NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

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New York State Department of Financial Services
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Good afternoon Chairpersons Young and Farrell, Vice Chair Savino, Chairpersons Hannon, Gottfried, Seward and Cahill, Ranking Members, and all distinguished Members of the State Senate and Assembly.

Thank you for inviting me to be here today. This is my first appearance before the Legislature in budget hearings, and I am happy to provide my perspective and answer your questions. I have now been the Superintendent (or Acting) of the Department of Financial Services (DFS) for almost a year. It has been a very busy year, and I am privileged to work for Governor Cuomo and serve all New Yorkers in this important role.

DFS's Budget and Mission

I understand from the invitation that this hearing is to address DFS's portion of the Health Budget and I will therefore focus my comments accordingly, after some background about DFS's budget and our health care work this year.

DFS's mission is to strengthen New York's financial services industries, safeguard our markets from fraud, and protect New York consumers. Under Section 206 of the Financial Services Law, DFS's operating expenses are assessed to industry. The Executive's Budget for DFS proposes $254,936,000 in budget appropriation, a 1.7 percent increase from last year due to contractual salary increases. As DFS Superintendent, I manage a staff of more than 1,350 individuals, supervising the activities of more than 1,400 insurance companies with assets of more than $4.3 trillion, and nearly 1,500 banking and other financial institutions with assets of more than $2.6 trillion. DFS licensees include nearly 200 life insurance and 1,100 property/casualty insurance companies, approximately 100 health insurers and managed care organizations, and 300,000 individual insurance licensees. Our licensees also include approximately 250 state chartered banks, approximately 1,200 other licensed financial services companies, and 7,600 mortgage loan originators and servicers.

<u>DFS Health Initiatives This Past Year</u>

As this is the Joint Budget Hearing on Health, it should come as no surprise that I have spent a substantial amount of my time this past year, and even more so since November, addressing New York's health care market. At DFS, we have been working with our commercial health insurers, and our colleagues at the Department of Health, the New York State of Health, and the Medicaid team, to be prepared for whatever happens at the federal level and to protect New Yorkers in their health care needs.

In the health field, this past year at DFS, we were privileged to help draft and issue guidance regarding the Governor's landmark legislation that mandates health insurance coverage with no cost-sharing for breast cancer screenings and diagnostic imaging for the detection of breast cancer, including diagnostic mammograms, breast ultrasounds, and magnetic resonance imaging covered under an insurance policy. I was also privileged to serve as a member of the Governor's Heroin and Opioid Task Force, and thereafter to assist with the landmark legislation to increase access to addiction treatment, expand community prevention strategies, and combat the over-prescription of opioids. As New York's insurance regulator, I also protected women who suffer from maternal depression, are victims of domestic violence, and who seek reproductive health care, ensuring access to insurance when needed.

The strength and vibrancy of New York's commercial health insurance market has been a priority for DFS this year. The process of setting the 2017 health insurance rates involved carefully examining the rates requested by insurers, applying sound actuarial principles, considering the insurer's financial condition, and taking into account the need for a competitive New York marketplace that supports consumer choice. Our final determinations permitted increases for individual policies offered through the NY State of Health exchange, and for small group plans, due primarily to increasing costs of prescription drugs and health care. Nonetheless, we reduced insurers' requested increases by more than 28 percent overall, which will save consumers more than $302 million in 2017.

It is important to note that, since the Affordable Care Act, enrollment in the individual market went from approximately 20,000 members to over 300,000, and premiums dropped by more than 50 percent, not counting federal tax credits. In New York, our uninsured rate has declined from 10 percent to 5 percent. Presently, we have 16 insurers participating in our individual market and 21 insurers in our small group market.

In addition, to further ensure market stability in New York's health insurance market, in June, DFS issued an emergency regulation to address certain unintended consequences from the federal risk adjustment program in New York's small group market for the 2017 plan year, and worked collaboratively with the federal Centers for Medicare & Medicaid Services (CMS) in issuing our regulation. Notably, CMS subsequently issued its rules for risk adjustment for the 2018 year, which included one of the factors that we had identified, resulting in a significant reduction of the statewide average premium to reflect the medical loss ratio, as risk adjustment should factor in medical expenses, not administrative costs or profit. DFS currently is reviewing for the 2018 plan year the continued impact of federal risk adjustment on both the individual and small group markets.

