ANALYSIS OF THE NEW JERSEY

FISCAL YEAR 2000 - 2001 BUDGET

DEPARTMENT OF BANKING AND INSURANCE

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

APRIL 2000

NEW JERSEY STATE LEGISLATURE

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DEPARTMENT OF BANKING AND INSURANCE

Budget Pages..... C-8, C-16, D-27 to D-33

Fiscal Summary ($000)

	Expended FY 1999	Adjusted. Appropriation FY 2000	Recommended FY 2001	Percent Change 2000-01
State Budgeted	$59,260	$59,326	$60,575	2.1%
Federal Funds	0	0	0	—
Other	5,652	37,617	37,617	0.0%
Grand Total	$64,912	$96,943	$98,192	1.3%

Personnel Summary - Positions By Funding Source

	Actual FY 1999	Revised FY 2000	Funded FY 2001	Percent Change 2000-01
State	468	470	553	17.7%
Federal	0	0	0	—
Other	4	4	5	25.0%
Total Positions	472	474	558	17.7%

FY 1999 (as of December) and revised FY 2000 (as of September) personnel data reflect actual payroll counts. FY 2001 data reflect the number of positions funded.

Introduction

The Department of Banking and Insurance is primarily responsible for the State's 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, including the financial condition of health maintenance organizations, 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. The department is fully funded by the industries it regulates.

Key Points

- The department's recommended FY 2001 General Fund appropriation is $60.6 million, representing an increase of 2.1 percent or $1.2 million over the current fiscal year. This increase reflects additional State support/funding for actuarial services, supervision and examination of financial institutions and financial examinations of health maintenance organizations (HMO's).

- For banking related functions, the overall increase provides an additional $138,000 to establish four financial examiner positions in the Supervision and Examination of Financial Institutions Unit.

- For insurance related functions, the increase in funding includes $114,000 for financial examinations of health maintenance organizations.

- The $765,000 increased appropriation for the Actuarial Services Unit, within the Division of Insurance, is recommended to support the revision of the current territorial rating plan, a part of the division's automobile insurance reform initiatives. The Automobile Insurance Territorial Rating Plan Advisory Commission, recently established within the division, is responsible for redrawing the 50-year-old territorial rating plan used to set automobile insurance premiums throughout the State.

- An additional $232,000 appropriation is recommended to reimburse the Office of Information Technology for the costs of their services to the department. In FY 2000, all departments participated in an Information Technology (IT) Strategic Planning process to improve the State's information highway, provide online access to State services, and manage State data, with the goal of transforming New Jersey into the Online State.

- While appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department, the fraud prevention investigator functions were shifted to the Department of Law and Public Safety in FY 1999 in an effort to provide more effective prosecution of insurance fraud related cases. These appropriations remain within the department's display because they are still funded through insurance industry assessments. However, 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 Anti-Fraud Compliance Unit within the Department of Banking and Insurance.

- The recommended appropriation from "all other" funds is $37.6 million, the same level as in FY 2000. Of that total, $34.6 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.

Program Description and Overview

The primary responsibilities of the Department of Banking and Insurance are the regulation and monitoring of the banking and insurance industries. The Division of Banking charters, licenses and supervises banks, savings and loans, and a wide range of other financial institutions and firms responsible for consumer finance in the State. The Division of Insurance monitors and examines policies, practices and the financial condition of insurance companies. The Division of Insurance also monitors the business activities of real estate brokers and agents. Previously two separate departments, the former Department of Banking and Department of Insurance were merged by P.L.1996, c.45 (C.17:1-13 et seq.) to form the current Department of Banking and Insurance. The department is fully funded by the industries it regulates.

Division of Banking

The Division of Banking is responsible for chartering, licensing and supervising 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 and the Office of Consumer Finance. The Office of Depositories conducts examinations of State-chartered banking and savings and loan institutions, and 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 functions, the division works closely with the Federal Deposit Insurance Corporation (the FDIC insures the deposits of all chartered institutions); the Board of Governors of the Federal Reserve System, which oversees State-chartered banks that are members of the Federal Reserve System; and the federal Office of Thrift Supervision (OTS), which oversees savings and loan associations. The division and the Federal Reserve examine State-chartered commercial banks on an alternating basis. The division shares information with the OTS to decide 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 an increase in the number of new bank charters, the need to examine financial institutions, additional categories of licensure, and changes in State and federal laws and regulations.

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 of 1989 (FIRREA); the Truth in Savings Act; the Crime Control Act of 1990 (known as the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990); the Federal Deposit Insurance Corporation Improvement Act of 1991; amendments to the Bank Secrecy Act concerning money laundering; the Community Reinvestment Act; the Housing and Community Development Act of 1992; the RTC Completion Act; the Reigle Community Development and Regulatory Improvement Act of 1994; the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 and (State interstate banking and branching laws); the Economic Growth and Regulatory

Program Description and Overview (Cont'd)

Paperwork Reduction Act of 1996; and most recently, passage of the Gramm-Leach-Bliley Act of 1999, repealing the last vestiges of the Glass Steagall Act of 1933 (see Background Paper). The Gramm-Leach-Bliley Act authorizes the creation of a new entity, the financial holding company, authorized to engage in: underwriting and selling insurance and securities; conducting both commercial and merchant banking; investing in and developing real estate; and other "complimentary activities."

Other recent changes in State law include: the Trust Modernization Act; the Licensed Lenders Clean-up Act; amendment to the New Jersey Credit Union Act; the New Jersey Money Transmitters Act; major changes requiring depository institutions to offer basic low-cost checking accounts; allowing for State-chartered mutual savings banks; and permitting State-chartered capital stock savings and loan associations to convert their charters to State-chartered capital stock savings banks.

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 simplify 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 monitors and examines the policies, practices and financial condition of insurance companies, including the financial condition of health maintenance organizations, and licensed and regulates insurance producers. According to the department, the division has direct regulatory responsibility over approximately 93 domestic insurance companies, 95,455 licensed producers and 962 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 has expanded and revised its responsibilities as a result of statutory changes and as a result of major events and changes within the insurance industry.

For example, the "Automobile Insurance Cost Reduction Act of 1998," P.L. 1998, c.21 (AICRA) provided for an overall 15 percent reduction in automobile insurance rates. Reform measures provided for several cost-saving modifications to the existing system, including the creation of a basic automobile insurance policy, in addition to the standard automobile insurance policy. Implementation of the basic policy encourages motorists who otherwise would be uninsured to obtain required insurance coverage.

Reforms under AICRA also included the adoption of medical protocols that reduce overuse and fraud in the treatment of injuries from automobile accidents, while ensuring that doctors provide necessary treatment to those who are truly injured. Pursuant to the general statutory authority of the commissioner, the Personal Injury Protection Technical Advisory Committee (PIPTAC) was established to monitor these procedures.

The AICRA established the Office of Insurance Claims Ombudsman. The office is charged with the responsibility to: investigate consumer complaints regarding policies of insurance and the payment of claims; monitor the implementation of various insurance regulations; respond to consumer inquiries about policy provisions and coverage availability; and publish and distribute

Program Description and Overview (Cont'd)

buyers' guides and comparative rates. The Insurance Claims Ombudsman was appointed and sworn in on August 2, 1999.

Pursuant to AICRA, the Anti-Fraud Compliance Unit was established on August 24, 1998 after the fraud investigative functions of the former Division of Insurance Fraud Prevention were transferred to the newly created Office of the Insurance Fraud Prosecutor housed in the Department of Law and Public Safety. The Anti-Fraud Compliance Unit is charged with three primary functions: insurance industry compliance, collection of penalties and fines, and industry education.

The Automobile Insurance Territorial Rating Plan Advisory Commission is responsible for the revision of the current territorial rating plan, another aspect of automobile insurance reform. Currently, State law places a cap on the automobile insurance premiums that can be charged in certain areas of the State, even though these areas generate more accidents, claims and lawsuits than other parts of New Jersey. The result is that automobile insurance premiums in these capped areas are inadequate to cover the losses that are generated there and shift costs to other New Jersey drivers to subsidize the rates. Therefore, the new reform law mandates a State-appointed commission to review and revise these geographic territories for the first time in over 50 years.

As a result of the increase in competition within the automobile insurance industry, the department developed the "Consumer Handbook on Tier Rating," to educate consumers to "shop" comparatively for automobile insurance. This handbook provides concise, comparative information about New Jersey's automobile insurers, including a wide range of prices available for automobile insurance policies. According to the department, consumer "shopping" increased by 20 percent since the implementation of tier rating.

