REPORT ON EXAMINATION

OF

INDEPENDENT HEALTH BENEFITS CORPORATION

AS OF

DECEMBER 31, 2010

DATE OF REPORT	**APRIL 23, 2014**
EXAMINER	**KENNETH I. MERRITT**

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April 23, 2014

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law and acting in accordance with the instructions contained in Appointment Letter 30757, dated August 29, 2011, attached hereto, I have made an examination into the financial condition of Independent Health Benefits Corporation, a not-for-profit health service corporation, licensed pursuant to the provisions of Article 43 of the New York Insurance Law, as of December 31, 2010, and respectfully submit the following report thereon.

The examination was conducted at the home office of Independent Health Benefits Corporation located at 511 Farber Lakes Drive, Buffalo, New York.

Wherever the designations "IHBC" or the "Plan" appear herein, without qualification, they should be understood to indicate Independent Health Benefits Corporation.

The examiner also conducted a concurrent financial examination of Independent Health Association, Inc., which is the parent of IHBC a not-for-profit health maintenance organization certified pursuant to the provisions of Article 44 of the New York Public Health Law.

Accordingly, a separate financial report on examination of Independent Health Association, Inc. has been submitted thereon.

In addition, a separate market conduct examination into the manner in which IHBC and IHA conduct their business practices and fulfill their contractual obligations to policyholders and claimants was conducted as of December 31, 2010. A separate report will be submitted thereon.

Wherever the designations "IHA" or the "HMO" appear herein, without qualification, they should be understood to indicate Independent Health Association, Inc.

Wherever the designation "IHA Companies" appears herein, without qualification, it should be understood to indicate Independent Health Benefits Corporation and Independent Health Association, Inc., collectively.

Wherever the designation the "Department" appears herein, without qualification, it should be understood to indicate the New York State Department of Financial Services.

1. SCOPE OF THE EXAMINATION

The Plan was previously examined as of December 31, 2005. This examination of the Plan is a financial examination as defined in the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook, 2010 Edition* (the "Handbook") and it covers the five-year period from January 1, 2006 through December 31, 2010. 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, 2010 were also reviewed.

The examination was conducted using a risk-focused approach 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 Plan'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 Plan. The examiner planned and performed the examination to evaluate the Plan's current financial condition, as well as identify prospective risks that may threaten the future solvency of IHBC.

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

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

These categories are as follows:

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

The Plan was audited annually for the years 2006 through 2010 by the accounting firm Deloitte & Touche ("D & T"). The Plan received an unqualified opinion in each of those years. Certain audit workpapers of D & T were reviewed and relied upon in conjunction with this examination. Since the Plan has no business personnel and facilities, IHBC relies on the common management of its parent, IHA. A review was therefore conducted of IHA's corporate governance structure, which included its internal audit function, audit committee activities, enterprise risk management program and Model Audit Rules {i. e. Department Regulation No. 118 (11 NYCRR 89.0)}.

The examiner reviewed the corrective actions taken by the Plan with respect to the recommendations concerning financial issues contained in the prior report on examination. The results of the examiner's review are contained in item 6 of this report.

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

2. DESCRIPTION OF THE PLAN

Independent Health Benefits Corporation is a not-for-profit health service corporation that was formed on October 26, 1994, under the name Integrated Benefits Corporation ("IBC"). IBC was granted a license by the Department effective June 20, 1995 and commenced writing business on December 6, 1995. Subsequently, IBC changed its name to Independent Health Benefits Corporation, effective May 10, 2001. The Plan is a taxable entity for federal income taxes purposes. IHBC is a 100% controlled affiliate of Independent Health Association, Inc.

A. Corporate Governance

Pursuant to IHBC's by-laws, management of the Plan is vested in a Board of Directors consisting of not less than thirteen (13) and no more than nineteen (19) members.

