ANALYSIS OF THE NEW JERSEY

FISCAL YEAR 1999 - 2000 BUDGET

DEPARTMENT OF BANKING AND INSURANCE

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

MARCH 1999

NEW JERSEY STATE LEGISLATURE

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DEPARTMENT OF BANKING AND INSURANCE

Budget Pages....... C-7, C-15, D-27 to D-33, G-2, I-17, I-40, I-43

Fiscal Summary ($000)

	Expended FY 1998	Adjusted. Appropriation FY 1999	Recommended FY 2000	Percent Change 1999-00
State Budgeted	$40,140	$57,908	$58,745	1.4%
Federal Funds	0	0	0	—
Other	38,253	37,617	37,617	0.0%
Grand Total	$78,393	$95,525	$96,362	0.9%

Personnel Summary - Positions By Funding Source

	Actual FY 1998	Revised FY 1999	Funded FY 2000	Percent Change 1999-00
State	558	469	534	13.9%
Federal	0	0	0	—
Other	4	4	5	25.0%
Total Positions	562	473	539	14.0%

FY 1998 (as of December) and revised FY 1999 (as of September) personnel data reflect actual payroll counts. FY 2000 data reflect the number of positions funded.

Introduction

The Department of Banking and Insurance's primary responsibilities are the regulation and monitoring of the banking and insurance industries. The Division of Banking is charged with the chartering, licensing and supervision of banks, savings and loans, and a wide range of other financial institutions and firms responsible for consumer finance in this State. The Division of Insurance monitors and examines the policies, practices and financial condition of insurance companies, and licenses and regulates insurance producers. The division also monitors the business activities of real estate brokers and agents. The two divisions were formerly distinct departments, and were consolidated into the current Department of Banking and Insurance in FY 1997.

Key Points

- The Governor's FY 2000 Budget proposes to increase State funding for the Department of Banking and Insurance by $837,000, or 1.4 percent, over the current fiscal year. The department is fully funded by the industries it regulates.

- The department's funding increase provides an additional $254,000 for banking related functions and $583,000 for insurance related functions. The bulk of this funding would be utilized for the hiring of 22 new staff within the department, according to the Office of Management and Budget.

- For banking functions, funding would be utilized to establish five new positions in the Division of Enforcement and Licensing, Office of Consumer Finance ($149,000) and one new auditor position in the Division of Examination ($32,000).

- For insurance functions, 13 new positions would be established in the Division of Enforcement and Licensing. Seven positions would focus on financial examinations ($281,000), while six positions would focus on enforcement and consumer protection ($193,000). According to the Office of Management and Budget, these positions are necessary due to increased workload resultant from the "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21, which is intended to produce a 15% roll back in auto insurance rates in 1999. In addition to these positions, three new actuarial staff would be hired in the Division of Actuarial Services ($109,000).

- Schedule I revenues for the department indicate an estimated $13.5 million in revenues from the "Special Purpose Assessment" in FY 2000 and an estimated $13.4 million in revenues from this insurance industry assessment in FY 1999. However, these revenue figures are predicated on the assumed passage of legislation, which the Office of Management and Budget indicates will be proposed by the administration, that would modify the growth cap placed on the Special Purpose Assessment pursuant to section 13 of P.L. 1995, c. 156 (C.17:1-31).

- Without legislation to modify the statutory cap, revenues for the Special Purpose Assessment will fall approximately $727,000 million short of the Budget proposal projections in FY 1999 and $1.4 million short in FY 2000, according to the Department of the Treasury. Budget language requires that in such an instance, the appropriation from this source to the department must be reduced.

- The proposed Budget continues funding for the Ombudsman Program at $766,000. However, according to the department, the Ombudsman has not yet been appointed as of the date of this printing. The Office of the Ombudsman was established pursuant to the "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21 to investigate consumer complaints regarding the disposition of claims settlements.

- While appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department, these functions have actually been transferred to the newly established Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety pursuant to P.L. 1998, c.21. These appropriations remain within the department's display because they are still funded through insurance industry assessments. All but $1.4 million of the $27.2 million appropriated for this purpose will be expended by the Department of Law and Public Safety. The $1.4 million will be utilized to fund the Division of Anti-Fraud Compliance within

Key Points (Cont'd)

the Department of Banking and Insurance.

! The recommended appropriation from "all other funds" is \$37.6 million, the same level as in FY 1999. Of that total, \$37.3 million represents assessments imposed to cover shared program losses related to the New Jersey Individual Health Coverage Program, P.L. 1992, c.161 (C.17B:27A-2 et seq.). Budget language authorizes this program to operate from receipts.

Background Paper:

The Financial Insolvency and Liquidation of HIP Health Plan of New Jersey .... p. 17

Program Description and Overview

The Department of Banking and Insurance's primary responsibilities are the regulation and monitoring of the banking and insurance industries. The Division of Banking is charged with the chartering, licensing and supervision of banks, savings and loans, and a wide range of other financial institutions and firms responsible for consumer finance in this State. The Division of Insurance monitors and examines the policies, practices and financial condition of insurance companies. The Division of Insurance also monitors the business activities of real estate brokers and agents. Pursuant to P.L. 1996, c.45 (C.17:1-13 et seq.) the former Department of Banking and Department of Insurance were merged in FY 1997 to form the current Department of Banking and Insurance.

Division of Banking

The Division of Banking is responsible for the chartering, licensing and supervision of commercial and savings banks, savings and loan associations, limited trust companies and credit unions. The division is also responsible for licensing, examining and supervising a number of other financial service entities, including, but not limited to: licensed lenders (mortgage bankers and brokers, mortgage solicitors, consumer lenders, secondary mortgage lenders and sales finance companies); money transmitters and foreign money transmitters; insurance premium finance companies; pawnbrokers and check cashers.

