

REPORT ON EXAMINATION

OF THE

MDNY HEALTHCARE, INC.

AS OF

JUNE 30, 2000

DATE OF REPORT

APRIL 2, 2001

Revised JULY 31, 2002

EXAMINER

PEARSON GRIFFITH

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

GEORGE E. PATAKI
Governor

GREGORY V. SERIO
Acting Superintendent of Insurance

July 31, 2002

Honorable Gregory V. Serio
Acting Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the provisions of the New York Insurance Law and acting in accordance with instructions contained in Appointment Number 21433 dated July 22, 1999 attached hereto, I have made an examination into the financial condition and affairs of MDNY Healthcare, Inc. as of June 30, 2000, and respectfully submit the following report thereon.

This examination was conducted at the offices of the Plan located at One Huntington Quadrangle, Melville, New York 11747.

Whenever the terms "Plan", "MDNY", "Company" or "HMO" appears in this report, without qualification, they should be understood to refer to MDNY HealthCare, Inc.

As a result of this examination, MDNY was determined to be insolvent in the amount of \$(4,311,487), and its required Contingency Reserves of \$7,919,846 was impaired in the amount of \$(12,231,333) as of June 30, 2000.

Subsequent to the examination, in July 2002, the Department approved a plan submitted by MDNY to eliminate the insolvency (See Item 4, Claims Payable, herein for further detail).

1. SCOPE OF EXAMINATION

This examination covers the four and a half-year period from January 1, 1996 through June 30, 2000. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of June 30, 2000 in accordance with generally accepted accounting principles (GAAP), and a review of income and disbursements deemed necessary to accomplish such verification. The examination also utilized to the extent considered appropriate, work performed by the Plan's independent certified public accountants. In addition, the examiner applied the Laws, Regulations or Rules promulgated by the New York Insurance Department where deemed appropriate. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners (NAIC):

- History of the Plan
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Officers' and employees' welfare and pension plans
- Territory and plan of operation
- Growth of the Plan
- Business in force
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

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

The examination determined that MDNY was insolvent in the amount of \$(4,311,487), and its required Contingency Reserves of \$7,919,846 was impaired in the amount of \$(12,231,333) as of June 30, 2000.

2. **DESCRIPTION OF THE PLAN**

The Plan was incorporated in New York on June 21, 1995 under the name of MDLI Healthcare, Inc. A Certificate of Amendment of the Certificate of Incorporation of MDLI Healthcare, Inc. which changed the name of the Company to MDNY Healthcare, Inc. was filed by the Department of State on October 12, 1995.

The Plan was originally licensed to operate a health maintenance organization under the provisions of Article 44 of the New York State Public Health Law in the Counties of Nassau and Suffolk and was granted a conditional the Certificate of Authority, effective November 1, 1995. The Plan commenced operations on January 1, 1996.

MDNY's conditional Certificate of Authority, stated that one year from the effective date of the issuance of the Certificate of Authority, and annually thereafter, it was required to submit to the New York State Department of Health a status report describing its activities to address the enrollment of Medicaid beneficiaries residing within the approved service area. In addition, the Certificate of Authority indicated that additional financing for \$2 million from the Catholic Healthcare Network of Long Island (CHSLI) was payable as follows:

<u>Date</u>	<u>Amount</u>
January 1, 1996	\$1,000,000
July 1, 1996	500,000
January 1, 1997	500,000

At January 1, 1996, the Company had outstanding 672 shares of \$0.001 par value Class A Common Stock issued to Long Island Physicians Holding Corp. (LIPH) for \$6,720,000. In addition, the Company also had outstanding at January 1, 1996 336 shares of \$0.001 par value Class B Common Stock issued to CHSLI for \$1,360,000 and a subscription receivable of \$2,000,000 payable as shown in the foregoing table.

During 1996, the Company issued 235 shares of \$0.001 par value Class A Common Stock to LIPH for a subscription receivable of \$2,350,000. In 1997, the Company issued 115 shares of \$0.001 par value Class B Common Stock to CHSLI for \$1,150,000. A review of the Company's cash receipts for the period under examination indicated that all subscriptions were received. However, MDNY was unable to provide the examiners an amended Certificate of authority that indicated the satisfaction of the foregoing financial conditions.

The Company's capital structure as of June 30, 2000 was as follows:

LIPH	Class A Common Stock (\$0.001 par value per share)	907
CHSLI	Class B Common Stock (\$0.001 par value per share)	451

On October 12, 1995, the Plan's Certificate of Incorporation was amended to change the name of the Corporation to MDNY Healthcare, Inc.

In November 1996, the Company received approval from the Health Care Financing Administration (HCFA) to enroll Medicare eligible members under a “Medicare Risk” contract, effective February 1, 1997.

