

**REPORT ON EXAMINATION**

**OF THE**

**MEDCO CONTAINMENT INSURANCE COMPANY OF NEW YORK**

**AS OF**

**DECEMBER 31, 2013**

**DATE OF REPORT**

**FEBRUARY 27, 2015**

**EXAMINER**

**KAIWEN K. GUO**

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

February 27, 2015

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 31174, dated March 25, 2014, attached hereto, I have made an examination into the condition and affairs of the Medco Containment Insurance Company of New York, a for-profit stock company licensed pursuant to the provisions of Article 42 of the New York Insurance Law, as of December 31, 2013. The following report is respectfully submitted thereon.

The examination was conducted at the home office of Medco Health Solution, Inc. (“MHS”) located at 100 Parsons Pond Drive, Franklin Lakes, New Jersey. The Company maintains its books of account and corporate records at this location. The Company has obtained regulatory approval for this arrangement pursuant to the requirements of Section 325(b) of the New York Insurance Law.

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 “ESHC” appears herein, without qualification, it should be understood to indicate Express Scripts Holding Company, MCICNY’s ultimate 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.

## 1. SCOPE OF THE EXAMINATION

The previous examination was conducted as of December 31, 2010. This examination of the Company was a combined (financial and market conduct) examination and covered the three-year period January 1, 2011 to December 31, 2013. 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, 2013 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, 2013 were also reviewed.

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 examiner planned and performed the examination to evaluate the Company’s current financial condition, as well as to 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 determined 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 2011 through 2013, 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 ESHC's Internal Audit function and Enterprise Risk Management program, as they relate to the Company.

The examiner reviewed the corrective actions taken by the Company with respect to the comments and recommendations contained in the prior report on examination. The results of the examiner's review are contained in Item Six of this report.

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 (“PBM”) 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, drug manufacturers, etc. Effective December 12, 2005, DFS’s predecessor, the New York State Department of Insurance approved MCICNY’s Certificate of Amendment of Charter whereby all of the authorized property and casualty insurance lines, 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 with accident and health lines and thereafter, MCICNY converted to an accident and health insurer pursuant to Article 42 of the New York Insurance Law. Commencing January 1, 2006, the Company began serving as a plan sponsor offering Medicare Part D prescription drug insurance coverage, under the Centers for Medicare & Medicaid Services (“CMS”) sponsored Medicare Part D benefit. The Company provides Medicare drug benefit plan options for beneficiaries, including (i) a “standard Part D” benefit plan as mandated by statute, and (ii) for an additional premium, benefit plans with coverage that exceeds the standard Part D coverage.

On July 21, 2011, MHS announced an agreement with Express Scripts Inc. (“ESI”) whereby Express Scripts Inc. agreed to buy MHS for \$29.1 billion in cash and stock. On April 2, 2012, Express Scripts, Inc. and MHS merged, and MHS and ESI each became wholly owned subsidiaries of Express Scripts Holding Company.

MCICNY is required to maintain \$100,000 of minimum paid-in capital based upon the line of business it is authorized to transact as set forth in Section 1113(a)(3)(i) of the New York Insurance Law. The Company reported, as of December 31, 2013, total paid-in capital of \$1,000,000, comprised of one million outstanding issued common shares at \$1 par value per share. Additionally, on December 31, 2013 the Company reported total capital and surplus in the amount of \$53,760,238. The Company’s Risk Based Capital (“RBC”) for the examination period increased during the examination period to 4,038% in 2013, from 2,872% 2011 resulting in a no-action level in each of the years.

A. Management and Controls

Pursuant to the Company's charter and by-laws, the corporate powers of the Company are to be exercised through a Board of Directors consisting of not less than seven nor more than fourteen members.

As of December 31, 2013, the seven members of the Board of Directors and their principal business affiliations were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Regina Dennis Nanuet, NY	Vice-President, Express Scripts Holding Company
Keith Ebling Town & Country, MO	General Counsel, Secretary, Express Scripts Holding Company
Michael Galvin Hopewell Junction, NY	Vice-President of Infrastructure, Express Scripts Holding Company
Mathew Harper Wildwood, MO	Treasurer, Express Scripts Holding Company
Edward Ignaczak Clarkson Valley, MO	Executive Vice-President, Express Scripts Holding Company
Patrick McNamee Clayton, MO	Executive Vice-President, Express Scripts Holding Company
Britton Pim St. Louis, MO	Vice-President of Product Development, Express Scripts Holding Company.

The board of directors (the "Board") held quarterly meetings for calendar year 2011 and the first half of calendar year 2012. On June 1, 2012, the Board adopted various amendments to MCICNY's by-laws, which were approved by the Department in August, 2012. One such

amendment permitted the Board to take actions pursuant to unanimous written consent, in lieu of holding physical meetings. Another amendment provided that regular meetings of the Board of Directors would take place on an annual basis, rather than on a quarterly basis. It was noted that after the adoption of the amendments, ten of the fifteen meetings were replaced by a written consent in lieu of a meeting. Additionally, the minutes of any meetings that were held, as well as the written consents, did not include any details or summary of issues, including certain material transactions that were discussed. As a result, it was not possible for the examiner to determine the amount of the Board's involvement in the management of the Company.