The following thirteen (13) members comprised IHBC's Board of Directors ("Board") as of December 31, 2010:

Name and Residence	Principal Business Affiliation
Subscriber Representatives	
Michael W. Cropp, M.D. Williamsville, New York	President & Chief Executive Officer, Independent Health Association, Inc.
Lawrence C. DiGiulio, Esq. Buffalo, New York	Vice-President & General Counsel, Independent Health Association, Inc.
Mark Johnson Buffalo, New York	Executive Vice-President & CFO, Independent Health Association, Inc.

Name and Residence	Principal Business Affiliation
Subscriber Representatives	
Mary E. Lowther Williamsville, New York	Benefits and Service Coordinator, Niagara Frontier Auto Dealers Association
John Rodgers, RPh, MBA Buffalo, New York	Executive VP & Chief Marketing Officer, Independent Health Association, Inc.
James B. Walleshauser Buffalo, New York	Vice-President, Office of Strategy Management, Independent Health Association, Inc.
Public Representative	
Stuart H. Angert Amherst, New York	Retired
John Antkowiak, MD Colden, New York	Retired
Moises Sudit, PhD. Getzville, New York	Professor, State University of New York at Buffalo
Nora B. Sullivan, JD Williamsville, New York	Financial Advisor Investment Banking, Sullivan Capital Partners, Inc.
Barry N. Winnick, D.D.S. E. Amherst, New York	Dentist, Amherst Dental Group
R. Marshall Wingate Buffalo, New York	President, DynaCom Industries, Inc.
Provider Representative	
James R. Coppola Williamsville, New York	Retired Pharmacist

The following individuals were the principal officers of the Plan as of December 31, 2010:

Name	Title
Michael W. Cropp, M.D.	President & Chief Executive Officer
Lawrence C. DiGiulio, Esq.	Secretary

Name	Title
Michael Faso	Director of Finance
Moises Sudit	Second Vice-Chairman of the Board
R. Marshall Wingate	Chairman of the Board

Sections 4301(k) (1) and 4301(k) (1) (A) of the New York Insurance Law state the following:

> "The board of directors of each health service, hospital service or medical expense indemnity corporation subject to this article shall be composed of persons who are representative of the member hospitals or licensed medical professionals of such corporation, persons covered under its contracts and the general public. The board of directors of such corporations may also include persons who are employees of such corporations and who also serve as officers of such corporations. Not more than one-fifth of the directors of any such corporation shall be persons who are licensed to practice medicine in this state (other than physicians employed on a full-time basis in the fields of public health, public welfare, medical research or medical education) or who are trustees, directors or employees of a corporation organized for hospital purposes, or any combination thereof. Not more than one-eighth of the directors of any such corporation shall be persons who are employees of such corporation and who also serve as officers of such corporation. Any person who is an officer of such corporation but not an employee of such corporation shall be considered under one of the other classifications of directors set forth in this section, as appropriate…"

> "(A) one-half in number, as nearly as possible, shall be persons covered under a contract or contracts issued by such health service, hospital service or medical expense indemnity corporation, and who are generally representative of broad segments of such covered persons, and ..."

As of December 31, 2010, the Plan was not fully compliant with its by-laws and Section 4301(k) of the New York Insurance Law relative to the composition of its Board of Directors and the Directors' statutory term limitations. It was noted that five of the total thirteen Board members of IHBC as of the December 31, 2010 were deemed to be employees of both IHA and IHBC based on their dual managerial roles with the two IHA Companies.

IHBC's appointment of its employees as directors to fulfill the requirements for "subscribers" on IHBC's Board of Directors does not comport with Section 4301(k) of the Insurance Law, which requires New York Insurance Law Article 43 corporation to have a Board of Directors that comprises a cross section of members from various business sectors and the general public. In addition, by not placing these five IHA Companies' employees into their proper classification on IHBC's Board, the Plan failed to comply with Section 4301(k) that mandates a maximum of one-eighth "employee-officer " directors, and a minimum of one-half (or as nearly as possible), "subscriber" directors, comprise the Plan's Board.

It is recommended that IHBC comply with Section 4301(k) of the New York Insurance Law by appointing individuals other than the employee-officers of the IHA Companies to represent the Plan's "subscriber" on its Board.

