.1990, c.8, (FAIR Act) enacted a comprehensive reform of automobile insurance regulation in the State. Section 27 of the FAIR Act, provided that no insurer be permitted to refuse to insure, refuse to renew, or limit coverage available for automobile insurance to an eligible person who meets its underwriting rules, as approved by the commission. This law, otherwise known as the "take all comers provision" expired on January 1, 2009. As of January 1, 2009, insurers no longer must accept all applicants for automobile insurance.

- **Question:** Please detail any consumer complaints that have resulted due to the expiration of the "take all comers provision." Please discuss the impact of the expiration of the "take all comers" law on New Jersey citizens' ability to access affordable automobile insurance.

14. In response to OLS discussion points for the FY2008 budget, the department explained that it had instituted a new system for the payment of various industry assessments and had collected \$92.3 million via a "lock box" system, whereby assessments are electronically deposited into a secure account maintained by a third party. The department asserted that the efficiencies gained by this system, along with the online processing and payment through a new insurance licensing system provided by the National Association of Insurance Commissioners, had resulted in reducing the fiscal staff by one third, saving \$67,800 in salary and benefits and resulting in \$60 million being deposited one day sooner in the State's General Fund. In addition, the department had begun electronically processing real estate transfers and terminations and hoped to begin implementing online processing and payment for the registration and termination of mortgage solicitors late last year.

- **Question:** Please indicate any additional cost savings the department attributes to this streamlined approach to fee and assessment collection. Please indicate what, if any, revenue increase occurred because the State collected those fees and assessments in a shorter time span. Please provide the cost of the lock box system and any future changes the department plans to implement to improve the efficiency of the collection of fees and assessments.

15. P.L.2005, c.199 (C.17:1C-33 et seq.), changed the way the Division of Banking (division) is funded. Beginning in FY2007, the division instituted an assessment on all financial entities it charters, licenses and registers for all services related to the division's financial regulation, supervision and monitoring of these entities. The division assesses the financial entities in two parts on, or around, October 1 of each year: a Licensing Banking Assessment and a Depositor Banking Assessment.

- **Question:** Please provide the amount of assessment charged to each entity, the assessment ratio and the total assessment charged for FY2007, FY2008 and estimated for FY2009. To maintain confidentiality, please identify the entity by industry type, being as specific as possible. Please compare the revenue collected under the assessment to the initial and annual renewal fees collected in the three years prior to the enactment of P.L.2005, c.199 (C.17:1C-33 et seq.).

Discussion Points (Cont'd)

16. P.L.1995, c.156 (C.17:1C-19 et seq.) established a special purpose apportionment for funding expenses incurred by the Division of Insurance in the department. The apportionment is charged to all insurers writing most classes of insurance in the State (including, but not limited to: property; fire; flood; vehicle; life and health; accident; title; death; credit; personal liability; malpractice; homeowners; and any other specified kinds of insurance) and those health maintenance organizations (HMOs), granted a certificate of authority to operate in New Jersey pursuant to P.L.1973, c.337 (C.26:2J-1 et seq.). This assessment is used for funding the activities of the division in regulating, monitoring and supervising these carriers. The apportionment of each carrier is based on the proportion that its net written premiums for the preceding calendar year bears to the combined net written premiums of all carriers in the preceding year, except that no carrier is required to pay an apportionment that exceeds 0.10 percent of its net written premium.

- **Question:** Please provide the amount of the special purpose apportionment assessed to each entity, the assessment ratio and the total apportionment for FY2007, FY2008 and estimated for FY2009. To maintain confidentiality, please use non-specific identifiers by carrier type and be as specific as possible.