On September 14, 1998, the Company received approval from the State of New York Department of Health to expand its service area to include Erie and Niagara Counties, effective January 1, 1999.

The Plan was granted a request to withdraw its marketing and enrollment services from Erie and Niagara Counties effective April 1, 2000.

In October 2000, MDNY was granted approval by HCFA to terminate its enrollment of Medicare eligible members effective January 1, 2001.

A. Management

Pursuant to the by-laws, management of the HMO is vested in a board of directors consisting of eighteen members, comprised of the following:

- i. Ten (10) members elected by the holders of Class A Common Stock (the “Class A Directors”);
- ii. Four (4) members elected by the holders of Class B Common Stock (the “Class B Directors”); and
- iii. Four (4) members elected by the holders of both the Class A Common Stock and the Class B Common Stock, all of whom, within one year after the date MDNY is licensed as an HMO, shall be representatives of enrollees of the Plan (each, an “Enrollee Representative,” and collectively, the “Class C Directors”).

A review of the composition of the board of directors indicated that the Plan did not have the requisite number of enrollee representatives. The provisions of Part 98-1.11(f) of the Health Department’s Administrative Rules and Regulations state in part that,

“...Within one year of the HMO receiving a certificate of authority, no less than 20 percent of the members of the governing authority shall be enrollees of the HMO. Employees of the HMO or providers of health services may not serve as enrollee representatives.”

None of the directors listed in the chart below appear to be enrollee representatives and therefore do not meet the requirements of Part 98-1.11(f) of the Health Department’s Administrative Rules and Regulations.

It is recommended that the Plan elect the requisite number of enrollee representatives to the board of directors to comply with the requirements of Part 98-1.11(f) of the Health Department’s Administrative Rules and Regulations.

A review of the records provided to the examiners of minutes of meetings of the board of directors, which were held during the period under examination, indicated that such meetings were not well attended. The examination review determined that almost all of the directors attended or participated in less than 50% of the meetings of the board of directors they were eligible to attend.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Individuals who fail to attend at least one-half of the board's regular meetings, unless appropriately excused, do not fulfill such criteria. Board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

The examination review of the contents of the minutes of the board of directors indicated areas, which may be deemed deficient. Several actions undertaken by the board were not recorded in the minutes. The following chart describes conditions and deficiencies that were common in many of the minutes reviewed:

- The minutes provided to the examiners often did not adequately address matters discussed and did not include copies of reports, schedules, board resolutions, board actions, or other appropriate documentation referenced therein.
- Several instances where attendance records that listed the directors who attended meetings were not appended to the minutes as referenced therein. This deficiency was in part a contributing factor in the examination determination of poor attendance at meetings by certain members of the board of directors.
- The minutes of the board of directors did not contain references of actions taken to appoint or elect new directors to replace those who had resigned or were removed.
- Motions to accept the minutes of previous meetings did not include appropriate references to the dates of those meetings. This deficiency was highlighted in situations where ratification of the minutes of prior meetings was deferred. As a result, the examiner could not determine if the deferred minutes were subsequently ratified by the board of directors.

It is recommended that the minutes of the board of directors include copies of reports, schedules, board resolutions, board actions, and other appropriate documentation referenced therein.

It is recommended that attendance records be appended to the minutes of the board of directors so that accurate records of directors who fail to demonstrate an ongoing interest in the affairs of the Plan may be appropriately disclosed.

It is also recommended that minutes of the board of directors contain appropriate references of actions taken by the board to appoint or elect new directors to replace those that resigned or were removed.

It is further recommended that motions to adopt the minutes of previous meetings include appropriate references to the dates of those meetings.

At June 30, 2000, the board of directors consisted of eighteen members, as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
<u>Class A Directors</u>	
Salvatore Caravella, M.D. Huntington, NY	President of the Board of Directors, and Pediatrician
Jeffrey Ashkin, M.D. Dix Hills, NY	Secretary of the Board of Directors, and Gastroenterologist
Robert Jason, M.D. Great Neck, NY	Treasurer of the Board of Directors, and Gynecologist
Anthony Caruso, M.D. Southampton, NY	Otolaryngologist
Steven Napoli, M.D. Port Jefferson Station, NY	Ophthalmologist
Amy Koreen, Ph.D. Cold Spring Harbor, NY	Assistant Professor of Psychiatry, Long Island Jewish Medical Center/ Albert Einstein College of Medicine
David Goldman, M.D. Old Westbury, NY	Primary Care Physician
<u>Class A Directors</u>	
Andrew Peters, M.D. Rockville Center, NY	Internal Medicine
Lynn Pierri, DDS Smithtown, NY	Dental Surgery
Franco Gallo, M.D. Port Jefferson, NY	Gastroenterologist

