

**REPORT ON EXAMINATION**

**OF**

**GROUP HEALTH INCORPORATED**

**AS OF**

**DECEMBER 31, 2008**

**DATE OF REPORT**

**AUGUST 10, 2012**

**EXAMINER**

**WAI WONG**

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

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Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

August 10, 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 30342, dated August 12, 2009, attached hereto, I have made an examination into the financial condition and affairs of Group Health Incorporated, a not-for-profit health service corporation licensed pursuant to Article 43 of the New York Insurance Law, as of December 31, 2008, and submit the following report thereon.

The examination was conducted at the home office of Group Health Incorporated, located at 55 Water Street, New York, New York.

Wherever the designations “the Plan” or “GHI” appear herein, without qualification, they should be understood to indicate Group Health Incorporated, a wholly-owned subsidiary of EmblemHealth, Inc.

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

A concurrent examination of the manner in which GHI conducts its business practices and fulfills its contractual obligations to policyholders and claimants was conducted as of December 31, 2008. A separate report has been submitted thereon.

Also concurrent with this examination, an examination was conducted of the financial condition and market conduct activities of GHI HMO Select, Inc. (“GHI HMO”), an affiliated for-profit health maintenance organization licensed under the provisions of Article 44 of the New York Public Health Law. A separate report thereon has been submitted.

## 1. SCOPE OF THE EXAMINATION

The Plan was previously examined as of December 31, 2003. This examination of the Plan is a financial examination as defined in the National Association of Insurance Commissioners (“NAIC”) *Financial Condition Examiners Handbook, 2008 Edition* (the “Handbook”) and it covers the five-year period from January 1, 2004 through December 31, 2008. The examination was conducted observing the guidelines and procedures in the Handbook. Where deemed appropriate by the examiner, transactions occurring subsequent to December 31, 2008 were also reviewed.

The examination was conducted on a risk-focused basis in accordance with the provisions of the Handbook. The Handbook’s guidance provides for the establishment of an examination plan based on the examiner’s assessment of risk in the insurer’s operations and utilizing that evaluation in formulating the nature and extent of the examination. The examiner planned and performed the examination to evaluate the current financial condition as well as identify prospective risks that may threaten the future solvency of GHI.

The examiner identified key processes, assessed the risks within those processes and evaluated 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, evaluating the overall financial statement presentation, and determining management’s compliance with Department statutes and guidelines, Statutory Accounting Principles as adopted by the Department, and annual statement instructions.

Information concerning the Plan’s organizational structure, business approach and control environment were utilized to develop the examination approach. The examination evaluated the

Plan'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 Plan was audited annually, for the years 2007 through 2008, by the accounting firm Deloitte & Touche LLP ("Deloitte"). From 2004 through 2006 the Plan was audited by the accounting firm BDO Seidman, LLP. GHI received an unqualified opinion in all five years. Certain audit workpapers of Deloitte were reviewed and relied upon in conjunction with this examination.

The Plan's corporate governance structure includes, but is not limited to three components: the Internal Audit Unit, the Regulatory Compliance Unit and the Sarbanes Oxley Unit (SOX) which has been given the task of assessing the internal control structure and (eventual) compliance with the Sarbanes-Oxley Act of 2002 ("SOX"). Where applicable, SOX workpapers and reports were reviewed and portions therein were relied upon for this examination.

The examiner reviewed the corrective actions taken by the Plan with respect to the violations, recommendations and comments contained in the prior report on examination. The results of the examiner's review are contained in item seven of this report.

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

## **2. DESCRIPTION OF THE PLAN**

### **A. History of the Plan**

GHI is a non-profit health service corporation which was licensed under the provisions of Article 43 of the New York Insurance Law. The Plan was originally incorporated as the Group Health Cooperative, Inc., and began operations on December 6, 1940. It was organized as a Consumer's Cooperative stock corporation under the provisions of Article VII of the Cooperative Corporation Law, for the purpose of furnishing medical expense indemnity insurance to its subscribers. On October 1, 1946, the name Group Health Insurance, Inc. was adopted and the Plan's operations became subject to the provisions of Article IX-C (now recodified as Article 43) of the New York Insurance Law. The change followed reincorporation as a membership corporation.

Effective December 7, 1971, the Charter of Group Health Insurance, Inc. was amended pursuant to the provisions of Section 803 of the Not-for-Profit Corporation Law, changing the name to Group Health Incorporated ("GHI") and extending the powers of the corporation to

include those of a health service corporation. On December 12, 1972, GHI merged with Group Health Dental Insurance, Inc., leaving GHI as the surviving corporation.

On June 1, 1999, GHI created a subsidiary, GHI HMO Select, Inc. (“GHI HMO”), a for-profit health maintenance organization licensed pursuant to Article 44 of the New York Public Health Law, concurrent with the purchase of the commercial business of WellCare of New York, a New York licensed health maintenance organization. GHI indirectly owns one hundred percent (100%) of GHI HMO, via GHI’s wholly-owned subsidiary, GHI Services LLC.

GHI filed a “Restated Certificate of Incorporation” with the Department in 2006, as part of GHI’s plan to pursue an affiliation with Health Insurance Plan of Greater New York (“HIP”).

On November 15, 2006, GHI and HIP were united under the leadership of the HIP Foundation, Inc. (“the Foundation”), the parent corporation of HIP, after having received regulatory approval from the New York State Insurance Department, and approval from the Boards of Directors of GHI and the Foundation. The Foundation is the sole corporate member of both companies. Also, on this date, the Foundation’s name was changed to EmblemHealth, Inc. (“EmblemHealth”). At the outset, the Board of Directors of EmblemHealth included an equal number of directors from the HIP and GHI Boards of Directors.

On March 31, 2007, the New York State Legislature passed legislation as part of the New York State Budget that would allow for the conversion of HIP and GHI into for-profit public companies and allow the holding company, EmblemHealth, to raise capital through the issuance of stock as a for-profit entity. If the conversion were to occur, the New York Public Asset Fund and the New York State Health Foundation, both created by the State of New York, would receive 100% of the fair market value of HIP and GHI determined at the time of Conversion, in

the form of voting and non-voting common stock and the cash proceeds of a public offering of a new for-profit holding company which, with its subsidiaries, would acquire or succeed to all of the assets and liabilities of HIP and GHI. To date, such conversion has not been effectuated.