17. In addition to the assessment referred to in Question #16 and the apportionment in Question #17, insurance carriers are assessed additional monies under several different statutes to reimburse the department for operating expenses, including the following:

- a. A tax of 0.1%, upon such taxable premiums of insurance carriers, except those that are life insurance companies, marine insurance companies, health maintenance organizations (HMOs), group accident and health insurance policies, and legal insurance policies must also be paid to the department for payment of administrative costs, pursuant to section 2 of P.L.1945, c.132 (C.54:18A-2). This revenue is deposited in the General Fund and then returned to the department for operating expenses.
 - b. A tax of 0.05%, upon such taxable premiums of group accident and health insurance policy and legal insurance policy carriers, must be paid to the department for payment of administrative costs, pursuant to section 2 of P.L.1945, c.132 (C.54:18A-2). This revenue is deposited in the General Fund and then returned to the department for operating expenses.
 - c. An assessment on insurers for all services related to the department's fraud prevention expenditures, pursuant to P.L.1983, c.320 (C.17:33a-1 et seq.).
 - d. An assessment on all Small Employer Health Insurance (SEH) carriers for the reasonable and necessary organizational and operating expenses of the SEH board of directors pursuant to section 16 of P.L.1992, c.162 (C.17B:27A-32).
 - e. An assessment on all Individual Health Care (IHC) carriers for the reasonable and necessary organizational and operating expenses of the IHC Program board of directors pursuant to section 10 of P.L.1992, c.162 (C.17B:27A-11).
- **Question:** Please provide an accounting of all assessments collected by the department for FY2007, FY2008 and estimated for FY2009. To maintain

Discussion Points (Cont'd)

confidentiality, please use non-specific identifiers by carrier type and be as specific as possible. Please detail this information by assessment source, as detailed above.

18. In the department's testimony to the Senate Budget and Appropriations Committee during the FY2009 budget hearings, the department addressed the issue of fines levied and recoveries collected for consumers by the department. In a follow up question submitted to the department on behalf of Senator O'Toole, the department provided a detailed inventory of the recoveries collected and fines levied by the department for FY2006, FY2007, FY2008.

- **Question:**
 - a. Please provide an inventory of all recoveries for consumers collected by the department for FY2007, FY2008 and thus far in FY2009. Please detail this information by division. Please discuss any challenges faced when making these recoveries, including the average time needed to make a recovery.
 - b. Please provide a detailed inventory of the fines levied and fines collected by the department for FY2007, FY2008 and thus far in FY2009. Please detail this information by division and by cause by industry. Please discuss any challenges faced when collecting these fines, including the average time before collection.

19. Over the past 20 years, there have been numerous extreme weather events in the United States; for example, Hurricane Andrew in Florida, Hurricane Iniki in Hawaii, and Hurricane Katrina along the Gulf Coast. In addition, industry experts, using catastrophic modeling, predict that the Northeast part of the country is statistically likely to endure a catastrophic weather event in the relatively near future. The combination of these weather events and the experts' warnings, have led insurance companies to exercise increased caution in writing new policies in coastal areas and to apply stricter standards to the type and condition of homes they would insure.

In response to OLS discussion points for the FY2009 budget, the department stated that 80 companies were writing homeowners insurance throughout the State at that time. This is 18 less (23%) companies than the department confirmed were writing homeowners insurance in FY2008. Additionally, the department indicated that five of these companies had advised the department that they were no longer writing business in the coastal areas of the State. In 2006, State Farm stopped writing new homeowners insurance in coastal areas of the State and in 2007, Allstate did likewise.

- **Question:**
 - a. Please define the coastal area and detail any changes made to this defined area since 1990.
 - b. Please provide for the State as a whole, for the years 1995 through the latest year available, the total number of insurers offering homeowners insurance policies in the State, and the percentage of total market share each of these insurers represent. Please indicate the number of these insurers who may write current policies but are not accepting new homeowners policies.
 - c. Please provide for the coastal area (as defined by the department), for the years 1995 through the latest year available, the total number of insurers offering homeowners insurance policies in the State, and the percentage of total market share each of these insurers represent. Please indicate the number of these insurers who

Discussion Points (Cont'd)

may write current policies but are not accepting new homeowners policies for homes in the coastal area.

d. Please indicate what efforts the department is making to address the affordability and availability of homeowners insurance in coastal areas of New Jersey. Have any additional insurers indicated any intention to stop writing in the State? What are the reasons for the decrease in the number of insurers offering homeowners insurance in the State?