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. To avoid future HMO insolvencies, the department developed initiatives to improve the monitoring of the financial conditions of HMO's operating in New Jersey, such as the regulation of "organized delivery systems" pursuant to P.L. 1999, c. 409, authorizing the department to review financial risk sharing between and among HMO's and subcontractors. In addition, newly promulgated managed care regulations, together with new laws promoting expedited billing and payment processes will increase the department's ability to monitor New Jersey's managed care industry and provide a stronger financial safety net for health care consumers and providers.

The department worked with the Department of Health and Senior Services to draft amendments to the rules governing HMO's. The amendments include: increasing the frequency of submission of actuarial certification of an HMO's reserves from an annual to a quarterly basis; mandating on-site pre-operational audits of the operations and financial controls of HMO's; increasing the amount of funds an HMO must have on deposit with the department; requiring that a minimum amount of an HMO's assets be in the form of cash or cash equivalents; and finally, imposing more stringent requirements on parental guarantees of an HMO's minimum net worth. As a result, the departments have adopted amendments to the HMO regulations, making New Jersey's financial requirements for HMO's, according to the department, among the most stringent in the United States.

Program Description and Overview (Cont'd)

The Recommended FY 2001 Budget

The department's recommended FY 2001 Budget, consisting of $60.6 million in Direct State Services funding and $37.6 million in "all other" funds, represents an increase in funding of 1.3 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 (C.17B:27A-2 et seq.). Budget language authorizes this program to operate from receipts.

The department's funding increase of $1.3 million provides an additional $138,000 for banking related functions (Supervision and Examination of Financial Institutions) and $879,000 for insurance related functions. The Division of Insurance would utilize the majority of this funding for the hiring of eight new positions within the department for the expansion of actuarial services ($765,000) and for financial examinations of health maintenance organizations ($114,000).

Of the $865,000 designated to enhance Insurance functions, the appropriation of $765,000 has been added to the Actuarial Services Unit to support automobile insurance reform that requires revising the current territorial rating plan. The Automobile Insurance Territorial Rating Plan Advisory Commission, within the Division of Insurance, will redraw the 50-year-old territory system.

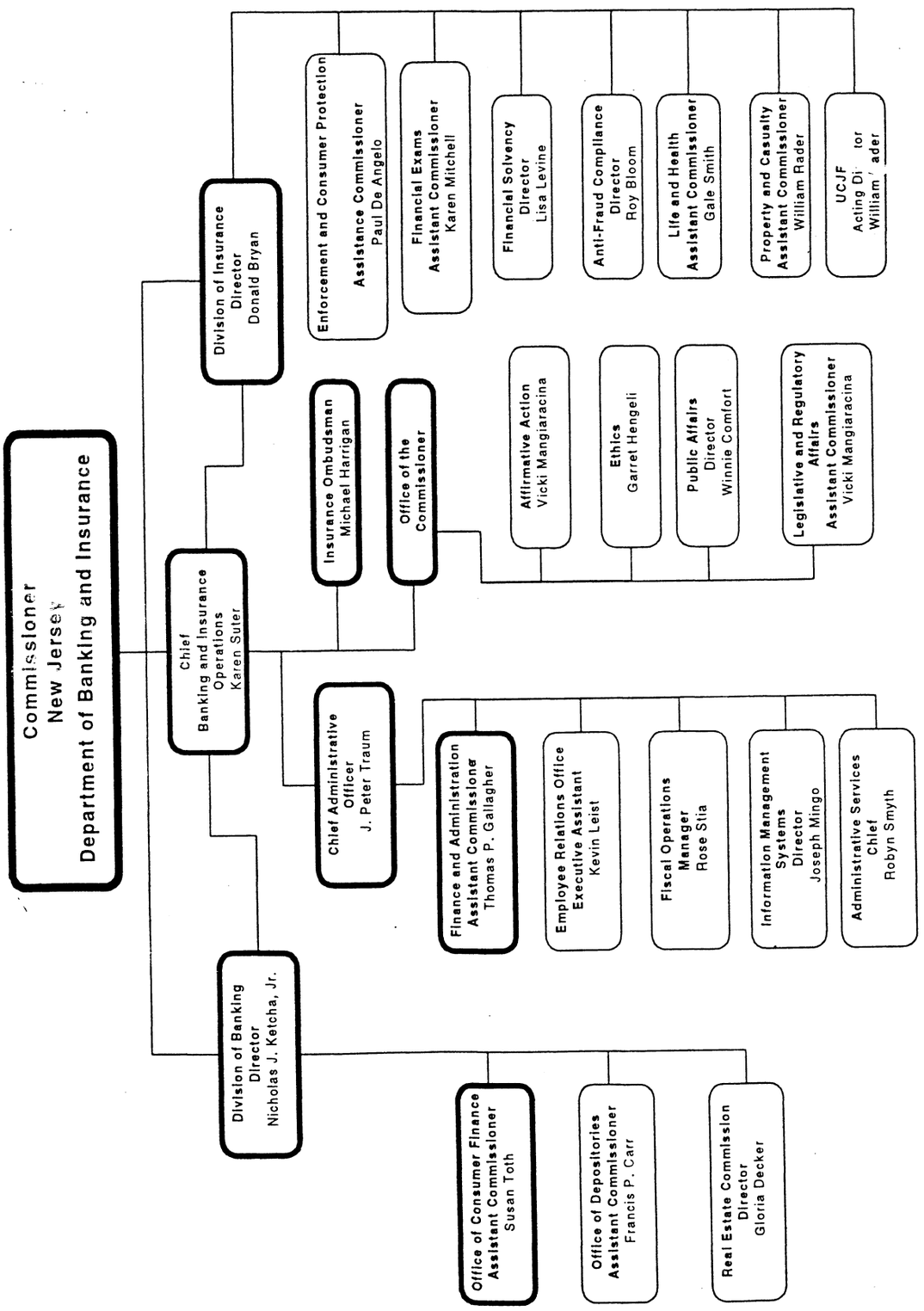
The regulated industries fully fund the department. The proposed FY 2001 budget anticipates revenues for the department of $80.7 million, an increase of $1.2 million or 1.6 percent, over the current year's estimate of $79.5 million. These revenues include an estimated $13.5 million in revenues from the "Special Purpose Assessment" in FY 2001. Pursuant to P.L. 1995, c.156 (C.17:1C-19 et seq.), the Special Purpose Assessment consolidates 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.

During the current fiscal year, legislation was enacted to modify the growth cap placed on the Special Purpose Assessment on insurers pursuant to section 13 of P.L.1995, c.156 (C.17:1C-31). This modification set the cap at 0.20 percent of the combined net written premiums received during the previous year and prohibited the department from raising more through the assessment than is required to reimburse the department for its "special purpose" expenses related to regulation, supervision and monitoring of the insurers and health maintenance organizations.

Although appropriations for Insurance Fraud Prevention and Insurance Fraud Prosecution remain within the department's display in the Governor's proposed Budget, as mentioned above, the Governor has transferred these functions to the Office of the Insurance Fraud Prosecutor in the Department of Law and Public Safety. These appropriations remain within the department's display because the industry funds them through insurance assessments. The Department of Law and Public Safety will expend all but $1.4 million of the $27.2 million appropriated for this purpose. The Division of Insurance will utilize the remaining $1.4 million to fund the Anti-Fraud Compliance Unit within the Department of Banking and Insurance.

The Governor recommended an additional $232,000 appropriation to reimburse the Office of Information Technology (formerly known as OTIS) for their service costs to the department. According to the Budget-In-Brief, in FY 2000, all departments participated in an Information Technology Strategic Planning process to improve the State's information highway, provide online access to State services, and manage State data, with the goal of transforming New Jersey into the Online State.

Organization Chart



Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS ($000)

	Expended FY 1999	Adj. Approp. FY 2000	Recom. FY 2001	Percent Change 1999-01	Percent Change 2000-01
General Fund					
Direct State Services	$59,260	$59,326	$60,575	2.2%	2.1%
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	$59,260	$59,326	$60,575	2.2%	2.1%
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%
Gubernatorial Elections Fund	$0	$0	$0	0.0%	0.0%
State Total	$59,260	$59,326	$60,575	2.2%	2.1%
Federal Funds	$0	$0	$0	0.0%	0.0%
Other Funds	$5,652	$37,617	$37,617	565.6%	0.0%
Grand Total	$64,912	$96,943	$98,192	51.3%	1.3%

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 1999	Revised FY 2000	Funded FY 2001	Percent Change 1999-01	Percent Change 2000-01
State	468	470	553	18.2%	17.7%
Federal	0	0	0	0.0%	0.0%
All Other	4	4	5	25.0%	25.0%
Total Positions	472	474	558	18.2%	17.7%

FY 1999 (as of December) and revised FY 2000 (as of September) personnel data reflect actual payroll counts. FY 2001 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	26.9%	27.4%	23.3%	----	----

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2000	Recomm. FY 2001	Dollar Change	Percent Change	Budget Page
		ECONOMIC REGULATION			
DIRECT STATE SERVICES					
Salaries and Wages	$26,801	$27,218	$417	1.6%	D-32

This data displays the overall salary and wages account of the department. The salary and wage components are highlighted below.