It is also recommended that IHBC comply with Section 4301(k) of the New York Insurance Law by ensuring that the Plan's Board of Directors does not include more than one-eighth that are employee-officers of the IHA Companies.

The minutes of the Board's meetings held during the period under examination evidenced that meetings were generally well attended, with all Board members attending at least one-half of the meetings for which they were eligible to attend.

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

> "No domestic insurer shall make any loan or investment, except as provided in subsection (h) hereof, 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."

A review of the Plan's internal records revealed that for the third and fourth quarters of 2010, the Board of Directors failed to approve IHBC's investment transactions in a timely manner. In addition, the Board of Directors failed to approve IHBC's investment transactions during the 2011 calendar year in a timely manner.

It is recommended that IHBC's Board of Directors fully comply with Section 1411(a) of the New York Insurance Law and ensure that all of IHBC's investment transactions are approved by either the Plan's Board of Directors or a Board designated Committee in a timely manner.

During the period under examination, IHBC maintained a custodial agreement with HSBC Bank for safekeeping of the Plan's invested assets. The NAIC Handbook, Section 1 – General Examination Guidance, Part III.F (Outsourcing of Critical Functions), lists numerous safeguards and protective clauses that should be included as part of such custodial agreements. However, the examiner's review of HSBC Bank custodial agreement revealed that none of the NAIC suggested safeguards and protective clauses was included in the agreement.

It is recommended that IHBC revise its custodial agreement with HSBC Bank to include the safeguards and protective clauses that are outlined in Section 1 – General Examination Guidance, Part III.F, of the NAIC Financial Condition Examiners Handbook.

(1) Enterprise Risk Management ("ERM")

As of the examination date, IHBC did not have its own ERM program and instead, relied on the management and support of IHA's ERM program. During the period under examination, IHA adopted a formal and comprehensive ERM program, for proactively addressing and mitigating risks, including prospective business risks, identified by IHA and IHBC. IHA's ERM utilizes the global framework that is based on the guidelines of the International Organization for

Standardization ("ISO31000"), a framework and process, for the management of risk that are conducive to any type of organization in either the public or private sector. The ISO31000 framework does not mandate a one size fits all approach, but rather emphasizes the fact that the management of risk must be tailored to the specific needs and structure of the particular organization.

IHA's ERM policy statement calls for the HMO to utilize an enterprise-wide approach for the management of key business risks. ERM supports IHA's Board of Directors' risk governance responsibilities and the risk-based decision-making responsibilities of IHA's executive/senior leadership. Among the managerial teams (governance bodies) that comprise the executive/senior leadership are the Executive Team, the Enterprise Risk and Fiscal Responsibility Council ("ER & FRC") and the Office of Strategic Management ("OSM"). IHA's OSM shares responsibility for integrating ERM into the strategic planning process. The alignment and integration of IHA's ERM process with its strategic planning function help ensure identification of the uncertainties related to the IHA Companies' goals and objectives, which is imperative to the HMO's and Plan's future operations.

During the course of the Department's interviews with the IHA Companies' senior management ("C Level interviews"), the examiner noted that IHA and IHBC lack a sufficient succession plan. During the years under this examination and thereafter, it was noted that certain job vacancies at key levels within the IHA Companies, including *the positions of IHA's Chief Risk Officer ("CRO") and Chief Audit Executive ("CAE"), as well as the* IHA Companies' General Counsel, were filled with individuals hired from outside the HMO and the Plan rather than by the internal promotion of IHA Companies' employees.

It is recommended that IHBC establish a viable succession plan relative to IHBC's senior management.

In support of its commitment to an effective ERM program, which includes IHBC's operations, IHA's Board of Directors established a Risk and Compliance Committee ("Risk Committee") responsible for the oversight, guidance and direction of the HMO's ERM Program. IHA has a CRO whose duties and responsibilities are to set IHA's direction for risk management, with oversight from the Risk Committee, ER & FRC and Executive Management Team. The Risk Committee reports to the full Board on all levels and aspects of enterprise-wide risk, and provides assurance that the appropriate level of risk management is in place and that strategic objectives are met.