B. Corporate Governance

Corporate governance is provided by GHI's Board of Directors, subject to its by-laws and to such rules and regulations as the Board may adopt for that purpose and for the conduct of its meetings. This governance is carried out by Plan management, as well as various management committees.

In 2008, HIP and GHI began integrating their various business units under EmblemHealth. As part of the integration, all officers at GHI and HIP were made officers of both companies. In addition, all officers also became officers of EmblemHealth Services Company, LLC ("EHS"), a subsidiary jointly owned by HIP and GHI. The employees of both companies were transferred to EHS which assumed all payroll and pension liabilities of HIP and GHI. HIP and GHI guarantee all liabilities of EHS and have an equal 50% stake in the subsidiary.

As part of the risk-focused examination approach, the examiner evaluated whether the Plan's management implemented effective oversight procedures to identify key risks inherent to the Plan's operations and applied adequate internal controls to mitigate those risks. Effective oversight of inherent business risks should include an internal audit function that comprehensively identifies and assesses key areas of risk. This can be accomplished through a formal risk identification and controls assessment process.

EmblemHealth's corporate governance and controls structure includes, but is not limited to the Internal Audit, Compliance, and Sarbanes-Oxley ("SOX") Units. The Internal Audit Unit is responsible for identifying potential auditable areas within GHI, identifying significant risk areas and activities, and conducting operational, compliance and IT related audits. The Compliance Unit is responsible for developing and maintaining the Compliance Program, incorporating the rules, regulations and guidelines under applicable federal and state regulatory authorities, as well as GHI corporate policies. This Unit also provides oversight and general guidance on all matters related to corporate compliance. The SOX Unit is responsible for ensuring that financial reporting controls are reliable. As a non-public company the Plan is not required to be in compliance with the provisions of the Sarbanes-Oxley Act, which requires management to report on the adequacy of its internal controls over financial reporting. Nonetheless, the management of EmblemHealth has taken action to move its entities toward becoming SOX compliant, including developing a formalized SOX program that evaluates the effectiveness of the Plan's internal control structure and procedures over financial reporting.

The internal audit function should be independent of others within the organization. Key factors and best practices that indicate the internal audit function is independent of management include, among others: (1) compensation for the head of internal audit is determined and approved by the audit committee, (2) the audit committee approves resource increases/decreases to internal audit staff, and (3) the internal audit plan and budget is submitted to and approved by the audit committee.

The Plan is in compliance with the three factors listed above. The Senior Vice President ("SVP") of Corporate Compliance and Internal Audit reports to the Audit Committee and they consider the base salary and compensation package provided to this individual in executive

session with no company employees present. The Senior Vice President of Corporate Compliance and Internal Audit is subject to Senior Management's performance metrics as reviewed by the Compensation Committee of the Board and approved by this committee, which, jointly with the Audit Committee, determines the compensation paid to the Senior Vice President of Corporate Compliance and Internal Audit. From a corporate governance perspective the responsibilities and performance should be measured by the Audit Committee to ensure independence from Senior Management.

It is recommended that the audit committee continue to review and approve the salary of the head of internal audit.

The examination review revealed that the Plan has a formalized risk management function, but no dedicated Enterprise Risk Management Officer or a unit or committee whose sole function is to conduct Enterprise Risk Management analysis.

Currently the SVP of Corporate Compliance and Internal Audit has also been given responsibility for facilitating the development of an Enterprise Risk Management function.

In 2009, the Institute of Internal Auditors ("IIA") published a position paper on the role of internal auditing in Enterprise Risk Management ("ERM"). According to the IIA, "Internal Auditing's core role with regard to ERM is to provide objective assurance to the Board on the effectiveness of risk management. Internal audit may extend its involvement in ERM, provided certain conditions apply. The conditions are:

- It should be clear that management remains responsible for risk management.
- The nature of the internal auditor's responsibilities should be documented in the internal audit charter and approved by the audit committee.

- Internal auditing should not manage any of the risks on behalf of management.
- Internal auditing should provide advice, challenge and support to management's decision making, as opposed to making risk management decisions themselves.
- Internal auditing cannot give objective assurance on any part of the ERM framework for which it is responsible. Such assurance should be provided by other suitably qualified parties.
- Any work beyond the assurance activities should be recognized as a consulting engagement and the implementation standards related to such engagements should be followed.

Since EmblemHealth has initiated the process to become a for-profit, publicly held company, it is recommended that a formalized risk management function be established to oversee and address key enterprise risks, risk measurement approaches, remediation plans and their implementation consistent with such applicable standards.

It is further recommended that such function be established in a manner that clearly sets forth roles and responsibilities in accordance with industry frameworks and standards.

During the examination review it was revealed that the Plan has a separate investment committee of the board, that relies on the advice and recommendation of its consultant expert in the field of investments and further relies on its external auditors Deloitte and Touche to review the results.

#### C. Board of Directors

In accordance with its by-laws, GHI is to be managed by a Board of Directors consisting of not less than thirteen or more than twenty-one Directors. Additional stipulations of the by-laws is that not more than one-fifth of the Directors shall be persons licensed to practice medicine or who are trustees, directors or employees of a corporation for hospital purposes and that not more than one-eighth of the directors shall be persons who are employees who serve as

officers of the Plan. The following listing, separated by the classifications set forth in Section 4301(k) of the New York Insurance Law, represents GHI's thirteen Board members and their principal business affiliations as of December 31, 2008.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
	<i><u>Subscriber Directors</u></i>
Harry Nespoli Stony Point, NY	President, Uniform Sanitationmen's Association-Local 831-IBT
Arthur B. Pepper Baldwin, NY	Executive Director, United Federation of Teachers Welfare Fund
Jay E. Russ Lloyd Harbor, NY	Principal Attorney, Russ & Russ, P.C.
Dennis Sullivan Yonkers, NY	Director, AFSCME District Council 37, AFL-CIO
Roger Toussaint Brooklyn, NY	President, Transit Workers Union Local 100
	<i><u>Officers-Directors</u></i>
Frank J. Branchini New York, NY	President and Chief Executive Officer, Group Health Incorporated
	<i><u>Public Interest Directors</u></i>
Howard Berliner Brooklyn, NY	Professor of Health Policy, New School University
James F. Gill Rockville Centre, NY	Chairman of the Board, Group Health Incorporated
Rosa M. Gil, DSW New York, NY	University Dean and Director of Health Science, City University of New York
Susan M. Mathews, PhD Niskayuna, NY	Business Owner, StoreSmart
Daniel D. Rubino, Esq. New York, NY	Attorney, Partner, Willkie Farr & Gallagher

