

**REPORT ON EXAMINATION**

**OF THE**

**MEDCO CONTAINMENT INSURANCE COMPANY OF NEW YORK**

**AS OF**

**DECEMBER 31, 2010**

**DATE OF REPORT**

**SEPTEMBER 27, 2012**

**EXAMINER**

**JEFFREY USHER**

## TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1.	Scope of the examination	3
2.	Description of the Company	5
	A. Management and controls	7
	B. Conflict of interest policy	9
	C. Corporate governance	10
	D. Enterprise risk management	12
	E. Internal audit	14
	F. Remediation plan procedures	16
	G. Territory and plan of operation	18
	H. Holding company system	18
	I. Significant operating ratios	23
	J. Accounts and records	24
3.	Financial statements	25
	A. Balance sheet	25
	B. Statement of revenue and expenses and capital and surplus	27
4.	Claims unpaid	28
5.	Market conduct activities	29
6.	Subsequent events	31
7.	Compliance with prior report on examination	32
8.	Summary of comments and recommendations	34



NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

---

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

September 27, 2012

Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and acting in accordance with the instructions contained in Appointment Number 30656, dated March 17, 2011, attached hereto, I have made an examination into the condition and affairs of the Medco Containment Insurance Company of New York, a for-profit accident and health insurance company licensed pursuant to the provisions of Article 42 of the New York Insurance Law, as of December 31, 2010, and respectfully submit the following report thereon.

The examination was conducted at the Company's administrative office located at 100 Parsons Pond Drive, Franklin Lakes, New Jersey.

Wherever the designations the "Company" or "MCICNY" appear herein, without qualification, they should be understood to indicate Medco Containment Insurance Company of New York.

Wherever the designations “MHS” or the “Parent” appear herein, without qualification, they should be understood to indicate Medco Health Solutions, Inc., MCICNY’s parent company.

Wherever the designation the “Department” appears herein, without qualification, it should be understood to indicate the New York State Department of Financial Services. It should be noted that the New York State Insurance Department merged with the New York State Banking Department on October 3, 2011 to become the New York State Department of Financial Services.

## 1. SCOPE OF THE EXAMINATION

The previous examination of the Company was conducted as of December 31, 2006. This examination of the Company was a combined (financial and market conduct) examination and covered the four-year period January 1, 2007 to December 31, 2010. The financial component of the examination was conducted as a financial examination, as defined in the National Association of Insurance Commissioners (“NAIC”) *Financial Condition Examiners Handbook, 2010 Edition* (the “Handbook”). The examination was conducted observing the guidelines and procedures in the Handbook. Where deemed appropriate by the examiner, transactions occurring subsequent to December 31, 2010, were also reviewed.

The financial portion of the examination was conducted on a risk-focused basis in accordance with the provisions of the Handbook, which provides guidance for the establishment of an examination plan based on the examiner’s assessment of risk in the Company’s operations and utilizes that evaluation in formulating the nature and extent of the examination. The risk-focused examination approach was included in the Handbook for the first time in 2007; thus, this was the first such type of examination of the Company. The examiner planned and performed the examination to evaluate the Company’s current financial condition, as well as identify prospective risks that may threaten the future solvency of MCICNY.

The examiner identified key processes, assessed the risks within those processes and assessed the internal control systems and procedures used to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, an evaluation of the overall financial statement presentation, and a

determination of management's compliance with the Department's statutes and guidelines, Statutory Accounting Principles, as adopted by the Department, and NAIC Annual Statement instructions.

Information concerning the Company's organizational structure, business approach and control environment were utilized to develop the examination approach. The examination evaluated the Company's risks and management activities in accordance with the NAIC's nine branded risk categories.

These categories are as follows:

- Pricing/Underwriting
- Reserving
- Operational
- Strategic
- Credit
- Market
- Liquidity
- Legal
- Reputational

The Company was audited annually for the years 2007 through 2010 by the accounting firm of PricewaterhouseCoopers LLP ("PwC"). The Company received an unqualified opinion in each of those years. Certain audit work papers of PwC were reviewed and relied upon in conjunction with this examination. A review was also made of the Parent's Internal Audit function and Enterprise Risk Management program, as they relate to the Company.

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters which involve departures from laws, regulations or rules, or which require explanation or description.

## **2. DESCRIPTION OF THE COMPANY**

The Company was incorporated in the State of New York on February 15, 1989, under the name “American Nisshin Insurance Company”, a property and casualty insurance corporation. The Company received its licensing authority from New York State on July 15, 1989, and commenced writing business on July 31, 1989. On November 1, 1994, the Company effected a name change to “Medco Containment Insurance Company of New York” following its August 31, 1994 acquisition by its current parent company, Medco Health Solutions, Inc. (formerly known as Merck-Medco Managed Care, LLC). Medco Health Solutions, Inc. (“MHS”) is a national pharmacy benefits manager and a third-party administrator of the prescription drug programs and services for such clients as large private and public sector employers and their employees, physicians, pharmacies, and drug manufacturers.

Effective December 12, 2005, the Department approved MCICNY’s Certificate of Amendment of Charter whereby all of the authorized property and casualty insurance lines of business as defined in Section 1113(a) of the New York Insurance Law were deleted from the Company’s license. The Company simultaneously replaced the aforementioned deleted lines of business with accident and health insurance lines of business and thereafter, MCICNY converted to an accident and health insurer, pursuant to Article 42 of the New York Insurance Law.

On July 21, 2011, subsequent to the examination date, MHS announced an agreement with Express Scripts, Inc., whereby Express Scripts, Inc. agreed to buy MHS for \$29.1 billion in cash and stock. The Department approved the acquisition, effective March 9, 2012, while the Federal Trade Commission approved the acquisition on April 2, 2012.