20. The "New Jersey Medical Care Access and Responsibility and Patients First Act," P.L. 2004, c.17 (the Act), provides a comprehensive set of reforms affecting the State's tort liability system, health care system, and medical malpractice liability insurance carriers. The Medical Malpractice Liability Insurance Premium Assistance Fund (MMLIPA), established by the Act, collected revenue from 2004 through 2007. The fund's purpose was to provide medical malpractice liability insurance premium relief for certain specialized health care providers in the State who experienced a liability insurance premium increase. Eligibility for the relief was determined by class of practitioner, whose average medical malpractice premiums as a class was in excess of a particular amount per year, as established by the Commissioner of Banking and Insurance by regulation.

The MMLIPA fund was comprised of revenue collected from a \$3 annual surcharge paid on or by employees who are subject to the "unemployment compensation law" and \$75 annual surcharges paid on the professional licenses of physicians, podiatrists, dentists, chiropractors, and attorneys, unless exempted under the law.

The MMLIPA fund, which stopped collecting revenue on June 30 2007, was administered by the department. In response to questions by OLS in the FY2009 budget, the department stated that a balance of \$276,839 remained in the account from FY2008. Additional revenue, totaling \$414,863 was collected in FY2008 through employee surcharges, assessments, and attorney fees. The department stated that these funds were not transferred to the MMLIPA fund as the program had expired.

The FY2010 proposed budget does not include a statement of the MMLIPA fund and the FY2009 proposed budget included data (page H-20) indicating that the fund would have a zero balance in FY2009. However, the Governor's proposed budget includes a language provision that transfers \$1.8 million from the MMLIPA fund to the General Fund as revenue for FY2010 (page C-9).

- **Question:** Please detail the source of the funds that are to be transferred from the MMLIPA fund to the General Fund pursuant to the Governor's proposed budget. Please provide an estimate for revenue to be received by the fund for FY2009, FY2010 and FY2011.

Background Paper: Horizon Blue Cross Blue Shield of New Jersey Conversion Opportunity

INTRODUCTION

On June 29, 2001, Governor DiFrancesco approved legislation, P.L.2001, c.131 (C.17:48E-49 et seq.), authorizing the conversion of Horizon Blue Cross Blue Shield of New Jersey (Horizon) from a nonprofit health service corporation to a for-profit domestic stock health insurer. The changing nature of the health care delivery system in this country has impacted Blue Cross Blue Shield insurers nationwide. In some instances, these insurers have struggled to remain effective, given the emphasis on managed care and increasing price competition among commercial insurers and health care providers. Horizon, if it converts, would join several other carriers from the nonprofit health insurance industry: since 1996, no less than 24 Blue Cross Blue Shield insurers in various states have either converted to for-profit status or have merged with or been acquired by for-profit corporations.

Current Status

On August 15, 2008, Horizon submitted to the Commissioner of Banking and Insurance and the Attorney General for review, pursuant to the provisions of P.L.2001, c.131, a conversion application. This application is currently under review, and will be subject to many statutory requirements before it can be deemed complete by both the Commissioner and the Attorney General. Once deemed complete, the application can move forward with the conversion process set forth under P.L.2001, c.131, as highlighted on page 4 of this background paper.

Horizon's Social and Financial History in New Jersey

Established in 1932, the Associated Hospitals of Essex County (later known as Blue Cross) began operations as the first multi-hospital pre-payment system in the country. At that time, this pre-paid hospital plan was an innovative way to meet the needs of citizens for affordable, accessible health care. Ten years later, Blue Shield was established as the Medical Surgical Plan of New Jersey to provide coverage for medical and surgical costs. Much later, in 1973, Blue Cross established the first health maintenance organization (HMO) to operate in New Jersey.

Most Blue Cross and Blue Shield insurers across the nation were first established as not-for-profit entities and granted charitable charters at the state level. Blue Cross and Blue Shield insurers offered health insurance coverage to anyone who desired it, regardless of health status, and utilized community rating¹ to set uniform premium rates for local residents who enrolled in the plans. In most instances, these insurers received special tax and regulatory treatment in exchange for this nonprofit community-service mission.

