

**REPORT ON EXAMINATION**

**OF**

**HUMANA INSURANCE COMPANY OF NEW YORK**

**AS OF**

**DECEMBER 31, 2009**

**DATE OF REPORT**

**MAY 12, 2011**

**EXAMINER**

**JEFFREY L. USHER**

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

Andrew M. Cuomo  
Governor

James J. Wrynn  
Superintendent

May 12, 2011

Honorable James J. Wrynn  
Superintendent of Insurance  
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 30520, dated May 12, 2010, attached hereto, I have made an examination into the condition and affairs of Humana Insurance Company of New York, an accident and health insurer licensed pursuant to Article 42 of the New York Insurance Law, as of December 31, 2009, and submit the following report thereon.

The examination was conducted at the home office of Humana Insurance Company of New York located at 500 W. Main Street, Louisville, Kentucky.

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

Wherever the designations "HI" or the "Parent" appear herein, without qualification, they should be understood to indicate Humana, Inc.; HICNY's parent company.

<http://www.ins.state.ny.us>

Wherever the designation the “Department” appears herein, without qualification, it should be understood to indicate the New York State Insurance Department.

## **1. SCOPE OF THE EXAMINATION**

An “on organization” examination of the Humana Insurance Company of New York was conducted as of December 31, 2005. This examination of the Company was a combined (financial and market conduct) examination and covered the four-year period from January 1, 2006 to December 31, 2009. The financial component of the examination was conducted as a financial examination, as defined in the National Association of Insurance Commissioners’ (“NAIC”) *Financial Condition Examiners Handbook, 2009 Edition* (the “Handbook”). The examination was conducted observing the guidelines and procedures in the Handbook, and where deemed appropriate by the examiner, transactions occurring subsequent to December 31, 2009, were also reviewed.

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

The examiners identified key processes, assessed the risks within those processes and assessed the internal control systems and procedures used to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, an evaluation of the overall financial statement presentation, and determined management's compliance with the Department's statutes and guidelines, Statutory Accounting Principles, as adopted by the Department, and NAIC Annual Statement instructions.

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

These categories are as follows:

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

The Company was audited annually, for the years 2006 through 2009, by the accounting firm of PricewaterhouseCoopers LLP ("PwC"). The Company received an unqualified opinion in each of those years. Certain audit work papers of PwC were reviewed and relied upon in conjunction with this examination. A review was also made of the Parent's Internal Audit function and Enterprise Risk Management program, as they relate to the Company.

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

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

Humana Insurance Company of New York (“HICNY”) is a wholly-owned subsidiary of Humana Inc., HICNY’s Parent.

Humana Insurance Company of New York is a for-profit stock insurance company, licensed pursuant to Article 42 of the New York Insurance Law to offer coordinated health insurance coverage in the State of New York under Section 1113(a)(3). HICNY provides medical and prescription drug coverage solely to Medicare-eligible individuals under Medicare Advantage, Medicare Advantage Plus and Medicare Prescription Drug Part D contracts with the Centers for Medicare and Medicaid Services (“CMS”). In addition, HICNY writes supplemental Medicare coverage; however, it is a very small part of HICNY’s operations.

### A. **Management and Controls**

Pursuant to the Company’s Charter and By-Laws, management of the Company is to be vested in a Board of Directors (“BOD”) consisting of not less than thirteen (13), and no more than twenty-five (25) members. The thirteen (13) directors of the Company as of December 31, 2009, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
George G. Bauernfeind Louisville, Kentucky	Vice President, Humana Inc.
James H. Bloem Louisville, Kentucky	Senior Vice President & CFO, Humana Inc.
Bruce J. Goodman Louisville, Kentucky	Senior VP & Chief Service & Information Officer, Humana Inc.
Paul A. Leo Albany, New York	Market Manager, Humana MarketPoint, Inc.
Thomas J. Liston Louisville, Kentucky	Senior VP-Senior Products, Humana Inc.
Heidi S. Margulis Louisville, Kentucky	Senior Vice President-Government Relations, Humana Inc.
Michael B. McCallister Louisville, Kentucky	Chairman of the Board of Directors & Chief Executive Officer, Humana Inc.
Steven E. McCulley Louisville, Kentucky	Vice President & Controller, Humana Inc.
James E. Murray Louisville, Kentucky	Chief Operating Officer, Humana Inc.
Kathleen Pellegrino Louisville, Kentucky	Vice President, Deputy Counsel & Assistant Secretary, Humana Inc.
Bruce D. Perkins Prospect, Kentucky	Senior VP HealthCare Delivery Systems, & Clinical Processes, Humana Inc.
Barbara J. Wagner Altamont, New York	Market Manager, Humana MarketPoint, Inc.
Melissa L. Weaver, M.D. Louisville, Kentucky	Vice President, Humana, Inc.