MCICNY is required to maintain a total of \$200,000 of minimum paid-in capital based upon the line of business it is authorized to transact, as set forth in Section 1113(a) of the New York Insurance Law. The Company reported, as of December 31, 2010, total paid-in capital of \$1,000,000, comprised of one million outstanding issued common shares at \$1 par value per share.

When MCICNY submitted its 2009 and 2010 Medicare bids to the Centers for Medicare and Medicaid Services (“CMS”), it utilized insufficient experience in establishing the amount of premiums it would need to support the business. As a result, CMS required the Company to obtain additional contributions, and as such, a \$30 million cash infusion from MHS was made. This paid-in surplus contribution was approved by the Department on June 28, 2010. The Company reported total capital and surplus in the amount of \$40,373,678 as of December 31, 2010.

The Company’s Risk Based Capital as of December 31, 2010 was 3,114%, up from 1,092% in 2009. This change was primarily due to the \$30,000,000 paid-in surplus contribution mentioned above, made on June 28, 2010. In each of the years under examination, the Risk Based Capital ratio was maintained at a “No Action Level”.

A. Management and Controls

Pursuant to the Company's charter and by-laws, management of the Company is to be vested in a Board of Directors ("BOD") consisting of not less than fourteen members.

The following fourteen (14) individuals served on the Company's Board of Directors as of December 31, 2010:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gabriel R. Cappucci Chatham, NJ	Vice-President, Medco Containment Insurance Company of New York
Mary T. Daschner Minneapolis, MN	Vice-President and Counsel, Medco Health Solutions, Inc.
Paul E. Dellorusso Glen Ridge, NJ	Vice-President/Secretary, Medco Containment Insurance Company of New York
Sarina DosSantos Denville, NJ	Vice-President/Associate Controller, Medco Containment Insurance Company of New York
Peter Gaylord New York, NY	Senior Vice-President Retiree Solutions, Medco Health Solutions, Inc.
Jayne Kasarda Chatham, NJ	Vice-President/Retiree Solutions, Medco Health Solutions, Inc.
Lori Beth Marino West Orange, NJ	Senior Director of Insurance /Risk Management, Medco Health Solutions, Inc.
Constantine Milcos Ramsey, NJ	Senior Vice-President and Treasurer, Medco Containment Insurance Company of New York
Richard J. Rubino Oakland, NJ	President, Medco Containment Insurance Company of New York
James Schalago Bloomingdale, NJ	Director Medicare Insurance, Medco Health Solutions, Inc.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert M. Shannon Harrison, NY	Vice-President and Treasurer, Medco Health Solutions, Inc.
Corlette V. Trim Franklin Lakes, NJ	Vice-President, Medco Containment Insurance Company of New York
Daniel C. Walden New Rochelle, NY	Vice-President/Assistant Secretary, Medco Containment Insurance Company of New York
Stephen E. Wogen Towaco, NJ	Senior Vice-President/Part D Solutions, Medco Health Solutions, Inc.

A review of the BOD's meeting minutes revealed that the board met four (4) times each year. All of the board's meetings were generally well attended by the directors with all board members participating in at least one-half of the meetings they were eligible to attend. It was noted, however, that the BOD's meeting minutes lacked meaningful content in that they did not include substantive details or contain a summary of the issues that were discussed during the meetings.

It is recommended that MCICNY include a detailed summary of the topics and issues that were discussed within the minutes of its board meetings.

MCICNY's by-laws provide the board with the authority to establish committees as it deems appropriate. The board has three (3) committees: Executive Medicare Part D Committee, Executive Finance Committee, and Executive New Business Committee. The committee charters require that the committees meet at least four (4) times annually. The Company was unable to provide documentation that the meetings were held, including an inability to provide meeting

minutes for these committees. Such minutes are critical to ensure that a record of meeting discussion items is maintained and that appropriate corporate governance is being conducted.

It is recommended that the Company maintain documentation that committee meetings were held, including minutes for all of its Board of Director's committee meetings.

The following individuals were the principal officers of the Company as of December 31, 2010:

<u>Name</u>	<u>Title</u>
Richard James Rubino	President
Constantine Milcos	Vice-President and Treasurer
Paul Dellorusso	Vice-President and Secretary

B. Conflict of Interest Policy

Policy Statement Four of the Company's Statement of Policy on Conflicts of Interest states the following:

*"No Director, officer or employee shall divulge to others confidential company information, or use such information for personal profit."*

The examiner reviewed the signed Board of Directors' Conflict of Interest Statements for the examination period. It was noted that none of the signed director statements included Policy Statement Four of the Statement of Policy on Conflicts of Interest.

It is recommended that the Company require its directors and officers to affirm to Policy Statement Four when signing their Conflict of Interest Statements.

In a request for a list of employee-relatives within the Company, the Company responded that they do not maintain such a list. Nor does the Company evaluate the duties or positions of employee-relatives for conflicts of interest.

It is recommended as a good business practice, that the Company maintain a list of employee-relatives employed within the Company. The list should include the position of each employee-relative, start dates, job description, and the results of a Compliance Department review.

C. Corporate Governance

The Company's Parent, Medco Health Solutions, Inc., is a publicly traded, diversified healthcare company that is subject to the Sarbanes-Oxley Act of 2002. Internal Audit and Enterprise Risk Management ("ERM") services for the Company are provided by MHS. Unless otherwise noted below, references to Medco Health Solutions, Inc. are applicable to the Company as well.

MHS has adopted an ERM framework for proactively addressing and mitigating risks, including prospective business risks. Exhibit M of the Handbook (*Understanding the Corporate Governance Structure*) was utilized by the examiner as guidance for assessing Corporate Governance. Although some issues exist, as detailed later in this report, it was determined that overall, the Company's Corporate Governance structure is adequate, sets an appropriate "tone at the top", supports a proactive approach to operational risk management, and contributes to an effective system of internal controls. It was concluded that Medco Health Solutions, Inc.'s

Board of Directors and key executives encourage integrity and ethical behavior throughout the organization and that senior management promotes a corporate culture that acknowledges, understands and maintains an effective control environment.