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
	<i><u>Provider Interest Directors</u></i>
Jerome S. Breslaw, M.D. New York, NY	Physician, Private Practice
Bernard Schayes, M.D. Roslyn, NY	Associate Medical Director, Lenox Hill Department of Medicine

Subsequent to the examination date, the following changes were made to GHI's Board of Directors. Aran Ron, M.D. replaced Roger Toussaint as a Subscriber Director and Paul Gibson was added as a Public Interest Director in March 2010.

A review of the minutes of the attendance records of the Plan's Board of Directors' meetings held during the examination period found that the following Directors failed to attend at least one-half of the meetings they were eligible to attend. It was also noted that in 2008 Harry Nespoli attended only 2 out of 5 meetings.

<u>Director's Name</u>	<u>No. of Meetings Attended</u>	<u>No. of Meetings Eligible to Attend</u>	<u>Attendance Percentage</u>
Roger Toussaint	10	24	42%
Daniel Donahue	2	18	11%

Attendance at Board and committee meetings is critical to allow board members to exercise their duties in a management oversight function. Members of the Board and its committees have a fiduciary responsibility and must evince an ongoing interest in the affairs of the Plan. It is essential that Board and committee members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached. Members who fail to attend at least one-half of the regular meetings do not fulfill such criteria.

Due to his inability to attend meetings regularly, subsequent to the examination period, Roger Toussaint was replaced on the Board at the May 2009 Board meeting, and Harry Nespoli started attending meetings on a regular basis since the beginning of 2009. Daniel Donahue had previously been replaced during the May 2008 Board meeting due to his poor attendance record.

It is recommended that GHI continue to take corrective action and evaluate whether board and committee members who are unable or unwilling to attend meetings consistently should resign or be replaced. Furthermore, in selecting prospective members, a key criterion should be their willingness and commitment to attend meetings and participate in the board's oversight of the Plan operations.

It should be noted that a similar finding was made during the previous examination.

D. Committees of the Board of Directors

Standing committees of the Board of Directors include the Executive, Nominating, Audit and Compliance, Organization and Remuneration, Quality Assurance, and Investment committees. In addition to the requirements set forth in the By-laws of the Board of Directors, each of the committees is also subject to its own charter. Individuals serving on each committee at December 31, 2008, were as follows:

Executive Committee

Frank Branchini, Chairperson  
Howard Berliner  
Jerome Breslaw, M.D.  
James F. Gill  
Susan Mathews  
Arthur Pepper  
Dennis Sullivan

Quality Assurance Committee

Jerome Breslaw, M.D., Chairperson  
Howard Berliner  
Frank Branchini  
James F. Gill  
Susan Mathews  
Harry Nespoli  
Arthur Pepper  
Bernard Schayes, M.D.  
Dennis Sullivan

Nominating Committee

Frank Branchini, Chairperson  
 Jerome Breslaw, M.D.  
 Rosa Gil  
 James F. Gill  
 Arthur Pepper

Organization and Remuneration Committee

James F. Gill, Chairperson  
 Howard Berliner  
 Dennis Sullivan

Audit and Compliance Committee

James F. Gill, Chairperson  
 Susan Mathews  
 Daniel D. Rubio  
 Jay E. Rus  
 Dennis Sullivan

Investment Committee

Arthur Pepper, Chairperson  
 Howard Berliner  
 Frank Branchini  
 James F. Gill  
 Harry Nespoli

The control environment at GHI is influenced significantly by the Plan's Board of Directors and Audit Committee. Factors conducive to an effective control environment include independence from management, experience and stature of members, extent of involvement and scrutiny of activities, and appropriateness of its actions. The degree to which difficult questions are raised and pursued with management regarding GHI's plans and performance is also an important factor. Also, the interaction of the Board of Directors or Audit Committee with the internal and external auditors affects the control environment.

The Board of Directors met five times in 2008 and at least four times each year since 2004. The Audit Committee met four times in 2008 and generally met at least twice a year from 2004 to 2007. At the Audit Committee meetings, presentations are made by the external financial auditors, Deloitte and Touche, as well as GHI's internal financial analysts, internal audit and compliance personnel, and the special investigations unit on fraud.

E. Executive Officers

Officers of the Plan are elected by the Board of Directors at its annual meeting for a term of one year and serve at the discretion of the Board. The principal officers of the Plan at December 31, 2008, were as follows:

<u>Name</u>	<u>Title</u>
Frank J. Branchini	President and Chief Executive Officer
Michael D. Fullwood	EVP, Chief Financial Officer & General Counsel
John H. Steber	EVP, Chief Information Officer
Daniel P. Finke	EVP, Healthcare Operations
David S. Abernethy	SVP, Government Relations
Jeffrey D. Chansler	SVP, Deputy General Counsel
Thomas K. Dwyer	SVP, Operations
Philip Gandolfo	SVP, Melville Operations
William A. Gillespie	SVP, Chief Medical Officer
William Mastro	SVP, Deputy General Counsel & Corporate Secretary
Michael Palmateer	SVP, Finance
Valerie A. Reardon	SVP, Compliance & Internal Audit
Leslie Strassberg	SVP, Underwriting-Actuarial & Chief Actuary
Pedro J. Villalba	SVP, InfoTech & Chief Technology Officer