Class B Directors

John Lovett, JD
Stony Brook, NY

Senior Vice president
Catholic Health Services of Long Island

Donna O'Brien
Garden City, NY

Senior Vice president
Catholic Health Services of Long Island

Richard Murphy
Miller Place, NY

Chief Executive Officer
Good Samaritan Hospital

Vincent DiRubbio
New Hyde Park, NY

President and Chief Executive Officer
Mercy Hospital Medical Center

Class C Directors

Kevin T. Murphy
Massapequa, NY

Chief Fiscal Officer,
Diocese of Rockville Center

Gregory Kalmar, DDS
Huntington, NY

Dentist

Robert Rose
Merrick, NY

Managing Director,
Marsh & McLennan

Joseph Tamburrino, DPM
Westbury, NY

Podiatrist

The principal officers of the HMO as of June 30, 2000 were as follows:

NameTitle

Paul Accardi

Chief Executive Officer and Chief
Financial Officer

The Company subsequently appointed Amy Koren, MD as Secretary and Concetta Pryor as Interim

Chief Financial Officer.

B. Territory and Plan of Operation

The Plan was granted a certificate of authority to operate an independent practice association (IPA) model health maintenance organization in Nassau and Suffolk counties under the provisions of Article 44 of the New York Public Health Law. The Plan has entered into certain risk sharing arrangements with a number of IPAs for the provision of healthcare services to its enrollees. These IPAs are responsible for establishing an adequate network of participating providers by contracting with physicians and other providers of medical or medically related services. The Plan pays the IPAs negotiated capitation amounts based on the number of subscriber members they serve, and the type of policy purchased by members. In exchange, the IPAs assume responsibility for payment of claims for professional and ancillary services rendered to members by network and out-of-network providers.

Under this HMO model, enrollees are free to select any primary care physician affiliated with the Plan and to transfer from one primary care physician to another. All medical care received by the enrollee, including referrals to specialists and hospital care, are coordinated by the enrollee's selected primary care physician. Premiums charged each commercial subscriber group are fixed for a twelve-month period. Such premium rates may be adjusted pursuant to Section 4308(c) of the Insurance Law with the prior approval of the Superintendent or, pursuant to Section 4308(g), upon not less than thirty (30) days prior notice to members and the Superintendent.

As of June 30, 2000, the Plan had 68,796 enrollees.

C. Reinsurance

The Plan was party to an excess of loss reinsurance agreement in force with an authorized insurer at

June 30, 2000. The agreement provided for the reinsurance of eligible hospital and medical services for the Plan's Commercial and Medicare members.

A review of the agreement indicated that the insolvency clause contained therein does not conform to the requirements set forth in Section 1308 of the New York Insurance Law. As a health maintenance organization organized under the provisions of Article 44 of the Public Health Law, the Plan is subject to the provisions of Part 98.8(b) of the of the Health Department's Administrative Rules and Regulations which requires the prior approval of the Superintendent and the Commissioner of Health for changes to reinsurance agreements.