MHS management has an adequate approach to identifying and mitigating risks across the organization, including prospective business risks. MHS deals proactively with its areas of risk. Management is knowledgeable about risk mitigation strategies. Through risk discussions and other measures, MHS management reviews significant issues and reacts to changes in the environment with a commitment to address risk factors and manage the business accordingly.

MHS has established an Internal Audit Department (“IAD”) function, independent of management, to serve MHS and its subsidiaries.

The IAD assists all levels of management by reviewing and testing financial and operational controls and processes established by management to ensure compliance with laws, regulations and MHS policies. The scope of the IAD program is coordinated with PwC, MHS’ independent certified public accountant, to ensure audit coverage and efficiency.

During the course of this examination, consideration was given to the significance and potential impact of certain IAD findings. To the extent possible, the examiner relied upon work performed by the IAD, as recommended by the NAIC Handbook.

The examiner noted the following reportable items related to Corporate Governance, IAD and ERM:

During the examination, the Company was requested by the examiner to supply a list of

the Internal Audit reports that had been prepared during the examination period. Several of the report titles that were provided were labeled as “privileged and confidential” with no further information granted. While the Company has a right to withhold certain documents as “privileged and confidential”, it is generally the Department’s position that only legal advice can be withheld in this manner and that legal advice can only be prepared by a licensed attorney. In order to understand how the reports could be deemed as legal advice, the examiner requested a brief description of the reports in question. The requested description of reports was not provided to the examiner by the Company.

After repeated attempts to resolve the issue, the Company continued to resist providing any information to the Department’s examiners to support their contention, instead simply repeating that the work was performed by the Internal Audit Department at the behest of the Company’s General Counsel and that the work therefore qualified as legal advice.

It is recommended that the Company cease the practice of withholding evidence that may support a conclusion that withheld documents are “Privileged and Confidential” and thus will not be provided to the examiners.

#### D. Enterprise Risk Management

MHS’ ERM function was reviewed as part of the examiner’s assessment of the overall Corporate Governance environment. MHS uses the Internal Audit Department to perform ERM management for the Company and the Director of the IAD operates in the lead role. The expertise of the remainder of the IAD staff is also leveraged in risk management and in establishing internal controls.

The examiner noted that the Internal Audit Department performed the following functions in its role as a consultant for ERM:

- Provided advice, facilitated workshops, coached the organization on risk and control and promoted the development of a common language and framework for ERM understanding;
- Performed as the central point for coordinating, monitoring, and reporting on risks;
- Supported managers as they worked to identify the best way to mitigate risks; and
- Made tools and techniques used by the IAD available to management to facilitate their analysis of risks and controls.

Since establishing its formal ERM office in April 2008, MHS management's risk maturity has increased and management has become more embedded in the operations of the business and its risks. Since Internal Audit is responsible for auditing the results of its own work, which can lead to a conflict of interest, it seems prudent for MHS to consider reducing IAD's role in championing ERM, and consider utilizing the services of an independent risk management specialist.

It is recommended that MHS management re-evaluate the current state of the ERM function and consider the following process improvements:

- It is recommended that MHS revisit its Internal Audit Department's roles and responsibilities, being mindful of its involvement in the ERM process, including facilitation roles. There should be a clear distinction between a facilitation role and the perception of "owning" parts of the ERM process and related documentation, since facilitation roles may be misconceived as management roles. In revisiting the ERM function and the primary responsibilities associated with ERM, it should be clear that management owns the entire risk management process, as well as the related supporting documentation. In short, management has ultimate accountability and responsibility for risk management, not the IAD.

- It is recommended that MHS establish a Chief Risk Officer (“CRO”) position, or designate someone with overall accountability for the ERM function (e.g., a Director of ERM). The CRO/Director of ERM would report directly to the Senior Risk Management Committee, which reports ERM information to the MHS Board of Directors. Additionally, MHS should consider reorganizing the ERM business segment leads so that they report to a CRO/Director of ERM.
- It is recommended that MHS establish a clear strategy and timeline for the migration of the responsibility and the substantial involvement of the IAD risk experts to a CRO/Director of ERM.

#### E. Internal Audit

The Vice-President of Corporate Audit (“VPCA”) reports to the Audit Committee (“AC”) functionally and reports to the Chief Financial Officer (“CFO”) administratively. A review of the VPCA’s performance evaluation revealed that the CFO has responsibility to comment on, as well as to sign the VPCA’s performance evaluation. The Company stated that the CFO is to acquire input for the VPCA’s evaluation from the Audit Committee. This is clearly mentioned within the AC Charter. The examiner was also advised that the VPCA’s compensation and salary are determined by the CFO and reviewed by the Audit Committee. However, the Company was not able to provide any documentation of the input, review and/or approval from the AC. Furthermore, no documentation of the AC’s review and approval of the compensation and salary as determined by the CFO was provided.

From a corporate governance perspective, the responsibilities and performance of the individual who manages Internal Audit should be directed by the Audit Committee to ensure independence from Senior Management.

Per guidance from the Information Systems Audit and Control Association (“ISACA”):

*“Audit independence is a critical component if a business wishes to have an audit function that can add value to the organization. The [internal] audit report and opinion must be free of any bias or influence if the integrity of the audit process is to be valued and recognized for its contribution to the organization’s goals and objectives.”*

This position is supported throughout the audit industry, including specific guidance from organizations such as the American Institute of Certified Public Accountants (“AICPA”) and the Institute of Internal Auditors (“IIA”). Per the IIA website:

*“The internal auditor occupies a unique position, he or she is employed by management but is also expected to review the conduct of management which can create significant tension since the internal auditor’s independence from management is necessary for the auditor to objectively assess the management’s action, but the internal auditor’s dependence on management for employment is very clear. To maintain objectivity, internal auditors should have no personal or professional involvement with or allegiance to the area being audited; and should maintain an un-biased and impartial mindset in regard to all engagements.”*

When presented with this conclusion, the Company provided industry support for a reporting structure under which Internal Audit reports to the Chief Executive Officer. In this case, however, the CEO for MCICNY also serves as the Chief Financial Officer for MCICNY’s Parent and affiliates. As a result, the industry support does not fit the structure as described.