F. Conflicts of Interest

Due to HIP's and GHI's affiliation under EmblemHealth Inc., GHI's own Conflict of Interest policy was superseded by EmblemHealth's as of August 23, 2007. EmblemHealth's policy requires that certain employees, based upon functionality, as determined by the Senior Vice President of Compliance, Internal Audit and Internal Control, fully disclose any personal interests, activities or relationships that constitute a conflict of interest or the appearance of a conflict of interest. Disclosures are made upon acceptance of employment and annually thereafter. Any reportable situations that occur or commence after the annual process should be reported to the Senior Vice President of Compliance, Internal Audit and Internal Controls or the

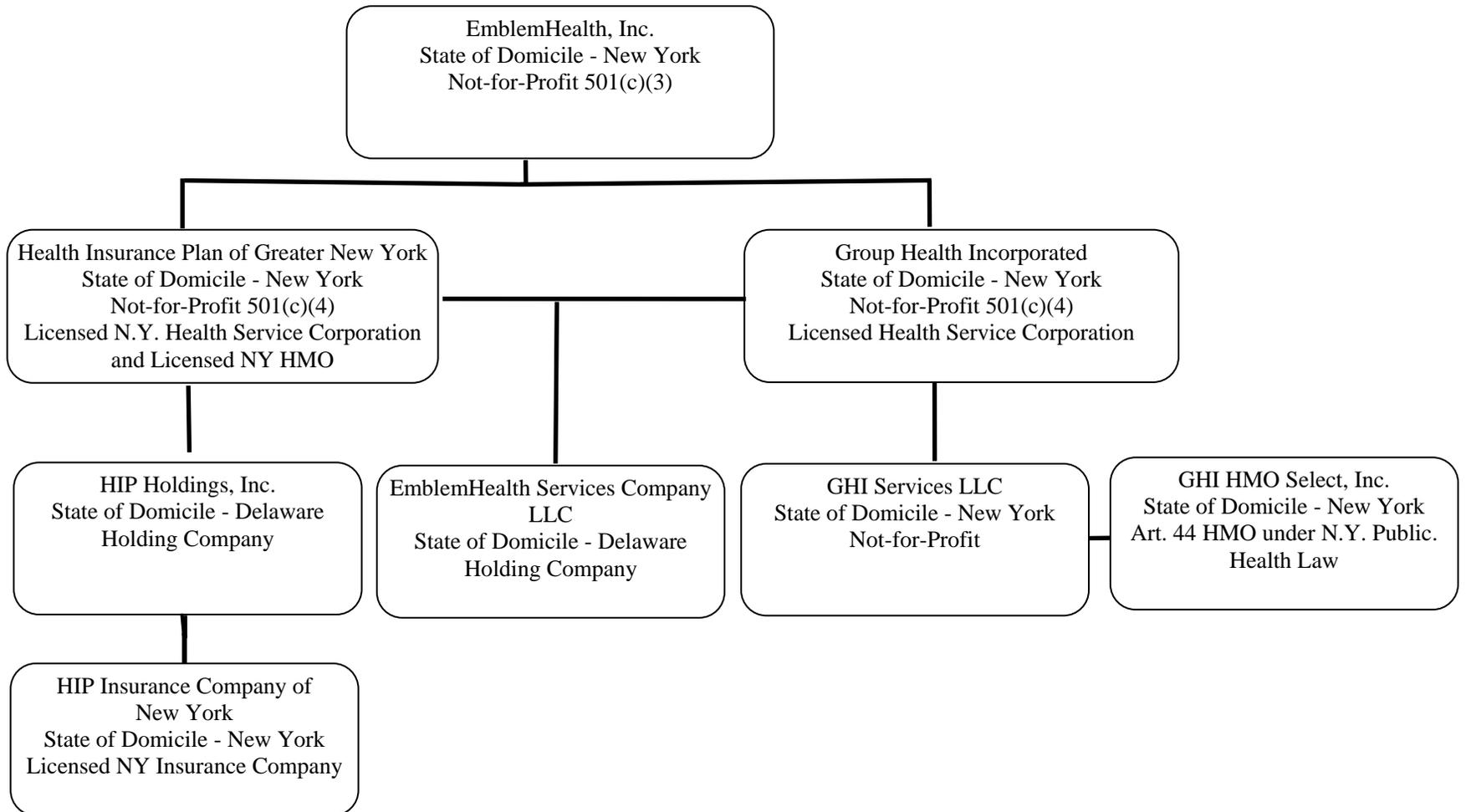
Executive Vice President, Chief Financial Officer and General Counsel within 30 days of occurrence or commencement.

According to the policy, if an employee has any doubt about whether a given situation presents a Conflict of Interest, it is the responsibility of that employee to promptly and fully disclose the situation for review to the Senior Vice President of Compliance, Internal Audit and Internal Controls or the Executive Vice President, Chief Financial Officer or General Counsel. If a situation is deemed to be not in conflict with the Plan's policy, written approval will be provided by the Executive Vice President, Chief Financial Officer or General Counsel. The policy provides that the Plan may request disclosure by any employee, at any time.

G.  Holding Company System

An organizational chart depicting the relationship between the Plan and significant entities in its holding company system as of December 31, 2008, is shown on the following page.

**EmblemHealth Inc. and Subsidiaries - Organizational Chart**



On November 15, 2006, EmblemHealth became the sole member and parent corporation of GHI and HIP. EmblemHealth, Inc. is a New York not-for-profit charitable organization established to implement, expand and coordinate community outreach, medical research and other community-based activities that support the well-being of the diverse population of the New York metropolitan area.

On March 6, 2007, EmblemHealth Services Company, LLC (“EHS”) was formed in a joint venture of GHI and HIP in order to integrate operations of these two entities. On January 1, 2008, assets such as vendor agreements and employees were transferred to EHS. The Plan, HIP and other New York health benefit plan providers controlled by EmblemHealth receive management and other services from EHS. Also, on that date, the Plan and HIP entered into a written guaranty assuming jointly and severally the employee related compensation liabilities of EHS.

Effective December 31, 2009, PerfectHealth Insurance Company (“PerfectHealth”), a subsidiary of HIP and an Article 42 for-profit health insurer, was merged into GHI. GHI purchased PerfectHealth from HIP through issuance of a surplus note to HIP Holdings. All former PerfectHealth group plans were discontinued by GHI on May 1, 2010.