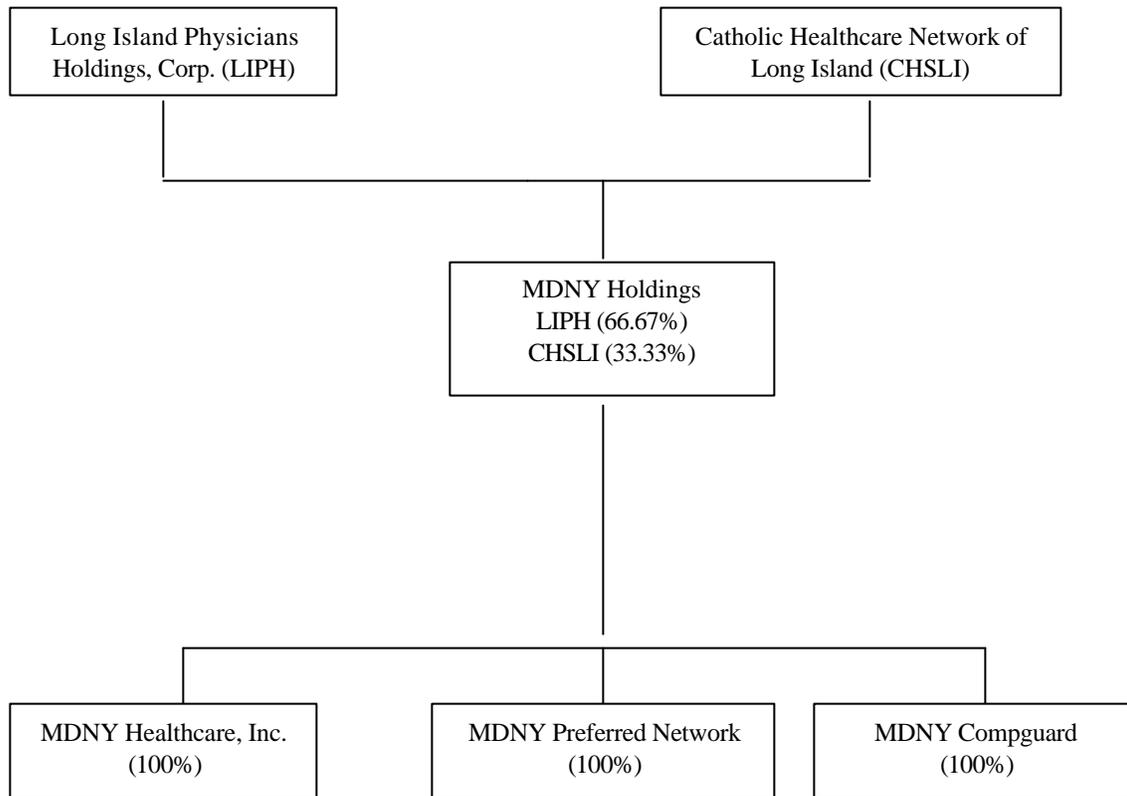
D. Holding Company System

MDNY Healthcare, Inc. is 67% owned by Long Island Physicians Holdings, Inc. (LIPH), a New York Corporation owned by physicians residing and practicing in New York State. Catholic Healthcare Services of Long Island, Inc. owns the remaining 33% of shares in MDNY.

LIPH is affiliated with LIPH, LLC, a New York limited liability company, which is solely owned by the shareholders of LIPH. The principal assets of LIPH, LLC are the net assets of Island Practice Association IPA, Inc., Island Behavioral Health Association IPA, Inc., and Island Dental Professional Association IPA, Inc. These entities are the primary independent practice associations with whom MDNY has contracted for the provision of healthcare services to its enrollees. In addition, LIPH has a minority ownership interest in Nextstage Healthcare, Inc. which provided management, administrative and operational services to MDNY and the above-mentioned IPAs.

The following chart depicts the HMO in relationship to its parent and affiliated companies as of the

examination date:



The relationship illustrated above makes the Plan a controlled HMO as defined in 10 NYCRR Part 98.2(1) and (n) of the Health Department’s Administrative Rules and Regulations. As a controlled insurer, any agreements between the Plan and members of its holding company system are subject to the provisions of 10NYCRR Part 98.10(c) of the referenced Rules and Regulations which sets forth certain standards for the prior approval of the Superintendent of Insurance and the Commissioner of Health as follows:

“...For the following types of transactions between a controlled HMO and any person in its holding company system: sales, purchases, exchanges, investments or rendering of services on a regular or systematic basis the aggregate of which involves ten percent or more of the HMO’s

admitted assets as of last year-end. Notice shall be required for such transactions of five percent or more.”

During the period under examination, the Plan was a party to risk transfer agreements with certain IPAs, which are owned by LIPH and CHSLI. A review was performed of the agreements in effect during the period under examination. All agreements reviewed have obtained the requisite approval of or notification to the Commissioner of Health and Superintendent of Insurance as set forth in 10NYCRR Part 98.10(c) of the Health Department’s Administrative Rules and Regulations.

E. Contingency Reserves

A certified operating HMO shall maintain Contingency Reserves pursuant to the provisions of Part 98.11(d) and (e) of the Administrative Rules and Regulations of the Health Department [10NYCRR 98.11(d), and (e)]. The Contingency Reserve consists of the greater of:

1. A reserve fund designed as the contingent reserve fund, which during each calendar year is increased in an amount equal to one percent of premium revenue until it reached an overall maximum of five percent of the most recent year’s net premium income; and
2. An escrow deposit account consisting of five percent of the estimated expenditures for health care services for the year.

The Plan was required to maintain Contingency Reserves in the amount of \$7,919,846 as of June 30, 2000. This amount is the same as that which was reported by the Company in its filed 1999 Annual Statement.

F. Accounts and records

During a review of the Company’s corporate records, the examiner noted several deficiencies in the Plan’s system of accounts, records, and internal controls.

1. Investments

A review of the Plan's investment transactions and the minutes of meetings of its board of directors indicated that actions taken by management were not authorized or approved by the board of directors.

Section 1411(a) of the New York Insurance Law states in part:

“No domestic insurer shall make any loan or investment... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

It is recommended that the board of directors authorize and approve the Company's investment transactions in accordance with the provisions of Section 1411(a) of the New York Insurance Law.

