

# **Facts on Legislation Regarding Pooled Risk Management Programs**

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## **Summary**

Legislation has been filed in both the House and the Senate to impose strict regulations on pooled risk management programs (PRMPs), including severe limitations on the amount of reserves that a PRMP may maintain. *Both proposals were filed, at the request of the Secretary of State, as non-germane amendments less than a week before the deadline for House and Senate committees to act on all bills. The Senate amendment was introduced two days before that deadline.*

The sponsors of both amendments claim that PRMPs, and in particular the Local Government Center's HealthTrust, have amassed excessive reserves that should be returned to their members—primarily municipalities and school districts. They have claimed that the legislation would cause HealthTrust to return either \$70 million (under the House amendment) or \$100 million (under the Senate amendment) to municipalities and school districts. They suggest that the return of these amounts would help to offset planned reductions in funding from the state.

These numbers are wildly inflated: HealthTrust's entire reserve is only \$71 million. Further, the proposed reserve limits would result in significantly higher and more volatile health insurance premiums for local governments, and would jeopardize the viability of PRMPs. In that circumstance, municipalities could be forced to seek insurance on the commercial market; their rates would be likely to rise significantly, and the availability of insurance for municipal and school employees at any cost would be uncertain.

## **Pooled risk management programs**

A pooled risk management program is an arrangement among a group of political subdivisions—cities, towns, counties, school districts, and village districts—that provides for the pooling of self-insurance reserves, risks, claims and losses, and related administrative services and expenses. A PRMP is governed by a board of directors that consists primarily, or entirely, of public officials, officers, or employees from the participating political subdivisions. Under RSA 5-B, all “earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance” must be returned to the members.

PRMPs were created beginning in the 1980s to respond to the problems local governments had in obtaining insurance on the commercial market. They are authorized by RSA 5-B, which requires informational filings with the Secretary of State's office and imposes certain organizational and operational requirements. Because PRMPs are governed by members and provide risk coverage only to members on a non-profit basis, they are expressly exempted from regulation as insurance companies.

There are three PRMPs in New Hampshire: the Local Government Center, Primex, and SchoolCare. (At the House hearing, a representative of the Secretary of State—the same office that maintains filings for PRMPs and believes it should have more regulatory authority—said he “believes there may be” a fourth PRMP in the state, but he could not identify it.) HealthTrust provides medical coverage for 60,000 employees, retirees, and dependents in the public sector.

## **The legislation**

Amendment no. 2010-1729-h is a proposed House amendment to SB 450. It would give the Secretary of State authority to conduct investigations, issue cease-and-desist orders, and seek injunctive relief and civil penalties against PRMPs. In addition, it would limit a PRMP's reserves to ten percent of estimated annual claims.

Amendment no. 2010-1830-s is a proposed Senate amendment to HB 1393. It would give the Secretary of State broad regulatory authority over PRMPs and would limit reserves to *five* percent of estimated annual claims. It also would require an almost immediate distribution to the PRMP's members of any amounts in excess of that limit, pursuant to a plan to be approved by the Secretary of State.

## **HealthTrust's reserve**

The Local Government Center's HealthTrust establishes its reserve based on risk-based capital (RBC), a formula developed by the National Association of Insurance Commissioners and used nationwide as a measure of financial solvency for both private insurance companies and public risk pools. An RBC ratio of 2.0 is the point at which regulators begin examining a company for solvency issues.

A survey of major New England health insurers showed that typical RBC ratios for the years 2007 to 2009 have been in the range of 5.0 to 8.0. The Blue Cross Blue Shield National Association, which licenses the local Blue Cross Blue Shield plans, will place a licensee in a monitored status when the licensee's RBC ratio drops below 5.0, and will withdraw the license if the ratio falls below 2.0.

As a non-profit risk pool, HealthTrust can tolerate a somewhat lower RBC ratio. LGC's board of directors has established an RBC target ratio of 4.2. HealthTrust's reserve at the end of March was approximately \$71 million, just above its target reserve of \$69 million based on an RBC ratio of 4.2.

HealthTrust's estimated annual claims for 2010 are \$397 million. Under the House amendment, its reserve would be limited to 10 percent of that amount, or \$39.7 million. This equates to an RBC ratio of 2.4, which is just above the level that would raise concerns about insolvency. *Under the Senate amendment, the reserve would be limited to five percent of estimated claims, or \$19.9 million; that would equate to an RBC ratio of 1.2, indicating a severely distressed company.*

