

Budget Balancing (and Other Magic Tricks)

The State of Nirvana has come up with a painless way to not only balance its budget, but to also increase spending on new programs and capital projects and reduce taxes. Nice trick, right? How, you may ask, is this possible? Nirvana has decided to require all state domiciled insurance companies to transfer excess reserves

insurance, will release reserves totaling approximately \$2 billion that are no longer required to fund future liabilities. The Enacted Budget authorizes using the released reserves over a period of four years, including \$250 million for debt management in FY 2014

shows transfers of more than \$1 billion in cash - a third of the fund's liquid assets - to the state treasury and describes the advance as a "contingent receivable," meaning it can be relied on only in special circumstances. But a contrary footnote explains that with permission of the Legislature and Governor, the fund can treat it as an "admitted asset," implying unchallengeable value."

Before you go scurrying around to find this article, or if you are asking how you could have missed it, note that it is dated *October 14, 1989* - almost 25 years ago - and the referenced Cuomo is Mario not Andrew.

The NY courts supported the State's taking of Insurance Fund assets as early as 1983, by determining that because the State Fund was a state agency and not a mutual insurance pool, policyholders had no property or contractual interest in the funds, and therefore there was no violation of the Federal or State constitutions. The original 1983 raid was "only" for \$190 million, and that sum was to be paid back by 1985. The 1989 raid, however, was for an amount in excess of \$1 billion. The New York Legislature prohibited further raids of the State Fund in 1996, but did not force the repayment of any prior transfers, nor did it stop the most recent raid beginning in 2013. The State Fund's audited 2012 balance sheet (the most recent available at the time of this writing) shows the transferred sums from the 1989 and earlier raids as an admitted asset in the amount of \$1.295 billion, and identified simply as a "Contingent receivable from New York State." That "admitted asset" represents over 40% of the State Funds reported surplus, and does not include the \$2 billion current round of raids! It will be interesting to see if the "release" of reserves authorized in 2013 will also be shown as a receivable from the State or simply a reduction in reserves, a transfer of assets and a source of revenue without any offsetting state obligation.

But wait! If the NY legislature prohib-

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- as determined by the State - to the State treasury. "Wait a minute," you say, "that cannot be right." You point out the obvious: it is not the companies' money to transfer or the State's to take. If Nirvana considers it a borrowing instead of a taking, it has to show a liability for the debt and borrowing costs, not to mention that insurance company reserves are largely set by statute and cannot be encumbered. Most importantly, however, those funds are held for the benefit of policyholders who paid premiums to ensure that their claims or insured obligations are covered in the future. Finally, such a practice would likely bring instability to the marketplace and raise serious solvency concerns for insurers if claim payments cannot be met in the future. But the government of Nirvana says not to worry, it has all that covered, and is just expanding on the precedent so wisely set by New York over the years.

Last year New York's budget included authority to transfer funds from the New York State Insurance Fund to the general funds of the State. The official report on the enacted budget explained the move as follows:

"As a by-product of the [Workers' Compensation] reform legislation, SIF, a State agency that provides Workers' Compensation

and \$1 billion for gap-closing purposes in FY 2015."

Never mind that the principal source of reserves being released to the State was premiums charged to policyholders, primarily small businesses. Why, you may ask, are these "unnecessary" reserves being transferred to the State rather than refunded to these small business owners?

Having obtained the authority for the transfers from the State Fund in 2013, it was understandably difficult to find any reference to the \$1 billion of released reserves included in Governor Cuomo's 2014-2015 budget unveiled this January. The revenue from the State Fund transfer is shown in the proposed 2014-2015 budget as a simple \$1 billion one-liner with no elaboration. The press release announcing the new budget heralded going from a \$10 billion deficit to a \$2 billion surplus over the past several years - a surplus that could not have been possible without this taking of "unnecessary" reserves.

If you think this budget strategy sounds familiar, you would be right. Consider the New York Times article, "*New York's Dangerous Insurance Policy*," reporting that: "Over the years, Governor Cuomo has repeatedly raided the fund in order to help balance state budgets. The new balance sheet

ited further raids in 1996, how was the current raid possible? Simple: what the Legislature giveth the Legislature can taketh away, and the present about face was accomplished by the Legislature's approval of the 2013 budget. (A word of caution lest one concludes that raiding insurance funds is solely a Cuomo thing; the authorization for the first State Fund raid actually predated

Cuomo#1's first term. Also there have been other raids, including the transfer of funds from the Insurance Security Funds to the State's general funds during the Pataki years.)

Can you imagine a licensed private insurer with 40% of its reported surplus represented by an unsecured IOU from the state? Or can you imagine a State declaring reserves of licensed insurers to be excessive and requiring the excess to be transferred to the State? Nirvana can! According to the Nirvana budget footnotes (in 8-point type),

approval of the budget will provide that the State will only take assets that are not needed to pay claims, or will allow IOUs for "borrowed" assets to be carried as admitted assets on insurers' balance sheets, so there would be no change in their financial condition. Also, the state will not be paying interest on the borrowings in any event so there are no carrying costs. If a solvency concern arises in the future, the state insurance regulators can require insurers to post additional reserves or take other remedial actions. Nirvana recognizes that these actions will probably lead to increased premiums for the consumers, but not to worry. Any additional costs to the public will lead to outrage against everyone's favorite target, the insurance companies. That outrage, however, will come long after any transfer or borrowing occurred so any attempt to reflect blame back on the budget action or to collect on any IOU will be futile. The public pays and the companies, who are used to playing the heavy, are blamed.

Outrageous! Could not possibly happen! The raid of the assets of the State Fund, which the NY courts found to be a public agency, is not comparable to taking from private insurers, and state legislatures and their courts would never condone a taking of assets from private companies to solve budgetary problems in any state. But given the propensity of courts to defer to the authority of the legislature and the government – particularly in New York – is it really that far-fetched? Following the precedent of the State Fund case, is it that much of a stretch to see a court holding, for instance, that once paid as premiums, policyholders have no continuing interest in the funds whether paid to a state agency (like the State Fund) or to a private insurer serving the same function? The courts could also determine that aggrieved policyholders have no "standing to sue," or that there are no damages until an actual default many years down the road, at which time the statute of limitations precludes a recovery.

Budget gimmicks are nothing new, and are not confined to government budgets. One hopes that there would be sufficient will on the part of administrators and legislators to draw a line in the sand to prevent a state from taking funds paid by policyholders to purchase insurance. But it has already happened and now it is a matter of degree. [A]

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