

REPORT ON EXAMINATION

OF THE

MEDCO CONTAINMENT INSURANCE COMPANY OF NEW YORK

AS OF

DECEMBER 31, 2006

DATE OF REPORT

FEBRUARY 13, 2009

EXAMINER

KENNETH I. MERRITT

TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1.	Scope of examination	2
2.	Description of company	3
	A. Management	4
	B. Territory and plan of operation	5
	C. Holding company system	7
	D. Significant operating ratios	12
	E. Accounts and records	13
3.	Financial statements	16
	A. Balance sheet	16
	B. Underwriting and investment exhibit	17
4.	Aggregate reserves and unpaid claims	18
5.	Compliance with prior report on examination	19
6.	Summary of comments and recommendations	19



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

David A. Paterson
Governor

Eric R. Dinallo
Superintendent

February 13, 2009

Honorable Eric R. Dinallo
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22623 dated August 1, 2007, attached hereto, I have made an examination into the condition and affairs of the Medco Containment Insurance Company of New York, a for-profit stock company licensed pursuant to the provisions of Article 42 of the New York Insurance Law. The following report is respectfully submitted.

The examination was conducted at the Company's home office located at 648 Plank Road, Suite 203, Clifton Park, New York 12065.

Wherever the designation "the Company" or "Medco NY" appears herein, without qualification, it should be understood to indicate Medco Containment Insurance Company of New York.

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

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2000. This examination covers the six year period from January 1, 2001, through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination comprised a verification of assets and liabilities as of December 31, 2006, in accordance with Statutory Accounting Principles (SAP) as adopted by the Department, a review of income and disbursements to the extent deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. 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 Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Territory and plan of operations
- Growth of the Company
- Mortality and loss experience
- Accounts and records
- Financial statements

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

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

2. DESCRIPTION OF COMPANY

The Company was incorporated in the State of New York on February 15, 1989 under the initial name of American Nisshin Insurance Company, a property and casualty insurance corporation. The Company received its licensing authority from the State on July 15, 1989 and commenced writing business on July 31, 1989. On November 1, 1994, the Company effected a name change to Medco Containment Insurance Company of New York following its August 31, 1994 acquisition by its current parent company, Medco Health Solutions, Inc. (formerly known as Merck-Medco Managed Care, LLC). Medco Health Solutions, Inc. (Medco Health) is a national pharmacy benefit manager and a third party administrator of the prescription drug programs and services for such clients as large private and public sector employers and their employees, physicians, pharmacies, drug manufacturers, etc. As more fully discussed in Item 2B of this report, effective January 1, 2006, the Company converted to an accident and health insurer pursuant to Article 42 of the New York Insurance Law.

Medco NY is required to maintain a total of \$200,000 of minimum paid in capital based upon the line of business it is authorized to transact as set forth in Section 1113(a) of the New York Insurance Law. The Company reported, as of December 31, 2006, total paid in capital of \$1,000,000 comprised of one million outstanding issued common shares at \$1 par value per share. The Company reported total capital and surplus in the amount of \$10,142,172.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is to be vested in a board of directors consisting of not less than thirteen (13) members. Directors serve a term of one year on the board. The board meets at least once each quarter during the calendar year.

The following thirteen (13) individuals served on the Company's Board of Directors as of December 31, 2006:

