Friday, March 18, 2011

Gary Teitel
Assistant Chief Actuary
State of New York Insurance Department – Health Bureau
25 Beaver Street
New York, New York 10004
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RE: Second Amendment to Part 350 (Regulation 140) of Title 11 NYCRR

Dear Mr. Teitel:

The New York Association of Homes and Services for the Aging (NYAHSA) has convened a Regulation 140 Workgroup to develop recommendations to the Department of Insurance (DOI) on a second amendment to Part 350 (Regulation 140) of Title 11 NYCRR on reserve requirements and allowable investment purchases by Continuing Care Retirement Communities (CCRCs).

The October 17, 2007 amendment of New York Insurance Regulation 140 regarding investments has proven to be of great value to New York CCRCs. However, much more can be done to prudently enhance investment returns. Improvements in investment policy will ultimately accrue to the exclusive benefit of New York State residents who reside in these communities.

The following notice was published in the January 5, 2011 State Register for the Insurance Department Regulatory Agenda:

> 54. Summary description of proposal: Amendment of 11 NYCRR 350 (Continuing Care Retirement Communities) (Regulation 140) to modify and clarify the actuarial reserve calculation, solvency testing, distribution allowances, fee adequacy, allowable investments, and needed filing requirements, in view of marketplace expansion in both the number and types of Continuing Care Retirement Communities.

Introduction

NYAHSA last met with DOI and the Department of Health (DOH) in the summer of 2008 to discuss expansion of permissible investments for CCRCs stipulated under Regulation 140. Unfortunately, the disruption in the financial markets that occurred shortly after our discussions created challenges for many of our members, and this endeavor was tabled due to limited resources and unprecedented market conditions. Recognizing the challenges faced in the financial markets as well as the direct impact on our individual operations we maintain our position that prudent investment is dependent upon diversification of assets.

Modern Portfolio Theory maintains that to minimize risk for a given level of return, a careful selection of the proportions of various assets be held. Currently, portfolios held by CCRCs typically have fixed income positions in excess of 90 percent. As we previously discussed with the Department, NYAHSA contends the current policy in favor of fixed income will fail to meet inflation over certain periods of time. We remain convinced that our business models are being negatively impacted by the limitations presented by permissible investments under Regulation 140 and respectfully request consideration of increased equity positions coupled with investments in mutual funds and Exchange Traded Funds (ETFs) as outlined in our original proposal. We believe that access to mutual funds and ETFs warrants immediate consideration as this investment allows for low cost access to managed funds.

In response to the Department's requests for qualitative criteria for mutual funds, ETFs and index funds, we recommend that permissible funds include those in the top two ratings categories, Morningstar or Moody's. To develop a "listing" of qualitative criteria would be far too onerous to monitor for the CCRC as well as for the Department. Additionally, allowing funds in the top two ratings categories is in keeping with the regulation's handling of fixed income and equity.

In response to the Department's question regarding how funded status will be impacted by fluctuations in valuations of investment portfolios on December 31, 2010, NYAHSA proposes that a community that does not meet funded status due to a fluctuation in investments be afforded the same opportunity as they currently are when not fully funded. Currently those communities that do not achieve or maintain the required funded status must provide the Department with a corrective plan of action. We propose that we continue to be afforded the same corrective action response.

NYAHSA has included the investment proposal as originally submitted.

Proposal

The NYAHSA Regulation 140 Workgroup proposes that all investments be included in the required investment policy. We propose that both Minimum Liquid Reserve (MLR) investments and non-MLR investments should be considered together in developing investment policy. MLR investments can currently be invested in various fixed income securities including United States government bonds, agency bonds and other fixed income securities rated in the top four rating categories. Our investment proposal directs that the maturity structure of these funds be limited much the same way debt service reserve funds are limited by bond indentures. As an example, maturities may be limited to 10 or 15 years, with a subset of the portfolio limited to a shorter limit such as five years.

In this way, MLR reserves can serve as the short-to-intermediate high quality portion of the overall fixed income portfolio. For example, a community with $12MM in MLR and $18MM in non-MLR will default to a minimum 40 percent allocation to fixed income by virtue of the MLR. This is illustrated by *Attachment One*, the schedule of New York state CCRC's calculation of MLR.

We propose that the current 5 percent of assets-minus-debt limitation be replaced with broader investment guidelines that promote risk management through portfolio diversification. We recognize that part of the rationale for the current restrictions lies in the potentially wide range of financial strength among New York CCRCs. Recognizing this wide range, we propose portfolio limits that are linked to tests of financial strength, including days cash on hand and debt service coverage.

Equity Investments

The NYAHSA Regulation 140 Workgroup proposes the following investment policy:

For CCRCs that have in excess of:

- 450 days cash on hand with minimum debt service coverage of 2.0, or:
- Debt service coverage of 2.50 with minimum 300 days cash on hand.
- Fully funded status

NYAHSA proposes the following limitations on total assets:

- No more than 60 percent invested in equity securities.