A review of the BOD's minutes and members' attendance during the period under examination for HICNY revealed that the BOD did not hold any meetings during this period. All decisions made and actions taken by the BOD during this period were through written consent. The Board has a responsibility to meet regularly to consult and provide guidance to Company management regarding the management of the business affairs of the Company. It should be noted however that, Article III, Section 4, of the Company's By-Laws states in part:

*"A regular meeting of the Board of Directors shall be held without other notice than this Bylaw, immediately after, and at the same place, as the annual meeting of shareholders.*

It is recommended that the Board of Directors hold board meetings on at least a quarterly basis during each calendar year.

It should be further noted that Article III, Section 4, of the Company's By-Laws states in part:

*"...whenever the laws of the State of New York authorize or permit directors to act other than at a meeting, including but not limited to acting through unanimous written consents, then such actions shall be as effective as if taken by the directors at a meeting; provided, however, that use of unanimous written consents by the Board shall be limited to occasions when time is of the essence and shall not in any case be used in lieu of a regularly scheduled meeting."*

It is also recommended that HICNY comply with its By-Laws by only using unanimous written consents by the BOD in lieu of a regularly scheduled meeting, in defined limited occasions.

Article III, Section 3, of the Company's By-Laws states:

*“The Board of Directors from time to time may appoint such standing or special committee as it may deem for the best interest of the Corporation, but no such committee shall have any power, except such as are expressly conferred upon it by the Board of Directors and as are otherwise permitted by law. At least one member of each committee shall be a board member.”*

A review of the list of Company's Finance Committee members revealed that none of the representatives were members of its Board of Directors.

It is recommended that the Company comply with Article III, Section 3, of its By-Laws and appoint a Board member(s) to the Finance Committee.

In addition, it was noted that the Company's Board of Directors did not adopt, as required by Department Circular Letter No. 9 (1999), procedures to ensure that all claims are being processed accurately, uniformly, and in accordance with applicable statutes, rules, and regulations.

It is recommended that HICNY's Board of Directors comply with the process requirements set forth in Department Circular Letter No. 9 (1999).

The principal officers of the Company as of December 31, 2009 were as follows:

<u>Name</u>	<u>Title</u>
Michael B. McCallister	President & Chief Executive Officer
James E. Murray	Chief Operating Officer
Thomas J. Liston	Senior Vice President Senior Products
James H. Bloem	Senior Vice President, Chief Financial Officer & Treasurer
Bruce J. Goodman	Senior Vice President and Chief Service and Information Officer

<u>Name</u>	<u>Title</u>
Heidi S. Margulis	Senior Vice President
Frank M. Armine	Appointed Actuary
Elizabeth D. Bierbower	Vice President/Chief Operating Officer Specialty Benefits
Joan O. Lenahan	Vice President and Corporate Secretary
Kathleen Pellegrino	Vice President and Assistant Secretary

## B. Corporate Governance

The Company's Parent, Humana Inc., is a publicly traded, diversified health insurance company subject to the Sarbanes-Oxley Act of 2002. Corporate Governance, Internal Audit and Enterprise Risk Management ("ERM") for the Company is provided by Humana Inc.; thus, unless otherwise noted, references to Humana Inc. are applicable to the Company.