The division consists of two offices. The Office of Depositories conducts examinations of State-chartered banking and savings and loan institutions, and it takes enforcement action if it discovers any violations of banking statutes or regulations. It also processes and reviews applications by depository institutions for new charters, branches, relocations, plans of acquisition, mergers, bulk sales, stock conversions and auxiliary offices. The Office of Consumer Finance examines and, when appropriate, takes enforcement actions against the other entities regulated by the division and also investigates complaints filed by consumers.

In its oversight function, the division works closely with the Federal Deposit Insurance Corporation (the deposits of all chartered institutions are insured under FDIC); the Board of Governors of the Federal Reserve System, which oversees State chartered banks which are members of the Federal Reserve system; and the federal Office of Thrift Supervision (OTS), which oversees savings and loan associations. State-chartered commercial banks which are members of the Federal Reserve System are examined on an alternating basis by the division and by the Federal Reserve. The division shares information with the OTS to determine whether State examinations of certain State-chartered savings and loan associations are necessary.

While the primary functions of the Division of Banking have not changed significantly in recent years, its responsibilities and workload have changed as a consequence of a significant number of new bank charters, the need to examine financial institutions for Year 2000 (Y2K) readiness, additional categories of licensure, and changes in State and federal laws and regulations. For example, the passage of the following federal laws has significantly increased the division's workload, as well as its staff training requirements: the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA); the Truth in Savings Act; the Federal Deposit Insurance Corporation Improvement Act of 1991; amendments to the Bank Secrecy Act concerning money laundering; the Community Reinvestment Act; and, most recently, passage of both federal (the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994) and State interstate banking and branching laws. Other changes in State law, such as the "New Jersey Money Transmitters Act," P.L. 1998, c.14(C.17:15C-1 et seq.) and major changes to the law under which credit unions are chartered and regulated; as well as changes requiring depository institutions to offer basic low-cost checking accounts; allowing for State-chartered mutual savings banks; and permitting State-chartered capital

Program Description and Overview (Cont'd)

stock savings and loan associations to convert their charters to State-chartered capital stock savings banks, have added to the department's responsibilities.

Also included within the division is the Pinelands Development Credit Bank, which is empowered to purchase and sell development rights in the Pinelands region. The intent of the program is to facilitate both the preservation of resources of the Pinelands area and the accommodation of regional growth influences in an orderly fashion.

Division of Insurance

The Division of Insurance is responsible for regulating and monitoring the policies, practices and financial condition of the State's insurance industry. According to the department, the division has direct regulatory responsibility over approximately 89 domestic insurance companies, 77,000 licensed producers and 510 public adjusters. In addition, the division works in conjunction with the Department of Law and Public Safety to enforce insurance fraud laws, administers the Unsatisfied Claim and Judgement Fund, regulates the training and licensing of real estate agents and brokers and investigates consumer inquiries or complaints regarding these industries.

Over the past several years, the division's responsibilities have been expanded and revised as a result of statutory changes and as a result of major events and changes within the insurance industry. For example, pursuant to the Governor's Reorganization Plan No. 007-1998, resultant from the "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21, certain investigative functions and personnel focusing on insurance fraud were transferred from the Department of Banking and Insurance to the newly established Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety. The Division of Insurance reassigned certain fraud-related staff that were not transferred out of the department to a newly established Division of Anti-Fraud Compliance, which will now, according to the department, be able to reach a greater part of the insurance industry for audit and compliance matters, as well as increase insurance industry training. In addition, the division will continue to track civil penalties imposed by the State's insurance fraud investigators and take necessary steps to collect on delinquent or past due accounts. Also, an Ombudsman's office was established in the division to investigate consumer complaints.

The Division of Insurance engaged in significant efforts in the current fiscal year to protect consumers of certain health maintenance organizations facing serious financial difficulties. The division, pursuant to Order No. A98-134, placed HIP of New Jersey under administrative supervision in September 1998 after discovering that HIP showed a negative $9.5 million statutory net worth. The Middlesex County Superior Court recently agreed to the department's plans to liquidate HIP. The division has also been overseeing the day-to-day operations of American Preferred Provider Plan (APPP) since October and has found the company to be insolvent by more than $22 million. According to newspaper reports, APPP will also be liquidated by the department. The administrative supervision and liquidation of these companies has involved a number of supervisory activities, as discussed in the background paper on page 17.

The "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21, which is designed to produce a 15% roll back in rates in 1999, has required the division to develop medical protocols for personal injury protection medical expense benefits, a new arbitration system, a new buyer's guide and coverage selection forms, and to monitor implementation of new basic automobile insurance policies and personal injury protection limits and coverage.

In addition, issues surrounding affordable health insurance, accessibility of certain insurance

Program Description and Overview (Cont'd)

products, increased competition, mergers and acquisitions, the aging of the population, and other factors have required the division to expand and modernize its resources.

The Recommended FY 2000 Budget

The department's recommended FY 2000 Budget, consisting of $58.7 million in Direct State Services funding and $37.6 million in "all other" funds, represents an increase in funding of less than one percent over the current fiscal year. The bulk of the $37.6 million in "all other" funds in the department's budget represents insurance industry assessments imposed to cover shared program losses related to the New Jersey Individual Health Coverage Program, P.L. 1992, c.161. Budget language authorizes this program to operate from receipts.