For CCRCs that have in excess of:

- 300 days cash on hand with a minimum debt service coverage of 1.5, or:
- Debt service Coverage of 1.75 with minimum 200 days cash on hand.
- Fully funded status

NYAHSA proposes the following limitations on total assets:

- No more than 40 percent invested in equity securities

For CCRCs that have in excess of:

- 200 days cash on hand with a minimum debt service coverage of 1.30; or:
- Debt service coverage of 1.50 with minimum 150 days cash on hand.
- Fully funded status

NYAHSA proposes the following limitations on total assets:

- No more than 20 percent invested in equity securities.

Examples

Example A:

Cash & Investments - $24MM
475 days cash on hand
Debt Service Coverage 2.0
MLR is $8MM

- $8MM MLR calls for minimum fixed income allocation of 33 percent.
- Financial ratios call for maximum of 60 percent equity investment.

Scenario: Debt service coverage drops to 1.8 for full year, maximum equity goes to 40 percent, to be implemented over 12 months.

Example B:

Cash & Investments $30MM
425 Days Cash on Hand
Deb Service Coverage 2.50
MLR $12MM

- $8MM MLR calls for minimum fixed income allocation of 40 percent.
- Financial ratios call for maximum of 60 percent equity investment.

Scenario: Days cash drops to 375 days for 12 months, maximum equity goes to 40 percent.

Example C:

Cash & Investments $20MM
375 days cash on hand
1.5 Debt Service Coverage
MLR $9MM

- $9MM MLR calls for minimum fixed income allocation of 45 percent.
- Financial ratios call for maximum equity of 40 percent.

Scenario: Debt service coverage drops to 1.35 for full year, maximum equity goes to 20 percent.

Example D:

Cash & Investments $10MM
225 Days Cash on Hand
1.8 Debt Service Coverage
MLR $7.5MM

- $7.5MM MLR calls for minimum 75 percent fixed income allocation.
- Financial ratios call for maximum equity of 25 percent.

Scenario: Cash & Investments increases to $12.5MM; maximum equity goes to 40 percent.

Example E:

Cash & Investments $10MM
225 Days Cash on Hand
1.35 Debt Service Coverage
MLR $ 7.5MM

- $7.5MM MLR calls for minimum 75 percent fixed income allocation.
- Financial ratios call for maximum equity of 20 percent.

Mutual Funds Investment

The current regulations are very specific as to the types of securities that a CCRC may invest in. For example, CCRCs may invest in equity securities. Yet, because there is not a specific provision for mutual funds or exchange traded funds, these investments are not permitted. Investment in mutual funds consisting of individual equity investments is widely acknowledged to be safer than investing in a single equity security. The NYAHSA workgroup proposes that the language in Regulation 140 be changed to permit investments in mutual funds and exchange traded funds. NYAHSA could assist DOI in developing mutual fund guidelines taking into account fund size, style, and other variables should this provision be adopted.

Asset Diversification

To further reduce portfolio risk, the workgroup proposes that additional asset classes be included in permitted investments. NYAHSA proposes that these "diversifying" asset classes be limited to a certain percentage of total assets. The asset classes we propose to permit are:

- Indexed Commodity Investment or Other Real Asset Portfolio;
- High Yield Bonds; and
- International Bonds.

NYAHSA also proposes a maximum of 5 percent per asset class.

Conclusion

The NYAHSA Regulation 140 Workgroup's proposal offers practical easy-to-implement risk guidelines that accommodate the financial needs of a wide range of CCRCs. On one end of the spectrum, some of our members will not have significant assets above and beyond the MLR and therefore asset allocation will not change in any significant manner. On the other end of the spectrum of financial strength, CCRCs will be able to invest prudently so that residents are protected and long term growth in assets can keep pace with ever-changing needs.

The members of the NYAHSA Regulation 140 workgroup would like to schedule a meeting to address our requests at your earliest convenience.

The NYAHSA Regulation 140 Workgroup appreciates the past cooperation of the Department of Insurance in discussing changes to Regulation 140 and looks forward to meeting with key staff at the department to discuss our proposal. If you have any questions, please contact Ken Harris at my new phone number at 518-867-8383, extension 139, or by e-mail at kharris@nyahsa.org.

Sincerely,

Ken Harris
Senior Policy Analyst
The New York Association of Homes and Services for the Aging

cc: James J. Wrynn, Superintendent, New York State Department of Insurance
James L. Seward, Chair, Senate Committee on Insurance
Joseph D. Morelle, Chair, Assembly Committee on Insurance
Linda Gowdy, Director, Department of Health, Bureau of Continuing Care Initiatives

The NYAHSA Regulation 140 Workgroup

Jennifer Anderson, Chief Financial Officer, Kendal on Hudson (Co-chair)
Bob Caulfield, Chief Financial Officer, Jefferson's Ferry (Co-chair)
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