While in the past Horizon had enjoyed a unique status in this respect, certain legislative reforms and market conditions resulted in major financial deficits for the company by the mid-1980s. As New Jersey's "insurer of last resort," the company provided health benefits coverage to otherwise "uninsurable" or high-risk individuals at affordable rates. However, this mandate of social responsibility had a negative impact on the company's bottom line. In 1985, as assets fell short of liabilities and estimates of potential future claims by \$278 million, the Legislature enacted P.L.1985, c.236 (C.17:48E-1 et seq.), authorizing the merger of Blue Cross and Blue Shield to address

¹ Community rating" means a rating system in which the premium for all persons covered by a contract is the same, based on the experience of all persons covered by that contract, without regard to age, sex, health status, occupation and geographical location.

Background Paper: Horizon Blue Cross Blue Shield of New Jersey Conversion Opportunity (Continued)

the company's financial difficulties. The merged Blue Cross Blue Shield entity is referred to under this 1985 enabling legislation as a "health service corporation."

Horizon's overall presence in the New Jersey health insurance marketplace is significant. According to the company, Horizon currently provides health care coverage to over 3.5 million people, which represents approximately 45 percent of the insured population in this State. Through the establishment of HMO subsidiaries, Horizon has continued to expand its participation in the State's Medicaid and NJ FamilyCare plans and the federal government's Medicare Advantage plans. In addition, Horizon covers approximately 65 percent of individuals purchasing health insurance through the Individual Health Coverage Program (IHCP) (compared to 60 percent in 2003), and holds an approximately 49 percent market share in the small employer marketplace (compared to 30 percent in 2003). Over the course of this decade, as other health insurance carriers exit both the individual and small employer marketplace, Horizon has increased its coverage of these populations.

However, Horizon, under its current organizational structure, is restricted from generating significant funds for capital expenditures through premium increases. In order to avoid having to resort to substantial premium increases for its policyholders, the company, through the enactment of P.L.2001, c.131, first sought the legal authority to issue stock and become a publicly traded company. As discussed in more detail below, the law established a comprehensive statutory structure in the event that Horizon (or any future health service corporation established in this State) elects to convert to a for-profit, stock issuing entity.

Approximately six months after the enactment of P.L.2001, c.131, a December 14, 2001 press release issued by Horizon stated that the Board of Directors authorized management to explore the process of converting the company to a for-profit corporation. While there was no immediate plan in December 2001 to exercise the conversion option, the legislation then provided, and continues to provide, Horizon with an additional means of meeting its substantial future financial responsibilities through access to the equity markets as an alternative to passing these costs on to policyholders. As such, a major determinant with regard to a conversion would appear to be the market conditions for the purchase and exchange of health insurance stocks.

THE CONVERSION TO FORPROFIT STATUS

Determination of Horizon's Charitable Status

The conversion statutes provide that Horizon must establish a charitable foundation and contribute to it the entire fair market value of the company at the time of the conversion to satisfy, on behalf of the people of the State, the former charitable obligations of the converting, for-profit corporation. Previously, in 1995, the Legislature enacted, P.L.1995, c.196 (C.17:48E-45 et seq.), authorizing the company to convert to a domestic mutual insurer, without mandating the transfer of any value to a charitable foundation for the benefit of the public. Under this form of corporate structure, the individual policyholders, rather than stockholders, would be the owners of the company.

However, a conversion to a mutual insurer never occurred. In 1997, Horizon proposed taking over Blue Cross Blue Shield of Delaware and then merging the combined operation into Anthem Insurance, an Indiana-based holding company that then owned Blue Cross Blue Shield insurers in three states. That proposed plan collapsed amid charges that the plan gave charitable assets away to Anthem that belonged to the people of New Jersey; the New Jersey Attorney General had determined Horizon was a charitable organization and therefore some type of transfer of its charitable

Background Paper: Horizon Blue Cross Blue Shield of New Jersey Conversion Opportunity (Continued)

purpose and assets for the benefit of the State would need to occur with the sale or conversion of Horizon.

The State's authority over the purpose and valuation of a private charitable organization derives from the legal doctrine of cy pres, a Norman French phrase meaning "as close as possible." Pursuant to common law principles, a charitable organization that changes its function or tax status must utilize its assets for a purpose as close as possible to the original one. In light of this legal doctrine and the experience in other states, including California, North Carolina, Missouri and Georgia, where not-for-profit Blue Cross Blue Shield insurers sought to reorganize their corporate structures with little or no state oversight, the Legislature included several key provisions in New Jersey's 2001 law.