During an analysis of investment activity, the examiner noted that MDNY utilized the services of EAB Financial Strategies (EAB) for its investment transactions and custodial services. It appears that EAB is licensed as an investment Broker and, as such, does not qualify under Insurance Department guidelines as a custodian of insurer owned securities.

The guidelines set forth in the NAIC Examiners Handbook require that securities held under custodial or safekeeping arrangements be in a bank or trust company licensed by the United States or any state thereof, if such bank trust company is regularly examined by a United States federal or state authority. The guidelines also provide that such securities held by a bank or trust company under other custodial or safekeeping arrangements need not be counted, at the discretion of the examiner-in-charge, if such deposits meet the following requirements:

- Examiners are furnished a copy of the custodial or safekeeping agreements and they are satisfied such agreement have the necessary safeguards and controls;
- The securities are held by a bank or trust company licensed by the United States or any state thereof, and such bank or trust company is regularly examined by the licensing authority;
- The securities so deposited are at all times kept separate and apart from other deposits with the custodian, so that at all times they may be identified as belonging solely to the company for which they are held;
- If such a deposit is not counted, a notarized custodial affidavit and a verification certificate signed by an authorized signatory of the bank or trust company holding the deposit, including sufficient detail to permit adequate identification of the securities, shall be secured by the examiners directly;

The Plan was unable to provide the examiner with a copy of the custodial agreement entered into with EAB or confirm whether securities held by EAB on its behalf were registered in the name MDNY Healthcare, Inc. or held in “street name”. In addition, EAB did not provide the examiners with the requisite affidavit and a verification certificate in accordance with the Insurance Department’s guidelines.

It is recommended that the Plan immediately transfer all securities or investments held under custodial or safekeeping arrangements to a bank or trust company that meet the guidelines set forth in the Insurance Department’s rules and the NAIC Examiners Handbook.

It is also recommended that the Plan obtain the requisite custodial or safekeeping agreements with a bank or trust company in accordance with the Insurance Department’s Rules and submit a copy of the same to the Department.

It is further recommended that the Plan instruct such a bank or trust company with which it executes any custodial or safekeeping agreements to provide the Insurance Department examiners with the requisite affidavit and a verification certificate in accordance with the Department's guidelines.

2. Reconciliations

During the review of the Plan's accounts and records, the examiners noted numerous instances where account balances per the general ledger and account balances per the filed statutory statements were not reconciled. In addition, the examiners noted several instances where prior year balances reported on current year statutory statements did not agree with the current balances reported on the prior year statutory statements. It appears that the Plan made certain changes to its filed statutory statements, which resulted from audit adjustments without submitting revised copies of its statutory statements to the Department. As a result, The Plan's four and one half year financial history on its filed statutory statements did not agree to its general ledger.

It is recommended that the Plan comply with the guidelines set forth by the NAIC in the instructions to the annual and quarterly statements and that its general ledger is reconciled to the filed statutory statements.

G. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law requires that certain unclaimed insurance proceeds which is unclaimed over three years be reported to the Office of the State Comptroller of the State of New York by April 1 of each year. Such reports comprise all abandoned property held by the Company at the

close of business on January 1 each year.

Section 1315 of the New York Abandoned Property Law requires that certain unclaimed vendor payments, outstanding checks and escrow amounts, or gift certificates which is unclaimed over five years be reported to the Office of the State Comptroller of the State of New York by March 10 of each year. Such reports comprise all abandoned property held by the Company at the close of business on December 31 each year.

The Company is also required to annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned cash amounts and to file proof of such publication with the Office of the State Comptroller.

The Company has not filed any of the requisite reports with the Office of the State Comptroller during 2000 for calendar year 1996.

It is recommended that the Plan comply with the provisions of Sections 1315 and 1316 respectively of the New York Abandoned Property Law as regards the reporting of certain unclaimed property.

It is also recommended that the Plan to annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned cash amounts and to file proof of such publication with the Office

of the State Comptroller.

H. Conflict of Interest

The Plan disclosed in its response to General Interrogatories question 6 in all its filed Annual Statements for the period under examination that it has an established procedure for disclosure to its Board of Directors, any material interest or affiliation on the part of any of its officers, directors, or responsible employees which is in, or likely to, conflict with the official duties of such person. It was noted in the Plan's response to the Examination Planning Questionnaire that it had no such procedure in effect. The Plan, however, provided a copy of its Standards of Conduct that was distributed to all new employees at the time of orientation. This policy covers the Company's code of conduct and behavior but does not address such matters as contemplated by question 6 in the General Interrogatories.