<u>Name and Address</u>	<u>Title and Principal Business Affiliation</u>
Gabriel Cappucci Chatham, NJ	Vice-President/ Treasurer, Medco Containment Insurance Company of NY
Mary T. Daschner Minneapolis, MN	Senior Vice-President, Retiree Solutions, Medco Health Solutions, Inc.
Paul E. DelloRusso Glen Ridge, NJ	Vice-President/Secretary, Medco Containment Insurance Company of NY
Sarina DosSantos Denville, NJ	Vice-President/Associate Controller, Medco Containment Insurance Company of NY
Donna M. Foti North Haledon, NJ	Senior Director of Insurance /Risk Management, Medco Health Solutions, Inc.
Walter D. Hosp Scarsdale, NY	Vice-President and Treasurer, Medco Health Solutions, Inc.
Thomas M. Moriarty Short Hills, NJ	Senior Vice-President, Medco Health Solutions, Inc.
JoAnn Reed Matawan, NJ	President, Medco Containment Insurance Company of NY
Daniele Ruskin New York, NY	Vice-President and Counsel, Medco Health Solutions, Inc.
James Schalago Bloomingtondale, NJ	Director Medicare Insurance, Medco Health Solutions, Inc.
Corlette V. Trim Franklin Lakes, NJ	Vice-President, Medco Containment Insurance Company of NY

<u>Name and Address</u>	<u>Title and Principal Business Affiliation</u>
Daniel C. Walden New Rochelle, NY	Vice-President/Assistant Secretary, Medco Containment Insurance Company of NY
Stephen E. Wogen Towaco, NJ	Vice-President/Retiree Solutions, Medco Health Solutions, Inc.

The minutes of all meetings of the board of directors held during the examination period were reviewed. The review revealed that all of the board's meetings were generally well attended by the directors during the period.

The following individuals were principal officers of the Company as of December 31, 2006.

<u>Name</u>	<u>Title</u>
JoAnn Reed	President
Gabriel R. Cappucci	Vice-President and Treasurer
Paul DelloRusso	Vice-President and Secretary
Daniel C. Walden	Vice-President

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to transact accident and health insurance as set forth in Section 1113(a)(3)(i) of the New York Insurance Law.

Effective December 12, 2005, the New York Insurance Department approved Medco NY's Certificate of Amendment of Charter whereby all of the authorized property and casualty insurance lines as defined in Section 1113(a) of the New York Insurance Law were deleted from the Company's license. The Company simultaneously replaced the aforementioned deleted lines with accident and health and

thereafter, Medco NY converted to an accident and health insurer pursuant to Article 42 of the New York Insurance Law.

As of December 31, 2006 the Company was licensed only in the State of New York.

Medco NY reported total direct written premiums written of \$3,089,515 during the examination period as per the following schedule:

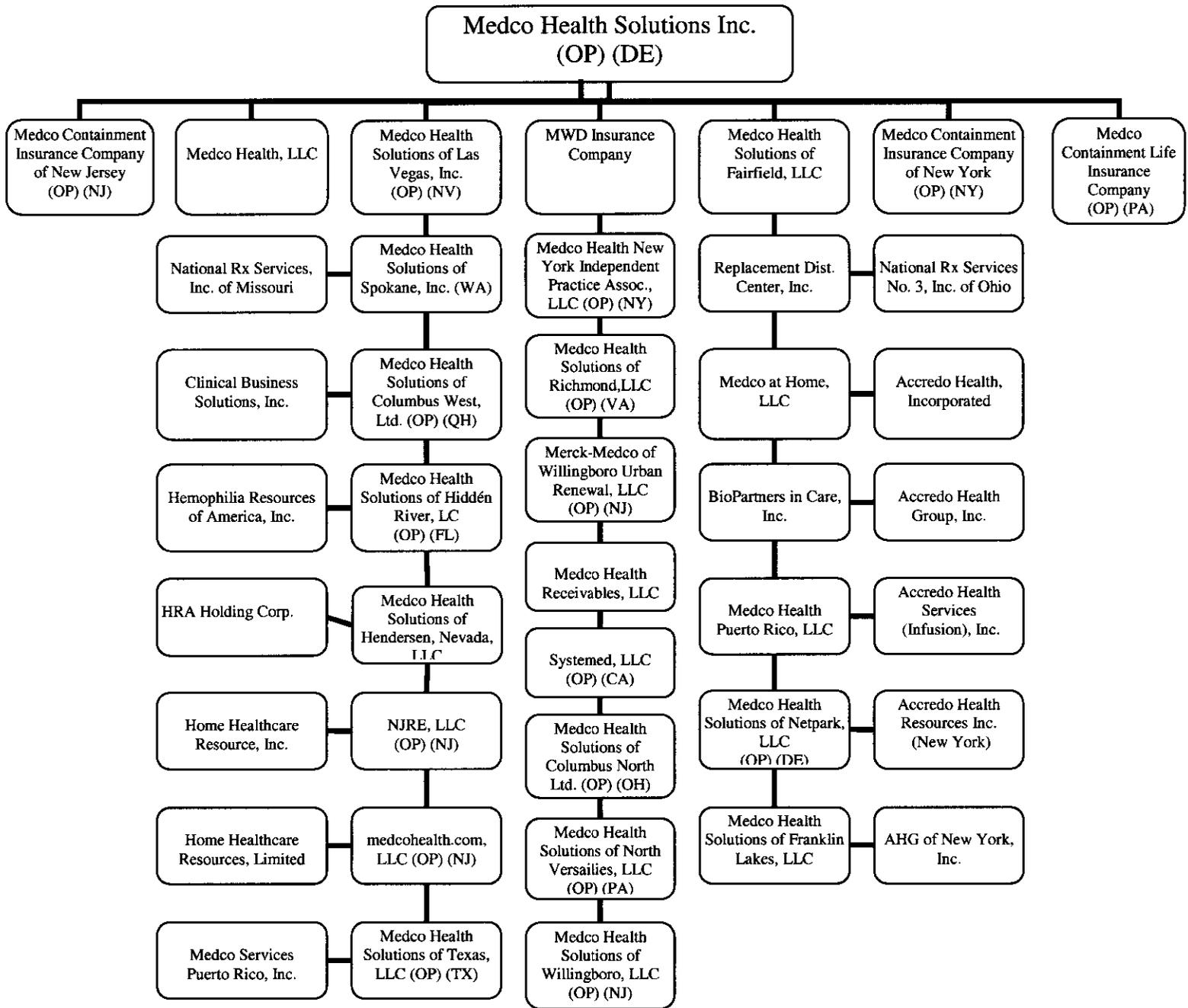
Year	Premiums Written
2001	\$ 0
2002	0
2003	0
2004	619,996
2005	184,760
2006	<u>2,284,759</u>
Total	<u>\$ 3,089,515</u>

As of January 2006, the Company began writing a fully insured prescription drug plan under the Medicare Part D Prescription Drug program. Prior to its entry into this market, Medco NY had written a small amount of aggregate stop-loss coverage on the prescription drug business provided by its parent company, Medco Health Solutions, Inc. to large commercial business groups. This stop-loss coverage included all of the Company's 2004 and 2005 writings. Prior to 2004, Medco NY had not written any business since 1997.

C. Holding Company System

The Company is a 100% controlled subsidiary of Medco Health, a Delaware incorporated and publicly traded corporation. Previously, a controlled subsidiary of Merck & Co., Inc, (Merck), Medco Health (formerly named Merck-Medco Managed Care, L.L.C.”) was spun off from Merck in August 2003. All of the outstanding shares of Medco Health were distributed to Merck’s shareholders. As a result of the spin-off, Medco Health became the ultimate controlling entity of the surviving holding company system which currently includes Medco NY.

The following chart illustrates the holding company system of the Company and its other affiliates as of December 31, 2006.



** No one individual or entity held interest of ten percent or more of the ultimate parent company, Medco Health Solutions, Inc., as of December 31, 2006.

The following inter-company agreements were in effect between the Company and Medco Health as of December 31, 2006:

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

The captioned agreement calls for Medco Health to provide the Company with accounting, underwriting, claims and investment services. The Department approved, on June 26, 2007, an amendment to this agreement that was filed by the Company. Such amendment included the following additional provisions: (i) Medco Health provided the Company with management and administrative services, including all personnel, necessary for the management of the operations and services of Medco NY and the implementation of the Company's policies; and (ii) the Department granted permission to the Company to maintain its accounts and records in Franklin, Lakes, New Jersey.