It is recommended that the minutes of the MCICNY Board of Directors' meetings document the active participation and decision-making of the Board in monitoring and overseeing MCICNY's business affairs. It is noted that a similar recommendation was made in the prior report on examination. This leads to a concern that the Board may not be taking a sufficient role in corporate oversight.

Sections 312(a) and (b) of the New York Insurance Law state in part:

“(a) The superintendent shall forward to every insurer or other person examined a copy of the report on examination as filed for public inspection, together with any recommendations or statements relating thereto which he may deem proper.

(b) A copy of the report shall be furnished by such insurer or other person to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's file confirming that such member has reviewed and read such report...”

The prior examination was conducted as of December 31, 2010, and the report on examination was filed in October 2012. However, members of the Company's board of directors

did not review the report and sign the attestation until March 26, 2014, when the current examination was already underway. It should also be noted that one board member did not sign the attestation.

It is recommended that each member of the board of directors comply with Section 312(b) of New York Insurance Law by reviewing the report on examination and signing the attestation in a timely manner.

As of December 31, 2013, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Britton Pim	President, Chief Executive Officer
Mathew Harper	Vice-President and Treasurer
Keith Ebling	Secretary

B. Corporate Governance

Corporate Governance, Enterprise Risk Management (“ERM”), Internal Audit, and Compliance functions for the Company are provided by the ultimate parent company, Express Scripts Holding Company (“ESHC”), a publicly traded company.

Exhibit M of the Handbook (Understanding the Corporate Governance Structure) was utilized by the examiner as guidance for assessing the company’s Corporate Governance. Overall, it was determined that 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 the 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.

### Enterprise Risk Management

Department Circular Letter No. 14 (2011), issued on December 19, 2011, encourages insurers to adopt a formal Enterprise Risk Management (“ERM”) function to identify, measure, aggregate, and manage risk exposures within predetermined tolerance levels across all activities of the enterprise.

Circular Letter No. 14 (2011) establishes the requirements for an effective Enterprise Risk Management program. It states in part:

“...When conducting an ERM evaluation, the Department will look for adherence to the following ERM function objectives...:

- A written risk policy that delineates the insurer’s risk/reward framework, risk tolerance levels, and risk limits. An insurer’s ERM function should provide for the identification and quantification of risk under a sufficiently wide range of outcomes using techniques that are appropriate to the nature, scale, and complexity of the risks the insurer bears and are adequate for capital management and solvency purposes.
- A process of risk identification and quantification supported by documentation providing appropriately detailed descriptions and explanations of risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run. Prospective solvency assessments, including scenario and stress testing, should be a key component of the ERM function, as they can help highlight the impact of such scenarios and stresses on an insurer’s future solvency. The insurer’s ERM function should incorporate risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes.
- In the context of its overall ERM framework, an insurer should consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and the regulatory capital requirements. Additionally, an effective ERM function should incorporate investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.

- An insurer should address as part of its ERM all reasonably foreseeable and relevant material risks including, as applicable: insurance; underwriting; asset-liability matching; credit; market; operational; reputational; liquidity; and any other significant risks associated with group membership. The assessment should include identifying the relationship between risk management and the level and quality of financial resources necessary as determined with quantitative and qualitative metrics.
  
- If an insurer is part of a holding company, consolidated enterprise, conglomerate, or other group characterized by common control or management, then the insurer's ERM function should identify, quantify, and manage any risks to which the insurer may be exposed by transactions, or affiliation, with the holding company or the other affiliates within the group. That is, the insurer should assess and identify methods to manage the impact of affiliated entities or the holding company on the insurer. If systems to perform these functions are located at the common control and management level (e.g. holding company), then the insurer should be able to demonstrate how those systems anticipate and mitigate or manage the risks to which affiliates expose the insurer. This demonstration should include not only those risks that may result in direct financial loss to the insurer through transactional or common control ties, but also reputational and other risks where the loss of confidence in one member of the group may cause distress to the insurance company."

Express Scripts Holding Company ("ESHC") adopted an ERM framework for proactively addressing and mitigating risks, including prospective business risks. ESHC relies on its Enterprise Risk Council (the "Council") to monitor the business and financial risk exposures of the Express Scripts Holding Company group, which includes MCICNY. The Council is led by the Vice President of Corporate Audit who meets regularly with other cross-functional Vice Presidents, known as risk champions, to discuss and review risk issues.

A key tool of Enterprise Risk Management is the Risk Register, which is a list of top risks that are rated by key criteria, such as the magnitude of impact and the probability of occurrence. The Company provided the examiner with the Risk Register as of December 31, 2013. However, when the examiner requested supporting documentation for the risks listed in the Risk Register, the Company was not able to provide either documentation or detailed

descriptions and explanations of the risks it identified. The examiner observed that the Company's comments and descriptions relating to the risks were general in nature and did not quantify such risks in a manner that was appropriate to the nature, scale, and the complexity of the risks, nor was adequacy for capital management and solvency purposes considered. It should be noted that prospective solvency assessments, including scenario and stress testing, should be a key component of the ERM function, as they can help highlight the impact of such scenarios and stresses on an insurer's future solvency. The examination also revealed that the Company's Enterprise Risk Management function does not describe a formal written risk policy that delineates the risk/reward framework, risk tolerance levels, and risk limits.