Salaries and Wages: Licensing and Regulatory Affairs	$7,944	$8,058	$114	1.4%	D-32

According to the Office of Management and Budget (OMB), the proposed increase of $114,000 would be utilized to fund existing positions for which funding was not provided in the current fiscal year. These positions are for financial examinations of HMO's.

Salaries and Wages: Licensing and Regulatory Affairs	$2,016	$2,266	$250	12.4%	D-32
Salaries and Wages: Supervision and Examination of Financial Institutions	$3,503	$3,391	($112)	(3.2)%	D-32

According to the Office of Management and Budget (OMB), the proposed increase of $250,000 for salaries and wages in the Enforcement and Licensing Unit would be offset by the decrease of $112,000 for salaries and wages in the Supervision and Examination of Financial Institutions Unit due to the reallocation of positions during the prior fiscal years. The net effect is an additional $138,000 for the establishment of four new financial examiner positions in the Supervision and Examination of Financial Institutions Unit.

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

Budget Item	Adj. Approp. FY 2000	Recomm. FY 2001	Dollar Change	Percent Change	Budget Page
DIRECT STATE SERVICES					
Salaries and Wages: Division of Actuarial Services	$3,720	$3,885	$165	4.4%	D-32
Special Purpose: Actuarial Service Expansion	$0	$600	$600	—	D-32

According to OMB, the appropriation of $765,000 has been added to the Division of Actuarial Services to support automobile insurance reform which requires revising the current territorial rating plan. The Automobile Territorial Rating Plan Advisory Commission, within the Division of Insurance, will redraw and amend the 50-year-old territory system.

The department's increase of funding for salaries and wages ($165,000) will be utilized in the hiring of four additional staff, two Actuarial Interns and two Analyst IVS, to support the Actuarial Service Expansion.

In the prior fiscal year, the department noted that it was unable to hire its own actuaries to meet the additional workload; salary being the most significant factor in the Department's recruiting difficulties for this profession. The department indicated that "There are approximately 2,500 property and casualty actuaries in the country." Since the department claims they "cannot compete with an insurance company that is willing to pay an Actuarial Fellow more than the highest salary we (the department) are authorized to pay," $600,000 is recommended to hire actuarial consultants.

Services Other Than Personal: OIT Data Processing Initiative	$40	$272	$232	580.0%	D-32

Within the department's overall Services Other Than Personal Account is an additional $232,000 appropriation recommended to reimburse the Office of Information Technology for the costs of their services to the department. In FY 2000, all departments participated in an Information Technology Strategic Planning process to improve the State's information highway, provide online access to State services, and manage State data, with the goal of transforming New Jersey into the Online State.

Language Provisions

2000 Appropriations Handbook	2001 Budget Recommendations

Explanation

The proposed FY 2001 Budget for the Department of Banking and Insurance does not contain any changes in language provisions when compared to the FY 2000 Appropriations Act.

Discussion Points

1. The Governor's proposed Budget recommends funding for 558 positions for the Department of Banking and Insurance. This proposal includes the department's request for 8 additional staff to support insurance actuarial services and examinations of financial institutions. Since the department currently has 474 filled full-time positions, the proposed FY 2001 budget would effectively provide funding for 84 funded, but currently vacant positions.

! *Question:* Please provide a detailed summary of how the department intends to utilize salary and wage funding requested for FY 2001, especially for the positions that are currently vacant. Please provide a detailed summary of how many new employees the department expects to hire, as well as where these positions will be filled within the department and when it expects to fill these positions. Please specify what type of positions are needed throughout the department, such as fraud investigators, actuaries, insurance analysts, consumer complaint investigators, real estate investigators, and clerical support.

How many positions does the recommended budget of the department support within other departments? For example, how many positions in the Department of Personnel under "Shared Services" or in the Department of Health and Senior Services under the "CHIME program" are recommended to be funded through the Department of Banking and Insurance? Please include any other department/program not mentioned above.

2. As with many industries, mergers have continued to sweep the banking industry. According to Division of Banking documentation, current through January, 2000, 18 bank mergers were accomplished in New Jersey in calendar year 1999, compared to 3 mergers in 1992, 10 each in 1993 and 1994, 11 in 1995, 18 in 1996, 8 in 1997, and 12 in 1998.

At the same time, New Jersey has seen a significant and continuous increase in the number of charters granted to new financial institutions in this State, including 28 new charters approved since 1994, with three applications currently pending.

According to the department's response to last year's discussion points, the number of new charters increased the workload of the Division of Banking significantly; therefore the department indicated the need to hire 8 to 10 additional people to provide adequate oversight, due to this increase.

! *Question:* How has the number of new charters affected the workload of the Division of Banking? As indicated in the response from last year's discussion points, did the department hire the additional staff as intended? What does the department anticipate future staffing needs will be, if the current trend continues?

3a. The Governor's Budget proposal for FY 2001 includes a $765,000 increase in the appropriation for the Actuarial Services Unit within the Division of Insurance. The appropriation is recommended to support the revision of the current territorial rating plan, as a component of the division's automobile insurance reform initiatives. The Automobile Insurance Territorial Rating Plan Advisory Commission, recently established within the division, is responsible for redrawing the 50-year-old territorial rating plan used in determining automobile insurance premiums throughout the State.

Historically, the department has experienced difficulty in hiring and retaining actuaries. Of the recommended increase in funding, $165,000 is allocated for the hiring of four additional staff,

Discussion Points (Cont'd)

two analysts and two interns, and $600,000 is allocated for the hiring of actuarial consultants.

! *Question:* How many actuaries does the department currently have on staff? Has the department been more successful in hiring actuaries during the past year? Please provide a summary of actuarial staff detail for the last five years.

Has the department needed to utilize consultants for FY 2000 oversight? What does the department anticipate it will spend on actuarial consultants in FY 2000? How many actuarial consultants does the department intend to hire in FY 2001?

What is the cost per hour or per consultant? Since the level of actuarial salaries has contributed to the department's difficulty in hiring actuaries, would the department recommend that the $600,000 be utilized to increase the level of staff salaries rather than for the hiring of consultants? Does the department anticipate the trend in using consultants to continue?

3b. In response to last year's discussion points, the department stated that the rules to establish standards for the Territorial Rating Plan were being drafted.

! *Question:* What is the current status of the Automobile Insurance Territorial Rating Plan Advisory Commission? Please specify what has been done to date. Are the rules to establish these standards completed? What is the anticipated time frame for the Commission to begin and complete its revision of the territories?

Does the department have sufficient actuarial and other staff to adequately review the territorial rating plans filed by insurers that choose to develop their own plan rather than use the plan developed by the Automobile Insurance Territorial Rating Plan Advisory Commission?

4. The Office of Insurance Claims Ombudsman was established by the "Automobile Insurance Cost Reduction Act of 1998" (AICRA) and charged with the responsibility to: investigate consumer complaints regarding insurance policies and the payment of claims; monitor the implementation of various insurance regulating laws; respond to consumer inquiries about policy provisions and coverage availability; and publish and disseminate buyers' guides and comparative rates.

The Insurance Claims Ombudsman was appointed by the Governor and began serving on August 2, 1999. The Ombudsman must report annually to the Governor and the Legislature on significant insurance industry problems related to claims settlement practices and make recommendations for changes that will improve the State's ability to resolve claims disputes.

! *Question:* Please detail how the $776,000 appropriation for the Ombudsman is allocated during FY 2000 and how the department anticipates the appropriation to be spent in FY 2001, including the number of staff funded and hired. Please detail the Office's accomplishments to date. Please provide the number of complaints and inquiries the Ombudsman's office has handled, including the disposition of those complaints.

5a. The AICRA also created the Office of the Insurance Fraud Prosecutor. The Insurance Fraud Prosecutor was sworn in on October 28, 1998. The mission of the Office of the Insurance Fraud Prosecutor (OIFP), who works within the Division of Criminal Justice in the Department of Law and Public Safety, is to thoroughly investigate allegations of Medicaid and insurance fraud and to

Discussion Points (Cont'd)

develop case-specific facts and evidence. This allows the State of New Jersey to make a reasoned decision whether and how to proceed in cases involving insurance fraud, especially against those who submit false or inflated insurance claims.