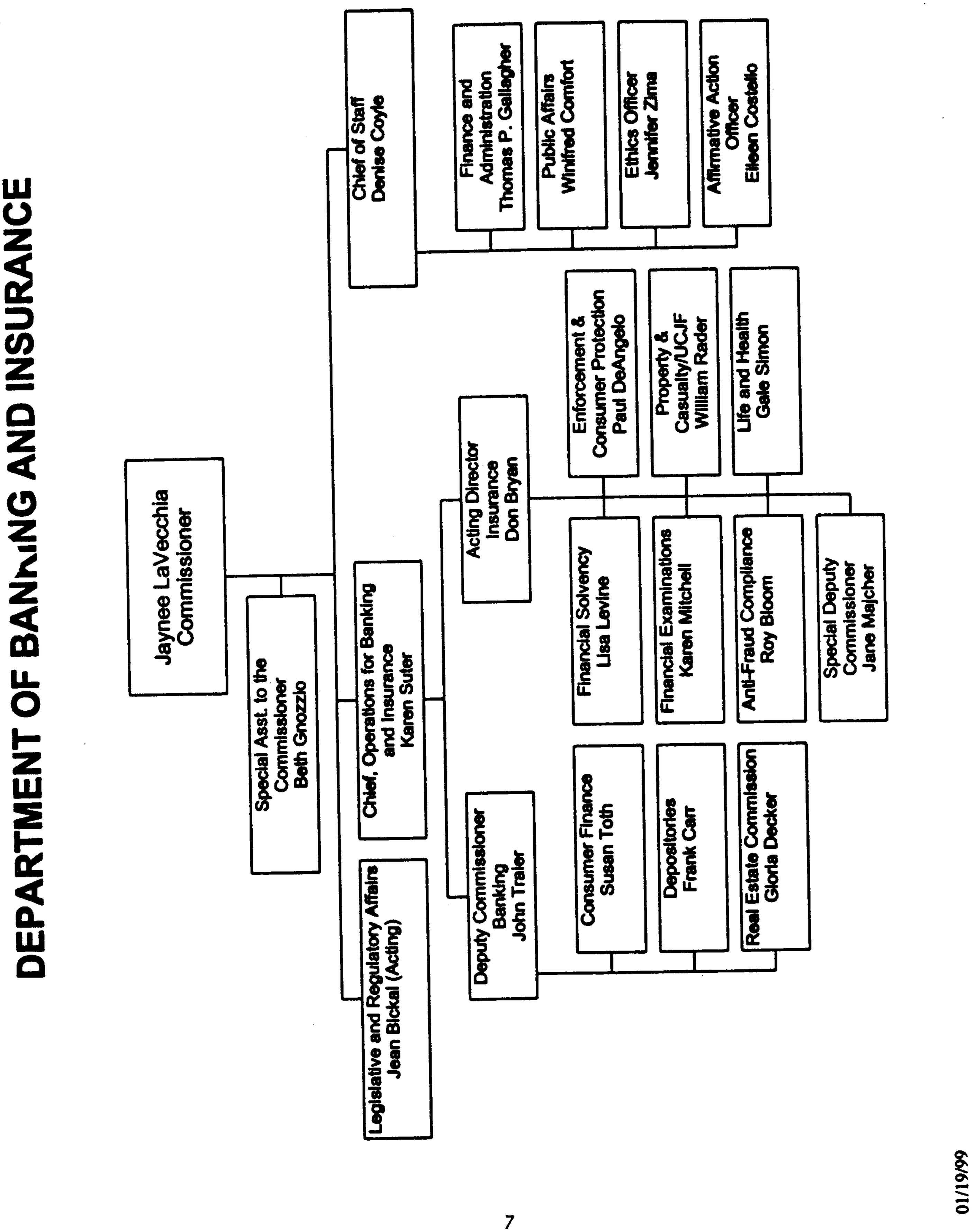
An increase in the department's Budget of $837,000 will be utilized to provide funding sufficient for 22 new positions within the department in FY 2000. $254,000 would be utilized to fund new banking related positions and $583,000 would be utilized to fund new insurance related positions.

The department is fully funded by the industries it regulates. The proposed budget anticipates FY 2000 anticipated revenues for the department of $79.0 million, an increase of $381,000 (less than one percent) over the current year's estimate of $78.6 million. These revenues include an estimated $13.5 million in revenues from the "Special Purpose Assessment" in FY 2000. Pursuant to P.L. 1995, c.156 (C.17:1C-19 et seq.), the Special Purpose Assessment was established to consolidate certain insurance industry fees and charges, to streamline the department's billing and collection process, and to permit the department to charge insurers for all direct and indirect costs to the department. The total amount that may be charged to companies through the Special Purpose Assessment may not increase, as a percentage, by more than the percentage increase in the combined net written premiums received by all companies for the previous year. This effectively creates a growth cap on the amount that may be assessed through the Special Purpose Assessment.

The revenue projections for the Special Purpose Assessment displayed in the Governor's FY 2000 Budget are predicated upon the passage of legislation, which OMB indicates will be proposed by the administration, that would modify the growth cap placed on the Special Purpose Assessment pursuant to section 13 of P.L. 1995, c.156 (C.17:1-31). Without legislation to modify the statutory cap, revenues will fall approximately $727,000 million short of Budget proposal projections in FY 1999 and $1.4 million short in FY 2000, according to the Department of the Treasury. Budget language requires that in such an instance, the appropriation from this source for the Division of Insurance must be reduced accordingly.

Even though appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department's display in the Governor's proposed Budget, these functions have been transferred to the Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety, pursuant to the "Automobile Insurance Cost Reduction Act of 1998, " P.L. 1998, c.21. These appropriations remain within the department's display because they are funded through insurance industry assessments. All but $1.4 million of the $27.2 million appropriated for this purpose will be expended by the Department of Law and Public Safety. The remaining $1.4 million will be utilized to fund the Division of Anti-Fraud Compliance within the Department of Banking and Insurance.