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

The captioned agreement calls for the Company to be included in Medco Health's consolidated Federal income tax return and combined or unitary state franchise or income tax returns.

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

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

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

Section 1505(d) of the New York Insurance Law states, in part, the following,

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

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

It is recommended that the Company comply with Section 1505(d) of the New York Insurance Law and file all of its inter-company agreements with the Department prior to implementation.

Per the addendum dated April 1998 to the above mentioned service agreement made with Medco Health, such agreement provides for the method to be utilized in the determination and allocation of joint expenses incurred by Medco Health in rendering the necessary services to its insurance subsidiaries (includes Medco NY). The addendum calls for the development of an analysis detailing the time devoted to Medco Health's three insurance subsidiaries (which include Medco NY) by each individual employee and organizational unit of Medco Health providing direct services to the companies. The results of these analyses are then applied to the direct salary costs of the individuals providing services with the resultant calculations then being multiplied by the following three factors:

1. Preliminary charges are increased by a factor to reflect payroll taxes, employee benefits and other indirect compensation costs.
 2. Preliminary charges are increased by a factor calculated to cover overhead costs, including supervision, administrative services and occupancy costs.
 3. Preliminary charges are increased by a factor to cover costs of Directors' time devoted to the insurance companies.
-

The sum of the resulting charges are allocated to the companies for services rendered under such service agreement. The resulting charges are allocated to each company in proportion to the time devoted to each company by the individuals analyzed.

It is noted that joint expenses incurred were allocated to Medco NY during the examination period on the basis of investment holdings.

It is recommended that the Company comply with the expense allocation method included in its Department approved inter-company service agreement with Medco Health Solutions, Inc.

The same addendum herein referred to also applied to the amended Service Agreement as well. However, it was noted that Medco NY failed to include such addendum with its amended service agreement that the Company filed with the Department in 2007.

It is recommended that the Company file with the Department, with its new service agreement, the related addendum section detailing the method of expense allocation.

Department Regulation 52 (11 NYCRR 80-1.2) states in part the following requirement regarding the time period under which a domestic insurer shall file annually its Form HC 1 Registration Statements (HC 1 Statements) with this Department:

“ (a) An insurer required to register or amend its registration pursuant to Insurance Law, section 1503(a) shall furnish the required information on registration statement form HC 1, as specified in the instructions made a part thereof [see subdivision (d) of this section]. The initial registration statement shall be accompanied by the information required by subdivisions (e) and (f) of section 80-1.4 of this Part. Thereafter, an amendment to the registration statement shall be required within 120 days following the end of its ultimate holding company's fiscal year and within 120 days following the end of each succeeding fiscal year, indicating changes, if any, during the preceding fiscal year in respect to items 1, 2, 4, 7 and 8 of the registration statement.”

A review of the Company's filings revealed that the Company failed to file with the Department within the 120 days deadline HC 1 Statements for the years 2003 and 2006 covered by this examination period.

It is recommended that the Company fully comply with Department Regulation 52 (11 NYCRR 80-1.2) by ensuring that its HC 1 Statements are filed timely with this Department.

D. Significant operating ratios

The following ratios have been computed as of December 31, 2006 based upon the results of this examination:

Net premiums written to Surplus	.23 to 1
Uncollected Premiums to Surplus	0%
Liabilities to Liquid assets	16%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Claims	\$2,162,135	70.0%
General administrative expenses	881,940	28.5%
Net underwriting gain	<u>45,440</u>	<u>1.5%</u>
Premium earned	<u>\$3,089,515</u>	<u>100.0%</u>

E. Accounts and records

The following accounting and reporting issues were noted in connection with the examiner's review of the captioned item:

(i) Inter-Company Payable Account

During the period under examination, Medco NY incorrectly booked expenses incurred in conjunction with its inter-company service agreement to its general expenses due and accrued account instead of its intercompany payable account.