The Governor's Executive Budget Re: Health

The Governor's Executive Budget proposes DFS initiatives as part of Article VII legislation, and there are two that specifically involve Health that I would like to discuss: Prescription Drug Costs and Pharmacy Benefit Manager (PBM) Reform.

Prescription Drug Costs

For the New York State commercial market, prescription drug costs have been the biggest drivers of health insurance premium increases. In 2015, pharmacy expenses were 25 percent of the total premiums in New York State, significantly higher than the second largest category of premium expense, inpatient hospitalization, which was 18%. In 2015, New York sales of branded drugs exceeded $200 billion, and the cost of specialty drugs has skyrocketed.

Despite considerable efforts by the New York State Medicaid Program to maintain affordability through formularies, preferred drug lists, rebates, and utilization management, total drug costs have grown by over $1.7 billion over the past three years, or 38% from $4.5 billion in FY 2014 to $6.2 billion in FY 2016.

Accordingly, the Governor's Executive Budget includes important proposals to maintain affordability of prescription drugs. The first proposal authorizes the Department of Health to collect cost and pricing information from drug manufacturers to establish State pricing benchmarks for certain drugs for Medicaid. The existing Drug Utilization Review Board (DURB) will expand its membership to include actuaries and health care economists, as well as a DFS representative, and DURB will conduct reviews for certain drugs where pricing is exorbitant relative to development costs and therapeutic value. That review will establish the benchmark pricing for Medicaid.

The Governor's proposal would then require drug manufacturers and wholesalers to pay a 60% surcharge applied to all first sales in New York State on gross receipts generated from drug costs in the commercial insurance market that exceed the DURB state pricing benchmark. That surcharge amount will be paid into a fund held at DFS, which DFS will distribute to health insurers and Medicaid, in proportion to their relative costs with respect to the drugs generating the surcharge. Surcharge amounts paid to commercial insurers will be used to reduce premiums paid by consumers. In this way, this proposal would benefit New Yorkers by maintaining affordability of health care coverage.

Pharmacy Benefit Manager Reform

The Governor's Executive Budget also includes a proposal for DFS to regulate pharmacy benefit managers servicing New York consumers. Pharmacy benefit managers are involved in almost every aspect of prescription drug delivery – from the manufacturers, to the insurers, employers, and individual pharmacies. The proposed bill grants DFS regulatory authority over PBMs to provide us with the oversight necessary to reduce the cost of drugs and limit any abusive or unreasonable practices. As prescription drug costs have skyrocketed, PBM profits have doubled. We are aware of at least 18 states that regulate PBMs in some way, and we believe New York should as well.

Under this proposal, DFS's authority over PBMs would come in two phases. First, PBMs would be required to register with DFS by June 1, 2017, and each PBM would be required to provide information requested by DFS; any company-specific proprietary information – just like DFS receives from other regulated entities – will be confidential. After conducting a thorough review through the registration and information gathering process, DFS would license PBMs beginning January 1, 2019. Based on the review of information obtained during the registration phase, DFS would develop a comprehensive set of regulations that could include requirements that PBMs disclose certain information to clients or to the public and that conflicts of interest, deceptive practices, and unfair trade practices be eliminated.

The goal of the proposal is to either eliminate the significant conflicts of interest that exist in current PBM models, or manage the conflicts under tight regulation to ensure that the financial incentives of PBMs, insurers, employers and consumers are aligned and that every effort is made to manage the costs of prescription drugs.

Other DFS Proposals

The Governor's Executive Budget includes other proposals relevant to DFS, including proposals to regulate student loan servicers, to protect vulnerable adults, and to provide DFS with administrative supervision authority as 31 other states have in order to protect our insurance market and guaranty funds from insurance company failures.

The Governor's budget also includes a proposal that DFS have the authority to ban bad actors from the business of banking, insurance, or financial services in New York if, after a hearing, the DFS Superintendent determines that the individual has done something so severe as to have a direct bearing on his or her fitness or ability to continue participating in the industry. I would think that everyone would be on the same page with this proposal. No one should want misconduct or malfeasance to persist in our financial services industry – and the disqualifying events set forth in the statute reflect this goal of addressing truly bad actors. Indeed, the Financial Services Law expressly provides that one of DFS's obligations is to reduce or eliminate fraud or unethical conduct in the financial services industry.