Organization Chart



Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS ($000)

	Expended FY 1998	Adj. Approp. FY 1999	Recom. FY 2000	Percent Change 1998-00	Percent Change 1999-00
General Fund					
Direct State Services	$40,140	$57,908	$58,745	46.4%	1.4%
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	$40,140	$57,908	$58,745	46.4%	1.4%
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	$40,140	$57,908	$58,745	46.4%	1.4%
Federal Funds	$0	$0	$0	0.0%	0.0%
Other Funds	$38,253	$37,617	$37,617	-1.7%	0.0%
Grand Total	$78,393	$95,525	$96,362	22.9%	0.9%

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 1998	Revised FY 1999	Funded FY 2000	Percent Change 1998-00	Percent Change 1999-00
State	558	469	534	-4.3%	13.9%
Federal	0	0	0	0.0%	0.0%
All Other	4	4	5	25.0%	25.0%
Total Positions	562	473	539	-4.1%	14.0%

FY 1998 (as of December) and revised FY 1999 (as of September) personnel data reflect actual payroll counts. FY 2000 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	22.6%	27.7%	24.3%	----	----

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 1999	Recomm. FY 2000	Dollar Change	Percent Change	Budget Page
ECONOMIC REGULATION					
DIRECT STATE SERVICES					
Salaries and Wages	$24,875	$25,639	$764	3.1%	D-32

According to the Office of Management and Budget (OMB), the proposed increase of $764,000 for salaries and wages would be utilized to fund 22 new staff. For banking functions, funding would be utilized for five new positions in the Division of Enforcement and Licensing, Office of Consumer Finance, and one new auditor position in the Division of Examination. For insurance functions, 13 new positions would be established in the Division of Enforcement and Licensing. Seven of these positions would focus on financial examinations, while six positions would focus on enforcement and consumer protection. In addition to these positions, three new actuarial staff would be hired in the Division of Actuarial Services.

Language Provisions

1999 Appropriations Handbook	2000 Budget Recommendation

The proposed FY 2000 Budget for the Department of Banking and Insurance does not contain any changes in language provisions over the FY 1999 Budget.

Discussion Points

1. Pursuant to P.L. 1995, c. 156 (C.17:1C-19 et seq.), a "special purpose " funding mechanism was established for the Department (now Division) of Insurance. The purpose of the assessment was to consolidate certain insurance industry fees and charges to streamline the department's billing and collection process, and to permit the department to charge insurers for all direct and indirect costs to the department. This Special Purpose Assessment is apportioned among companies in the proportion that the net written premiums received by each company during the prior calendar year bears to the sum total of all such net written premiums received by all companies during that calendar year. The assessment is based upon expenses incurred by the department in the previous year and is utilized to reimburse the State for those expenses.

The amount that may be raised through the Special Purpose Assessment is capped pursuant to section 13 of P.L.1995, c.156 (C.17:1C-31). Under this provision, the total amount assessable to all companies in any one fiscal year may not increase, as a percentage, by more than the percentage increase in the combined net written premiums received by all companies for the previous year. In recent years, these total premiums have increased approximately 2 percent annually.

The Governor's FY 2000 Budget proposal projects revenues of $13.5 million from the Special Purpose Assessment in FY 2000 and $13.4 million in FY 1999. However, the Office of Management and Budget (OMB) indicates that these revenue figures are predicated upon the passage of legislation, which will be proposed by the administration, that would modify the growth cap on the assessment. Without such legislation, it was indicated that revenues from the Special Purpose Assessment will fall approximately $727,000 short of budget projections in FY 1999 and $1.4 million short in FY 2000. Budget language requires that in such an instance, the appropriation to the Division of Insurance must be reduced accordingly.

! *Question:* If legislation to modify the growth cap on the Special Purpose Assessment is not adopted, which areas of the department's budget would be reduced and by how much in FY 1999 and FY 2000? Please indicate whether staff levels would be affected and, if so, to what degree.

If modification of the Special Purpose Assessment statue does not occur, will the department have sufficient funding to maintain the 16 new insurance-related positions proposed for the department in the FY 2000 Budget?

By category (property/casualty, life/health, HMO), what is the amount of net written premium dollars for 1997 (actual) and 1998 (estimated)? Please enumerate the percentage increase in combined net written premiums for every year since the inception of the Special Purpose Assessment.

2 The "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21, made a number of substantial changes to the automobile insurance system under the State's no-fault law and was designed to bring about a 15% roll back in rates in 1999. Among its most significant requirements are the establishment of a new "basic policy" designed to permit people to meet the State's mandatory insurance requirement at substantially lower cost; the establishment of new medical treatment protocols designed to reduce the over utilization of medical benefits; the establishment of a new dispute resolution process using dispute resolution organizations to replace the previous arbitration procedure and part time arbitrators; the establishment of the Office of the Insurance Claims Ombudsman in the Department of Banking and Insurance to investigate consumer complaints; the establishment of an Automobile Insurance Territorial Rating Plan Advisory Commission; and the establishment of a new "verbal threshold" to limit the number of lawsuits filed.

Discussion Points (Cont'd)

The department has recently adopted regulations to implement many of these changes, including N.J.A.C. 11:3-3, which concerns the "basic policy" and becomes operative on March 22, 1999; N.J.A.C. 11:3-4, which concerns new medical protocols and diagnostic tests and becomes operative on March 22, 1999; and N.J.A.C. 11:3-5, which concerns dispute resolution and became effective on December 21, 1998.

The department's FY 2000 proposed budget contains $583,000 to provide funding for 16 new insurance-related positions. The Office of Management and Budget indicates that some of these new positions are necessary due to an increased workload, due in part to the "Automobile Insurance Cost Reduction Act of 1998."

! *Question:* Which of the 16 new insurance-related positions proposed for the department in FY 2000 are deemed necessary due to new departmental responsibilities under the "Automobile Insurance Cost Reduction Act of 1998?" What specific responsibilities will each of the new positions have as they relate to the new requirements under the act?