The sponsors of the Senate amendment claim that HealthTrust could reasonably maintain a reserve of five percent of estimated claims, because that is the level of the state's reserve for its health insurance. This is a meaningless comparison. The state's health insurance program is a single-employer, self-insured plan. If the state experiences an unusual loss, it can simply appropriate the additional funds to pay it. HealthTrust and other PRMPs do not have that option. HealthTrust's only options are (1) to maintain a sufficient reserve to meet all possible claims; and/or (2) to purchase reinsurance. The latter option, of course, costs money and would necessarily increase the rates paid by HealthTrust's members. Unlike funds that go into the trust's reserve for the benefit of its members, funds paid to a third-party reinsurer are simply gone, never to be recovered. For this reason, LGC's board of directors has made the prudent business decision—typical of risk pools around the country—to forgo reinsurance and maintain a sufficient reserve. (LGC does buy reinsurance for individual claims over \$1 million, but there are very few individual claims that large. The reserve is needed not to protect against a few large claims, but against a significant increase in ordinary claims. To purchase aggregate reinsurance for a pool as large as HealthTrust would be extremely expensive and would require a significant rate increase.)

When HealthTrust's reserve exceeds its target, it returns the excess to its members, typically in the form of lower rates. HealthTrust's RBC ratio first substantially exceeded its target value of 4.2 at the end of 2006. At that point, the trust undertook to return \$23.5 million in excess reserves to members in the form of rate credits over the next three years. These rate credits, together with investment losses in the volatile 2008-09 financial market and an increased level of claims, eventually returned the reserve to its target level.

As required by RSA 5-B:5, HealthTrust annually obtains an actuarial evaluation of "the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan." That evaluation is filed with the Secretary of State's office and is distributed to all of the trust's members.

### **Consequences of the reserve limit**

It is not unusual for an insurance company's claims to vary from 10 percent above to 10 percent below projections. HealthTrust's claims have run more than 10 percent above projections on more than one occasion. With a reserve limited to \$39.7 million (or, under the Senate bill, \$19.9 million), a spike in claims would exhaust the trust's reserve and render it insolvent, leaving claims unpaid and leaving municipalities and school districts to fend for themselves in the commercial market.

Even a smaller jump in unanticipated claims would cause the reserve to fall to dangerously low levels. In addition to jeopardizing the trust's ability to pay claims, this would require a sharp increase in premiums to rebuild the reserve.

Beyond ensuring the ability to pay all claims, the maintenance of a sufficient reserve provides for stability in rates. This is essential for predictability in local governmental budgeting. Local officials familiar with HealthTrust's operations have routinely stated that they would rather see the trust maintain a sufficient reserve that can be used to cushion rate fluctuations, instead of receiving a rebate one year and a sharp rate increase the next.

The Senate amendment would result in a *one-time rebate* of \$50 million spread among hundreds of municipalities, school districts, and other political subdivisions. (The House amendment would rebate \$30 million.) Under the best-case scenario, that would be followed immediately by sharp rate increases and large year-to-year fluctuations in rates. Under the worst-case scenario, it would lead to the insolvency of one or more of the non-profit risk pools that are helping to keep health insurance affordable for public employers and employees, leaving political subdivisions to try to buy insurance in the commercial market. The unavailability of that insurance is what gave rise to the establishment of PRMPs in the first place.

### **Regulation by the Secretary of State**

PRMPs exist in 47 states. In 24 states of those states, PRMPs are regulated by the state insurance department. In the other 23 (including New Hampshire), they are not regulated by any government agency, although they are required to submit informational filings. Typically these filings are made with the secretary of state's office, just as other corporate filings are, without any expectation of regulatory oversight. That has been the legislative intent in New Hampshire since 1987.

At the hearing on the Senate amendment, the New Hampshire Secretary of State made it clear that he is, nevertheless, determined to regulate pooled risk management programs in New Hampshire. The reason for this insistence is a mystery. The operations of a PRMP are substantially identical to those of an insurance company. The Secretary of State's office has no experience in regulating insurance or actuarial matters. No secretary of state in the country regulates PRMPs. Giving the Secretary of State regulatory authority over PRMPs makes as much sense as allowing him to regulate dentists or public utilities.

If the Secretary of State is concerned about regulation of PRMPs, it is unclear why he waited until *one week* before the House and Senate deadlines and attached his amendments to entirely unrelated legislation. It is, however, almost an exact repeat of last year's events. According to a statement made by the Secretary of State this week, he decided *in the fall of 2008* to request legislation giving him greater oversight over PRMPs; yet he waited until *the end of May 2009*, to the *last day* for committee action, to submit an amendment, with no public hearing, giving him the authority he wanted. No explanation has been offered for the inability or unwillingness to follow normal legislative procedures.

If PRMPs need to be regulated by a government agency, it makes sense for them to be regulated by an agency that understands something about their business. That would be the insurance department. The New Hampshire Insurance Department has expressed no concern about PRMPs. Still, it is reasonable to consider whether they should be subject to Insurance Department regulation. That question, however, deserves more than a two-day study. PRMPs have provided important services to local governments and their employees without regulation for 23 years. No one has identified a crisis that requires ramming a new law through the legislature in this fashion.