Humana Inc. has adopted an ERM framework for proactively addressing and mitigating risks, including prospective business risks. Exhibit M of the Handbook (*Understanding the Corporate Governance Structure*) was utilized by the examiner as guidance for assessing Corporate Governance. Overall, it was determined that the Company's Corporate Governance structure is adequate, sets an appropriate "tone at the top", supports a proactive approach to operational risk management, and contributes to an effective system of internal controls. It was found that Humana Inc.'s BOD and key executives encourage integrity and ethical behavior throughout the organization and that senior management promotes a corporate culture that acknowledges, understands and maintains an effective control environment.

Humana Inc.'s management has an adequate approach to identifying and mitigating risks across the organization, including prospective business risks. Humana Inc. deals proactively with its areas of risk, and its management is knowledgeable about mitigation strategies. Through

risk discussions and other measures, Humana Inc.'s management reviews significant issues and reacts to changes in the environment with a clear commitment to address risk factors and manage the business accordingly. Humana Inc.'s overall risk management process takes a proactive approach to identifying, tracking, and dealing with significant current and emerging risk factors.

Humana Inc. has an established Internal Audit Department ("IAD") function, which is independent of management, to serve Humana Inc. and its subsidiaries. The Audit Committee of the Humana Inc. BOD (the "Audit Committee" or "AC"), is comprised entirely of members independent of Humana Inc. and HICNY.

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

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

C. Territory and Plan of Operation

HICNY is licensed in the State of New York to offer coordinated health insurance coverage as an accident and health insurer and provides medical coverage solely to Medicare eligible individuals. HICNY contracts with the Centers for Medicare and Medicaid Services

(“CMS”) to cover Medicare Advantage, Medicare Advantage Plus and Medicare Prescription Drug Part D stand-alone programs that provide a comprehensive array of health insurance benefits, including wellness programs to Medicare eligible individuals, in exchange for contractual payment(s) received from CMS.

An enrollee in Medicare Advantage receives benefits in excess of traditional Medicare, including: reduced cost sharing, enhanced prescription drug benefits, care coordination, case management, disease management, wellness and prevention programs and reduced monthly Part B premiums (Physician Care and other services).

The Company offers Private Fee-For-Service (“PFFS”) plans which have no preferred network. Individuals in these plans pay a premium to receive typical Medicare Advantage benefits, along with the freedom to choose any health care provider that accepts as reimbursement, rates equivalent to traditional Medicare payment rates.

HICNY offers stand-alone Medicare prescription Drug Part D plans which offer basic coverage with mandated benefits, as well as plans providing enhanced coverage with varying degrees of out-of-pocket costs for premiums, deductibles and co-insurance. The provisions of the stand-alone prescription drug plans are applicable to the Medicare Advantage plans.

In addition, HICNY writes Supplemental Medicare Coverage; however, it is a small line of business. In 2006 to 2008 the Company had zero written premiums for Supplemental Medicare Coverage. In 2009 the Company had written premiums of \$94,386.