The enactment in 1997 of legislation establishing health care claims fraud as a criminal offense further reveals the Legislature's purpose in criminally targeting purveyors of insurance fraud. Under this act, a practitioner who knowingly submits fraudulent insurance claims has committed a crime of the second degree, for which the practitioner can be sentenced to a term of imprisonment of five to ten years. With this legislative emphasis in mind, and because practitioners play a major role in the processing of all insurance claims, one of the OIFP's chief missions is to target practitioners who submit false and inflated insurance claims.

! *Question:* Please detail the progress of the OIFP to date, broken down by years. For example, please provide the following data regarding criminal and Medicaid fraud cases: the number of cases referred, cases investigated, cases pending; licenses surrendered/suspended and revoked; subjects prosecuted: indictments, accusations; convictions: pleas/sentences; total fines and total restitution.

For civil fraud cases, please include the number of: complaints filed, complaints served; enforcement actions, penalty amounts imposed and collected, including the number of penalty amounts "Paid in Full;" and the number of cases resolved, and judgment amount totals.

Please discuss the reasons for an anticipated decrease in revenues, from $2.257 million in FY 1999 to $1.914 million per year in FY 2000 and FY 2001, from fines collected by the Insurance Fraud Division.

5b. In a newspaper article, dated March 1, 2000, it was reported that the State's Insurance Fraud Prosecutor indicated that, although investigations are continuing, the 1999 program to find New York City and Philadelphia "rate evaders" or residents, who misrepresent themselves as New Jersey drivers to obtain lower auto insurance rates, has been extremely difficult.

According to the article, the Insurance Fraud Prosecutor indicated that, "in many cases, underlying facts might not constitute fraud, such as cases of New Jersey residents moving recently to New York or Pennsylvania." According to the article, the program was a highly touted part of the State's efforts to fight fraud. However, the Insurance Fraud Prosecutor continued to say that, "only a handful of people have ever actually been charged," and although the department continued the program throughout 1999, the continuation of this controversial program "may not be worth the effort."

! *Question:* Please indicate whether or not funding will be allocated for this program in FY 2001. Does the department have any alternative recommendations on how the unit can address this issue?

Of all the current insurance fraud investigators hired, how many are assigned to long-term, and to undercover, investigations? How many investigators does the department anticipate hiring in the current fiscal year? In FY 2001?

6. Prior to the enactment of AICRA, disputes over excessive or inappropriate medical treatment for injuries resulting from automobile accidents were resolved by panels of lawyers, not doctors.

Discussion Points (Cont'd)

Under the new arbitration system, independent full-time professional arbitrators and if necessary, independent medical review boards of doctors, have been charged with the responsibility to review and settle disputes regarding PIP medical expense benefits.

According to the department, competitive bids for the responsibility of arbitration were sought through the Division of Purchase and Property, Department of Treasury. After a thorough evaluation, the division has announced its intent to award the contract to the American Arbitration Association.

! *Question:* Has the American Arbitration Association accepted the contract award? If not, is the contract being placed with another bidder? Briefly outline the terms of the contract including costs. Please provide a copy of the contract to the Legislative Budget committees through the Office of Legislative Services.

Have any cases been considered by the dispute resolution organizations, as provided under AICRA? If so, how many cases have been heard and what has been the disposition of these cases?

7. During the current fiscal year, legislation (P.L. 1999, c.143) was enacted to modify the "growth cap" placed on the Special Purpose Assessment imposed on insurers pursuant to section 13 of P.L. 1995, c.156 (C.17:1C-31). The new law set the cap at 0.20 percent of the combined net written premiums received during the previous year, while prohibiting the department from raising more through the assessment than is required to reimburse the department for its "special purpose" expenses related to regulation, supervision and monitoring of insurers and health maintenance organizations.

! *Question:* Please specify what department expenditures will be covered by the Special Purpose assessment in the current fiscal year.

8. During the past year, the Department of Banking and Insurance has dedicated significant time and resources to the insolvency of HIP of New Jersey, Inc. (HIP-NJ) and American Preferred Provider Plan, Inc. (APPP) health plans, confronting the challenge to address the fiscal obligations of the two organizations while managing the needs of the patients and subscribers in the health plans. According to the department, every action taken by the department with respect to the insolvencies was consumer driven. The plans presented to the court provided for continuity of care, consumer choice and public disclosure. The department indicated that this experience has forged a stronger working relationship between the medical profession, hospital and health plan associations and the department.

The Division of Insurance engaged in significant efforts in the current fiscal year to protect consumers of certain health maintenance organizations (HMO's) facing serious financial difficulties. To avoid future HMO insolvencies, the department has developed initiatives to improve the monitoring of the financial conditions of HMO's operating in New Jersey. For example, the regulation of "organized delivery systems," P.L. 1999, c. 409, authorizes the department to review financial risk sharing between and among HMO's and subcontractors. In addition, newly promulgated managed care regulations, together with new laws promoting expedited billing and payment processes will increase the department's ability to monitor New Jersey's managed care industry and provide a stronger financial safety net for health care consumers and providers.

The department worked with the Department of Health and Senior Services to draft

Discussion Points (Cont'd)

amendments to the rules governing HMO's. The amendments include: increasing the frequency of submission of actuarial certification of an HMO's reserves from an annual to a quarterly basis, mandating on-site pre-operational audits of the operations and financial controls of HMO's, increasing the amount of funds an HMO must have on deposit with the department, requiring that a minimum amount of an HMO's assets be in the form of cash or cash equivalents, and finally, imposing more stringent requirements on parental guarantees of an HMO's minimum net worth. As a result, amendments to the HMO regulations have been adopted and implemented, making New Jersey financial requirements for HMO's among the most stringent in the United States.

Pending legislation (ACS-1809/1605;S-1046) creates the New Jersey Insolvent Health Maintenance Organization Assistance Fund, a limited purpose trust fund, and authorizes the fund to pay certain unpaid contractual obligations of these HMO's incurred prior to the date of insolvency. The purpose of this bill is to protect, subject to certain limitations, covered individuals and providers against the failure or inability of HIP and APPP to perform certain contractual obligations due to insolvency. In its current form, the bill appropriates $50 million from the State's tobacco settlement proceeds and provides for an additional aggregate sum of not more than $50 million to be collected through assessments on HMO's over a three-year period. In addition, providers of health care services must agree to forgive one-third of those unpaid contractual obligations due them to receive payment from the fund.

! *Question:* Please discuss the current status of HIP and APPP. Please include the total number and amount of outstanding claims for both insolvent HMO's. What are the other outstanding claims? How will these other claims be paid?

What financial requirements do HMO's have to meet? Does the department have sufficient staff to provide adequate oversight?

Please estimate the total expenses to the department, to date, of HIP and APPP oversight and liquidation activities, including the legal and court costs incurred by the department, as well as staff training and staff time spent in these activities. What proportion of their time was spent on oversight versus other duties? Please indicate whether the department has sufficient staff to continue its oversight and liquidation efforts of HMO's?

Has the department filed any litigation with respect to recovery of any assets of the two insolvent HMO's? If not, does the department anticipate that it may file to recover assets of the failed HMO's? Please explain the department's efforts to date. What are the estimated costs, if any, associated with any litigation?

9a. The Anti-Fraud Compliance Unit within the department focuses on two critical areas concerning insurance fraud. Its primary function is to ensure insurance industry compliance of those insurers writing health or private passenger automobile insurance in this State. The Anti-Fraud Compliance Unit consists of three main sections: Audits and Compliance, Industry Education and Collections.

There are two Compliance Sections in operation which periodically monitor the functional units of the aforementioned carriers to assure compliance with their fraud prevention and detection plans. In addition, a sampling of case files are reviewed and carriers' annual fraud reports are examined.

In response to last year's discussion point regarding fraud compliance, the department

Discussion Points (Cont'd)

indicated that its auditing activities would be focused on better enforcement of the Fraud Compliance Plan provisions.

! *Question:* Does the department have any quantifiable estimates of how the services provided by this section have improved or will improve? How many on-site audits has this section completed? How many resulted in findings of non-compliance of standards?

9b. The Industry Education Section within the Anti-Fraud Compliance Unit focuses on another critical area: addressing contemporary problems and concerns of the insurance industry regarding insurance fraud. This unit develops and implements seminars and training programs for insurance industry professionals. Training sessions have been developed for claims representatives, underwriters, Special Investigative Unit personnel, and insurance brokers and agents. The issues addressed include: current fraud trends; fraud indicators in claims investigations; problems encountered in suspicious claims investigations; elements of application fraud; and compliance issues. The training sessions can be tailored to meet specific needs and time schedules.