Since it is DFS that regulates the financial services industry, it clearly is appropriate that DFS have the authority to disqualify persons working in the industries over which DFS – and not any other state official – has supervisory oversight every day.

Under this proposal, disqualifying events include acts of fraud, certain criminal convictions, the making of material misrepresentations to DFS or other regulators, or conduct constituting such gross misconduct, incompetence, or dereliction of responsibility as to compromise the banking, insurance, or financial services industries in New York. This proposal is similar to the statutory disqualification provisions existing in the federal securities laws that are enforced by the Securities & Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), and the disqualification powers that the Federal Reserve – the federal counterpart to DFS – has for the banking industry. Moreover, the administrative process in this bill is not materially different than processes that lawyers, doctors, real estate agents, and other professionals must follow if a charge is brought against them for malfeasance. The proposal provides due process to those charged by DFS in a proceeding – as well as the ability of the individual to seek redress in court if DFS determines that he or she should be disqualified.

New York sits at the financial center of the world. Giving DFS this ability protects our markets from recidivist bad actors and, equally importantly, communicates the message that we have zero tolerance for those who seek to defraud consumers and undermine the fundamental ethics and fairness of our system.

Health Republic

Finally, I would like to update you on the Health Republic liquidation. On May 11, 2016, pursuant to an Order of the Supreme Court, New York County, I was appointed Liquidator of Health Republic, which as you know was a nonprofit corporation formed pursuant to the Federal Co-op Program. As Liquidator of Health Republic, my first priority has been to build a process for resolving policy-related claims in a fair and expeditious manner.

Prior to its liquidation, Health Republic paid all claims up to November 2015, and all members were transitioned to new plans.

Currently, there are approximately 700,000 remaining policy-related claims that require resolution. We believe the true valid claims are much less than this figure. To ensure that the claims are accurately and properly determined in a liquidation of this size and claim complexity, we have engaged a Court-approved claims auditor to determine those claims that are in compliance with plan designs, benefits, exclusions and eligibility requirements, and to remove duplicative claims. We expect the audit will be substantially complete by this May, and we will be issuing claims determinations in the form of Explanations of Benefits/Allowances (EOBs) beginning in the second quarter of 2017 and through year-end. Claimants will have the opportunity to appeal the EOBs under the Court-approved Claims Adjudication Procedures.

From the start, I have been committed to an honest and transparent process for Health Republic's liquidation. We publish on our website relevant events and court orders, as well as financial information. I have directed an audit of the company's financial statements for year-end, which will be completed shortly. The unaudited September 30, 2016 financial statement contains an estimate of about $212 million in policy-related claims, which amount is not a determination of the actual amount of claims. The claims audit that is underway will determine the actual amount of claims. That said, Health Republic's liabilities exceed its current assets.

Presently, we are assessing the merits of Health Republic's claims against the federal government, including approximately $432 million due under the risk corridors program and $51 million due under the federal reinsurance program, as well as what we anticipate will be the federal government's claims of offset for start-up loans provided to Health Republic and amounts allegedly owed for risk adjustment, which we dispute. As many other states with similar Co-op failures have argued, Congressional limits on funding these federal programs in 2014 caused significant solvency risk for the Co-ops. Court actions are underway and we are considering whether to join those actions, while seeking to be as efficient as possible in managing the liquidation process and steadily decreasing the expenses of the process. In addition, we are assessing other potential third-party claims, including against directors and officers, and the availability of a D&O policy.

Apart from potential action against the federal government, we do not believe that there will be significant additional assets with which to pay claims. We will not know the amount of liabilities until the end of this year at the earliest, and payments to claimants cannot be made until the dueling claims with the federal government are resolved. We will continue to provide updates throughout the year and will remain committed to a fair, efficient and transparent process.

Conclusion

During my confirmation hearings, I promised candor and transparency and spoke about my belief in a fair process and a deliberative approach. Throughout the year, I have been consistent in my outreach to stakeholders and in my interactions with both industry and consumers, and the public at large. I have employed my authority based on substantive analysis and a deliberative process.

I have also been responsive to legislative inquiries, and my staff is ready and willing to assist your constituents. When you call or write, I do answer. Or – as today – I appear in person. My team at DFS is working hard every day to build on our successes and make New York's financial services industries work better for both industry and consumers. And we are doing all of this effective work as efficiently as possible, and within our budget.

Thank you. I look forward to your questions.