#### H. Inter-company Agreements

GHI had the following inter-company agreements, which were submitted to and approved by the Department, with affiliates included in the holding company chart:

- Management Services Agreements between GHI and HIP wherein HIP allows GHI to use HIP’s personnel, facilities, equipment, personnel property and other resources to administer GHI’s Medicare Advantage and Medicare Part D programs. GHI reimburses HIP at cost for all services provided.

- A Management Services Agreement with its subsidiary GHI HMO Select, Inc., under which GHI provides GHI HMO with underwriting and actuarial, legal, auditing, fraud prevention and other administrative and financial services. GHI HMO pays GHI a management fee equal to the costs incurred by GHI in providing the required services.
- Tax Allocation Agreement between GHI, GHI Services, LLC and GHI HMO Select, Inc., wherein GHI agrees to compute and pay the consolidated income tax due from the group. GHI subsidiaries reimburse GHI for any liability or GHI will forward any refund to the subsidiaries.

#### I. Fidelity Bonds and Other Corporate Insurance

To mitigate the risk of financial loss, the Plan is included as a named insured on a financial institution bond that covers EmblemHealth, Inc., and its subsidiaries, in an amount in excess of the NAIC's suggested minimum amount of fidelity insurance for companies of comparable size. Similarly, the Plan is insured under other policies that protect EmblemHealth, Inc., and its subsidiaries against property and liability insurable losses.

#### J. Territory and Plan of Operations

With over two million members, GHI is the largest not-for-profit health insurance company in New York State, offering a full range of medical, hospital, dental, mental health, vision and prescription drug plans. Services are provided to more than 2.1 million individuals. The Plan's total network of independent physicians and other providers, including the networks of its subsidiaries, comprises over 98,000 physicians and other providers in New York State.

Upon completion of its affiliation with HIP, GHI serves a combined 4 million members. Under the EmblemHealth organization, it ranks as the largest health plan in New York State. The Plan's revenues consist primarily of premiums earned for health insurance relating to services

provided to its members by physicians under contract with the Plan. All premiums are written in New York State.

Beginning January 1, 2006, the Plan began serving as a plan sponsor offering Medicare Part D prescription drug insurance coverage (“Part D”) under a contract with the Centers for Medicare & Medicaid Services (“CMS”).

As of December 31, 2008, the Plan’s primary internal business divisions were focused on the following segments: Commercial large and small employer group business, Medicare programs, Dental, Federal Employee Health Benefit Plan, and Administrative Services Only.

During the examination period, GHI maintained two corporate offices in New York. GHI’s corporate headquarters was located at 441 Ninth Avenue, and it also maintained offices at 55 Water Street.

K. Information Technology

Information Technology (“IT”) at GHI is used for the delivery of services and products, and to provide support for all management processes. Accordingly, a review of GHI’s computer systems and related operations was performed. The examiner evaluated GHI’s response to the Department’s information technology questionnaire (NAIC Handbook - Exhibit C), the information system internal control testing performed by GHI’s Sarbanes-Oxley (“SOX”) function and its independent auditors, Deloitte and Touche. As a result of the procedures performed, the examination team obtained reasonable assurance that information technology (“IT”) general controls and general application controls were functioning as management

intended and that an effective system of internal controls was in place and conducive to the accuracy and reliability of financial information processed and maintained by the Plan.

GHI shares some information systems with members of its holding company system, referred to herein as EmblemHealth. As part of the affiliation between GHI and HIP, additional computer processes are to be consolidated between the two companies.

Currently the main system shared by HIP and GHI is the Peoplesoft General Ledger System used for the accessing, updating and reporting of GHI's financial information. The Peoplesoft system had previously been examined during the examination of HIP as of December 31, 2006. As there were no findings from that examination, the Peoplesoft system was not reviewed.

Systems which will not be merged as part of the affiliation will be GHI's legacy claims systems listed below:

- Medical Claims System (MCS) - processes professional claims for GHI Preferred Provider Organization (PPO).
- Hospital Claims System (HCS) - processes all GHI PPO claims submitted by facilities/hospitals.
- Fastrak - processes all GHI legacy dental claims.

Some additional operational processes which will be consolidated in the future but had not been at the time of the examination include membership data, payroll, premium billing and enrollment.

The examiner's review found the following reportable items related to IT controls:

### 1. Information Security: User Entitlements

Deloitte found that the process in place to review user access privileges for certain applications systems was not completed or performed ineffectively and documented inconsistently.

Among the recommendations made by Deloitte was that semi-annual user reviews be performed.

Annual certification of user access remains the standard at EmblemHealth.

### 2. Information Security: Segregation of Duties

Deloitte found that there was a lack of segregation of duties within GHI's claims systems, membership systems and general ledger system.

GHI responded to Deloitte's finding by removing or limiting access to certain systems for specified IT personnel.

### 3. Change Management Controls

Deloitte identified several application changes that went into effect without the proper testing and management approval.

GHI responded that with the EmblemHealth affiliation a centralized Quality Assurance function for the IT unit will be created which will oversee application change control as one of its functions.

It is recommended that GHI implement the proposed changes to its Information Security and Change Management Controls to mitigate the security and change management risks to its IT systems.

L. Accounts and Records

During the course of the examination, it was noted that GHI's treatments of certain items was not in accordance with Statutory Accounting Principles or Annual Statement Instructions. A description of such items is as follows:

- The Plan has various defined benefit pension plans which cover substantially all employees. After the affiliation with HIP, changes were made to GHI's pension plans as part of the reorganization.

GHI's management personnel were transitioned into the EmblemHealth Services Pension Plans from the GHI Cash Balance Pension Plan as of January 1, 2008, and benefit accruals for the GHI Cash Balance Pension Plan were frozen at that date. The EmblemHealth Services Pension Plan was originally the pension plan for HIP employees. Non-management employees of GHI continue to participate in the GHI Local 153 plan. Both the EmblemHealth Services Pension Plan and the GHI Local 153 plan are defined benefit plans with guaranteed compensation.