Subsequent to the examination, the State of New York codified Insurance Regulation 203 (11 NYCRR 82), which formally established the requirements defined by Circular Letter No. 14 (2011), as described above.

It is recommended that the Company maintain supporting documentation with appropriate detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run.

It is recommended that the Company identify and quantify its risks in a manner that is appropriate to the nature, scale, and complexity of the risks the insurer bears and that such identification and quantification should be adequate for capital management and solvency purposes.

It is also recommended that the ERM function incorporate risk tolerance levels and limits in the risk policy and procedures, business strategy, and day-to-day strategic decision making processes.

It is recommended that the Company implement a formal written risk policy to delineate the risk/reward framework, risk tolerance levels and risk limits.

It is recommended that prospective solvency assessments, including scenario and stress testing, be made a key component of the Company's ERM function, highlighting the impact of such scenario and stresses on the Company's future solvency.

It is recommended that the Company consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and regulatory capital requirements.

It is recommended that the ERM function incorporate investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.

C. Territory and Plan of Operation

As of the examination date, 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, 2013, the Company was licensed only in the State of New York.

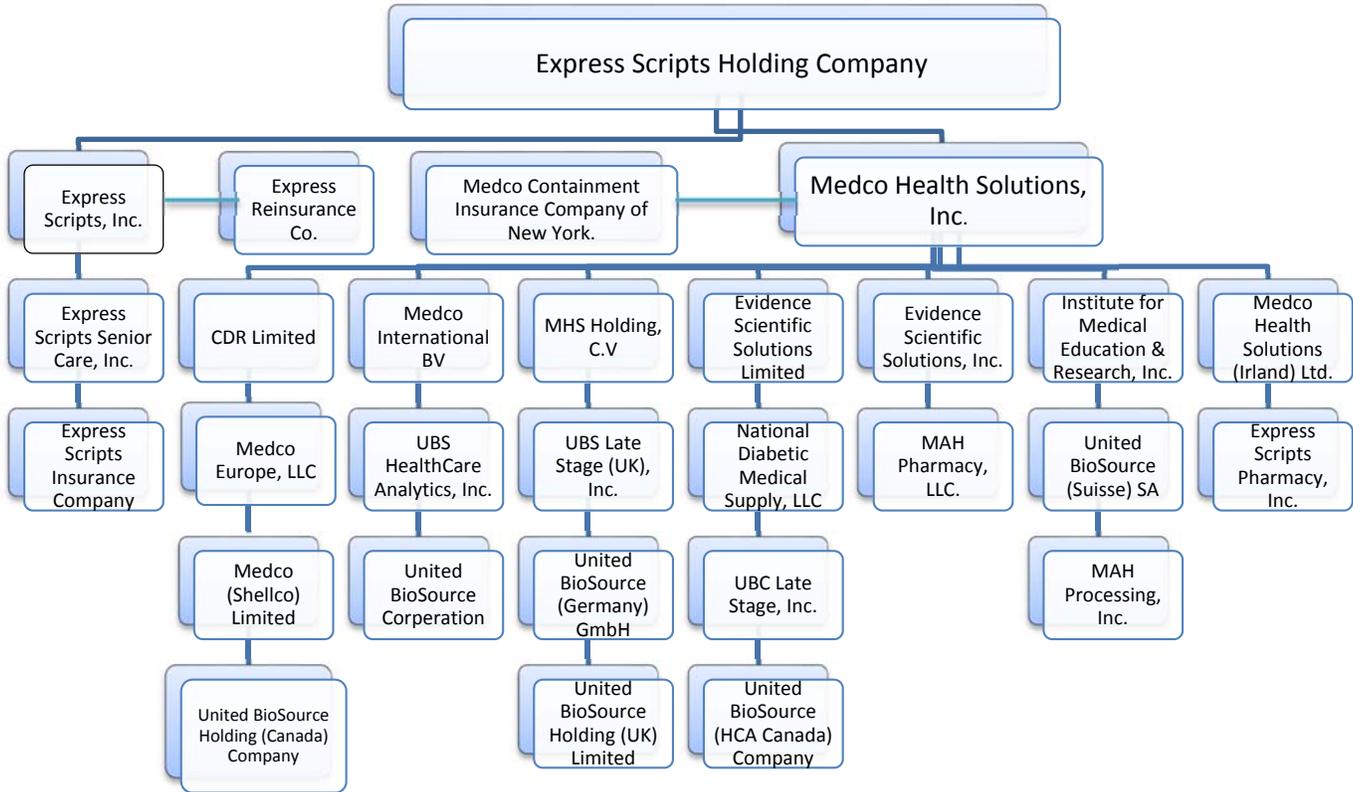
MCICNY reported total direct written premiums of \$238,731,708 during the examination period as per the following schedule:

<u>Year</u>	<u>Premiums Written</u>
2011	\$ 78,236,655
2012	83,341,300
<u>2013</u>	<u>77,153,753</u>
Total	\$ <u>238,731,708</u>

D. Holding Company System

The Company is a 100% controlled subsidiary of MHS, a Delaware-incorporated and publicly traded corporation. On July 20, 2011, Express Scripts, Inc. (“Express Scripts”) entered into an Agreement and Plan of Merger (“Merger Agreement”) with MHS, Aristotle Merger Sub, Inc. and Plato Merger Sub, Inc. These latter two entities were both wholly-owned subsidiaries of MHS. The Merger Agreement provided that Aristotle Merger Sub, Inc. merged with and into Express Scripts, with Express Scripts being the surviving corporation. Immediately thereafter, Plato Merger Sub, Inc. merged into MHS, with MHS being the surviving corporation. As a result of the merger, both MHS and Express Scripts became wholly-owned subsidiaries of Aristotle Holding, Inc., and MCICNY became an indirect subsidiary of the Aristotle Holding, Inc. The effective date of the merger was April 2, 2012. As part of the completion of the merger, Aristotle Holding, Inc. changed its name to Express Scripts Holding Company.

The following abbreviated chart illustrates the holding company system of the Company and its other affiliates as of December 31, 2013.



\* No one individual or entity held interest of ten percent or more of the ultimate parent company, Express Scripts Holding Company, as of December 31, 2013.

The Company is party to four agreements with members of its holding company system, detailed as follows:

- (1) Service agreement
- (2) Tax Allocation Agreement
- (3) Integrated Medicare Part D Prescription Drug Program Master Agreement
- (4) Intercompany Agreement

### Service Agreement

Effective August 31, 1994, the Company entered into a service agreement with MHS whereby MHS agreed to perform accounting, underwriting, claims processing and investment services for a fee, which permits the allocation of expenses between the two entities. On June 26, 2007, the Department approved an amendment to this agreement. The amendment included the following additional provisions: (i) MHS was 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 was to maintain its accounts and records in Franklin Lakes, New Jersey.

After the merger, the Company underwent integration and streamlining processes in which certain functions previously performed by MHS were delegated to the ultimate parent, Express Scripts Holding Company and/or other affiliates within the holding company. For example, part of the claims processing services was delegated to Express Scripts, Inc. Monitoring and oversight responsibilities with respect to regulatory compliance, internal audit function and the system of internal controls were delegated to the ultimate parent. However, the service agreement did not reflect these changes. Additionally, the service agreement contains an outdated cost allocation schedule for payments of expenses among the affiliates.

It is recommended that the Company revise the service agreement to reflect the changes implemented as a result of the merger and provide the agreement to the Department for review and non-disapproval.

It is also recommended that the Company update the cost allocation schedule in the service agreement to accurately reflect the cost allocation methodology currently being used.

Pursuant to the terms of the Service Agreement, inter-company balances are due and payable within 15 days of the applicable statement. A review of the inter-company transactions revealed that payments settled between the Company and MHS were not always within the timeframe set forth by the terms of the Service Agreement.

It is recommended that the Company settle the inter-company payments with MHS within the timeframe set forth by the term of the Service Agreement.

A similar recommendation was made in the prior report on examination.

#### Tax Allocation Agreement

Effective March 10, 2004, the Company entered into a Tax Allocation Agreement (the “Agreement”) with MHS. The Agreement calls for the Company to be included in MHS’s consolidated federal income tax return and combined or unitary state franchise or income tax returns. A revised Agreement was submitted to the Department for approval on September 27, 2013. The intent of the revised Agreement was to reflect the merger between Express Scripts, Inc and MHS. While the initial Agreement was approved by the Department, the revised Agreement has not yet been approved. It should be noted that the revised Agreement did not include the arbitration, assignment and inspection of records clauses as required by Insurance Circular Letter No. 33 (1979). In addition, certain provisions in the revised Agreement were inconsistent with the requirements of Insurance Circular Letter No. 33 (1979). On March 13, 2014, the Department furnished a letter to the Company requesting further revisions to the revised Tax Sharing Agreement. As of the examination date, a response to the letter has not been provided.

It is recommended that the Company revise its Tax Allocation Agreement to comply with the requirements of Insurance Circular Letter No. 33 (1979) and file the revised Agreement with the Department for approval.

#### Integrated Medicare Part D Prescription Drug Program Master Agreement

Effective June 6, 2005, the Company entered into the captioned agreement with MHS. The agreement was amended annually to reflect updated rate changes for prescription drug reimbursement. The most recent amendment was effective on January 1, 2013. The agreement provided 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.