The Industry Education Section indicated that over thirty Insurance Fraud seminars were held. The department anticipated that once formal notification was released to the industry, the number of requests for educational seminars addressing contemporary problems and concerns of the insurance industry was expected to increase noticeably.

! *Question:* How many seminars has this section provided since formal notification? What is the response to and demand for these seminars?

Who are the attendees of these seminars? Is there a cost to those attending the seminar? Are the seminars self-supporting? Has the department received any response from the industry with respect to the effectiveness of these seminars? Please summarize this response, if any. Are any follow-up studies being conducted to evaluate the results of the seminars? Does the department anticipate that it will have sufficient staff to continue supporting this program?

9c. The final section within the Anti-Fraud Compliance Unit is the Collections Section. It has been established to coordinate the collection of all penalties and fines resulting from the civil resolution of insurance fraud cases. This section locates delinquent subjects, updates the fines database, investigates delinquent case files, and assists with the preparation of legal action against violators of the law.

! *Question:* How much revenue has the Collections Section collected annually since inception.

Is the Collections Section still assisting the Insurance Section within the Division of Law? If so, how many employees are assisting the Division of Law? How many investigations have resulted in legal actions?

10a. The federal "Financial Services Act of 1999," known as the Gramm-Leach-Bliley Act, broke down the barriers separating banks, insurance companies and securities firms to expand the entire financial services marketplace. That act, among other things: repeals the restrictions on banks affiliating with securities firms imposed under the Glass-Steagall Act; creates a new "financial holding company" under the Bank Holding Company Act, which can engage in a prescribed list of financial activities, including insurance and securities underwriting and agency activities and

Discussion Points (Cont'd)

insurance company portfolio investment activities; confirms state regulations of insurance while prohibiting states from discriminating against persons affiliated with a bank; permits national banks to engage in new financial activities through financial subsidiaries; initiates processes for creating uniform nationwide licensing of insurance agents and brokers; permits national bank subsidiaries and affiliates to sell all types of insurance, including title insurance; preempts state laws that interfere with affiliations between banks and insurance companies; and requires every financial institution to disclose its policy regarding the sharing of "non-pubic personal information" with affiliates and with third parties and requires that consumers be given an opportunity to "opt out" of sharing their non-public personal information with nonaffiliated third parties.

! *Question:* Please describe what impact the new federal banking law will have on the department in terms of adding to its oversight responsibilities. What actions does the department anticipate it will need to take in regard to the new federal banking law in terms of any added staffing and training needs?

If more staff is required, does the department intend to utilize some of the funded, but vacant positions? If so, how many?

Does the department anticipate the formation of financial holding companies in New Jersey? If so, to what extent?

As a result of the enactment of the new federal banking law, does the department anticipate the need for any action in order to keep State-chartered banks, savings banks and savings and loan associations more competitive? If so, please describe what the department feels would be necessary.

Does the department anticipate any necessary changes or modifications to the "New Jersey Insurance Producer Act," N.J.S.A. 17:22-1 et seq. as a result of the enactment of this new federal law?

10b. The Bureau of Securities, New Jersey's counterpart to the federal Securities and Exchange Commission, prosecutes fraud and enforces the New Jersey Uniform Security Act by ensuring that broker-dealer firms, agents and investment advisors are registered with the State.

! *Question:* As a result of the enactment of the Gramm-Leach-Bliley Act that breaks down the barriers separating banks, insurance companies and securities firms, should the transfer of the Bureau of Securities within the Department of Law and Public Safety, Division of Consumer Affairs, to the Department of Banking and Insurance be considered? If not, has a cooperative plan between the two departments to provide effective oversight been considered, proposed or adopted? Please provide the details of that plan or any other dual oversight activities.

Background Paper: ATM Surcharges and Fees

Overview

This background paper explains the most common types of ownership and location arrangements under which automated teller machines (ATM's) are operated and discusses the different types of ATM transactions and the potential surcharges and fees a consumer may incur in using an ATM. It then discusses the debate over fees and surcharges, using national statistics to illustrate. The paper concludes with a discussion of local, state and federal legislative initiatives and some suggestions for consumer use of ATMs.

ATM Locations

There are three usual ownership/location arrangements at which a consumer can utilize an ATM. The first is a depository institution owned ATM, operated at a depository institution location. The second is a depository institution owned ATM, operated at a non-depository institution location. The third is an ATM which is owned by an entity other than a depository institution and is operated at a non-depository institution location. In order for a non-depository institution to own and operate an ATM, it must have access to certain regional and national networks, of which there are about 40 and all of which are owned by depository institutions. Further, for a non-depository institution to have access to these networks, it must be sponsored by a depository institution.

ATM Transactions and Potential Fees

A depository institution's customer is one who has an account with the institution. An "On Us" transaction refers to a customer's ATM transaction in which the machine used is that of the customer's institution. Depository institutions do no typically charge their customers additional fees for accessing the depository institution's ATM. An "On Others" transaction refers to a customer's ATM transaction in which the machine used is that of another institution. For example, (A) has an account at Bank (1), but uses Bank (2)'s ATM. As a result of this type of transaction, (A) may incur additional ATM fees. These fees may include an "Interchange Fee," in which Bank (1) pays Bank (2) for utilizing a regional or national network, or a "Switch Fee," where Bank (1) directly pays a regional or national network for utilizing the network. (A) may also incur a "Surcharge," where (A) pays Bank (2) for utilizing Bank (2)'s ATM, or a "Foreign Fee," where (A) pays Bank (1) for using Bank (2)'s ATM.

Summary of Actual Fees

According to data contained in the Department of Banking and Insurance's "Consumer Guide to Bank Fees," approximately 85 percent of the depository institutions in this State do not impose monthly service charges; 97 percent of these institutions do not impose transaction fees for "On Us" transactions; and 53 percent of these institutions do not impose a charge on customers for "On Others" transactions. Of the 47 percent that do impose such a charge, the fee may be as much as $1.50 per transaction. Moreover, 94 percent of the depository institutions in this State impose a "surcharge" on non-customers who use the institution's ATM. This "surcharge," which is an additional charge to a potential transaction fee for transactions "On Others," may also be as much as $1.50 per transaction.

Background Paper: ATM Surcharges and Fees (Cont'd)

The Debate over Surcharges/Fees

- Banks argue that fees on non-customers offset the costs of installing and maintaining the network of ATMs. According to the industry, ATM machines operated at a loss for years, therefore, ATM surcharges help banks recoup costs.

- Banks and credit unions say they are justified in charging non-customers to use their ATMs because it means those non-customers are paying for convenience, and it keeps costs down for their own customers.

- Consumer groups argue that: ATM surcharges are not adequately disclosed, making fees deceptive; ATM surcharges do not represent a market price determined by competition, and are therefore, anti-competitive; and ATM surcharges bear little relationship to banks' costs, generating windfall profits for already profitable banks.

- Consumer advocacy groups claim the most dramatic effect on surcharging has been the rapid conversion of existing surcharge-free ATMs into surcharging ATMs. They note that thousands of ATMs were deployed across the United States before surcharges were permitted; therefore, consumers groups disagree that surcharging is necessary to cover costs for the increase in ATM installations.

History of Surcharges

On April 1, 1996, national ATM networks, MasterCard's Cirrus and VISA's Plus, and regional ATM networks began allowing private companies to surcharge non-account holders for ATM credit and debit card transactions. According to a 1999 Public Interest Research Group (PIRG) report, surcharging was only allowed in 15 states before April 1996. Despite the conveniences ATMs provide, surcharging ATM users has caused a considerable amount of controversy.

Number of ATM Machines

According to the American Bankers Association (ABA), the number of ATMs nationwide has nearly doubled since 1996, providing consumers greater access to their money. According to the ABA, if banks cannot charge for the service of providing cash to non-customers, consumers around the country will be deprived of the ability to withdraw cash from any ATM but those of their own bank.

Number of ATM Machines in the U.S.

1991	1992	1993	1994	1995	1996	1997	1998	1999
83,000	87,330	94,822	112,755	122,706	139,134	165,000	187,000	227,000

Source: American Bankers Association 1999 ATM Fact Sheet

Total U.S. ATM Transactions

The industry admits that ATM transactions cost about one tenth as much as teller transactions, but claim that consumers find ATMs so convenient that they engage in more and more transactions.

Background Paper: ATM Surcharges and Fees (Cont'd)

Although the number of ATMs has increased, the ABA indicated that ATM transactions stalled at near $11 billion annually for four years, with monthly transactions per machine declining sharply.