EmblemHealth Services Company, LLC ("EHS") is a subsidiary jointly owned by HIP and GHI. Non-union employees of both companies were transferred to EHS which assumed all payroll and pension liabilities of HIP and GHI for those employees. HIP and GHI guarantee all liabilities of EHS and have an equal 50% stake in the subsidiary.

The guarantee of EHS' liabilities by GHI and HIP is based on the following two contingencies: EHS shall provide the Department and its examiners access to the books, records and personnel of EHS on the same terms and conditions as GHI, HIP, and their respective successors must provide under applicable law; and, without the prior written consent of the Department, EHS will not provide services to any individual or entity other than EmblemHealth, Inc., a New York not-for-profit corporation and the sole member of HIP and GHI, HIP and its successors, GHI and its successors, HIP's and GHI's current indirect subsidiaries and their respective successors, or any of the entities resulting from the conversion of HIP and GHI pursuant to the plan of conversion as may be amended, restated or otherwise modified from time to time.

As of December 31, 2008, EHS had a net worth of (\$95.0 million) which consisted of an accumulated other comprehensive loss of (\$43.6 million) and retained deficit of (\$51.5 million). The retained deficit of (\$51.5 million) represents the amount of unfunded pension and post-retirement liabilities that were transferred from HIP and GHI to EHS upon EHS' formation on January 1, 2008.

GHI valued its investment in EHS at (\$21.8 million) which is one-half of the one year's loss accumulated by EHS of (\$43.6 million). However both GHI and HIP neglected to account for the transfer of their unfunded and post retirement liabilities to EHS in their 2008 annual statement filing.

GHI's share of the retained deficit was approximately (\$7 million) and its investment in EHS should have reflected this amount. However, there was no net effect on GHI's net worth in 2008 as the valuation of GHI's investment in EHS should have been reduced by \$7 million, which was offset by the unfunded pension and post-retirement liabilities carried by GHI on its books.

In regard to the foregoing, there were no changes made to the financial statements contained herein.

- The New York State Department of Health contracted with the auditing firm KPMG to perform an audit of EmblemHealth's liability under the Health Care Reform Act ("HCRA") for the period January 1, 2001 through December 31, 2001. In the report provided to the New York State Department of Health on November 30, 2009, KPMG determined that GHI had underpaid its HCRA assessment by \$1,296,272 during 2001.

GHI disagreed with the methodology used by KPMG in their calculation of the HCRA assessments and provided the New York State Department of Health with its own estimate of what GHI owed in HCRA assessments.

Using GHI's methodology for estimating the HCRA underpayments for the period 2001 through 2009, the additional amount owed for the period would be \$8,297,431. At year end 2008, GHI needed to reserve an additional \$6,576,345 to cover the HCRA underpayments.

In regard to the above item, there were no changes made to the financial statements contained herein, as the amounts were deemed immaterial.

- As part of its SOX controls, the EmblemHealth Board Package, containing the financial results for the current accounting period, budget variance analysis and explanation for variances, is to be reviewed and approved by the Senior Vice President of Finance on a monthly basis. GHI was not able to provide the examination team with any evidence that the EmblemHealth Board Package was reviewed and approved in 2008 and a review of the SOX workpapers affirmed that this control failed.

It should be noted that this control was re-tested in 2009 and passed.

It is recommended that GHI continues to comply with its policies and procedures by reviewing and approving the EmblemHealth Board Package on a monthly basis.

Part 243.2(b)(8) of Department Regulation No. 152 (11 NYCRR 243) states:

“(b) Except as otherwise required by law or regulation, an insurer shall maintain:

(8) Any other record for six calendar years from its creation or until after the filing of a report on examination or the conclusion of an investigation in which the record was subject to review.”

- A review was performed to determine if changes to the chart of accounts were properly handled. The examiner selected a sample of chart of account changes and reviewed copies of change request forms to check for proper approvals and sign-offs. For one of the five sample items selected, GHI’s accounting department could not locate the change request form.

It is recommended that GHI ensures that proper and timely signoffs are documented and are maintained in compliance with Part 243.2(b)(8) of Department Regulation No. 152.

- A review of legal fees and expenses as of December 31, 2008 was performed. A listing of all legal fees and expenses was reviewed for possible unreported items. The amounts from the listing were traced to the December 31, 2008 trial balance and the Underwriting and Investment Exhibit. Differences were found between the trial balance (\$3,922,337) and the Underwriting and Investment Exhibit, Part 3 (\$34,627,908). According to GHI, there was an error in the classification of expenses in its December 31, 2008 Annual Statement filing. The Plan had misclassified \$34,206,806 in commission expenses as legal fees and expenses in the Underwriting and Investment Exhibit, Part 3, Analysis of Expenses. Additionally, actual legal fees and expenses of \$3,508,298 were misclassified as certification and accreditation fees.

It is recommended that GHI accurately report its commission expenses, legal, certification and accreditation fees in its annual statement filings.

- In its December 31, 2008 and 2009 annual statement filings, GHI reported the incorrect amounts for the change in unearned premium reserves and premiums written. In 2008, GHI consolidated its general ledger system with HIP’s by moving to HIP’s PeopleSoft General Ledger System. When this was done there were changes created in GHI’s trial balance accounts. GHI failed to map an additional account created in its general ledger system after its move to PeopleSoft back to the consolidated statements resulting in the misstatements. Change in unearned premium reserves was overstated by \$23,929,603 and premium written was understated by the same amount.

It is recommended that GHI accurately reports its change in unearned premium reserves and premiums written on its annual statement filings.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and capital and surplus as determined by this examination. This statement is the same as the balance sheet reported by GHI as of December 31, 2008.