Prudent business practices dictate that Company management establish formal procedures to govern the relations between their company and its directors, officers and responsible employees who are charged with the conduct of its affairs. Such formal procedures should proscribe unethical practices and should recite in clear language the standards of performance expected of each. These procedures should also be devised in such a manner as to permit the board of directors to properly oversee and handle any conflicts disclosed. In addition, it is not sufficient merely to adopt procedures, since to be effective and to avert occurrences of conflicts, they must be accompanied by an enlightened policy of enforcement. To this end, management should designate a responsible officer, who reports directly to the board of directors, to implement these procedures and oversee

the annual distribution of Conflict of Interest statements and questionnaires to directors, officers, and responsible employees.

It is recommended that Management establish formal procedures to govern the relationship between the company and its directors, officers and responsible employees who are charged with the conduct of the Company's affairs.

It is also recommended that the Company distribute annually Conflict of Interest statements and questionnaires to the directors, officers, and responsible employees.

It is further recommended that the board of directors maintain complete minutes of its proceedings on conflict of interest matters.

I. Regulatory Matters

On December 29, 1999, MDNY consented, upon its failure to comply with certain conditions (which included a contribution of capital), to the entry of a court order for rehabilitation pursuant to Article 74 of the New York Insurance Law. Such an order would permit the Insurance Department, as rehabilitator, to take possession of the Plan's assets and assume the Plan's business. As of the date of this examination, the Department has not sought such an order for rehabilitation of the Plan.

3. FINANCIAL STATEMENTSA. Balance Sheet

The following compares the assets, liabilities and net worth as determined by this examination with those reported by the Plan in its June 30, 2000 filed quarterly statement:

<u>Current Assets</u>	<u>Plan</u>	<u>Examination</u>	Net Worth Increase (Decrease)
Cash and cash equivalents	\$ 5,589,744	\$ 5,589,744	\$
Premiums receivable	9,922,066	9,922,066	
Amounts due from affiliates	566,576	566,576	
Reinsurance Recoverable on Paid Losses	874,998	874,998	
Prepaid and other assets	724,190	724,190	
Accounts Receivable – CHSLI	<u>2,382,027</u>	<u>2,382,027</u>	<u>0</u>
Total current assets	<u>\$ 20,059,601</u>	<u>\$ 20,059,601</u>	<u>\$ 0</u>
<u>Other assets</u>			
Bonds	\$ 3,753,365	\$ 3,753,365	\$
Management Fee Retainer	1,256,349	1,256,349	
Restricted Cash – Money Market	<u>115,863</u>	<u>115,863</u>	<u>0</u>
Total other assets	<u>\$ 5,125,577</u>	<u>\$ 5,125,577</u>	<u>\$ 0</u>
<u>Property and Equipment</u>			
Furniture and Equipment	<u>14,255</u>	<u>14,255</u>	<u>0</u>
Total property and equipment	<u>14,255</u>	<u>14,255</u>	<u>0</u>
Total assets	<u>\$ 25,199,433</u>	<u>\$ 25,199,433</u>	<u>\$ 0</u>

<u>Liabilities and Net Worth</u>	<u>Examination</u>	<u>Plan</u>	Net Worth Increase <u>(Decrease)</u>
Current Liabilities			
Accounts payable	\$ 1,176,714	\$ 1,176,714	\$
Claims payable	24,000,000	10,706,324	13,293,676
Accrued medical incentive pool			
Unearned premiums	<u>4,334,206</u>	<u>4,334,206</u>	<u> </u>
Total liabilities	\$ <u>29,510,920</u>	\$ <u>16,217,244</u>	\$ <u>13,293,676</u>
Net worth			
Common stock	\$ 2	\$ 2	\$
Paid in surplus	13,579,998	13,579,998	
Surplus notes	2,400,000	2,400,000	
Contingent reserves	7,919,846	7,919,846	
Retained earnings/Fund balance	<u>(28,211,333)</u>	<u>(14,917,657)</u>	<u>(13,293,676)</u>
Total net worth	<u>\$ (4,311,487)</u>	<u>\$ 8,982,189</u>	<u>\$(13,293,676)</u>
Total liabilities and net worth	<u>\$ 25,199,433</u>	<u>\$ 25,199,433</u>	<u>\$ (0)</u>

Note 1: No liability appears herein for a loan in the amount of \$2,400,000 and accrued interest thereon in the amount of \$422,884. This loan was granted pursuant to the provisions of Section 1307 of the New York Insurance Law. As provided in Section 1307, repayment of principal and interest shall only be made out of free and divisible net worth, subject to the prior approval of the Superintendent of Insurance.

Note 2: The Internal Revenue Service has not conducted any audits of the income tax returns filed on behalf of the Plan through tax year 1999. The examiner is unaware of any potential exposure of the Plan to any tax assessments and no liability has been established herein relative to such contingency.

Note 3: As a result of this examination, MDNY was determined to be insolvent in the amount of \$(4,311,487), and its required Contingency Reserves of \$7,919,846 was impaired in the amount of \$(12,231,333) as of June 30, 2000.