Total U.S. ATM Transactions (in billions)

1991	1992	1993	1994	1995	1996	1997	1998	1999
6.41	7.20	7.70	8.45	9.68	10.70	11.00	11.20	11.00

American Bankers Association 1999 ATM Fact Sheet

Facilities Imposing Surcharges

According to the 1999 PIRG report, surcharging by big banks, which own the majority of ATMs, poses a competitive threat to smaller banks and credit unions, which usually offer consumers a low-priced alternative to the big banks. According to PIRG, if small bank customers switch accounts to big banks to avoid surcharges, then the big banks, facing less competition, will raise the fees they charge their own customers. Small banks and credit unions attack surcharges as not only anti-consumer, but anti-competitive.

Percentage of Facilities Imposing a Surcharge

	1997	1998	1999	% change '98-'99	Average surcharge
Big Banks	51%	83%	95%	15%	$1.42
Small Banks	39%	65%	91%	40%	$1.30
All banks	45%	71%	93%	31%	$1.37
Credit Unions	N.A.	13%	42%	31%	$0.98

Source: Public Interest Research Group 1999 ATM surcharge survey

However, from the industry's perspective, according to the Consumer Bankers Association (CBA), many community bankers view ATMs as a substitute for extensive branch networks, another way to attract customers. The CBA indicated that surcharges serve to support the expansion of the ATM networks, particularly at non-branch locations for small banks, big banks and non-banks. The banking industry considers these "convenience fees" not uncommon to the industry and note that many other businesses (for example, Ticket Master) assess fees on consumers for convenience services.

Off-Premise ATM Deployment

Owners of ATMs also deploy and operate ATM machines at "off-premise" locations, ATMs that are not at bank branches. Originally, ATMs were installed at bank branches only. However, the ABA reported that the number of "off-premise" ATMs, has more than doubled since 1996, totaling 117,000 ATMs in locations that previously had no ATM access. According to the ABA, more than half of the ATMs in the U.S. are now in convenient off-premise locations.

Background Paper: ATM Surcharges and Fees (Cont'd)

Number of Off-Premise ATM Deployment in U.S.

1994	1995	1996	1997	1998	1999
28,707	37,804	51,507	67,000	84,000	117,000

Source: American Bankers Association 1999 ATM Fact Sheet

According to the banking industry, ATMs also are increasingly expensive to own, operate and maintain. The ABA estimates that the cost of new machines can be as high as $50,000, depending upon features. An additional $12,000 to $15,000 is required every year for maintenance costs to replenish the cash, service the equipment, and pay other operating expenses. Additional ATM costs may include lighting and cameras, advertising, monthly network fees and the interest income lost on deposits.

Off-Premise ATM Monthly Costs

Depreciation	$300
1st Line Maintenance	$270
2nd Line Maintenance	$150
Cost of funds	$97
Telecommunications	$123
ATM processing	$100
Other	$50
Total	$1,090

Source: American Bankers Association 1999 ATM Fact Sheet

What Are States Doing to Regulate ATM Fees?

A number of states and localities have attempted to restrict ATM fees and surcharges, resulting in a number of legal challenges by the banking industry. Locally, for instance, members of the Woodbridge, New Jersey Town Council voted on February 15, 2000 to eliminate surcharges at township ATMs owned by financial institutions. The ordinance was supposed to take effect on March 9, 2000 charging financial institutions $1,000 a day for non-compliance. However, on February 17, 2000, U.S. District Judge Joseph A. Greenaway Jr. issued a temporary restraining order blocking enforcement of the Woodbridge Township ordinance.

In Iowa, a similar ban was upheld only for state-chartered banks. In Connecticut, surcharges were banned statewide; however, a State Supreme Court decision in December overturned state Banking Commissioner John Burke's interpretation of a 1975 law banning service charges by banks, saying the law predated widespread use of ATMs and therefore did not apply.

In a case that has garnered national attention, municipal ATM surcharge bans in two California cities, San Francisco and Santa Monica, prompted two banks to close off non-customer access to their machines and a federal judge to bar enforcement of the bans. The California Bankers Association, in a lawsuit currently pending against the two cities, argues that federally-chartered banks are exempt from such ordinances because the Office of the Comptroller of the Currency is

Background Paper: ATM Surcharges and Fees (Cont'd)

their sole regulatory authority.

A summary of State actions to regulate ATMs follows:

States that Regulate ATM Fees

State	State Prohibit/Limit ATM Fees	Only Banks may set up ATMs	State Authorization for Dispensation from ATMs other than Cash
Alaska		Yes	Yes
Arkansas	Yes		Not addressed in code.
Colorado			No specifically prohibited.
Connecticut	Yes	No. But only banks and credit unions are authorized to accept deposits.	
Delaware		Yes	Yes
Georgia		Yes, but other businesses may operate "cash dispensing machines" that dispense cash or scrip redeemable for cash or other goods and services.	Yes
Guam (Territory)	Yes		
Hawaii			Yes
Illinois			Yes
Indiana			Yes
Iowa	Yes		
Maine		Yes	
Michigan		Yes	
Minnesota			Yes
Mississippi	Yes		
Nebraska			No, but permissible if authorized by Department order.
New Hampshire			Yes
New Mexico		Yes	
North Dakota			Yes

Background Paper: ATM Surcharges and Fees (Cont'd)

State	State Prohibit/Limit ATM Fees	Only Banks may set up ATMs	State Authorization for Dispensation from ATMs other than Cash
Ohio		Yes	
Puerto Rico		Yes	
South Dakota		Yes	
Tennessee		Yes	
Texas			Yes
Utah		Yes	Yes
West Virginia	No, but prohibits banks from charging each other unreasonable fees for sharing machines.	No, but credit unions may establish such machines within West Virginia.	
Wyoming	Yes		Yes

Conference of State Bank Supervisors

Federal Legislation

At the federal level, the "Gramm-Leach-Bliley Act," Pub.L. 106-102, (see background paper) signed into law on November 12, 1999, requires ATM operators to post fee notices on their machines, note any transaction charges on-screen, and offer consumers the option of canceling the transfer.

Other federal legislation currently pending before Congress regulating ATM fees includes: the "State & Local Automated Teller Machine Regulation Protection Act of 1999" (H.R. 3493) would affirm the authority of state and local governments to regulate ATM surcharges. The "Fair ATM Fees for Consumers Act" (H.R. 1575), which would amend the "Electronic Fund Transfer Act" to limit fees charged by financial institutions for the use of automatic teller machines, and for other purposes; the "Electronic Fund Transfer Fees Act of 1999" (H.R. 3229), which would prohibit ATM operators from imposing ATM surcharges; and the "ATM Surcharge Elimination and Consumer Empowerment Act" (H.R. 3494), which would provide for basic low-cost banking accounts, eliminate certain automated teller machine surcharges, and re-authorize a bank fee survey conducted by the Board of Governors of the Federal Reserve System.

The industry is opposed to any federal legislation restricting ATM surcharges and fees. According to Consumer Bankers Association, the decision of whether or not to use a particular ATM is best left to the individual consumer, and the decision of whether or not to charge consumers for the convenience of using a particular ATM is best left to the individual organization operating that machine.

Background Paper: ATM Surcharges and Fees (Cont'd)

Suggestions for Consumers

Finally, the following are suggestions from consumer advocacy groups for consumers wishing to inoculate themselves from ATM fees:

- Use your own bank or credit union's ATM. According to the results from the Administration's comprehensive bank fee survey, 97 percent of New Jersey banks offer free access for their own customers.

- Withdraw more money than you need to eliminate the temptation of using another financial institution or off-site ATM.

- Ask for cash back at the grocery store. Most financial institutions do not charge for this type of transaction.

- Write a check or use your card at a store that allows you to get money back without a fee.

- Write a check for cash when you deposit your paycheck.

- Try to establish an account at a bank that has many of ATMs.

- If you have an account at a smaller institution, find out if it belongs to a surcharge-free ATM network of other smaller banks and credit unions.

- Compare the costs of your accounts to those of other banks in your area.

Background Paper: Financial Oversight of the Managed Health Care Industry-Update on the Financial Insolvency of HIP Health Plan of New Jersey and American Preferred Provider Plan

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Overview

Discussion Point #8 within this booklet highlights the activities of the Department of Banking and Insurance over the course of the current fiscal year relevant to the financial oversight of the managed care industry in New Jersey, with special emphasis on its activities in connection with the liquidation of two insolvent health maintenance organizations (HMOs), HIP Health Plan of New Jersey (HIP) and American Preferred Provider Plan (APPP). Legislative and regulatory actions continuing in the current fiscal year have expanded the department's responsibilities in this area, with a direct impact on the department's workload. This background paper identifies the areas of increased financial oversight now required to be performed by the department, summarizes the department's liquidation activities to date and discusses pending legislation which would provide funding for a portion of the claims against HIP and APPP.