<u>Assets</u>	<u>Examination</u>	<u>GHI</u>
Bonds	\$ 286,965,297	\$ 286,965,297
Preferred stock	5,782,943	5,782,943
Common stock	21,177,741	21,177,741
Properties occupied by the Company	119,520,000	119,520,000
Cash and short-term investments	6,224,400	6,224,400
Other invested assets	(28,336,749)	(28,336,749)
Receivables for securities	243,759	243,759
Investment income due and accrued	2,441,540	2,441,540
Uncollected premiums and agents' balances in the course of collection	158,618,983	158,618,983
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,535,071	1,535,071
Accrued retrospective premium	4,635,099	4,635,099
Amounts receivable relating to uninsured plans	76,015,182	76,015,182
Current federal and foreign income tax recoverable and interest thereon	1,879,812	1,879,812
Net deferred tax asset	3,227,561	3,227,561
Electronic data processing equipment and software	5,077,586	5,077,586
Furniture and equipment, including health care delivery assets	74,362	74,362
Receivables from parent, subsidiaries and affiliates	13,563,594	13,563,594
Health care and other amounts receivable	22,497,626	22,497,626
Aggregate write-ins for other than Invested assets	<u>134,686,387</u>	<u>134,686,387</u>
Total assets	<u>\$ 835,830,194</u>	<u>\$ 835,830,194</u>

<u>Liabilities</u>	<u>Examination</u>	<u>GHI</u>
Claims unpaid	\$ 353,472,760	\$ 353,472,760
Unpaid claims adjustment expenses	16,759,389	16,759,389
Aggregate health policy reserves	93,268,835	93,268,835
Premiums received in advance	10,377,851	10,377,851
General expenses due or accrued	35,538,118	35,538,118
Amounts withheld or retained for the account of others	12,163,143	12,163,143
Amounts due to parent, subsidiaries and affiliates	33,637,780	33,637,780
Payable for securities	591,918	591,918
Liability for amounts held under uninsured plans	5,101,974	5,101,974
Aggregate write-ins for other liabilities	<u>39,104,470</u>	<u>39,104,470</u>
 Total liabilities	 \$ <u>600,016,238</u>	 \$ <u>600,016,238</u>
 <u>Capital and surplus</u>		
Aggregate write-ins for other surplus funds	327,391,767	327,391,767
Unassigned funds	<u>(91,577,811)</u>	<u>(91,577,811)</u>
 Total capital and surplus	 \$ <u>235,813,956</u>	 \$ <u>235,813,956</u>
 Total liabilities, capital and surplus	 \$ <u>835,830,194</u>	 \$ <u>835,830,194</u>

Note: The Internal Revenue Service has not conducted any audits of the income tax returns filed on behalf of GHI through tax year 2008. The examiner is unaware of any potential exposure of GHI to any tax assessments and no liability has been established herein relative to such contingency.

Group Health Incorporated files its tax returns on a consolidated basis with GHI Services, LLC. and GHI HMO Select, Inc.

B. Statement of Revenue, Expenses and Capital and Surplus

Capital and surplus increased \$56,487,771 during the five-year examination period, January 1, 2004 through December 31, 2008, detailed as follows:

Revenue

Net premium income	\$ 12,275,309,625	
Change in unearned premium reserves and reserves for rate credits	(30,057,860)	
Risk revenue	<u>9,959,953</u>	
Total revenue		\$ 12,255,211,718

Expenses

Hospital/medical benefits	3,404,814,680	
Other professional services	3,563,876,172	
Outside referrals	21,940,011	
Emergency room and out-of-area	1,646,414,086	
Prescription drugs	2,254,634,491	
Net reinsurance recoveries	<u>(1,706,096)</u>	
Total medical and hospital	\$ 10,889,973,344	
Claims adjustment expenses	483,862,118	
General administrative expenses	850,318,583	
Increase in reserves for life and accident and health contracts	<u>(1,007,745)</u>	
Total underwriting deductions		<u>12,225,161,790</u>
Net underwriting gain		\$ 30,049,928
Net investment income earned		86,571,433
Net realized capital loss		(18,152,626)
Net gain from agents or premium balances charged off		(1,643,741)
Aggregate write-ins for other income and expenses		<u>(1,952,013)</u>
Net income before federal income taxes		94,872,981
Federal and foreign income taxes incurred		<u>(24,976,028)</u>
Net income		<u>\$ 69,896,953</u>

Changes in Capital and Surplus

Capital and surplus, per report on examination, as of December 31, 2003			\$ 179,326,186
		<u>Gains in Surplus</u>	<u>Losses in Surplus</u>
Net income	\$ 69,896,953		
Change in net unrealized capital gains			\$ 38,583,423
Change in net deferred income tax	110,468,256		
Change in non-admitted assets			147,537,337
Cumulative effect of changes in accounting Principle	25,836,014		
Aggregate write-ins for gains or losses in surplus	<u>36,407,307</u>		<u>                    </u>
Net increase in surplus			<u>56,487,770</u>
Capital and surplus, per report on examination, as of December 31, 2008			\$ <u>235,813,956</u>

**4. CLAIMS RESERVES**

The examination liability of \$353,472,760 for the above captioned account is the same as the amount reported by GHI in its 2008 filed annual statement.

The examination analysis of the claims unpaid reserve was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in GHI's internal records and its 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 GHI's past experience in projecting the ultimate cost of claims incurred on or prior to December 31, 2008.

## 5. EMPLOYEE BENEFITS

Effective January 1, 2008, Emblemhealth, Inc., integrated the payroll processing of Group Health Incorporation (“GHI”) and Health Insurance Plan of Greater New York (“HIP”). It was noted that EmblemHealth did not perform sufficient testing around the newly integrated payroll environment. As a result, when the system went live during the beginning of 2008, EmblemHealth discovered outdated personnel information that was not properly deactivated in PeopleSoft HR, was incorrectly interfacing with the Enterprise system. (Note: This was a finding from Deloitte. EmblemHealth made the necessary corrections).

It is recommended that GHI implements a policy to ensure that all changes made to the system including integration of two applications are tested before putting it into a live environment.

A review of GHI’s SOX payroll controls found that the following control failed during the SOX testing. The control required the payroll manager to compare the total payroll amount per the ADP Statistical Summary against the ADP Control Totals Report. GHI’s SOX team tested this control in 2009, for the period January 1, 2009 to August 31, 2009 (the control was not tested in 2008), and determined that the control was not designed effectively based on the exception found.