Subsequent to the examination, in July 2002, the Department approved a plan submitted by MDNY to eliminate the insolvency (See Item 4, Claims Payable, herein for further detail).

B. Statement of Revenues, Expenses and Net Worth

Net worth decreased by \$8,432,699 during the examination period from January 1, 1996 through June 30, 2000, detailed as follows:

Revenues

Premiums	\$328,152,656
Title XVIII – Medicare	73,138,567
Reinsurance premiums	(3,897,323)
Net Investment income	1,537,805
Administrative service income	744,028
Miscellaneous income	2,382,027
Other income	<u>41,554</u>
Total revenues	\$402,099,314

Expenses

Medical and Hospital	\$334,765,053
Administrative	<u>83,601,735</u>
Total expenses	<u>418,366,788</u>
Net loss before taxes	\$(16,267,474)
Provision for federal income taxes	<u>(9,489)</u>
Net loss	<u>\$(16,276,963)</u>

Net worth

Net worth, January 1, 1996	\$ 4,121,212
Net loss from operations	(16,276,963)
Section 1307 loans	2,400,000
Increase in paid in surplus	<u>5,444,264</u>
Decrease in Net Worth	<u>(8,432,699)</u>
Net worth, June 30, 2000	<u>\$ (4,311,487)</u>

4. CLAIMS PAYABLE

The examination liability of \$24,000,000 is \$13,293,676 more than the \$10,706,324 reported by the HMO in its filed quarterly statement.

The Plan's claims payable liability is comprised of unpaid capitation due to its contracting IPAs in the amount of \$10,706,324. The Plan has historically paid actual claims to providers on behalf of the IPAs. Such payments are then applied against the capitation allowance. For contract years 1996 through 1999, the Plan paid out amounts in excess of the capitation allowance, thereby generating a receivable balance of \$ 5,951,601. In May 2000 the Plan, LIPH, CHSLI, and the Island Practice Association IPA, Inc. entered into an agreement to offset the excess payments against the unpaid capitation allowance as of December 31, 1999. Consequently, the receivable balance of \$5,951,601 was eliminated and the claims payable liability was reduced by the corresponding amount.

The examination liability is comprised of the unpaid claims on the books of the IPAs as of the examination date as determined by an independent actuarial review conducted by the Plan's Certified Public Accountant. The examiner reviewed the risk transfer arrangements and related transactions between MDNY and its IPAs for the period 1996 to present. This review included an analysis of certain IPA financial reports, which indicated that almost all of the IPAs were insolvent. The examiner noted that the IPAs' insolvency was largely the result of the risks transferred under the agreements with MDNY. There is substantial uncertainty about the IPAs' ability to continue as going concerns and to fulfill their obligations under the risk transfer arrangements with the Plan. The examination review also noted MDNY's contractual obligations to its

subscribers wherein it retains overall responsibility for the delivery of healthcare services to such subscribers. Based on the uncertainty that the IPAs will be able to fulfill their obligations under the risk transfer arrangements in effect as of the examination date, and in light of MDNY's subsequent decision to accrue additional reserves on its balance sheet to offset the IPA deficits (including deficits related to the IPA owner / providers), the examiner determined that MDNY should have accrued the entire \$24,000,000 IPA liability as its own claims payable liability as of June 30, 2000. The Plan estimates that \$14,466,574 of this liability is owed to the LIPH's owner/providers and \$2,570,557 is owed to CHSLI.

Subsequent Events

Subsequent to the examination date, MDNY converted the capitation based contract with its major IPA, Island Practice Association IPA, Inc. (Island IPA) to a fee for service based contract effective January 1, 2001, thereby discontinuing any risk transfer to the IPA. In addition, most of the other single specialty IPAs, whose providers were also participants and/or owners of Island IPA, were dissolved during 2000. The dissolution of the single specialty IPAs did not alter MDNY's provider network since these providers continue to participate through their original contracts with Island IPA. Any remaining IPAs, that have requested to continue to operate under risk bearing contracts, were required to post financial security deposits. Actual medical expenses were reflected on the HMO's financial records during 2001 and participating providers in the MDNY network have direct back-up contracts with the HMO.

During 2001, the Plan paid claims incurred prior to 2001 that were in excess of capitation allowed for such prior years. The Plan reinstated a receivable from Island IPA for the excess payments on its balance sheet. At December 31, 2001, the total receivable balance for all contract years through December 31, 2000

was reported at \$23,257,000, which compares to the \$5,951,601 reported herein as of June 30, 2000. Since the IPA continues to report itself insolvent, this receivable would not be allowed as an admitted asset by the Department, thereby resulting in the continued and increased insolvency of MDNY as of December 31, 2001.