#### Intercompany Agreement

Effective August 30, 2013, the Company and Medco Containment Life Insurance Company (“MCLIC”), a subsidiary of MHS domiciled in Pennsylvania, entered into an agreement with Smart Insurance Company (“Smart”) to purchase the membership in Smart’s SmartD Rx stand-alone prescription drug plan contract with the Center for Medicare and Medicaid Services (“CMS”). Pursuant to the agreement, from the period September 1, 2013 through December 31, 2013, the Company agreed to service the CMS contract for Smart as an Administrative Services Only arrangement. Effective January 1, 2014, subsequent to the examination date, the Company and MCLIC began to bear full risk similar to any of the Medicare Part D CMS contracts for the members in their respective licensed states.

E. Significant operating ratios

The following ratios have been computed as of December 31, 2013:

Net Premiums Written to Surplus	143.5%
Uncollected Premiums to Surplus	1.7%
Liabilities to Liquid Assets	18.7%

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

F. Insurance Circular No. 3 (2013) – Disaster Planning, Preparedness and Response

Insurance Circular Letter No. 3 (2013), which replaced Circular Letter No. 2 (2012) states in part:

“By June 30, 2013, each company must submit a Disaster Response Plan to the Department. Entities must provide their completed Disaster Response Plan to the Department via the Department’s Portal Application or in hard copy...

By June 30, 2013, the Disaster Response Plan Questionnaire must be submitted to the Department via the Department’s Portal Application or in hard copy...

By June 30, 2013, the Business Continuity Plan Questionnaire must be submitted to the Department via the Department’s Portal Application or in hard copy...”

It should be noted that Circular Letter No. 2 (2012) contained similar requirements to the foregoing, for that year.

During 2012 and 2013, the Company failed to file the required annual Disaster Response Plan, Disaster Response Plan Questionnaire and Business Continuity Plan Questionnaire. The Company submitted its 2013 filing in May 2014, well beyond the acceptable filing date. Further,

the filing lacked many of the parameters required for such filings, including the completion of an acceptable Disaster Response Plan.

It is recommended that the Company comply with the requirements of Circular Letter No. 3 (2013), and any updates to that Circular Letter, by filing timely and completely, its annual Disaster Response Plan, Disaster Response Plan Questionnaire and Business Continuity Plan Questionnaire.

G. Accounts and Records

During the course of the examination, it was noted that the Company's treatment of certain items was not in accordance with Statutory Accounting Principles, annual statement instructions and/or Department guidelines. The examiner also noted several deficiencies in the Company's system of accounts, records and internal controls. A description of such items is as follows:

1. Schedule Y Reporting

The NAIC Annual Statement Instructions for Schedule Y, Part 1 A states in part:

“All insurer and reporting entity members of the holding company system shall prepare a schedule for inclusion in each of the individual annual statements that is common for the group with the exception of Column 10, Relationship to Reporting Entity...

Column 8 – Name of Parent, Subsidiaries or Affiliates  
Names of all insurers and parent, subsidiaries or affiliates, insurance and non-insurance, in the insurance holding company system...

Column 14 – Ultimate Controlling Entity(ies)/Person(s)  
Name of the Ultimate Controlling Entity(ies)/Person(s)..."

Upon review of the 2013 annual statement, it was noted that Schedule Y did not include all entities within the Express Scripts Holding Company system. It was also noted that some of the entities that were sold during 2013 were still listed in the Schedule Y. Additionally, Column 14 of Schedule Y did not show the name of the ultimate controlling entity.

It is recommended that the Company exercise greater care and complete Schedule Y in accordance with the NAIC's Annual Statement Instructions.

## 2. Annual Statement Disclosure

The "Notes to Financial Statements" section of the 2013 annual statement included a section disclosing certain information concerning the parent, subsidiaries, affiliates and other related parties. The section contained an inaccurate statement in which the Company indicated that it had a federal tax allocation agreement with Medco Health Solutions, Inc. As indicated in Section D of this report, after the merger, the Company revised the tax allocation agreement to reflect Express Scripts Holding Company being a party to the agreement. Effective April 2, 2012, the Tax Allocation Agreement was entered into between the Company and Express Scripts Holding Company.

It is recommended that the Company report accurate information with respect to the parties of the Tax Allocation Agreement in its filed annual statement.

## 3. Schedule G Reporting

In addition to the NAIC Annual Statement, the Company is required to file the New York Annual Statement Supplement (the "Supplement"). Pursuant to the instructions of the

Supplement, the Company should report in Schedule G salaries paid to directors, trustees and officers by the Company as well as salaries paid by all other companies within the holding company system. During the examination, it was noted that some directors received a salary from the Company and also from the parent company. However, reported salaries in Schedule G only included salaries paid by the Company, excluding those salaries paid by the parent company.

It is recommended that the Company comply with the instructions of the New York Annual Statement Supplement and report directors' and officers' salaries from all entities within the holding company system.

#### 4. Pharmaceutical Rebates Receivables

The asset account "Health Care and Other Account Receivables" consists of pharmaceutical rebate receivables and guaranteed receivables. The Company receives pharmaceutical rebates associated with prescription drugs covered under its Medicare Part D prescription drug plan. The examination review indicated that the balance of pharmaceutical rebates as of December 31, 2013 was fully collected within ninety days of the due date.