SSAP No. 67 Other Liabilities, Paragraph 11, of the NAIC Accounting Practices and Procedures Manual, states in part the following:

“A liability shall be recognized and identified as due to affiliates for expenditures incurred on behalf of the reporting entity by a parent, affiliates, or subsidiaries or for amounts owed through other inter-company transactions.....”

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

(ii) Investment Expenses

The Company did not report any investment expenses in Part 3 of the Underwriting and Investment Exhibit of its 2006 filed annual statement.

(iii) Annual Statement Disclosure of Method of Expense Allocation

The Company failed to disclose in the Notes to the Financial Statement the method used for allocation of expenses in connection with the total management and service fees reported.

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

(iv) Premium Billing and Collection

A review of the premium account revealed the Company experienced a problem with premium collection that was derived as withheld payments deductible from the monthly checks of Social Security recipients. Based upon an arrangement between Medco Health Solutions, Inc. and the Center for Medicare and Medicaid Services ("CMS"), CMS was responsible for the collection of the premiums that the Social Security Administration ("SSA") billed and withheld from the Social Security checks of eligible members during 2006. However, processing errors occurred with SSA's billing and collection function that stemmed from the SSA either: (1) withholding premiums that were less than the amount anticipated by CMS, (2) having conflicting data files with CMS of beneficiaries participating in the program, and/or (3) withholding excess premium amounts from members' Social Security benefits. These discrepancies generated processing error edits that rejected the payment of any withheld amounts for the prescription drug coverage.

CMS communicated the aforementioned issues to Medco Health during the fourth quarter of 2006 and further advised Medco Health Solutions, Inc. that it would not be responsible for collecting any unpaid member premiums aged past two months. As a result, Medco Health commenced to retroactively bill the members for the delinquent premiums payable to Medco NY but cautioned that the majority of these uncollected amounts would likely not be collected. Consequently, the Company set up reserves for all receivables aged more than thirty days as well as having written off as non-admitted \$236,311 of the total \$282,566 uncollected premiums asset amount reported as of the 2006 Annual Statement.

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

(v) Custody Investment Agreement

The Company's existing custodial agreement excludes several of the recommended standard provisions in the NAIC Examiners Handbook.

The below enumerated provisions in the Handbook were excluded in the Company's current custodial agreement:

- 2e. In the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability.
- 2f. 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 superintendent of insurance.
- 2h. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control.
- 2i. 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.
- 2k. The custodian shall secure and maintain insurance protection in an adequate amount.

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

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as determined by this examination and reported by the Company in its filed annual statement as of December 31, 2006.

Assets

Bonds	\$ 743,931
Cash, cash equivalents and short-term investments	10,829,425
Investment income due and accrued	29,232
Uncollected premiums	46,255
Accrued retrospective premiums	213,567
Net deferred tax asset	89,346
Health care and other amounts receivable	<u>51,703</u>
 Total assets	 <u>\$12,003,459</u>

Liabilities

Claims unpaid	\$ 165,657
Unpaid claims adjustment expenses	2,285
Premiums received in advance	92,635
General expenses due and accrued	433,834
Current federal and foreign income tax payable, including interest due thereon	103,173
Remittances and items not allocated	428,582
Liability for amounts under uninsured plans	<u>635,121</u>
 Total liabilities	 <u>\$ 1,861,287</u>

Capital and surplus

Common capital stock	\$ 1,000,000
Gross gain in and contributed surplus	4,068,941
Unassigned surplus funds	<u>5,073,231</u>
Total capital and surplus	<u>10,142,172</u>
 Total liabilities, capital and surplus	 <u>\$ 12,003,459</u>

Note: The Internal Revenue Service has completed its audits of the Company's federal income tax returns through tax years 2001. The Internal Revenue Service is currently undergoing an audit of the Company's consolidated federal income tax return with its parent company, Medco Health Solutions, Inc. for the period August 20, 2003 through December 31, 2005. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to any contingency.