If the special Purpose Assessment law is not amended, as described in Discussion Point #1, what would the impact be on the department's ability to carry out the requirements of the "Automobile Insurance Cost Reduction Act of 1998?"

Please detail how the $776,000 appropriation for the Ombudsman was spent in FY 1999 and will be spent in FY 2000, including the number of staff funded and hired. Please provide the number of complaints the Ombudsman's office has handled.

What is the status of the Territorial Rating Plan Advisory Commission and the dispute resolution organization called for under P.L. 1998, c.21?

The "Automobile Insurance Cost Reduction Act of 1998" resulted in the filing of a number of lawsuits against the State, including those filed by a coalition of auto body shops, New Jersey chiropractors, and the New Jersey Coalition of Health Care Professionals. Please provide an estimate of the overall legal and court costs to the State from these lawsuits thus far, and anticipated future costs.

3. In response to a FY 1999 O.L.S. discussion point regarding the department's responsibilities under P.L. 1997, c.151 (C17:33B-64 et seq.), legislation which established a tier rating system for automobile insurance premiums, the department indicated that it would need to utilize actuarial consultants to meet the department's responsibility to review rate fillings within 120 days. P.L. 1997, c.151 also provided for an expedited rate filing process in certain circumstances, with a 45 day turn-around time. While the department was attempting to hire its own actuaries to meet the additional workload, it indicated in its response that hiring actuaries was extremely difficult and that there "are only approximately 2500 property and casualty actuaries in the country." After an "extensive recruitment effort" the department noted that it was unable to hire anyone. The department indicated that in FY 1999, it had eight actuaries on staff with two resignations pending. It was also actively recruiting to fill three actuarial vacancies.

The proposed FY 2000 Budget contains funding for three new actuaries.

! *Question:* How many actuaries does the department currently have on staff? Was the

Discussion Points (Cont'd)

department able to fill the three actuarial vacancies in FY 1999? What does the department anticipate it will spend on actuarial consultants in FY 1999?

What does the department anticipate will be spent for actuarial consultants in FY 2000? Does the expenditure assume the department will be able to fill the three new actuarial positions funded in FY 2000? If so, please estimate what the department will need to spend on actuarial consultants in FY 2000 if it is unable to fill the three new actuary positions?

What are the entry level and average salaries for the department's actuaries? How does this compare to the private sector? To what does the department attribute its difficulty in hiring actuaries?

4. Pursuant to the "Automobile Insurance Cost Reduction Act," P.L. 1998, c.21, insurance fraud investigative staff have been transferred from the Department of Banking and Insurance to the Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety. However, the $27.2 million appropriation for Insurance Fraud Prevention and Insurance Fraud Prosecution in FY 2000 remains within the Budget display for the Department of Banking and Insurance, because this appropriation is still funded through insurance industry assessments (Budget page D-32).

The Office of Management and Budget indicates that all but $1.4 million of the $27.2 million will be expended by the Office of the Insurance Fraud Prosecutor in the Department of Law and Public safety in FY 2000. The $1.4 million will be utilized to fund the Division of Anti-Fraud Compliance within the Department of Banking and Insurance. The Division of Anti-Fraud Compliance consists of three main sections: Audits and Compliance, Industry Education and Collections. Departmental materials indicate that under the new structure, the Audit and Compliance section will be able to reach "a greater part of the insurance industry in an enhanced time frame" and the Industry Training Section "will provide the insurance industry with increased training opportunities."

! *Question:* Does the $1.4 million of the Insurance Fraud Prevention appropriation remaining within the Department of Banking and Insurance reflect the entire budget of the Division of Anti-Fraud Compliance? How many staff are funded and employed within the Division and what are each of their functions?

Please provide further elaboration on the duties of each of the three sections under the Division of Anti-Fraud Compliance. Does the department have any quantifiable estimates of how the services provided by this Division have improved or will improve since the assignment of the Insurance Fraud Prevention functions to the Department of Law and Public Safety?

5. The Division of Insurance has been heavily involved in the current fiscal year with the protection consumers of certain health maintenance organizations (HMOs) facing serious financial difficulties. The division, pursuant to Order No. A98-134, placed HIP of New Jersey (HIP) under administrative supervision in September 1998 after discovering that HIP showed a negative $9.5 million statutory net worth. The division has also been overseeing the day-to-day operations of American Preferred Provider Plan (APPP) since October and has found that HMO to be insolvent by more than $22 million. The division's ongoing monitoring of these managed care organizations has involved a number of activities, including on-site evaluation of operations, financial oversight

Discussion Points (Cont'd)

and other actions deemed necessary to address "any claims backlog in order to properly protect subscribers and consumers," according to the department.

Middlesex County Superior Court recently approved the department's plan to liquidate HIP by March 31. As part of the department's effort, the commissioner ordered all HMOs and health care carriers licensed in New Jersey to hold a special open enrollment period to give HIP's 165,000 members, except those receiving Medicaid, time to transfer to other health care plans. The 21,400 Medicaid recipients who are HIP members will be assisted by the Department of Human Services in finding new health plans. The department also has reported that 20 hospitals and a sufficient number of physicians have agreed to continue to provide care to their HIP patients at 75 percent of their previous reimbursement rate for a month after HIP's liquidation. Patients in certain critical care circumstances would be allowed to continue with their doctors for longer periods.

In addition, the department announced on February 22 that APPPs members would be shifted to Horizon Healthcare, and that the State would be filing papers to liquidate APPP when this process is complete.

In December, the Commissioner convened a public forum to assist the department in "developing plans to tighten the oversight of the state's 23 HMOs to protect consumers and health care providers." The Commissioner noted that "notwithstanding the fact that New Jersey has the strongest net worth and deposit requirements for HMOs of any state...the controls are apparently not enough..."