Increased Financial Oversight Responsibilities

During FY 1999-2000 the Department of Banking and Insurance engaged in substantial activities related to the financial oversight of the managed care industry in this State. Specifically, in connection with its ongoing activities dedicated to the liquidation of HIP and APPP, the department, in conjunction with the Department of Health and Senior Services, adopted stricter regulations aimed at monitoring the financial condition of health maintenance organizations and other managed care entities doing business in New Jersey. These regulations, among the most stringent in the United States:

- mandate an on-sight pre-operational audit of an HMO, prior to the issuance of a certificate of authority, to evaluate its operations and financial controls and its ability to perform its essential functions;
- require that 60% of an HMO's admitted assets, necessary to support its minimum net worth requirements, be in the form of cash or cash equivalents;
- require a minimum net worth guarantee of at least $25 million and continuous recent satisfactory ratings from an established financial rating organization;
- require maintenance of a restricted asset deposit with the department, equivalent to 50% of the highest quarterly premiums for the most recent four quarters; and
- require submission of actuarial certifications of an HMOs reserves on a quarterly, in addition to annual, basis.

Furthermore, it is anticipated that additional legislative and regulatory safeguards will prevent future HMO insolvencies of the scope and magnitude of HIP and APPP. For example, new laws promoting expedited billing and payment processes, Healthcare Information Networks and

Background Paper: Financial Oversight of the Managed Health Care Industry-Update on the Financial Insolvency of HIP Health Plan of New Jersey and American Preferred Provider Plan (Cont'd)

Technologies, P.L.1999, c.154 ("HINT") strengthen the department's ability to monitor the managed care industry as a whole. In addition, legislation requiring the licensing of "organized delivery systems," P.L.1999, c.409, increases the department's ability to review financial risk sharing between HMOs and subcontractors, which was a primary obstacle encountered by the department with respect to its approval of certain business mergers of HIP prior to its insolvency. The department has obtained the statutory authority to review the financial viability of subcontractors, with the goal of stabilizing the quality and continuity of health care for consumers.

HIP Liquidation and Subsequent Activities

By May of 1999, the department had refocused its regulatory oversight activities with respect to the insolvency of HIP from rehabilitation of the financially impaired HMO to the liquidation and the winding down of its business affairs. The department's efforts included distribution of limited payments to providers and ensuring continued care to HIP members. In addition, during that time, the department engaged in notifying the approximately 165,000 HIP members of the decision to close the HMO and transitioning members to other health care plans. Moreover, as of April 1, 1999, the department had established a mandatory open enrollment period whereby all HMOs were required to enroll former HIP members seeking continued health services coverage. Both the department and the Department of Health and Senior Services expended considerable efforts with respect to the oversight of this open enrollment process.

Because certain HIP members were granted a 120 day period from March 31, 1999, the day HIP ceased operations, to continue with their treating physician, whether or not that physician was affiliated with any new health plan of the member (or six weeks post-partum for pregnant members in their second or third trimester), the department's oversight activities extended well beyond the March 31, 1999 date of liquidation. Thus, subsequent to March of 1999, the department, together with the Deputy Liquidator, has concentrated on marshaling any assets of HIP, disseminating and collecting proof of claims and continuing payment to physicians and hospitals who continued to provide services to members during the rehabilitation period, and afterwards.

When HIP was placed in rehabilitation on November 21, 1998, it had approximately $45.4 million in assets. With respect to asset recovery activities, former Commissioner LaVecchia indicated in testimony before the Senate Health Committee on May 20, 1999, that the department was in the process of identifying the full scope of the debt of the insolvent HMO, which included a forensic accounting analysis to determine whether HIP's partner improperly diverted HIP premium payment to sources other than providers. In addition, the former commissioner indicated that special counsel was being secured for purposes of investigating and evaluating all possible legal causes of action, including a directors and officers action against HIP management and board members, which could bring as much as $45 million into the asset pool. Other assets included funds on deposit with the department and premiums paid to HIP during the rehabilitation period. Also, surplus moneys from the liquidation of HIP Insurance Company of New Jersey, Inc., a small indemnity insurer that issued group policies in conjunction with HIP's in-network HMO coverage, were transferred to HIP to pay providers who participated during the rehabilitation period.

Background Paper: Financial Oversight of the Managed Health Care Industry-Update on the Financial Insolvency of HIP Health Plan of New Jersey and American Preferred Provider Plan (Cont'd)

In addition to the approximately $30 million distributed in late December of 1998 as advance incentive payments to providers who agreed to continue providing services to HIP members during the rehabilitation efforts and transition period, the department negotiated payment for claims for services rendered at 75 percent of the provider's contract rate. These payments only applied to post-rehabilitation services, subsequent to November of 1998, and had no application to any outstanding debt or claims incurred prior to that time. Prior to March 31, 1999 and while HIP was still operating, under the rehabilitation plan agreement using the 75 percent payment scale, $32,172,551 was paid to providers participating in the plan and continuing to serve HIP members. Additional payments at the 75 percent payment rate were made by the department as follows:

- May 6, 1999 - $3,490,026;
- July 14, 1999 - $7,042,633;
- October 10, 1999 - $1,686,950;
- December 3, 1999 - $5,999,520;
- January 3, 2000 - $6,160,191;

for a total payment under the rehabilitation plan agreement of $56,551,871.

In addition to these payments, the department is reviewing claims filed under the "proof of claim" process, which applies to any claim against HIP, both prior and subsequent to liquidation. Actual or potential claim holders were directed to file a notice of claim by the filing deadline of August 7, 1999. After all claims have been submitted and reviewed, the extent to which these claims can be paid from the assets of HIP will be determined. Claim holders will be notified of any payment plan when that plan is presented to the court for approval.

APPP Insolvency and Sale of Business

At the same time that it was overseeing the liquidation of HIP, the department was also engaged in activities related to the liquidation of APPP. That HMO was declared insolvent on December 10, 1998 and placed under an Order of Liquidation on April 20, 1999. According to first quarter 1998 financial statements, the department had discovered that APPP had made loans outside the normal course of business to companies owned by Dr. Magdy Elamir, the sole owner of APPP. The loans were improperly listed as "receivables," contrary to State regulations, and appeared as assets on the company's financial statements. The improper accounting for the loans, along with inaccurate claim and reserve data, falsely inflated the company's net worth. The approximate claims liability of APPP was determined to be $30 million.

During the period of rehabilitation, the department focused on protecting APPP members and marshaling the assets of both APPP and Dr. Elamir personally. The major portion of APPP's business consisted of services to Medicaid recipients and New Jersey KidCare program participants. The Medicaid business was sold to Horizon Healthcare of New Jersey, Inc. from which the

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department recouped approximately $4 million. The sale of an affiliate company of Dr. Elamir's netted $850,000, which was deposited in court pending a determination as to whether the money would be paid to the liquidator or to Dr. Elamir. In addition, by court order, $4 million of Dr. Elamir's related corporations' assets were frozen and he was required to post a bond for $848,000 to guarantee the availability of funds if the court determines that payments made directly to Dr. Elamir were improper.

With respect to payments to providers, departmental projections indicate that claims for the post-rehabilitation period (December 10, 1998 through April 20, 1999) will be paid in full at 100 percent of the contract rate, while pre-rehabilitation claims will be paid at 18 to 22 percent of that rate.

New Jersey Insolvent Health Maintenance Organization Assistance Fund

In 1991 the Legislature enacted the "New Jersey Life and Health Insurance Guaranty Association Act," P.L.1991, c.208, to provide protection through the limited payment of benefits and continuation of coverages to certain policyholders affected by the impairment or insolvency of life and health insurers that issue policies in New Jersey. All life and health insurers licensed to do business in New Jersey are required to belong to the guaranty association which is funded through member assessments. HMOs are specifically excluded from the provisions of that act and do not contribute to the guaranty association fund.

Recently, legislation has been introduced, based upon an Administration proposal, to provide a funding mechanism for payment of pre-rehabilitation claims of providers and certain covered individuals of both HIP and APPP. Pursuant to the provisions of A-1890/1605(ACS)(ACS)(1R) and its Senate counterpart, S-1046, $50 million is appropriated from the tobacco settlement proceeds and $50 million will be collected through the assessment of HMOs, over a three-year period. As of March 23, 2000, the bills have passed the Legislature and currently await signature by the Governor.

While the total outstanding debt of both insolvent HMOs is estimated at $150 million, the bill establishes the "New Jersey Insolvent Health Maintenance Organization Assistance Fund," (the "fund") as a limited purpose trust fund, not to exceed $100 million. Provisions of the bill stipulate that hospitals, physicians and other health care providers must agree to forgive approximately $50 million of the total amount owed as a condition of receiving any payment under the bill.