B. Underwriting and investment exhibit

Capital and surplus increased by \$1,113,752 during the period under this examination, January 1, 2001 through December 31 2006, detailed as follows:

Revenue

Net premium income \$ 3,089,515

Expenses:

Prescription drugs \$ 2,159,850

Claim expenses incurred 2,285

General administration expenses 881,940

Total underwriting deductions 3,044,075

Less: Total underwriting deductions 3,044,075

Net underwriting gain \$ 45,440

Net investment gain 1,737,998

Net income after capital gains tax and before all other federal income taxes incurred \$ 1,783,438

Less: Federal income taxes incurred 527,255

Net income \$ 1,256,183

Change in capital and surplus

Capital and surplus per report on examination as of December 31, 2000			\$ 9,028,420
	<u>Gains in capital and surplus</u>	<u>Losses in capital and surplus</u>	
Net Income	\$ 1,256,183		
Change in net deferred income taxes	94,273		
Change in nonadmitted assets	<u>0</u>	\$ <u>236,704</u>	
Total gains and losses	\$ <u>1,350,456</u>	\$ <u>236,704</u>	
Net increase (decrease) in capital and surplus			<u>1,113,752</u>
Capital and surplus per report on examination as of December 31, 2006			<u>\$ 10,142,172</u>

4. **AGGREGATE RESERVES AND UNPAID CLAIMS**

The examination liability of \$167,942 is the same as the amount reported by the Company as of the examination date. The examination analysis 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.

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

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2000, contained one (1) recommendation. The current status of this matter is as follows (page numbers refer to the prior report):

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1.	<u>Abandoned Property Law</u> It is recommended that the Company comply with Section 1316 of the New York Abandoned Property Law by filing the necessary report annually with the Comptroller's Office of the State of New York. The Company has complied with this recommendation.	8

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM.</u>		<u>PAGE NO.</u>
.	<u>Holding Company System</u>	
A.	It is recommended that the Company comply with Section 1505(d) of the New York Insurance Law and file all of its inter-company agreements with the Department prior to implementation.	10
B.	It is recommended that the Company comply with the expense allocation method included in its Department approved inter-company service agreement with Medco Health Solutions, Inc.	11
C.	It is recommended that the Company file with the Department, with its new service agreement, the related addendum section detailing the method of expense allocation.	11
D.	It is recommended that the Company fully comply with Department Regulation 52 (11 NYCRR 80-1.2) by ensuring that its HC 1 Statements are filed timely with this Department.	12

.	<u>Accounts and Records</u>	
E.	It is recommended that all incurred expenses related to the Company's inter-company service agreements with Medco Health be booked to the Company's inter-company payable account in accordance with SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual.	13
F.	It is recommended that the Company report its related investment expenses in the manner prescribed by Department Regulation 33 and the NAIC annual statement instructions. Also, it is further recommended that Medco NY follow the annual statement instructions by disclosing in the Notes to the Financial Statement its method used for allocation of expenses in connection with management and service fees reported.	14
G.	It is recommended that the Company continue to enhance its controls and monitor CMS' rules regarding premium billing and collection.	14
H.	It is recommended that the Company update its current custodial investment agreement to include each of the above standard provisions as listed in the NAIC Examiners Handbook for inclusion within such custodial agreement.	15

Appointment No. 22623

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

I, **Eric R. Dinallo**, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

Kenneth Merritt

as a proper person to examine into the affairs of the
Medco Containment Insurance Company of New York
and to make a report to me in writing of the condition of the said
Company

with such 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 1st day of August 2007



Eric R. Dinallo
Superintendent of Insurance