! *Question:* Please discuss the current status of HIP and APPP oversight and liquidation activities.

Please estimate the total expense to the department to date of HIP and APPP oversight and liquidation activities, including and legal and court costs incurred by the department, as well as estimated staff time spent in these activities. How many staff have been involved in the oversight of these two managed care organizations and what proportion of their time was spent on oversight versus their other duties?

Does the department have sufficient staff to continue its oversight and liquidation efforts? Are any of the 16 new insurance-related positions proposed for the department necessary to continue these efforts?

Please discuss department efforts to prevent similar problems from occurring in other managed care organizations in the future. Does the department have any plans to propose additional regulations or legislation to address this issue?

6. According to the Federal Reserve Bank, achieving year 2000 ("Y2K") readiness for the banking industry is "critical to ensuring the safety and soundness of the banking system." In fact, the Federal Reserve, through its "Century Date Change Project," has made ensuring Year 2000 compliance one of its highest priorities. In order to be compliant, financial institutions must assess their computer software and hardware, change code that may cause processing errors and test these changes prior to implementation. Currently, federal regulators are conducting examinations of financial institutions to ensure progress in computer system renovations, computer testing, and the development of contingency plans.

Discussion Points (Cont'd)

The State Division of Banking has also been involved in ensuring Year 2000 compliance for the financial institutions it oversees, which include State-chartered commercial banks and savings and loan institutions. The division has been working closely with Federal regulators to share information and to share the workload. The department completed its first phase of oversight in May 1998, which involved ensuring that banks subject to State examination were setting adequate resources aside to deal with the Y2K issue and that these banks had adequate plans in place. The banks were also ordered to complete a survey to gather information about the status of their computer systems. The division indicates that it received a 100 percent response rate from its survey and is now in the second phase of its effort, which includes activities similar to those conducted by federal regulators, such as ensuring that rewriting of computer code, internal computer testing, testing with vendors, and the development of contingency plans occurs. This phase should be completed by the end of March.

! *Question:* Please provide an update on the activities of the Division of Banking as they pertain to ensuring Year 2000 compliance for the financial institutions of this State. How many staff are involved with this effort currently and how many will be involved in FY 2000? What proportion of their time in consumed by Year 2000 compliance efforts versus their other responsibilities? Has the division needed to utilize consultants for Year 2000 oversight? If so, what is the amount spent in FY 1999 and budgeted in FY 2000 for those consultants?

Can the division at this point provide the Legislature with an appraisal of the banking industry's progress towards Year 2000 compliance?

7. Prior to the merger of the Department of Banking and the Department of Insurance, the Department (now Division) of Banking published an annual report which contained comprehensive statistical information on financial institutions licensed in this State. Such information is no longer made available through the Department of Banking and Insurance's annual report.

! *Question:* Please provide the following information: the number of entities licensed under the Division of Banking by type of license (and multiple authorities where appropriate) for the most recent date available and the same information for a similar date one year prior. For each license please indicate the fee charged, the maximum fee permitted under current statute, and whether the license is annual or biennial.

8. As with many industries, mergers have been sweeping the banking industry. According to Loretta Mester, head of the Banking and Financial Markets section in the Philadelphia Federal Reserve Bank, easing of rules concerning how and where banks may expand, as well as the advent of new technologies, have contributed to a rapid consolidation in the banking industry. Nationwide, the number of insured commercial banks has fallen from over 14,000 in 1985 to around 9,000 today. At the same time, according to Ms. Mester, "assets held by banks have been growing and banks have been getting larger." The share of assets held in bank holding companies has skyrocketed, with these entities now holding more than 40 percent of banking industry assets. (Banking Industry Consolidation: What's a Small Business to Do?" Loretta J. Mester, Business Review, January/February 1999, Federal Reserve Bank of Philadelphia)

This trend has held true in New Jersey as well. According to Division of Banking documentation current through October 1, 1998, 12 bank mergers were accomplished or pending

Discussion Points (Cont'd)

in New Jersey in calendar year 1998, compared to 3 mergers in 1992, 10 mergers in 1993, 10 mergers in 1994, 11 mergers in 1995, 18 mergers in 1996, and 8 mergers in 1997.

At the same time, New Jersey has seen a significant number of charters granted to new financial institutions in this State, including 14 new charters approved since 1997, with three applications currently pending. In addition, four federal savings banks, one national bank, one out of State national bank with offices in New Jersey, one out of state federal savings bank with offices in New Jersey, and a foreign bank representative office have opened in the State.

! *Question:* How has the number of new charters impacted on the workload of the Division of Banking? Does the division have a sufficient number of staff to continue to provide adequate oversight if this trend continues?

9. The "New Jersey Money Transmitters Act," P.L. 1998, c.14 (c17:15C-1 et eq.), provides for the licensing and regulation of persons engaged in the business of money transmission, foreign and domestic money transmitters, sellers of money orders, and third party bill payers. Prior to this act, only foreign money remitters and sellers of money orders were regulated under law. Under this act, a license, which is valid for two years, may be issued to engage in foreign money transmission only or to engage in all four of the activities regulated by this act. The act caps the license fee that may be charged to these entities at $4,000. Regulations which became effective in September 1998 set a biennial license of $1,400 for money transmitters and $1,200 for foreign money remitters.

When the Legislature was considering the bill that established this act, the Department of Banking and Insurance estimated that it would need an additional clerical support person, one additional professional staff position, modification of its computer licensing system, and printing of a new application and instructional materials relevant to the new license, in order to implement the act. The department did not provide a cost estimate but stated that revenues from license fees should cover the costs.

! *Question:* Has the department hired the additional staff it stated were necessary to implement the "New Jersey Money Transmitters Act?" Has necessary modification of the computer licensing system been completed, and is the application and licensing system fully in place? Have the license fees thus far been sufficient to cover the program's cost? Please compare estimated FY 2000 revenues and costs for the act.