It is recommended that the Vice-President of Corporate Audit report directly to the Audit Committee on audit matters.

It is recommended that the salary and performance evaluation of the Vice-President of Corporate Audit become the full responsibility of the Audit Committee.

It is recommended that, on a going forward basis, the Company include within the minutes of the Audit Committee meetings, documentation to support the Audit Committee's review of the Vice-President of Corporate Audit's performance with compensation being explicitly stated.

It is recommended that the Company revise the Internal Audit and Audit Committee charters to clearly reflect the Audit Committee as Internal Audit's primary report and to provide the AC with full responsibility for the evaluation and salary of the IA director.

F. Remediation Plan Procedures

When an Internal Audit is performed, findings are presented to the appropriate manager so the item can be remediated and closed. As part of that process, the Audit Committee requires Internal Audit to conduct Quarterly Implementation Status Updates for all audit findings until they have been resolved.

In order to examine this process and to establish whether the Company was actively monitoring actions taken to close Internal Audit findings, the examiner selected multiple Internal Audit recommendations and requested the Quarterly Implementation Status Updates for those items. The following was noted:

- The Company was not able to show that remediation plans had been evaluated by Internal Audit.
- The Company was not able to provide support for having consistently conducted the quarterly implementation updates.

- Where items had been marked by a Manager as closed, the Company was unable to provide support to show that the item had in fact been remediated.
- In no case reviewed was the Company able to explain why, or show how, it had responded when items were not closed within the period specified.

It is noted that some of the above weaknesses identified by the examiner were deemed to be significant. It should also be noted that in certain cases, the Company's inability to document the remediation did not permit a conclusion that such remediation did not, in fact, occur.

It is recommended that the Company adhere to its own written procedures for tracking the Implementation Status Updates for the audit findings.

It is recommended that the Company maintain records/documentation of the Audit Director's evaluation of the clients' responses; the Director's assertion that actions taken on any audit finding remedy the underlying conditions; and the Director's summary reports given to the Audit Executive Director and Vice-President of Corporate Audit on the overall status of open audit issues.

It is recommended that the Company document that it has followed-up with business owners with respect to the mitigation of risks until such risks are mitigated.

It is recommended that the Company maintain accurate and detailed records of the implementation progress and of the remediation that occurs after an audit.

G. Territory and Plan of Operation

As of December 31, 2010, the Company was licensed to transact accident and health insurance as set forth in Section 1113(a)(3)(i) of the New York Insurance Law.

As of December 31, 2010, the Company was licensed only in the State of New York.

MCICNY reported total direct written premiums of \$131,700,322 during the examination period as per the following schedule:

<u>Year</u>	<u>Premiums Written</u>
2007	\$ 1,961,004
2008	21,029,682
2009	48,775,668
2010	<u>59,933,968</u>
Total	<u>\$131,700,322</u>

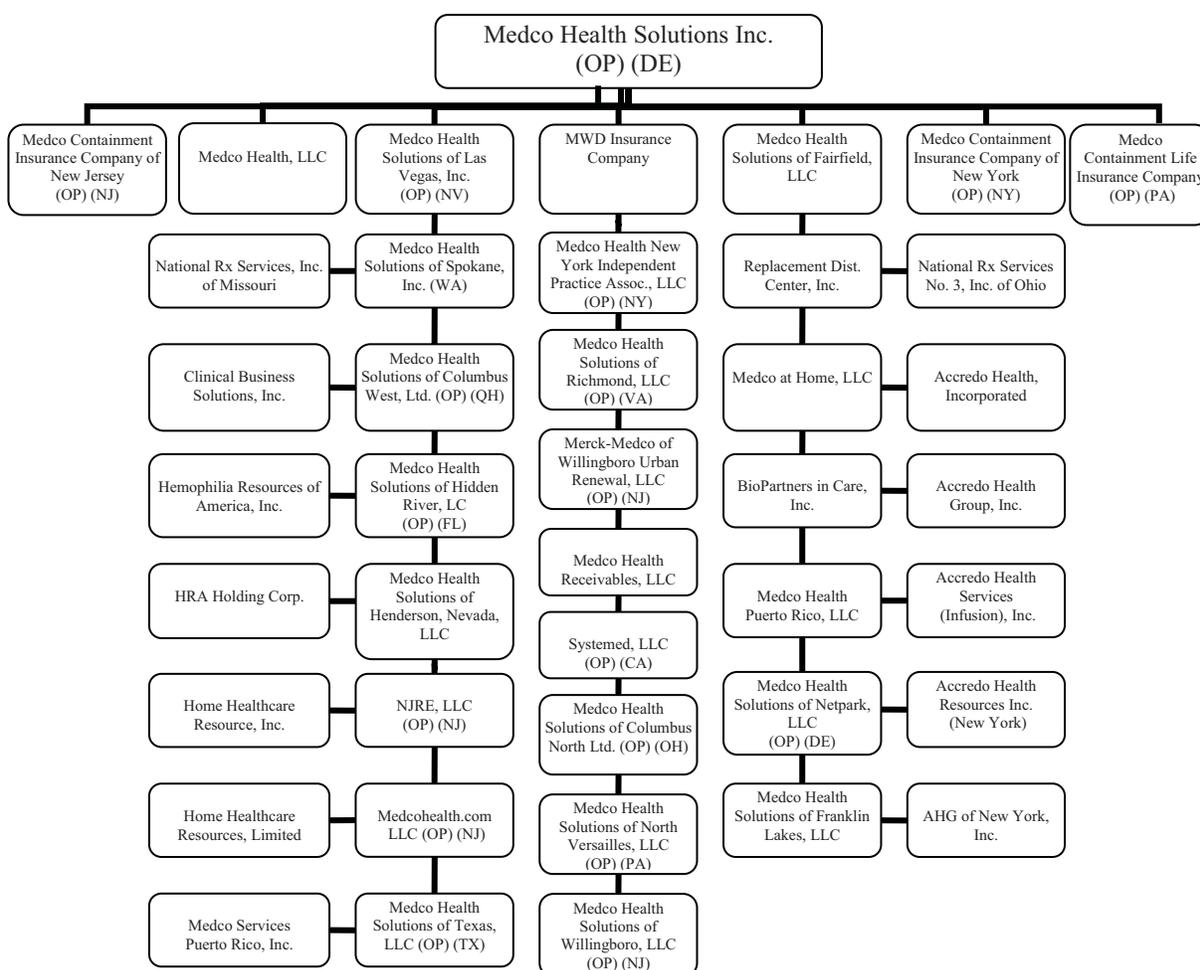
As of January 2006, the Company began writing a fully insured prescription drug plan under the Medicare Part D Prescription Drug program. Prior to its entry into this market, MCICNY had written a small amount of aggregate stop-loss coverage which was marketed to large commercial business groups relative to prescription drug business written by MHS. This stop-loss coverage constituted all of the Company's writings for 2004 and 2005. There was no stop-loss coverage in force during the examination period.