The bill establishes the "New Jersey Insolvent Health Maintenance Organization Assistance Association," (the "association") as a tax-exempt, nonprofit legal entity, of which all HMOs authorized to transact business in this State are designated members as a condition of their authority to continue to transact business in New Jersey. The bill provides for a claims adjudication process and establishes standards to determine which claims are eligible for payment under the bill. The cost of the claims adjudication shall be borne by the association members and shall not exceed $2

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million. Member HMOs will be assessed, in installments, over a three year period, in amounts as needed to pay eligible claims.

It is estimated by the department that an HMO will pay less than 1 percent of its annual net written premiums, or approximately .6 percent, to the fund. Assessment estimates based on 1999 premium revenue of $4.5 billion indicate an annual amount of approximately $16.7 million, to be distributed among the HMO industry in accordance with the provisions of the bill. Member HMOs in an unsafe or unsound financial condition would be exempt from assessment. If assets or funds, including amounts available from the insolvent HMOs, exceed the amounts necessary to meet the obligations of the association, the bill provides that excess contributions to the fund will be refunded on a pro rata basis to association members and the State.

Under the bill, HMOs are prohibited from passing through their assessment amounts to their policyholders or enrollees, in the form of higher premiums. However, an HMO is provided the opportunity to write off, through a corporation business tax credit, up to 50 percent of its assessment. The bill provides that an HMO may offset 50 percent of its contributions over a five-year period, on or after the third year following payment of its assessment, but may not offset more than 20 percent of its total corporation business tax in any one year. Pursuant to fiscal estimates, the maximum State exposure is the $50 million State contribution plus the maximum $25 million tax revenue loss for a total of up to $75 million.

Background Paper: The Gramm-Leach-Bliley Act and its Potential Impact on Banking Operations and Regulation in New Jersey

Introduction

On November 12, 1999, President Clinton signed into law the "Gramm-Leach-Bliley Act," Pub. L. 106-102 , formally allowing affiliations among banks, insurance companies and securities firms. Most notably, the law authorizes the formation of a new entity, the "Financial Holding Company," which will be permitted to engage in various activities which are "financial in nature" including: banking, insurance and securities activities, as well as some "complementary" activities. From a regulatory standpoint, the states remain the primary regulators of insurance companies, but cannot interfere in the cross-industry affiliations authorized by the new law, existing federal law and regulations and pertinent court decisions.

Discussion Point # 10 within this booklet briefly outlines the various aspects of the act which will be important to the State's regulation of the financial services industries. This background paper provides a more in-depth overview of the act's provisions so as to highlight how the department's regulatory responsibilities may be affected.

Cross-Industry Affiliations (Title I)

Title I of Gramm-Leach facilitates affiliations among banks, securities firms and insurance companies, by repealing the Depression-era prohibitions the Glass-Steagall Act placed on cross-industry affiliations. It also amends the provisions of the Bank Holding Company Act of 1956 to expand permissible holding company activities to include those which are "financial in nature," including: insurance and securities underwriting and agency activities; merchant banking (venture capital) and insurance company portfolio investment activities; as well as "complementary" financial activities. The Federal Reserve Board is authorized to promulgate regulations enumerating what activities are "financial in nature," after consultation with Secretary of the Treasury.

A new form of holding company is authorized under the act, the financial holding company or "FHC." The current bank holding company still exists as an entity, but its activities are "frozen": it can't expand its activities further. A bank holding company may elect to become an FHC, but the Federal Reserve Board is prevented from permitting the formation of an FHC if any of its insured institution subsidiaries are not well-capitalized and well-managed, or if they have not received a satisfactory Community Reinvestment Act ("CRA") rating. Gramm-Leach further prevents the appropriate federal banking authority from approving additional new activities or acquisitions for insured depository institutions or affiliates of an FHC if they have received less than a satisfactory CRA rating.

Additionally, national banks are permitted to engage in new financial activities, except for insurance underwriting, merchant banking, insurance company portfolio investments and real estate development or investment, through a financial subsidiary or "FS," up to an aggregate asset limit for all FS's of 45% of the parent bank's consolidated assets or $50 billion, whichever is less.

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Federal Jurisdiction and State Regulation (Titles II and III)

Title II of Gramm-Leach reorganizes the regulatory authority of federal agencies over securities and investment activities along functional lines to assure consistency in the treatment of banks and other financial companies. For example, it replaces broad bank exemptions from broker-dealer regulation with limited exemptions designed to permit banks to continue current activities, develop new products and, under certain circumstances, compensate employees for cross-referrals.

Title III reaffirms the primacy of state regulation of insurance activities under the McCarran-Ferguson Act. No person may engage in the insurance business without appropriate state licensure. States are therefore the functional regulators of insurance activities of federally-chartered banks and securities firms, as long as the they do not interfere with permitted bank/insurance/securities affiliations. To the extent that they do, state laws are preempted.

At the same time it reaffirms state regulation of insurance, Title III defines some of the insurance activities in which banks may engage. It designates the types of insurance products that banks and their subsidiaries may provide. For example, it prohibits national banks from underwriting or selling title insurance if they did not actively conduct those activities before its enactment, but permits national banks to sell title insurance in those states in which state-chartered banks are specifically authorized to do so. (Currently in New Jersey, State banks are prohibited from selling title insurance.) National bank subsidiaries and affiliates are permitted to sell, but not underwrite, all types of insurance, including title insurance. In this regard also, Title III requires federal banking agencies to prescribe consumer protection regulations for banking insurance sales. It further permits mutual insurance companies domesticated in states which do not have reasonable demutualization procedures to redomesticate (move their home office to another state), thus facilitating demutualization.

Title III also initiates a process for uniform licensing requirements for insurance agents and brokers nationwide. If, within three years of enactment of Gramm-Leach, a majority of states have not adopted such uniform requirements, then the National Association of Registered Agents and Brokers will be established as provided in the act as a voluntary membership, non-profit entity and state laws discriminating against members based on non-resident status will be preempted.

Gramm-Leach, therefore, compounds and intensifies the tension between state insurance regulators and federal and state bank regulators. In this regard, Title III establishes expedited and equalized dispute resolution procedures between state and federal regulators.

Privacy (Title V)

Gramm-Leach permits the sharing and cross selling of customer information between affiliates and with unaffiliated third parties, although a customer may "opt out" of permitting the sharing of non-public personal information with unaffiliated third parties. Regardless of whether

Background Paper: The Gramm-Leach-Bliley Act and its Potential Impact on Banking Operations and Regulation in New Jersey (Cont'd)

a customer "opts out," banks are prohibited from disclosing customer account numbers or access codes to unaffiliated third parties for telemarketing or other direct marketing purposes. The act requires banks to develop written privacy policies and disclose them annually to customers. Each customer must receive a form giving him or her the choice to "opt out" of financial information sharing with third parties. At the same time, the act permits joint marketing agreements between financial institutions that do not trigger the opt out disclosures. These privacy provisions will apply to any company engaged in "financial activities" as defined under the act, not just banks and insurance companies, but others, such as retailers and travel agencies under certain circumstances.

The act safeguards the continuing effectiveness of restrictions on information-sharing imposed under the Fair Credit Reporting Act.

State laws providing consumer privacy protections, including the privacy of medical information and health care claims, may co-exist with the provisions of Gramm-Leach so long as they are not inconsistent and more restrictive State privacy laws may override Gramm-Leach rules in certain instances. However, prohibitions over the sharing of medical information among affiliates or with third parties were omitted from Gramm-Leach, with the expectation that other pending federal legislation would handle this issue separately. Therefore, more federal legislation on the issue of medical information privacy may be forthcoming.

ATM Fees (Title VII)

Title VII of Gramm-Leach contains a variety of provisions affecting the delivery of financial services, with particular emphasis on ATM fees. It requires ATM operators to post a schedule of fees on the ATM screen or by way of a paper notice issued from the machine before the consumer consummates an ATM transaction. It also requires notice at the time ATM cards are issued that surcharges may be imposed on non-customers by other partes and amends the Electronic Funds Transfer Act accordingly.

Conclusion

Gramm-Leach embodies a comprehensive overhaul of the financial services industry in the United States, with major implications for banks, securities firms and insurance companies, as well as their federal and state regulators. The various provisions of the statute become effective on different dates over the course of the next few years, and the full impact will not be realized until implementing regulations are issued; however, it may nevertheless be wise for both the affected industries and their regulators to begin now to plan and position for the changes it will bring.

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Individuals wishing information and committee schedules on the FY 2001 budget are encouraged to contact:

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