Maryland
INSURANCE ADMINISTRATION

MARYLAND HEALTH BENEFIT EXCHANGE

December 1, 2022

The Honorable Delores G. Kelley
Chair, Senate Finance Committee
Senate Office Building, 3 East Wing
11 Bladen Street
Annapolis, MD 21401

Re: Recommendations on State Reinsurance Program Fund Cap

Dear Chair Kelley:

In accordance with our joint letter of March 29, 2022, please accept this letter as the Joint Report of the Maryland Insurance Administration ("MIA") and the Maryland Health Benefit Exchange ("MHBE") on the potential establishment of a State Reinsurance Program Fund Cap.

**Background**

In connection with the passage of HB 413 in the 2022 Session of the General Assembly, the question was raised as to whether a cap on the amount that may be maintained in the State Reinsurance Program Fund should be established. To address this, a request was made that MIA and MHBE evaluate and make recommendations with respect to such a cap, including the evaluation of the model currently utilized by the State of Delaware. The MIA and MHBE agreed to conduct the study and to provide a completed report by December 1, 2022.

**Evaluation and Analysis**

As of the date of this report, there are 16 states with approved 1332 waivers to operate state reinsurance programs. Delaware is the **only** state that has enacted an explicit cap on the amount of state funds that can be accumulated to fund the approved reinsurance program. The large majority of state waivers, including Maryland, cap program costs at the level of available funding by allowing the reinsurance parameters to be adjusted if/when funding is projected to be insufficient. The inclusion of a cap on cost rather than fund balances reflects the fact that the risk that funding will be insufficient is significantly higher than the risk that funding will be excessive. It should be noted that Delaware's assessment is set at 2.75% of premium (compared to 1% under the current Maryland law), and that level of continuous funding increases the possibility that the amounts assessed will exceed program needs in Delaware.

Under Delaware law,

> The State may not hold more than 5 years of operating and administrative funds to cover the Program. In the event collections exceed that amount, the State must notify the carriers that the following year's assessment will be waived.[1]

The Delaware approach to capping the amount of funds that can be accumulated to fund the Delaware reinsurance program has three key elements. First, the statutory cap is calculated with reference to the amounts that are necessary to cover the administrative and operating costs of the program. Second, the statutory cap is equal to 5 years of those projected costs. Third, if the statutory cap is exceeded, the consequence is to waive the following year's assessment.

With respect to the first key element, it was unclear whether the Delaware statute was drafted with the intent of considering all of the funds held and used to cover the total cost of the reinsurance program or whether the intent was to consider only whether funds were sufficient to cover the state portion of costs after expected federal pass-through funding has been applied. The Delaware Department of Insurance has confirmed that it takes the latter approach and compares the accumulated state funds to the projected state portion of program costs over the future 5-year period when determining whether or not to waive their assessment.

It is our view that these variables are reasonable metrics for comparison in evaluating whether existing funds are sufficient to support a reinsurance program. Delaware focuses only on state funds accumulated and state funding obligations projected in calculating the cap. This is a reasonable approach.

With respect to the second key element, the Delaware approach utilizes a "rolling" 5-year period to calculate the cap, regardless of the time remaining under any existing waiver. This approach assures the accumulation of sufficient funding to continue the reinsurance program if a waiver is extended, which is contemplated by most states that have obtained such waivers and created such programs, including Maryland.

Language was proposed in the 2022 legislative session that would have capped funding at the amount sufficient "to fund the remainder of the current waiver period." That approach does not anticipate waiver extensions and would be likely to result in the assessment being waived in the final year of a waiver. That would result in the depletion of the fund to an extent that would jeopardize the sufficiency of the fund to meet the obligations of the program in the early years of the extension period. That would either result in a capping of program costs and a reduction of the effectiveness of the program or require an increase in the amount of the assessment needed to fund the waiver extension.

Given this dynamic, it is our view that any cap on funding should adopt the Delaware approach that evaluates the level of accumulated funding against a fixed number of years of future funding

[1] 18 Del. C. § 8703(g).

requirements. We also believe that 5 years is a reasonable time requirement, as it assures consistent funding for the typical waiver period and waiver extension periods.

With respect to the third key element, if the amount held in the fund is found to exceed the cap, under the Delaware approach the assessment is waived in its entirety for the next year. Provided that a cap is determined with reference to the funds necessary to maintain the program for a significant period, this can be a reasonable approach that would not jeopardize the program.

It is our view that this approach is not unreasonable. However, the legislature may want to provide the Insurance Commissioner with the discretion as to the percentage of the next year's assessment that must be waived. We note that waiving the assessment in whole or in part for a year, then reinstating it in a subsequent year, would create fluctuating pressure on rates, first downward, then upward. This type of fluctuation may not be in alignment with the goal of the reinsurance program to promote stability.

**Recommendations**

As a preliminary matter, it is important to note that it is highly unlikely that at the current 1% assessment level the State Reinsurance Program Fund will ever be overfunded and, to the contrary, it is likely that the amounts assessed will be insufficient to fully fund the program through the 5-year waiver extension period, which the state will seek by March 2023.

It is currently projected that the portion of reinsurance the state must cover will exceed the 1% state assessment starting in 2023, and for all future years. This shortfall will be covered by drawing down the state funding that accumulated and was not used during the early years of the waiver. However, current projections indicate that the accumulated state funds, plus the annual assessment amounts collected each year, will only be sufficient to fund the program through 2027. Projections indicate that the Fund will have a $51 million shortfall in 2028, the final year of the proposed waiver extension. If the state fund is exhausted prior to the end of the 5-year waiver extension, it will be necessary to either secure additional funding or reduce the magnitude of the reinsurance program, which would put upward pressure on individual premium rates across the state.

That said, it is our view that the Reinsurance Program Fund would not be harmed by the establishment of a cap on the funds that may be accumulated in the Fund, provided that any such cap:

- Measures the sufficiency of funding by comparing state assessed funds accumulated against the projection of the state's portion of the program's operating and administrative costs, like the Delaware model;
- Sets the cap at a minimum of the amount necessary to fund the program's operating and administrative costs for a rolling 5-year period, like the Delaware model; and
- Provides that if the cap is exceeded, the Insurance Commissioner must waive the next year's assessment in whole or in part.

To illustrate how such a cap would operate in Maryland, for the 2023-2027 program years, total reinsurance cost is projected to be $3.2 billion, with federal pass-through funding anticipated to cover 68% of that cost. This leaves the projected state cost for this timeframe at slightly over $1 billion, which is the value that would be utilized for the purpose of setting a cap using the Delaware model. The fund balance at the end of 2021 is $523 million and is projected to decline to $423 million by the end of 2022. Therefore, the probability that the fund would exceed $1 billion and, therefore, need to be capped is extremely low and would require the combination of federal pass-through funding coming in significantly higher than expected and reinsurance costs coming in significantly lower than anticipated if the assessment remains at 1%.

We are happy to discuss our findings in more detail with you at your convenience.

Sincerely,

Kathleen A. Birrane
Commissioner
Maryland Insurance Administration

Michele Eberle
Executive Director
Maryland Health Benefit Exchange

Cc: Chair Joseline Pena-Melnyk
Senator Katherine Klausmeier