H. Holding Company System

The Company is a 100% controlled subsidiary of MHS, a Delaware-incorporated and publicly traded corporation. Previously a controlled subsidiary of Merck & Co., Inc. ("Merck"),

MHS (formerly named Merck-Medco Managed Care, LLC) was spun off from Merck in August 2003. All of the outstanding shares of MHS were distributed to Merck's shareholders. As a result of the spin-off, MHS became the ultimate controlling entity of the surviving holding company system, which currently includes MCICNY.

The following chart illustrates the holding company system of the Company and its affiliates as of December 31, 2010:



\*\* No one individual or entity held interest of ten percent or more of the ultimate parent company, Medco Health Solutions, Inc., as of December 31, 2010.

Section 1505(d)(3) of the New York Insurance Law states in part:

“(d) The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period: ...

(3) rendering of services on a regular and systematic basis...”

The following inter-company agreements were in effect between the Company and MHS, as of December 31, 2010:

**Service Agreement effective August 31, 1994 and as amended by addendum, dated April 16, 1998**

The captioned agreement calls for MHS to provide the Company with accounting, underwriting, claims and investment services. On June 26, 2007, the Department approved an amendment to this agreement. Such amendment included the following additional provisions: (i) MHS is to provide the Company with management and administrative services, including all personnel, necessary for the management of the operations and services of MCICNY and the implementation of the Company’s policies; and (ii) the Company is to maintain its accounts and records in Franklin Lakes, New Jersey.

**Tax Sharing Agreement with Medco Health Solutions, Inc., dated March 10, 2004**

The captioned agreement, which was approved by the Department, states that the Company is to be included in MHS’ consolidated Federal income tax return and consolidated state income tax returns.

The Department issued a non-objection letter to the Company on March 4, 2004, relative to this agreement.

**Integrated Medicare Part D Prescription Drug Program Master Agreement with Medco Health Solutions, Inc., dated June 6, 2005 (Master Drug Program Agreement)**

This agreement provides for MCICNY to retain MHS and its subsidiaries, which hold TPA licenses in certain states, to provide a Medicare Prescription Drug Program including, but not limited to, retail pharmacy, mail order pharmacy, and specialty drug pharmacy services for eligible persons, point-of-care, physician office communications and cost containment initiatives developed and implemented by MHS. Such cost containment initiatives may include communications with prescribers, patients and/or participating pharmacies, and financial incentives to participating pharmacies for their participation in such initiatives.

The Company failed to file the Master Drug Program Agreement with the Department, in violation of Section 1505(d)(3) of the New York Insurance Law.

It is recommended that the Company comply with the requirements of Section 1505(d)(3) of the New York Insurance Law by filing its inter-company agreements with the Department prior to implementation. It should be noted that during the examination, the Company complied with this recommendation and the agreement was approved by this Department on April 19, 2012.

The Service Agreement between MCICNY and its Parent indicates that inter-company balances will be due and payable within fifteen (15) days of the applicable statement. A review of the inter-company transactions between the Company and its Parent, MHS, revealed that settlement dates were not within the timeframe set forth by the agreement.

It is recommended that the Company settle inter-company transactions with its Parent within the timeframe of 15 days, in accordance with its service agreement.

New York Insurance Law §1505 (a)(3) states:

“(a) Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:

(3) Expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied.”

Part 91.4 of Department Regulation No. 33 (11 NYCRR 91) states in part:

“(a) *General instructions.* (1) It is the responsibility of each life insurer to use only such methods of allocation as will produce a suitable and equitable distribution of income and expenses by lines of business. Unless impractical or unfeasible, an insurer may use only such methods of allocation in its distribution of income and expenses within annual statement lines of business as are compatible with the methods it uses for distribution between annual statement lines of business...

4) Bases of allocation shall be reviewed periodically to ascertain their suitability for continued use.

5) Allocations of income and expenses between companies shall be treated in the same manner as if made for major annual statement lines of business.”

Further, Paragraphs 8 and 9 of Statement of Statutory Accounting Principles (“SSAP”)

No. 70 of the NAIC Accounting Practices and Procedures Manual state in part:

“8. Many entities operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the entities incurring the expense as if the expense had been paid solely by the incurring entity. The apportionment shall be completed based upon specific identification to the entity incurring the expense. Where specific identification is not feasible, apportionment shall be based upon pertinent factors and ratios.

9. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of a reporting entity, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the reporting entity and are not to be apportioned to other entities within a group.”