Statement of Statutory Accounting Principle ("SSAP") No. 84 sets forth the statutory accounting principle for reporting pharmaceutical rebate receivables.

Paragraph 10 of SSAP No. 84 states in part:

- "a. Estimated amount shall be related solely to actual prescriptions filled during the 3 months immediately preceding the reporting date;
- b. Billed amounts represent pharmaceutical rebate receivables that have been invoiced or confirmed in writing but not collected as of the reporting date. Billed amounts for an estimated amount under paragraph 10 a. shall be admitted only if the determination of the rebate, based on actual

prescriptions filled, occurs and is invoiced or confirmed in writing within the 2 months following the reporting date of the estimated amount...”

Exhibit C – Implementation Guide of SSAP No. 84 states in part:

“...for those entities that use a PBM, the SSAP requires that to admit billed amounts the reporting entity must receive reports from the PBM on a quarterly basis; the reports should provide fairly detailed information as to the number of each prescription drug filled, the rebate for each individual drug, the total amount of rebates to be received, any rebates to be received that relate to prior periods, etc. The reporting entity must then accept or “confirm” the report, and then communicate formal acceptance of the report to the PBM. Only after this occurs is the amount considered confirmed as required by the SSAP.”

Upon review of the pharmaceutical rebate receivables, it was noted that the Company’s pharmaceutical rebates were processed by MHS, which functioned as the Company’s pharmaceutical benefits manager. The Company relied on the PBM to provide the correct billed amount of pharmaceutical rebate receivables. According to the Company’s management, on a monthly basis, MHS provided the Company with a spreadsheet file indicating the amount of pharmaceutical rebates receivable. However, it should be noted that the file did not include detailed information as to the number of actual prescriptions filled and the rebate of each individual drug. Further, when the examiner requested confirmation of pharmaceutical rebates, the Company could not provide any documentation supporting the confirmation process.

It is recommended that the Company comply with the requirements of SSAP No. 84 and confirm the amount of pharmaceutical rebates it is entitled to receive prior to reporting them as an admitted asset.

5. Cash and Short-Term Investments

Upon review of the annual statement, it was noted that the Company maintains all of its cash in one bank account. It should be noted that the maximum insured amount of a single deposit account by the federal government is \$250,000. Should the financial institution experience any financial difficulty, any deposits that exceed the amount insured by the federal agencies may expose the Company to the potential risk of loss. The Company can further reduce its risk of financial loss by diversifying into other forms of investments.

It is recommended that the Company take steps to reduce the potential risk of loss of its cash.

### 3. FINANCIAL STATEMENTS

#### Independent Accountants

The firm of Price Waterhouse Coopers, LLC was retained by the Company to audit the Company's combined statutory basis financial statements of financial position as of December 31st for each year in the examination period, and the related statutory-basis statements of operations, surplus, and cash flows for the year then ended.

Price Waterhouse Coopers, LLC concluded that the statutory financial statements presented fairly, in all material respects, the financial position of the Company at the respective audit dates. Balances reported in these audited financial statements were reconciled to the corresponding years' annual statements with no discrepancies noted.

The following statements show the assets, liabilities, and surplus as of December 31, 2013, as contained in the Company's 2013 filed annual statement, a condensed summary of operations and a reconciliation of the surplus account for each of the years under review. The examiner's review of a sample of transactions did not reveal any differences which materially affected the Company's financial condition as presented in its December 31, 2013 filed annual statement.

A. Balance SheetAssets

Bonds	\$ 499,037
Cash	42,911,350
Investment income due and accrued	104
Uncollected premiums and agents' balances in the course of collection	895,178
Funds held by or deposited with reinsured companies	770
Amounts receivable relating to uninsured plans	9,913,745
Net deferred tax asset	546,881
Health care and other amounts receivable	<u>7,276,338</u>
 Total assets	 \$ <u>62,043,403</u>

Liabilities

Claims unpaid	\$ 1,947,114
Unpaid claims adjustment expenses	17,045
Aggregate health policy reserve	949,182
Premiums received in advance	14,978
General expenses due and accrued	275,611
Current federal and foreign income payable	3,991,915
Amounts due parent, subsidiaries and affiliates	876,545
Liability for amounts held under uninsured plans	<u>210,775</u>
 Total liabilities	 \$ <u>8,283,165</u>

Capital and surplus

Common capital stock	\$ 1,000,000
Gross paid-in and contributed surplus	34,068,941
Unassigned funds (surplus)	<u>18,691,297</u>
Total capital and surplus	<u>53,760,238</u>
 Total liabilities, capital and surplus	 \$ <u>62,043,403</u>

**Note:** The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax return with its parent company for the tax years 2008 - 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

Capital and surplus increased by \$13,386,560 during the period under examination, January 1, 2011 through December 31, 2013, detailed as follows:

<u>Revenue</u>		
Net premium income	\$ 238,731,708	
Net investment gain/(loss)	(59,682)	
Total revenue		\$ <u>238,672,026</u>
<u>Expenses</u>		
Prescription drugs	\$ <u>195,377,860</u>	
Total hospital and medical expenses:	\$ <u>195,377,860</u>	
<u>Administrative expenses</u>		
Claim adjustment expenses	\$ 1,659,779	
General administration expenses	<u>18,667,509</u>	
Total administrative expenses	\$ <u>20,327,288</u>	
Total underwriting deductions		\$ <u>215,705,148</u>
Net underwriting gain		\$ 22,966,878
Net loss from agents or premium balances charged off		(804,325)
Aggregate write-in for other expenses		<u>(35,767)</u>
Net income before federal income taxes incurred		\$ 22,126,786
Federal income taxes incurred		<u>8,005,219</u>
Net income		\$ <u>14,121,567</u>

Change in Capital and Surplus

Capital and surplus, per report on examination, as of December 31, 2010			\$ 40,373,678
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	<u>Gains in surplus</u>	<u>Losses in surplus</u>	
Net Income	\$ 14,121,567		
Change in net deferred income taxes	648,656		
Change in non-admitted assets		\$ <u>1,383,663</u>	
Net increase (decrease) in capital and surplus			<u>13,386,560</u>
Capital and surplus, per report on examination, as of December 31, 2013			\$ <u>53,760,238</u>

#### **4. 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 lines of business, Prescription Drug Part D, which falls under the purview of CMS' requirements, as opposed to the statutory requirements of the Department. Thus, the review was general in nature and is not to be construed to encompass the more precise scope of a market conduct examination and the review was limited to agents and brokers.

No issues or areas of non-compliance were noted.

## 5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2010, contained the following twenty five (25) comments and recommendations (page numbers refer to the prior report):

<u>ITEM NO.</u>	<u>PAGE NO.</u>
<u>Board of Directors</u>	
1. It is recommended that MCICNY include a detailed summary of the topics and issues that were discussed within the minutes of its board meetings.	7
<i>The Company has not complied with this recommendation.</i>	
2. 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.	7
<i>The Company has complied with this recommendation.</i>	
3. It is recommended that MCICNY comply with Article III, Section 6 of its bylaws and refrain from paying Board of Director fees to salaried officers.	8
<i>The Company has complied with this recommendation.</i>	
<u>Conflict of Interest</u>	
4. It is recommended that the Company require its directors, officers, and employees to affirm Policy Statement Four (4) when signing their Conflict of Interest Statements.	9
<i>The Company has complied with this recommendation.</i>	
5. It is recommended as a good business practice that the Company maintain a list of employee relatives within the company. The list should include the position of each employee relative, start dates, job description and the result of the Compliance Dept. review.	9
<i>The Company has complied with this recommendation.</i>	

**ITEM NO.****PAGE NO.**Corporate Governance

- |    |   |    |
|----|---|----|
| 6. | 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 examination. | 12 |
|----|---|----|

*The Company has complied with this recommendation.*

Enterprise Risk Management

- |    |  |    |
|----|--|----|
| 7. | It is recommended that MHS revisits 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 (mis)conceived 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. | 13 |
|----|--|----|

*The Company has complied with this recommendation.*

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|----|---|----|
| 8. | It is recommended that MHS establishes a Chief Risk Officer (CRO) position, or designate someone with overall accountability for the ERM function (e.g. a Director of ERM), who reports directly to the Senior Risk Management Committee, which reports ERM information to MHS BOARD OF DIRECTOR. Additionally, MHS should consider reorganizing the ERM business segment leads so that they report to a CRO / Director of ERM. | 13 |
|----|---|----|

*The Company has complied with this recommendation*

**ITEM NO.****PAGE NO.**

9. It is also recommended that MHS establishes a clear strategy and timeline for the migration of the responsibility and the substantial involvement of the IAD risk expert to a CRO/ Director of ERM. 13

*The Company has complied with this recommendation.*

**Internal Audit**

10. It is recommended that the Vice-President of Corporate Audit report directly to the Audit Committee on audit matters. 14

*The Company has complied with this recommendation.*

11. It is recommended that the salary and performance evaluation become the full responsibility of the Audit Committee. 15

*Due to the change in requirements, this recommendation no longer applied. The Company is now in compliance with the new standard.*

12. 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. 15

*Due to the change in requirements, this recommendation no longer applied. The Company is now in compliance with the new standard.*

13. 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. 15

*Due to the change in requirements, this recommendation no longer applied. The Company is now in compliance with the new standard.*

**ITEM NO.****PAGE NO.**Remediation Plan Procedures

14. It is recommended that the Company adheres to its own written procedures for tracking the implementation status updates for the audit findings. 16

*The Company has complied with this recommendation.*

15. 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, Corporate Audit on the overall status of open audit issues. 16

*The Company has complied with this recommendation.*

16. 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. 16

*The Company has complied with this recommendation.*

17. It is recommended that the Company maintain accurate and detailed records of the implementation progress and the remediation that occurs after an audit. 16