The SOX team proposed to have the control changed to the following: *“Every pay cycle, the Payroll Manager reviews the ADP Payroll Register and ADP Statistical Summary to verify that the payroll is accurately calculated and recorded. The review is evidenced by his/her dated sign-off on the summary page of the Payroll Register and the Statistical Summary. Upon*

*completion of the review, the Payroll Manager emails the Statistical Summary to the Treasury Department for banking reconciliation and approval of Payroll funding.”*

It is recommended that GHI implements the proposed change to effectively mitigate the risk associated with the inaccurate calculation of the employee payroll.

## **6. SUBSEQUENT EVENTS**

Subsequent to the examination date, as of April 30, 2012, GHI was found to be impaired by \$157,274,000.

As of April 30, 2012, GHI reported a net income of over \$14 million and negative cash flow from operations of over \$88 million. The Plan had capital and surplus of \$205,447,000 and a required statutory reserve of \$362,720,000. Since the required statutory reserve fund is \$362,720,000, the maximum invasion allowed by Section 4310(e)(1) is \$181,360,000 (or 50% of \$362,720,000). The April 2012 monthly filing with the Department revealed that the Plan's reported invasion was \$157,274,000 (unassigned funds less the Section 1307 loan amount or  $((\$322,585,000) + \$165,311,000)$ ). Health Insurance Plan of Greater New York, in accordance with Section 1307 of the Insurance Law, made the following Section 1307 loans to GHI: \$40 million on March 29, 2012, \$10 million on June 29, 2011 and \$80 million on December 29, 2010, the intent of which was to ensure that GHI's net worth continues to be at least 50% of its statutory reserve fund.

## 7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2003, contained eight (8) comments and recommendations that pertained to the financial examination, as follows (page number refers to the prior report):

<u>ITEM NO.</u>	<u>PAGE NO.</u>
<u>Management</u>	
1. Although Board members' absences were excused, it is recommended that Board members attend the majority of meetings that they are eligible to attend in order to evince their fiduciary responsibility. <i>The Plan has not fully complied with this recommendation. A similar recommendation is included with this report on examination.</i>	8
2. It is recommended that GHI's Board review its policy on excusing Board member absences. <i>The Plan has complied with this recommendation.</i>	8
3. It is recommended that the Plan amend its by-laws to require its Board to meet a minimum of four times per calendar year. <i>The Plan has complied with this recommendation.</i>	10
<u>Holding Company System</u>	
4. It is recommended that GHI settle its inter-company account balances on a monthly basis as called for in its service agreements. <i>The Plan has complied with this recommendation.</i>	13
<u>Accounts and Records</u>	
5. It is recommended that GHI report its claim reimbursements to third parties as a component of its Unpaid Claims liability in its filed financial statements. <i>The Plan has complied with this recommendation.</i>	16
6. It is recommended that GHI report advances from its PBM as an "Aggregate Write-in" liability item in its future financial statement filings. <i>The Plan has complied with this recommendation.</i>	17

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

7. It is recommended that GHI report income from the leasing of its provider panel as Risk Revenue on the Statement of Revenue and Expenses. It was noted that GHI reported \$0 as Risk Revenue in 2003. GHI reported Risk Revenue in the amount of \$1,147,080 in its 2004 Annual Statement. 17

*The Plan has complied with this recommendation.*

8. It is recommended that GHI report all allocations to its subsidiary as inter-company transactions in Schedule Y. 17

*The Plan has complied with this recommendation.*

## 8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Corporate Governance</u>	
i. It is recommended that the audit committee continue to review and approve the salary of the head of internal audit.	9
ii. Since EmblemHealth has initiated the process to become a for-profit, publicly held company, it is recommended that a formalized risk management function be established to oversee and address key enterprise risks, risk measurement approaches, remediation plans and their implementation consistent with such applicable standards.	10
iii. It is further recommended that such function be established in a manner that clearly sets forth roles and responsibilities in accordance with industry frameworks and standards.	10
B. <u>Board of Directors</u>	
It is recommended that GHI continue to take corrective action and evaluate whether board and committee members who are unable or unwilling to attend meetings consistently should resign or be replaced. Furthermore, in selecting prospective members, a key criterion should be their willingness and commitment to attend meetings and participate in the board's oversight of the Plan operations. It should be noted that a similar finding was made during the previous examination.	13
C. <u>Information Technology</u>	
It is recommended that GHI implement the proposed changes to its Information Security and Change Management Controls to mitigate the security and change management risks to its IT systems.	23
D. <u>Accounts and Records</u>	
i. It is recommended that GHI continues to comply with its policies and procedures by reviewing and approving the EmblemHealth Board Package on a monthly basis.	24

<u>ITEM</u>	<u>PAGE NO.</u>
D. <u>Accounts and Records (Cont'd.)</u>	
ii. It is recommended that GHI ensures that proper and timely signoffs are documented and in compliance with Part 243.2(b)(8) of Department Regulation No. 152	25
iii. It is recommended that GHI accurately reports its commission expenses, legal, certification and accreditation fees in its annual statement filings.	25
iv. It is recommended that GHI accurately reports its change in unearned premium reserves and premiums written on its annual statement filings.	26
E. <u>Employee Benefits</u>	
i. It is recommended that GHI implements a policy to ensure that all changes made to the system including integration of two applications are tested before putting it into a live environment.	31
ii. It is recommended that GHI implements the proposed change to effectively mitigate the risk associated with the inaccurate calculation of the employee payroll.	32

Appointment No. 30342

**STATE OF NEW YORK  
INSURANCE DEPARTMENT**

I, **Kermitt J. Brooks**, Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

**Wai Wong**

as a proper person to examine into the affairs of the

**Group Health Incorporation**

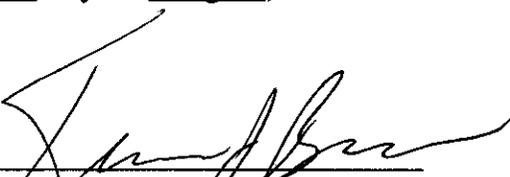
and to make a report to me in writing of the condition of the said

**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 12<sup>th</sup> day of August, 2009

  
\_\_\_\_\_  
Kermitt J. Brooks  
Acting Superintendent of Insurance