The Addendum to the Service Agreement between MCICNY and its Parent states in part:

*“Analyses of time devoted... by each individual will be evaluated by reports and studies from each organization unit providing direct services to the companies. These reports and studies will be developed annually...”*

The Parent pays its employees directly and allocates those expenses to the various subsidiaries. When considering the amount to charge MCICNY, the Parent consolidates insurance company expenses into a single amount. It was noted that the Parent charged 85% of total expenses to MCICNY’s Pennsylvania affiliate, and 15% to MCICNY. Both Companies

provide Medicare Part D coverage. When asked, the Company was not able to provide reports or studies to support the rationale behind the 85%/15% allocation split. The Company stated that the percentage has not changed since 2005.

It is recommended that the Company comply with Section 1505(a)(3) of the New York Insurance Law, Part 91.4 of Department Regulation No. 33, and Paragraphs 8 and 9 of Statement of Statutory Accounting Principles No. 70 and ensure that expenses are allocated from the Parent to the Company on an equitable, prescribed basis.

It is recommended that the Company comply with its own service agreement and prepare and update studies on a regular basis to ensure that the allocations are prepared accurately.

It is also recommended that the Company comply with its own service agreement and maintain the monthly reports and supporting documentation for all inter-company allocations.

MCICNY made all the required holding company filings for the years under examination, pursuant to Department Regulation No. 52, in a timely manner.

#### I. Significant Operating Ratios

The following ratios have been computed as of December 31, 2010, based upon the results of this examination:

Net Premiums Written to Surplus	148.00%
Uncollected Premiums to Surplus	0.29%
Liabilities to Liquid Assets	90.00%

Each of the above ratios fell within the benchmark ranges established by the NAIC.

The following underwriting ratios are presented on an earned-incurred basis and encompass the four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Claims	\$117,700,136	89.37%
Claim adjustment expenses	1,475,090	1.12%
General administrative expenses	12,475,571	9.47%
Net underwriting gain	<u>49,525</u>	<u>.04%</u>
Premium earned	<u>\$131,700,322</u>	<u>100.00%</u>

J. Accounts and Records

During a review of Part 3 of the Company’s “Underwriting and Investment Exhibit – Analysis of Expenses”, it was noted that all expenses were reported in the “General Administrative Expenses” column 3. The Company failed to allocate its expenses within the appropriate categories contained in Part 3 of the Underwriting and Investment Exhibit, in accordance with Department Regulation No. 33 (11 NYCRR 91) and the NAIC Health Annual Statement Instructions.

It is recommended that the Company properly allocate the claims adjustment expenses and investment expenses to the line items shown in Part 3 of its Annual Statement Underwriting and Investment Exhibit (“Analysis of Expenses”) in accordance with the requirements of Department Regulation No. 33 and the NAIC Health Annual Statement Instructions.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities, and capital and surplus as determined by this examination and reported by the Company in its filed annual statement, as of December 31, 2010. This is the same as the balance sheet filed by the Company as of December 31, 2010.

<u>Assets</u>	<u>Examination</u>	<u>Company</u>
Bonds	\$ 5,416,058	\$ 5,416,058
Cash	10,410,426	10,410,426
Investment income due and accrued	4,683	4,683
Uncollected premiums and agents' balances in the course of collection	117,627	117,627
Accrued retrospective premiums	1,765,366	1,765,366
Amounts receivable relating to uninsured plans	35,043,999	35,043,999
Current federal and foreign income tax recoverable and interest thereon	1,120,154	1,120,154
Net deferred tax asset	190,320	190,320
Health care and other amounts receivable	<u>565,783</u>	<u>565,783</u>
Total assets	\$ <u>54,634,416</u>	\$ <u>54,634,416</u>

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>
Claims unpaid	\$11,999,842	\$11,999,842
Unpaid claims adjustment expenses	149,531	149,531
Premiums received in advance	5,408	5,408
General expenses due and accrued	247,657	247,657
Amounts due parent, subsidiaries and affiliates	<u>1,858,300</u>	<u>1,858,300</u>
Total liabilities	\$ <u>14,260,738</u>	\$ <u>14,260,738</u>
 <u>Capital and surplus</u>		
Common capital stock	\$ 1,000,000	\$ 1,000,000
Gross paid-in and contributed surplus	34,068,941	34,068,941
Unassigned surplus funds	<u>5,304,737</u>	<u>5,304,737</u>
Total capital and surplus	\$ <u>40,373,678</u>	\$ <u>40,373,678</u>
Total liabilities, capital and surplus	\$ <u>54,634,416</u>	\$ <u>54,634,416</u>

**Note:** The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax return with its Parent Company for tax years 2006 - 2007. The next cycle (2008-2009) commenced in the fall of 2010. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to any contingency.

B. Statement of Revenue and Expenses and Capital and Surplus

Capital and surplus increased by \$30,231,506 during the four-year period covered by this examination, January 1, 2007 through December 31, 2010, detailed as follows:

<u>Revenue</u>		
Net premium income	\$ <u>131,700,322</u>	
Total revenue		\$131,700,322
<u>Expenses</u>		
Prescription drugs	\$ 117,700,136	
Claim adjustment expenses	1,475,090	
General administration expenses	<u>12,475,571</u>	
Total underwriting deductions		\$ <u>131,650,797</u>
Net underwriting gain		\$ 49,525
Net investment income	\$ 869,683	
Net realized capital gains	<u>1,042</u>	
Net investment income		870,725
Net loss from agents or premium balances charged off		(478,813)
Aggregate write-in for other expenses		<u>(2,001)</u>
Net income before all other federal income taxes incurred		\$ 439,436
Federal income taxes incurred		<u>(225,081)</u>
Net income		\$ <u>214,355</u>

Changes in Capital and Surplus

Capital and surplus, per report on examination, as of December 31, 2006	\$ 10,142,172
--	---------------

	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$ 214,355		
Change in net deferred income taxes	100,974		
Paid in surplus	30,000,000		
Change in non-admitted assets	<u>                    </u>	\$ <u>83,823</u>	
Net increase in capital and surplus			<u>30,231,506</u>
Capital and surplus, per report on examination, as of December 31, 2010			<u>\$ 40,373,678</u>

**4. CLAIMS UNPAID**

The examination liability of \$11,999,842 is the same as the amount reported by the Company as of the examination date.