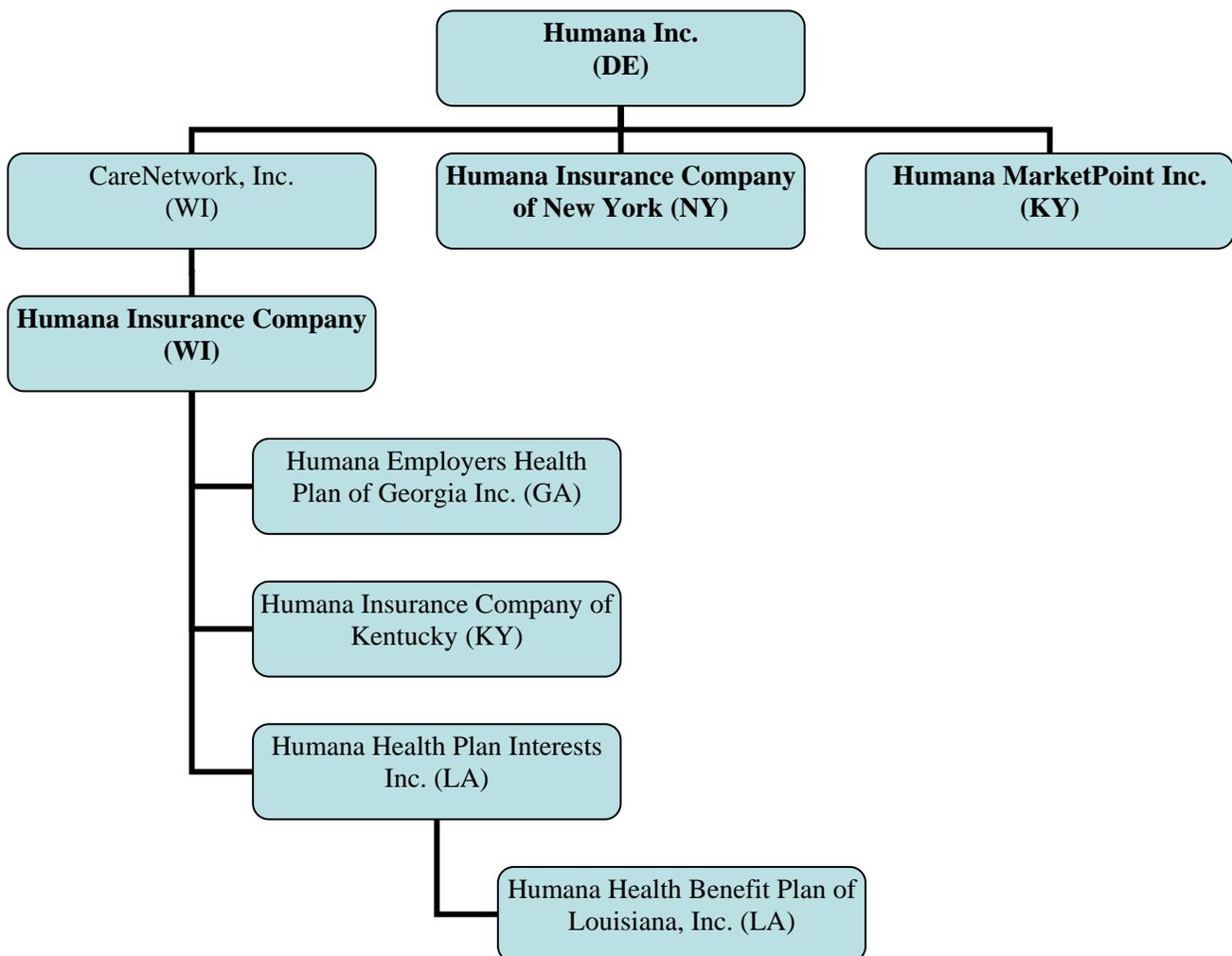
The following table displays HICNY's net admitted assets, capital and surplus, net premium income and net income during the period under examination:

	Net Admitted Assets	Capital and Surplus	Net Premium Income	Net Income
2009	\$110,023,051	\$75,418,825	\$120,712,619	\$8,499,152
2008	83,697,724	66,770,435	131,605,689	(7,613,200)
2007	136,997,425	74,084,329	198,245,088	14,895,222
2006	111,014,034	15,039,048	130,929,846	(750,077)

In 2008, the Company's net admitted assets decreased due to a reduction in healthcare receivables due from CMS. Capital and surplus decreased due to the net loss for 2008. The net loss for 2008 was largely due to CMS not assigning low income members to the Company, as in 2007. PFFS members increased in 2008, but did offset the decline of low income members, however, the change in health benefits paid in 2008 increased 280% from 2007, resulting in a net loss.

D. Holding Company System

HICNY is a wholly-owned subsidiary of Humana Inc. Its Parent, is a publicly traded corporation domiciled in the State of Delaware. The following chart depicts the Company's holding company system as of December 31, 2009:



The above chart does not include all of the subsidiaries of the holding company. The chart includes only the affiliates of which there are service agreements with HICNY.

#### Inter-company Agreements

The Company is a party to nine (9) inter-company agreements with its Parent and affiliates, which are subject to the Department's review and approval. These agreements involve activities such as: administrative services, cash management, investment management, tax consolidation filing, etc. The most significant of these agreements is the Corporate Service Agreement between Humana Inc. and the Company. Under the terms of this agreement, dated June 29, 2006, Humana Inc. provides the following services to the Company: financial, management, accounting, underwriting, marketing, legal, medical provider, member services, medical management, agency development, employee management and benefit, information systems and other general and administrative services.