In July, 2002, the Department approved a plan submitted by MDNY to withhold funds from ordinary claim payments made to the Island IPA providers, and to retain network access fees otherwise due to Island IPA, in an amount sufficient to fully satisfy the receivable due from Island IPA within a three year period. That plan is supported by a written agreement between MDNY, Island IPA, and the participating hospitals represented by CHSLI. It also includes a provision whereby, in the event of MDNY's declared insolvency, claims payable to Island IPA and CHSLI participating network providers will be subordinated to the claims of all other MDNY creditors. The parties executed the agreement on July 12, 2002 (effective January 1, 2002). Based upon this action, the IPA receivable will be allowed as an admitted asset by the Department and the examination insolvency will be eliminated. The Department will monitor the impact of the agreement.

5. CONCLUSION

As a result of this examination, MDNY was determined to be insolvent in the amount of \$(4,311,487), and its required Contingency Reserves of \$7,919,846 was impaired in the amount of \$(12,231,333) as of June 30, 2000.

Subsequent to the examination, in July 2002, the Department approved a plan submitted by MDNY to eliminate the insolvency (See Item 4, Claims Payable, herein for further detail).

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
A.	<p>The examination determined that MDNY was insolvent in the amount of \$(4,311,487), and its required Contingency Reserves of \$7,919,846 was impaired in the amount of \$(12,231,333) as of June 30, 2000.</p> <p>Subsequent to the examination, in July 2002, the Department approved a plan submitted by MDNY to eliminate the insolvency (See Item 4, Claims Payable, herein for further detail).</p>	1, 20, 25
B.	<p>It is recommended that the Plan elect the requisite number of enrollee representatives to the board of directors to comply with the requirements of Part 98-1.11(f) of the Health Department's Administrative Rules and Regulations.</p>	6
C.	<p>Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Individuals who fail to attend at least one-half of the board's regular meetings, unless appropriately excused, do not fulfill such criteria. Board members who are unable or unwilling to attend meetings consistently should resign or be replaced.</p>	6-7
D.	<p>It is recommended that the minutes of the board of directors include copies of reports, schedules, board resolutions, board actions, and other appropriate documentation referenced therein.</p>	7
E.	<p>It is recommended that attendance records be appended to the minutes of the board of directors so that accurate records of directors who fail to demonstrate an ongoing interest in the affairs of the Plan may be appropriately disclosed.</p>	8
F.	<p>It is also recommended that minutes of the board of directors contain appropriate references of actions taken by the board to appoint or elect new</p>	8

directors to replace those that resigned or were removed.

- G. It is further recommended that motions to adopt the minutes of previous meetings include appropriate references to the dates of those meetings. 8

<u>ITEM NO.</u>	<u>PAGE NO.</u>
H. It is recommended that the board of directors authorize and approve the Company's investment transactions in accordance with the provisions of Section 1411(a) of the New York Insurance Law.	14
I. It is recommended that the Plan immediately transfer all securities or investments held under custodial or safekeeping arrangements to a bank or trust company that meet the guidelines set forth in the Insurance Department's rules and the NAIC Examiners Handbook.	15
J. It is also recommended that the Plan obtain the requisite custodial or safekeeping agreements with a bank or trust company in accordance with the Insurance Department's Rules and submit a copy of the same to the Department.	15
K. It is further recommended that the Plan instruct such a bank or trust company with which it executes any custodial or safekeeping agreements to provide the Insurance Department examiners with the requisite affidavit and a verification certificate in accordance with the Department's guidelines.	16
L. It is recommended that the Plan comply with the guidelines set forth by the NAIC in the instructions to the annual and quarterly statements and that its general ledger is reconciled to the filed statutory statements.	16
M. It is recommended that the Plan comply with the provisions of Sections 1315 and 1316 respectively of the New York Abandoned Property Law as regards the reporting of certain unclaimed property.	17
N. It is also recommended that the Plan to annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned cash amounts and to file proof of such publication with the Office of the State Comptroller.	17
O. It is recommended that Management establish formal procedures to govern the relationship between the company and its directors, officers and responsible employees who are charged with the conduct of the Company's	18

affairs.

- P. It is also recommended that the Company distribute annually Conflict of Interest statements and questionnaires to the directors, officers, and responsible employees. 19

- Q. It is further recommended that the board of directors maintain complete minutes of its proceedings on conflict of interest matters. 19

Respectfully submitted,

Pearson A. Griffith
Senior Insurance Examiner

STATE OF NEW YORK)
) SS.
)
COUNTY OF NEW YORK)

PEARSON A. GRIFFITH, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Pearson Griffith

Subscribed and sworn to before me

this _____ day of _____ 2002