The examination analysis of the unpaid claims reserve was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and filed annual statements as verified during the examination. The examination reserve was based upon actual payments made through a point in time, plus an estimate for claims remaining unpaid at that date. Such estimate was calculated based on actuarial principles, which utilized the Company's past experience in projecting the ultimate cost of claims incurred on or prior to December 31, 2010.

The examination liability consisted of contract claims on Medicare Part D prescription drug coverage.

## 5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. In determining the scope of this review, the examiner took into consideration the Company's line of business, Medicare Part D Prescription Drug, which mainly falls under the purview of CMS' requirements, instead of the statutory requirements of the Department. Thus, the market conduct review was limited to agents and brokers. Noted are the following compliance issues:

The Company uses a combination of internal and external distribution methodologies for the Medco Pharmaceutical Drug Plan. The external sales force is limited to General Agencies ("GAs"). The GAs are paid a commission for enrollments in accordance with CMS' rules and guidance.

Section 2112(a) of the New York Insurance Law states:

"Every insurer, fraternal benefit society or health maintenance organization doing business in this state shall file a certificate of appointment in such form as the superintendent may prescribe in order to appoint insurance agents to represent such insurer, fraternal benefit society or health maintenance organization."

Section 2112(d) of the New York Insurance Law states in part:

"Every insurer, fraternal benefit society or health maintenance organization... doing business in this state shall, upon termination of the certificate of appointment... file with the superintendent within thirty days a statement, in such form as the superintendent may prescribe, of the facts relative to such termination for cause..."

During the examination period, the Company failed to properly appoint its GA or the GA's sub-agents. The Company did not notify the Superintendent of the agents' appointments,

as required by Section 2112(a) of the New York Insurance Law. Furthermore, the Company failed to file agent termination notices with the Superintendent, as required by Section 2112(d) of the New York Insurance Law.

It is recommended that the Company comply with the requirements of Sections 2112(a) and 2112(d) of the New York Insurance Law and notify the Department of all appointments and terminations of its agents.

Sections 2101(a)(1) and (10) of the New York Insurance Law states:

(a) In this article, “insurance agent” means any authorized or acknowledged agent of an insurer, fraternal benefit society or health maintenance organization issued a certificate of authority pursuant to article forty-four of the public health law, and any sub-agent or other representative of such an agent, who acts as such in the solicitation of, negotiations for, or sale of, an insurance, health maintenance organization or annuity contract, other than as a licensed insurance broker, except that such term shall not include:

(1) any regular salaried officer or employee of a licensed insurer, fraternal benefit society or health maintenance organization or a licensed insurance agent, who does not solicit or accept from the public, outside of an office of such insurer, health maintenance organization or agent, applications or not receive a commission or other compensation for his services which commission or other compensation is directly dependent upon the amount of business done;

(10) Any salaried full-time employee who counsels or advises his or her employer relative to the insurance interests of the employer or of the subsidiaries or business affiliates of the employer, provided that the employee does not sell or solicit insurance or receive a commission.

Section 2114(a)(3) of the New York Insurance Law states in part:

“No insurer, fraternal benefit society or health maintenance organization doing business in this state... shall pay any commission or other compensation to any person... except to a licensed... agent of such insurer...”

The Company’s Internal Distribution Department consists of call center-based Customer Service Representatives (“CSRs”) who respond to inbound phone calls. The Company noted that

CSRs are MCICNY employees and are compensated via salary, not enrollments. The compensation paid to the Company's CSRs consists of a bi-weekly salary that is based on an hourly rate and a "qualified-based bonus". This bonus is a volume-based compensation and is, therefore, considered a form of commission. Thus, it appears that the Company paid commissions to unlicensed agents, which is a violation of Section 2114(a)(3) of the New York Insurance Law.

It is recommended that the Company comply with the requirements of Section 2114(a)(3) of New York Insurance Law and pay commissions only to licensed and appropriately appointed agents.

## **6. SUBSEQUENT EVENTS**

As noted earlier in this report on examination, On July 21, 2011, subsequent to the examination date, MHS announced an agreement with Express Scripts, Inc., whereby Express Scripts, Inc. agreed to buy MHS for \$29.1 billion in cash and stock. The Department approved the acquisition, effective March 9, 2012, while the Federal Trade Commission approved the acquisition on April 2, 2012.

## 7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2006, contained nine (9) recommendations. The current status of these matters is as follows (page numbers refer to the prior report):

<u>ITEM NO.</u>		<u>PAGE NO.</u>
	<b><u>Holding Company System</u></b>	
1.	It is recommended that the Company comply with Section 1505(d) of the New York Insurance Law and file all of its inter-company agreements with the Department prior to implementation.  <i>The Company did not comply with this recommendation. A similar recommendation is in this report under item 2 (H).</i>	10
2.	It is recommended that the Company comply with the expense allocation method included in its Department approved inter-company service agreement with Medco Health Solutions, Inc.  <i>The Company did not comply with this recommendation. A similar recommendation was issued in this report under item 2 (H).</i>	10
3.	It is recommended that the Company file with the Department, with its new service agreement, the related addendum section detailing the method of expense allocation.  <i>The Company has complied with this recommendation.</i>	11
4.	It is recommended that the Company fully comply with Department Regulation 52 (11 NYCRR 80-1.2) by ensuring that its HC 1 Statements are filed timely with this Department.  <i>The Company has complied with this recommendation.</i>	12