Based upon the "Model Act for Nonprofit Healthcare Conversion Transactions," drafted by the National Association of Attorneys General, these provisions require, among other safeguards, that Horizon establish a charitable foundation to expand access to affordable, quality health care for underserved individuals and promote fundamental improvement in health status for all New Jersey citizens. The foundation is required to be separate and independent of Horizon, and to acquire 100 percent of Horizon's fair market value, as determined by an independent appraiser.

Pre-Conversion Requirements

The following must occur before a conversion can take place:

- the filing of a plan of conversion with the Commissioner of Banking and Insurance and Attorney General at least 120 days prior to the proposed conversion date (which includes a requirement for a description of the manner in which the fair market value of the company will be transferred to the charitable foundation);
- the filing of documentation with the commissioner which details, among other items, the business plan of the converted, for-profit company, including five-year financial projections, and a comparative premium rate analysis of all policies for the period of three years before the conversion filing and the period of three years following the proposed conversion; and
- the filing of a petition for review of the foundation plan with the Attorney General.

In February 2003, the Rutgers Center for State Health Policy issued a report entitled "Sustaining the Charitable Mission of Horizon Blue Cross Blue Shield after Conversion to a For-Profit Corporation: Issues and Best Practices" (see: <http://www.cshp.rutgers.edu/Downloads/340.pdf>). The Rutgers publication provided an overview of Blue Cross Blue Shield conversions to date and offered suggestions for the conversion of Horizon, so this conversion could avoid the pitfalls and criticisms articulated by consumers and other advocates in relation to conversions in other states.

Asset Valuation

Certain previous conversions of Blue Cross Blue Shield insurers that occurred in other states came under criticism and some were even reexamined by insurance regulators or Attorneys General because their charitable assets were severely undervalued or a fair market valuation did not take place. In light of these oversights, New Jersey's law includes a fair market valuation requirement and a description of the manner in which the fair market value of the company shall be transferred to the charitable foundation. While the conversion statutes established by P.L.2001, c.131 do not specify the manner in which the asset valuation is to occur, the Rutgers publication identifies three generally accepted accounting methods

Background Paper: Horizon Blue Cross Blue Shield of New Jersey Conversion Opportunity (Continued)

of asset valuation, any one of which the appointed independent appraiser required for the conversion may utilize for a Horizon valuation:

- a comparative market transaction, which estimates worth in comparison to the asset value of comparable companies;
- a reproduction/replacement cost, which calculates the cost of replacing all assets, minus depreciation costs and liabilities; and
- an income/discounted cash flow approach, which involves future projections with discounts made to the present value.

In determining fair market value, consideration is required to be given to value as a going concern, market value, investment or earnings value, net asset value and a control premium, if any. With respect to Horizon, its value will not only include its tangible assets, such as provider contracts and subscriber lists, but will also include such intangible assets as the traditional Blue Cross and Blue Shield trademarks and company goodwill. The February 2003 Rutgers publication noted that the Blue Cross and Blue Shield trademarks are among the most widely recognized corporate trademarks in the United States.

Horizon's annual revenue, as listed in the most recently available annual report, covering 2007, reached \$7.5 billion. Horizon's current net worth may range between \$1 billion and \$4 billion, based on several June 2008 published newspaper reports, although these reports do not indicate a source for such estimates. These reported amounts, however, represent an increase over the value of \$921 million estimated by a May 2005 Duke University health policy analysis titled "Horizon Blue Cross Blue Shield of New Jersey: The Benefits, Costs, and Equity of a For-Profit Conversion," which utilized financial information from Horizon's 2003 annual report to make its estimate.

Public Hearings and Final Approval

Prior to any conversion, P.L.2001, c.131 requires that the Commissioner of Banking and Insurance hold a public hearing on the proposed plan of conversion, and the Attorney General also hold at least one public hearing concerning the proposed foundation. A joint public hearing addressing both issues may instead take place, if the commissioner and Attorney General so agree.