Background Paper: The Financial Insolvency and Liquidation of HIP Health Plan of New Jersey

Budget Pages.... D-30

Overview

Discussion Point #5 within this booklet briefly summarizes the significant activities of the Department of Banking and Insurance over the course of the current fiscal year relevant to the insolvency and liquidation of HIP Health Plan of New Jersey (HIP). Insurance related staff within the department's Division of Enforcement and Licensing and the Division of Actuarial Servcies have been heavily involved with this effort. The FY 2000 Budget recommends an additional 16 staff for these two divisions (Salaries and Wages line, Budget page D-30). While other areas of the department's responsibility, such as implementation of auto insurance reform, have impacted the department's workload, the present and future activities surrounding HIP clearly have had a significant impact. This background paper provides a more in-depth overview of the department's activities to date, and explores future activities involving the oversight of HIP and other managed care organizations which may further impact the workload on the department.

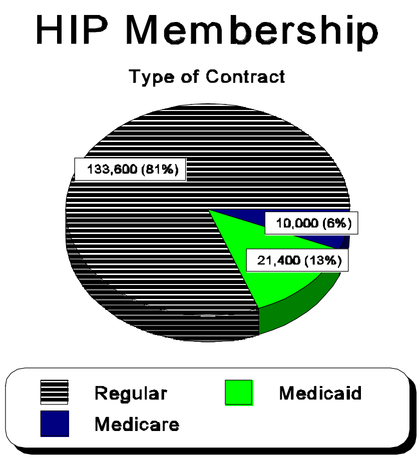
The Insolvency of HIP Health Plan of New Jersey

On November 20, 1998, HIP Health Plan of New Jersey (HIP) was declared insolvent and placed in rehabilitation under the control of the Commissioner of Banking and Insurance. Since that time, the Department of Banking and Insurance attempted to restore HIP's viability by searching for an investor, reducing expenses and adjusting rates. As reported by the department, these efforts were hampered by the bankruptcy of HIP's former partners, PHP Healthcare Corporation and Pinnacle Health Enterprises, and have not been sufficient to restore HIP to profitability. Thus, HIP will cease operations as of March 31, 1999 by order of the Middlesex County Superior Court.

HIP, the State's fourth largest health maintenance organization, is an affiliate of the Health Plan of Greater New York (HIP-NY) and has been operating in New Jersey since 1980 when federal regulators asked HIP-NY to take over a failing health maintenance organization in West New York. At the time of the November declaration of insolvency, HIP had 165,000 enrolled members, which included approximately 10,000 Medicare recipients, 21,400 Medicaid recipients, and approximately 6,760 members of the State Health Benefits Plan. HIP is the only health maintenance organization in New Jersey that offered clinic-based or "one-stop" shopping for medical care, x-rays, and lab work at its 23 centers located across the State, in addition to maintaining its own network of physicians in private practice.

Since mid-1998 the department had been monitoring the financial condition of HIP, when quarterly earnings information indicated a negative net worth of approximately $20 million. Information received by the department at that time also indicated mounting unpaid claims from doctors and hospitals. When HIP fired approximately 400 employees without prior notification to the department in September of 1998, the department placed HIP under administrative supervision.

Background Paper: The Financial Insolvency and Liquidation of HIP Health Plan of New Jersey (Con't)



In order to remain competitive, HIP had offered one of the lowest premium rates available, according to the Department of Treasury, and collected more than $300 million in premiums during 1998. However, financial reports indicate that HIP was spending far more than the industry average of 80 to 85 cents of every dollar it collected in premiums on medical services.

While, according to the department, the collapse of HIP can be attributed to a number of factors, which include poor management, increased competition and inadequate financing, State officials and financial experts have indicated in recent newspaper articles that the situation might have been avoided if the State had been able to examine the financial records of both HIP's former partner, Pinnacle Health Enterprises, and its parent company, PHP Healthcare Corporation. Initially, the sale of HIP's system of health centers and physicians' networks to Pinnacle Health Enterprises, which would operate as a "third-party administrator," was viewed by the department as a logical attempt to rejuvenate the financially troubled health maintenance organization. The sale was approved by the department, the Department of Health and Senior Services and the Attorney General's Office in October of 1997.

However, current law does not provide for the review of the financial condition of a third-party administrator, an entity that provides certain services for managed care organizations, in order to ensure that the third-party administrator is capable of meeting financial and health care delivery requirements. Thus, the department lacked the statutory or regulatory authority to require an in-depth review of the financial status of Pinnacle Health Enterprises and PHP Healthcare Corporation or require either company to establish a cash reserve to ensure continued care for HIP members. This may have contributed to the department's inability to ascertain the overall financial stability of those two entities, which were both experiencing financial difficulties of their own. Dual authority for the regulation of health maintenance organizations is shared by the department and the Department of Health and Senior Services. The department is charged with the initial and ongoing financial review of such entities, and the Department of Health and Senior Services is responsible for the issuance of certificates of authority to operate a health maintenance organization in this State, and the monitoring and resolution of quality of care issues.

On December 15, 1998, the Banking and Insurance Commissioner held a public policy forum on the oversight of health maintenance organizations. During the forum, areas of potential regulatory changes were identified, a number of which would clearly impact on the workload of the department, including: revised actuarial certification procedures; pre-operational audits prior

Background Paper: The Financial Insolvency and Liquidation of HIP Health Plan of New Jersey (Con't)

to licensure; pre-operational audits of subcontractors; revised claim insolvency deposit requirements; requiring minimum liquid asset levels or risk based capital requirements; revised parental guarantee requirements and rate filing protocols. Regulations incorporating certain regulatory changes discussed at the forum, with some modifications, were proposed by the Department of Health and Senior Services on March 1, 1999. These changes are based, in part, on guidelines issued by the National Association of Insurance Commissioners (NAIC), which recommend increased claims reserve requirements for health maintenance organizations nationwide. The department indicated in its rule proposal that other rule modifications will likely follow.