*The Company has complied with this recommendation.*

Holding Company Agreement

18. 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. 20

*The Company has complied with this recommendation.*

<u>ITEM NO.</u>		<u>PAGE NO.</u>
19.	It is recommended that the Company settle the inter-company transactions with its Parent within the timeframe of 15 days, in accordance with its service agreement.  <i>The Company has not complied with this recommendation.</i>	20
20.	It is recommended that the Company comply with 1505(a)(3) of the New York Insurance Law, Part 91.4 of Department Regulation No. 33, and Paragraph 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 basis.  <i>The Company has complied with this recommendation.</i>	21
21.	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.  <i>The Company has complied with this recommend.</i>	21
22.	It is also recommended that the Company comply with its own service agreement and maintain the monthly reports and supporting documents of all inter-company allocations.  <i>The Company has complied with this recommendation.</i>	21
 <u>Accounts and Records</u>		
23.	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.  <i>The Company has complied with this recommendation.</i>	22

**ITEM NO.****PAGE NO.**Agents and Brokers

24. It is recommended that Medco 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. 27

*The Company has complied with this recommendation.*

25. It is recommended that the Company comply with the requirements of Sections 2114(a) (3) of New York Insurance Law and pay commissions only to licensed and appropriately appointed agents. 27

*The Company has complied with this recommendation.*

## 6. SUMMARY OF COMMENTS AND RECOMMENDATION

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management and Controls</u>	
i. It is recommended that the minutes of the MCICNY Board of Directors' meetings document the active participation and decision-making of the Board in monitoring and overseeing MCICNY's business affairs. It is noted that a similar recommendation was made in the prior report on examination. This leads to a concern that the Board may not be taking a sufficient role in corporate oversight.	8
ii. It is recommended that each member of the board of directors complies with Section 312(b) of New York Insurance Law and reviews the report on examination and sign the attestation in a timely manner.	9
B. <u>Enterprise Risk Management</u>	
i. It is recommended that the Company maintains supporting documentation with appropriate detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run.	12
ii. It is recommended that the Company identifies and quantifies its risks in a manner that is appropriate to the nature, scale, and complexity of the risks the insurer bears and that such identification and quantification should be adequate for capital management and solvency purposes.	12
iii. It is also recommended that the ERM function incorporates risk tolerance levels and limits in the risk policy and procedures, business strategy, and day-to-day strategic decision making processes.	13

<u>ITEM</u>	<u>PAGE NO.</u>
iv. It is recommended that the Company implements a formal written risk policy to delineate the risk/reward framework, risk tolerance levels and risk limits.	13
v. It is recommended that prospective solvency assessments, including scenario and stress testing, be made a key component of the Company's ERM function, highlighting the impact of such scenario and stresses on the Company's future solvency.	13
vi. It is recommended that the Company considers a risk and capital management process to monitor the level of its financial resources relative to its economic capital and regulatory capital requirements.	13
vii. It is recommended that the ERM function incorporates investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.	13
 D. <u>    Holding Company System</u>	
i. It is recommended that the Company revises the service agreement to reflect the changes implemented as a result of the merger and provide the agreement to the Department for review and non-disapproval.	16
ii. It is also recommended that the Company updates the cost allocation schedule in the service agreement to accurately reflect the cost allocation methodology currently being used.	16
iii. It is recommended that the Company settles the inter-company payments with MHS within the timeframe set forth by the term of the Service Agreement.	17

A similar recommendation was made in the prior report on examination.

<u>ITEM</u>	<u>PAGE NO.</u>
iv. It is recommended that the Company revises its Tax Allocation Agreement in compliance with the requirements of Circular Letter No. 33 (1979) and files the revised Agreement with the Department for approval.	18
E. <u>Circular Letter No. 3 (2013) – Disaster Planning, Preparedness and Response</u>	20
<p>It is recommended that the Company complies with the requirements of Circular Letter No. 3 (2013), and any updates to that Circular Letter, by filing timely and completely, its annual Disaster Response Plan, Disaster Response Plan Questionnaire and Business Continuity Plan Questionnaire.</p>	
F <u>Accounts and Records</u>	
i. It is recommended that the Company exercises greater care and completes Schedule Y in accordance with the NAIC’s Annual Statement Instructions.	21
ii. It is recommended that the Company reports accurate information with respect to the parties of the Tax Allocation Agreement in its filed annual statement.	21
iii. It is recommended that the Company complies with the instructions of the New York Annual Statement Supplement and reports directors’ and officers’ salaries from all entities within the holding company system.	22
iv. It is recommended that the Company complies with the requirements of SSAP No. 84 and confirms the amount of pharmaceutical rebates it is entitled to receive prior to reporting them as a receivable.	23
v. It is recommended that the Company take steps to reduce the potential risk of loss of its cash.	24



NEW YORK STATE  
**DEPARTMENT OF FINANCIAL SERVICES**

I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

**Kaiwen Guo**

as a proper person to examine the affairs of

**Medco Containment Insurance Company of New York**

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

**Company**

with such other information as he shall deem requisite.

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

this 25th day of March, 2014

**BENJAMIN M. LAWSKY**  
Superintendent of Financial Services

By:



Lisette Johnson  
Bureau Chief  
Health Bureau