Any hearing shall be in the nature of a legislative hearing and any person wishing to make comments and submit information may file written statements with the commissioner on the conversion plan and with the Attorney General on the foundation plan. In addition, members of the public may appear and be heard at any hearing. In this manner, the commissioner is required to receive comments and information from the public for use in making the final decision to approve or disapprove the plan of conversion.

With respect to the Attorney General's separate review of the foundation plan, the conversion statutes further authorize the Attorney General to subpoena additional information or witnesses, including, but not limited to: information about any transaction that is collateral to the proposed conversion and any related documents; require and administer oaths; require sworn statements; take depositions; and use related discovery procedures. These actions are available to serve the purposes of any public hearing and for use at any time prior to the completion of the review of the proposed conversion.

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Once the Attorney General concludes the review of the foundation plan, Horizon is then required to obtain court approval of the establishment of the foundation. In that action, the Attorney General shall advise the court whether he supports or opposes the foundation plan.

Establishment of a Health Service Corporation Conversion Temporary Advisory Commission

To assist with the proposed conversion by Horizon, P.L.2001, c.131 established a 15-member Health Service Corporation Conversion Temporary Advisory Commission (Advisory Commission) in, but not of, the Department of Treasury. The purpose of this Advisory Commission is to examine issues related to access to affordable, quality health care for underserved individuals and promoting fundamental health improvements in New Jersey, and it may additionally review experiences in other states related to the establishment of foundations resulting from the conversion of similarly organized not-for-profit health insurers. Its members include representatives from community groups that provide or assist in providing health care services in New Jersey, the hospital, physician, dental and other health care provider communities, organized labor, and members of the public.

As part of its task, the Advisory Commission will help develop the charitable focuses of the foundation. The February 2003 Rutgers publication indicates that, to date, the majority of charitable foundations established in conjunction with other Blue Cross Blue Shield conversions have concentrated their charitable efforts by making grants for direct health care initiatives. In addition, some foundations have broadened their mission beyond assisting in the provision of direct care, to include initiatives regarding improvements to the general well being of a population.

The conversion statutes provide that all Advisory Commission members are direct appointments by the Governor, or by the Majority and Minority Leadership in each House of the Legislature. Additionally, these statutes, as amended by P.L.2001, c.387 (only amending C.17:48E-68), provide that the appointed members of the commission in place at the time of conversion will continue as the initial board of directors of the charitable foundation. All 15 members of the Advisory Commission were appointed between 2001 and 2002; however, the commission is not currently active and has not filed any reports with the State on its work.

CONCLUSION

As addressed in the beginning of this paper, Horizon has begun the process of converting to a for-profit entity. The length of time needed for the conversion process to be complete is uncertain and is governed both by statutorily required processes and the time needed for the parties involved to conduct thorough research and to provide adequate public input.

First, the different portions of the application, submitted on August 15, 2008, must be deemed complete by the Commissioner of Banking and Insurance and the Attorney General. Completion is dependent upon a thorough review by each official, not on an established time table. When, and if, the entire application is deemed complete, P.L.2001, c.131 requires at least one public hearing to be held within 90 days of the completion of the application regarding the conversion plan by the Commissioner of Banking and Insurance. Additionally, the Attorney General must also hold at least one public hearing concerning the proposed foundation within 90 days of the completion of the application regarding the foundation. One, or more, joint public hearings addressing both the issue of conversion and the foundation may instead take place, if the commissioner and Attorney General so agree. Page 4 of this paper, details some of the actions that

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may take place in connection with these hearings. The actions may take considerable amounts of time and may cause the hearing process to be elongated.

Following the one or more public hearings, and the conclusion of any further review of the foundation plan by the Attorney General, Horizon is then required to obtain court approval of the establishment of the foundation. Court approval is not limited to any time frame and may also take considerable time dependent upon the actions of the Attorney General and other interested parties during the court proceedings.

As Horizon continues to actively pursue a for-profit conversion, it will surely be closely monitored by consumer and health care advocates, given the experiences of conversions of Blue Cross Blue Shield insurers in other states.

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Individuals wishing information and committee schedules on the FY 2010 budget are encouraged to contact:

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