The Corporate Service Agreement between HICNY and Humana, Inc. states in part:

*"...settlement of the current month's costs of this service agreement shall occur during the same month based on an estimate. Final settlement of any residual activity will be made February 28, May 15, August 15, and November 15 for the preceding calendar quarter based upon an invoice for the balance due."*

A review of the inter-company transactions between the Company and its Parent, Humana, Inc., revealed that settlement dates were not within the timeframe set forth required by the agreement, as detailed above.

It is recommended that the Company settle the inter-company transactions with its Parent in accordance with the specified due dates in the service agreement.

E. Custodial Agreement

A review of the Domestic Custody Agreement dated March 23, 2005, between Humana Insurance Company of New York and JPMorgan Chase Bank, N.A. revealed that the agreement did not include the following protective covenants, as suggested by the National Association of Insurance Commissioners (“NAIC”):

1. The Custodial Agreement shall be authorized by a resolution on behalf of the board of directors or an authorized committee of the insurance company.
2. The custodian is obligated to indemnify the insurance company for any insurance company’s loss of securities in the custodian’s custody, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard, the custodian shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian.
3. In the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.
4. The custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control.
5. If the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer’s domiciliary commissioner.
6. During regular business hours, and upon reasonable notice, and officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company.
7. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information.

8. The custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian.

9. The custodian shall secure and maintain insurance protection in an adequate amount.

It is recommended that the Company amend its custodial agreement with JPMorgan Chase Bank, N.A. to include all of the provisions in the NAIC guidelines.

### 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 included by HICNY in its filed annual statement, as of December 31, 2009:

	<u>Examination</u>	<u>Company</u>
<u>Assets</u>		
Bonds	\$ 249,302	\$ 249,302
Cash and cash equivalents	100,887,660	100,887,660
Short-term investments	21,916	21,916
Interest income due and accrued	1,352	1,352
Uncollected premiums and agents' balances in the course of collection	919,974	919,974
Accrued retrospective premiums	633,882	633,882
Amounts recoverable relating to uninsured plans	3,193,495	3,193,495
Net deferred tax asset		
Healthcare and other amounts receivable	<u>4,115,470</u>	<u>4,115,470</u>
Total assets	\$ <u>110,023,051</u>	\$ <u>110,023,051</u>

	<u>Examination</u>	<u>Company</u>
<u>Liabilities</u>		
Claims unpaid	\$ 12,667,862	\$ 12,667,862
Unpaid claims adjustment expenses	216,519	216,519
Aggregate health policy reserves	637,762	637,762
Aggregate health claim reserves	21,000	21,000
Premiums received in advance	853,526	853,526
General expenses due and accrued	3,715	3,715
Net deferred tax liability	33,651	33,651
Amounts due to parents, subsidiaries and affiliates	1,793,072	1,793,072
Liability for amounts held under uninsured plans	18,329,989	18,329,989
Aggregate write-ins for other liabilities	<u>47,130</u>	<u>47,130</u>
Total liabilities	\$ <u>34,604,226</u>	\$ <u>34,604,226</u>
<u>Capital and Surplus</u>		
Common capital stock	\$ 1,500,000	\$ 1,500,000
Gross paid-in and contributed surplus	60,500,000	60,500,000
Unassigned funds	<u>13,418,825</u>	<u>13,418,825</u>
Total capital and surplus	\$ <u>75,418,825</u>	\$ <u>75,418,825</u>
Total liabilities, capital and surplus	\$ <u>110,023,051</u>	\$ <u>110,023,051</u>

**Note:** The Internal Revenue Service (“IRS”) has completed audits of Humana, Inc.’s consolidated Federal Income Tax returns which the Company is a party to, for fiscal years 2006 and prior. Humana, Inc.’s 2007 to 2009 Federal income tax return was under review by the IRS during March of 2011. The examiner is unaware of any potential exposure to HICNY for any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Revenue, Expenses and Capital and Surplus

Capital and surplus increased \$75,035,554 during the four-year examination period, January 1, 2006 through December 31, 2009, detailed as follows:

Revenue

Premium income	<u>\$581,493,242</u>
Total revenue	581,493,242

Hospital and medical expenses

Hospital/medical benefits	\$ 72,269,858	
Other professional services	561,620	
Emergency room and out-of-area	1,452,482	
Prescription drugs	427,883,400	
Incentive pool, withhold adjustments and bonus amounts	<u>382,907</u>	
Total hospital and medical expenses	\$502,550,267	
Claims adjustment expenses	14,850,690	
General administrative expenses	<u>43,206,238</u>	
Total underwriting deductions		\$ <u>560,607,195</u>
Net underwriting gains		\$ 20,886,047
Net investment income earned	\$ 1,934,126	
Net realized capital gains	<u>1,583</u>	
Net investment gains		1,935,709
Aggregate write-ins for other income		<u>1,671</u>
Net income before federal and foreign income taxes		\$ 22,823,427
Federal and foreign income taxes incurred		<u>7,792,331</u>
Net income		\$ <u>15,031,096</u>

## Changes in Capital and Surplus

Capital and surplus, per report on organization, as of December 31, 2005			\$ 383,271
	<u>Gains</u> <u>in Surplus</u>	<u>Losses</u> <u>in Surplus</u>	
Net income	\$ 15,031,096		
Change in net deferred income tax		\$ 33,653	
Change in non-admitted assets		461,889	
Paid-in surplus	<u>60,500,000</u>	<u>          </u>	
Net increase in capital and surplus			\$ <u>75,035,554</u>
Capital and surplus, per report on examination, as of December 31, 2009			\$ <u>75,418,825</u>

The Paid-in surplus of \$60,500,000 consists of capital contributions for the calendar years 2007 and 2006, totaling \$45 million and \$15.5 million, respectively, from Humana Inc., HICNY's Parent

#### 4. CLAIMS UNPAID

The examination liability of \$12,667,862 for the above captioned account is the same as the amount reported by the Company in its filed annual statement as of December 31, 2009. 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 the Company's internal records and in its filed annual statements as verified by the examiner. The examination reserve was based upon actual payments made through a point in time, plus an estimate for claims remaining unpaid at that date. Such estimate was calculated based on

actuarial principles, which utilized the Company's experience in projecting the ultimate cost of claims incurred on or prior to December 31, 2009.

## 5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. In determining the scope of this review, the examiner took into consideration the Company's lines of business, Medicare Advantage and Prescription Drug Part D, which fall under the purview of CMS' requirements, as opposed to the statutory requirements of the Department. Thus, the market conduct review was limited.

No issues or areas of non-compliance were noted.

## 5. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Board of Directors</u>	
i. It is recommended that the Board of Directors hold board meetings on at least a quarterly basis during each calendar year.	6
ii. It is also recommended that HICNY comply with its By-Laws by only using unanimous written consents by the BOD in lieu of a regularly scheduled meeting, in defined limited occasions.	6
iii. It is recommended that the Company comply with Article III, Section 3 of its By-Laws and appoint a Board member(s) to the Finance Committee.	7
iv. It is recommended that HICNY's Board of Directors comply with the process requirements set forth in Department Circular Letter No. 9 (1999).	7
B. <u>Inter- Company Agreements</u>	
It is recommended that the Company settle the inter-company transactions with its Parent in accordance with the specified due dates in the service agreement.	13
C. <u>Custodial Agreement</u>	
It is recommended that the Company amend its custodial agreement with JPMorgan Chase Bank, N.A. to include all of the provisions in the NAIC guidelines.	15

Appointment No. 30520

**STATE OF NEW YORK  
INSURANCE DEPARTMENT**

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

**Jeffrey Usher**

as a proper person to examine into the affairs of the

**Humana Insurance Company of New York**

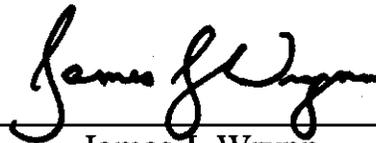
and to make a report to me in writing of the condition of the said

**Company**

with such other information as he shall deem requisite.

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

this 12<sup>th</sup> day of May, 2010



James J. Wrynn  
Superintendent of Insurance