Potential Regulatory Changes re: HMO Oversight
Identified at Department's December Policy Forum

- Revised actuarial certification
- Pre-operational audits
- Revised claim insolvency deposit requirements
- Minimum liquid asset levels or risk based capital requirements
- Revised parental guarantee requrements and rate filing protocols

The Interim Plan of Rehabilitation

Prior to December 18, 1998, the estimated liabilities of HIP totaled approximately $119 million. Under an Interim Plan of Rehabilitation, providers (hospitals and other facilities, physicians, and ancillary providers) were guaranteed payment for claims for services rendered subsequent to November 20, 1998 (post-rehabilitation) at 75 percent of the provider's contract rate. In addition, the plan included an advance incentive payment for services rendered post-rehabilitation. Only providers who agreed to continue providing services to HIP members during the rehabilitation efforts and transition period would be eligible to receive advance incentive payments. As of January of 1999, more than 97 percent of the physicians and physician organizations and approximately 96 percent of the hospitals in the HIP network prior to the rehabilitation were included in the HIP network pursuant to these terms.

When HIP was placed in rehabilitation, it had approximately $45.4 million in assets from which it was estimated that no more than $35.7 million would be available for making advance incentive payments. As of February 2, 1999, advance incentive payments totaling $23.3 million had been made to 31 hospitals, 24 facilities, 989 physicians or physician organizations and 15 ancillary providers or suppliers. With regard to balances due subsequent to the rehabilitation date, HIP has paid $8.9 million on post-rehabilitation claims, using the 75 percent payment arrangement. For the five-week period ending on February 5, 1999, reports indicate the processing of an average of 11,300 claims per week with a claims inventory of 31,700 claims.

The Plan of Liquidation and Continuation of Services to Members

On February 19, 1999, the department issued a detailed transition plan which ensures the continuity of health care for HIP members, in accordance with instructions from Superior Court Judge Jack Lintner, who required the department to establish an extensive liquidation plan with

Background Paper: The Financial Insolvency and Liquidation of HIP Health Plan of New Jersey (Con't)

strong patient protections. Previously, on February 8, 1999, the Commissioner had issued Order 99-108 providing for a special open enrollment period during which all health insurers in the State were to make their health benefits plans available to HIP members, with certain conditions and restrictions placed on the insurers. Under the terms of the liquidation plan, HIP members enrolled in new health plans will be able to continue their course of treatment with their current physician for 30 days after March 31, 1999. The plan provides that pregnant members in their second and third trimesters and members who are acutely ill can continue to see their physician for a longer period. The plan also provides that until April 1, 1999, prescriptions for certain maintenance drugs, such as insulin and seizure medications, will be issued and filled for up to an additional 30 days. Physicians and hospitals are prohibited from billing HIP members for covered services, other than requiring payments of normal co-pays and deductibles.

The department has issued notices about the special open enrollment period to all HIP members, including those members who may be wintering outside of the State, indicating that the health maintenance organization is closing and that they must find new health care coverage. The department anticipates sending follow-up reminder notices. Approximately 100 State employees from various departments, including Banking and Insurance, Labor, Health and Senior Services, Human Services and the Treasury, will operate in on-site teams at the HIP health centers for counseling purposes. The department has also established a call center with a toll-free number to answer questions. In addition, health fairs are scheduled for Medicare recipients beginning March 1, 1999 in Bergen, Burlington, Camden, Middlesex, Ocean and Somerset counties.

The Future Role of the Department

While the department's most intensive efforts with respect to the insolvency and liquidation of HIP may have already occured, ending with the termination of the transition and open enrollment period for HIP members on March 31, 1999, the department will continue to be responsible for various activities associated with the insolvency of HIP.

For example, under the terms of the liquidation plan, certain HIP members are permitted to continue with their HIP physicians for a period beyond March 31, 1999, the final date of operations for HIP. The department is also involved, along with the Department of Human Services, in negotiations to transfer HIP's Medicaid business to another health insurance carrier.

In addition, the Commissioner, as Rehabilitator, continues to oversee the activities of the investment banker, Paine Webber, retained to assist in developing a plan to fully realize the value of HIP's assets, and the PACE Group, which is serving as Deputy Rehabilitator. The department will continue overseeing the last of HIP's operations, including the processing and payment of outstanding claims.

Finally, it will also be necessary for the department to respond to and monitor the status of the various lawsuits that have been, and may still be, filed with respect to the insolvency and dissolution of HIP. Moreover, upon the adoption of the proposed regulations strengthening the financial requirements for health maintenance organizations operating in New Jersey, the department's oversight role will be expanded to include heightened review of additional financial data.

OFFICE OF LEGISLATIVE SERVICES

The Office of Legislative Services provides nonpartisan assistance to the State Legislature in the areas of legal, fiscal, research, bill drafting, committee staffing and administrative services. It operates under the jurisdiction of the Legislative Services Commission, a bipartisan body consisting of eight members of each House. The Executive Director supervises and directs the Office of Legislative Services.

The Legislative Budget and Finance Officer is the chief fiscal officer for the Legislature. The Legislative Budget and Finance Officer collects and presents fiscal information for the Legislature; serves as Secretary to the Joint Budget Oversight Committee; attends upon the Appropriations Committees during review of the Governor's Budget recommendations; reports on such matters as the committees or Legislature may direct; administers the fiscal note process and has statutory responsibilities for the review of appropriations transfers and other State fiscal transactions.

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Individuals wishing information and committee schedules on the FY 2000 budget are encouraged to contact:

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