**ITEM NO.****PAGE NO.****Accounts and Records**

5. It is recommended that all incurred expenses related to the Company's inter-company service agreements with Medco Health be booked to the Company's inter-company payable account in accordance with SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual. 13

*The Company has complied with this recommendation.*

6. It is recommended that the Company report its related investment expenses in the manner prescribed by Department Regulation 33 and the NAIC annual statement instructions. Also, it is further recommended that MCICNY follow the annual statement instructions by disclosing in the Notes to the Financial Statement its method used for allocation of expenses in connection with management and service fees reported. 14

*The Company did not fully comply with this recommendation. A similar recommendation in this report is under item 2 (J).*

7. It is recommended that MCICNY follow the annual statement instructions by disclosing in the Notes to the Financial Statement its method used for allocation of expenses in connection with management and service fees reported. 14

*The Company did not fully comply with this recommendation. A similar recommendation in this report is under item 2 (J).*

8. It is recommended that the Company continue to enhance its controls and monitor CMS's rules regarding premium billing and collection. 14

*The Company has complied with this recommendation.*

9. It is recommended that the Company update its current custodial investment agreement to include each of the above standard provisions as listed in the NAIC Examiners Handbook for inclusion within such custodial agreement. 15

*The Company has complied with this recommendation.*

## 8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
<b>A. <u>Management and Controls</u></b>	
i. It is recommended that MCICNY include a detailed summary of the topics and issues that were discussed within the minutes of its board meetings.	8
ii. It is recommended that the Company maintain documentation that committee meetings were held, including minutes for all of its Board of Director's committee meetings.	9
<b>B. <u>Conflict of Interest</u></b>	
i. It is recommended that the Company require its directors and officers to affirm to Policy Statement Four when signing their Conflict of Interest Statements.	9
ii. It is recommended as a good business practice, that the Company maintain a list of employee-relatives employed within the company. The list should include the position of each employee-relative, start dates, job description, and the results of a Compliance Department review.	10
<b>C. <u>Corporate Governance</u></b>	
It is recommended that the Company cease the practice of withholding evidence that may support a conclusion that withheld documents are "Privileged and Confidential" and thus will not be provided to the examiners.	12

**ITEM****PAGE NO.****D. Enterprise Risk Management**

It is recommended that MHS management re-evaluate the current state of the ERM function and consider the following process improvements: 13

- i. It is recommended that MHS revisit its Internal Audit Department's roles and responsibilities, being mindful of its involvement in the ERM process, including facilitation roles. There should be a clear distinction between a facilitation role and the perception of "owning" parts of the ERM process and related documentation, since facilitation roles may be misconceived as management roles. In revisiting the ERM function and the primary responsibilities associated with ERM, it should be clear that management owns the entire risk management process, as well as the related supporting documentation. In short, management has ultimate accountability and responsibility for risk management, not the IAD

- ii. It is recommended that MHS establish a Chief Risk Officer ("CRO") position, or designate someone with overall accountability for the ERM function (e.g., a Director of ERM). The CRO/Director of ERM would report directly to the Senior Risk Management Committee, which reports ERM information to the MHS Board of Directors. Additionally, MHS should consider reorganizing the ERM business segment leads so that they report to a CRO/Director of ERM. 14

- iii. It is also recommended that MHS establish a clear strategy and timeline for the migration of the responsibility and the substantial involvement of the IAD risk experts to a CRO/Director of ERM. 14

**E. Internal Audit**

- i. It is recommended that the Vice-President of Corporate Audit report directly to the Audit Committee on audit matters. 15

<b><u>ITEM</u></b>	<b><u>PAGE NO.</u></b>
ii. It is recommended that the salary and performance evaluation of the Vice-President of Corporate Audit become the full responsibility of the Audit Committee.	15
iii. It is recommended that, on a going forward basis, the Company include within the minutes of the Audit Committee meetings, documentation to support the Audit Committee's review of the Vice-President of Corporate Audit's performance with compensation being explicitly stated.	16
iv. It is recommended that the Company revise the Internal Audit and Audit Committee charters to clearly reflect the Audit Committee as Internal Audit's primary report and to provide the AC with full responsibility for the evaluation and salary of the IA director.	16
<b>F. <u>Remediation Plan Procedures</u></b>	
i. It is recommended that the Company adhere to its own written procedures for tracking the Implementation Status Updates for the audit findings.	17
ii. It is recommended that the Company maintain records/documentation of the Audit Director's evaluation of the clients' responses; the Director's assertion that actions taken on any audit finding remedy the underlying conditions; and the Director's summary reports given to the Audit Executive Director and Vice-President of Corporate Audit on the overall status of open audit issues.	17
iii. It is recommended that the Company document that it has followed-up with business owners with respect to the mitigation of risks until such risks are mitigated.	17
iv. It is recommended that the Company maintain accurate and detailed records of the implementation progress and of the remediation that occurs after an audit.	17



**ITEM****PAGE NO.****I. Market Conduct Activities**

- |  |    |
|--|----|
| i. It is recommended that the Company comply with the requirements of Sections 2112(a) and 2112(d) of the New York Insurance Law and notify the Department of all appointments and terminations of its agents. | 30 |
| ii. It is recommended that the Company comply with the requirements of Section 2114(a)(3) of New York Insurance Law and pay commissions only to licensed and appropriately appointed agents.                   | 31 |

Appointment No. 30656

**STATE OF NEW YORK  
INSURANCE DEPARTMENT**

I, James J. Wrynn, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

**Jeffrey Usher**

as a proper person to examine into the affairs of the

**Medco Containment Insurance Company of New York**

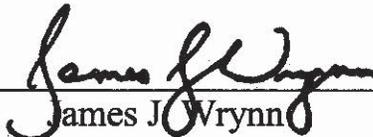
and to make a report to me in writing of the condition of the said

**Company**

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by name and affixed the official Seal of this Department, at the City of New York.

This 17<sup>th</sup> day of March, 2011

  
James J. Wrynn

Superintendent of Insurance