The examiner utilized as guidance for assessing the effectiveness of the HMO's corporate governance, Exhibit M of the Handbook (*Understanding the Corporate Governance Structure*). Overall, it was determined that IHA has a comprehensive and effective ERM program that covers all IHA affiliates within the holding system. Accordingly, executive management sets a positive and appropriate "tone at the top", and supports a proactive approach to operational risk management, including prospective business risk. Additionally, it was noted that IHA's Board of Directors and key executives encourage integrity and ethical behavior throughout the organization.

(2) Internal Audit Department ("IAD") and Audit Committee Activities

As of December 31, 2010, IHBC did not have an IAD function or a Board designated Audit Committee. Instead, IHBC relied on IHA's IAD and Audit Committee for management support and oversight. During the examination period, IHA had an established IAD to assist the HMO and the Plan at all levels of management by reviewing and testing financial and

operational controls and processes established by management. In addition, IHA had four (4) independent board members that comprised the Audit Committee to assist the Board of Directors of IHA in fulfilling its oversight responsibilities relative to the HMO's and the Plan's financial reporting, internal controls and the audit process.

Section 89.1(c) of Department Regulation No. 118 allows IHA's Audit Committee to be deemed the audit committee of all affiliates and subsidiaries.

The importance of both independence and an audit committee's active involvement within the internal audit function is a widely supported position throughout the audit industry, including the support from the Institute of Internal Auditors ("IIA") as "best practices". Below is the related guidance, as listed on the website of the IIA:

> (a) "The internal auditor occupies a unique position, he or she is employed by management but is also expected to review the conduct of management which can create significant tension since the internal auditor's independence from management is necessary for the auditor to objectively assess management's action, but the internal auditor's dependence on management for employment is very clear; and to maintain objectivity, internal auditors should have no personal or professional involvement with or allegiance to the area being audited; and should maintain an un-biased and impartial mindset in regard to all engagements."
>
> (b) "A critical activity of the audit committee is to be involved in the hiring of the CAE* of the organization. Because the CAE reports to the audit committee, the committee should be responsible for ensuring that the CAE receives fair and timely performance reviews. The audit committee should have an active role in determining the annual salary adjustment for the CAE. The audit committee should be the decision-making party in any decision to terminate the CAE."
>
> ***Note**: The acronym, "CAE", as noted above, refers to Chief Audit Executive.*

During the examination period, IHA's IAD providing of management support to the IHA Companies did not function independently of the IHA Companies' management, due to an improper reporting structure whereby the IAD was aligned under the direct supervision of

IHA's management and not the Audit Committee. The Director of Internal Audit ("DIA"), who was the most senior level position within IHA's IAD during the examination period, reported to IHA's President between 2006 and part of 2008 and thereafter reported to IHA's Chief Risk Officer. Simultaneously, the DIA reported on an informal and limited basis to an individual who was both the Chairman of IHA Board's Audit Committee and a member of IHBC's Board of Directors.

It is recommended that IHBC, in its reliance on the internal audit function of IHA, ensure that IHA comply with the IIA's guidance on the standard of independence of the internal audit function, by ensuring that the Internal Audit Department is aligned under the direct supervision of the Audit Committee, with limited and informal reporting to the IHA Companies' management.

During the examination period, it was noted that IHA's management, not the Audit Committee, had sole responsibility for evaluating the job performance and approving the job compensation and annual salary adjustments, of IHA's DIA. In addition, in January 2012, IHA's management terminated the DIA's employment with the HMO. Based on the examiner's subsequent meeting with the Chairman of IHA's Audit Committee, the Chairman confirmed that IHA's decision to terminate the DIA was made without his prior knowledge.

It is recommended that IHBC, in its reliance on IHA's Internal Audit function, ensure that IHA comply with IIA's guidance regarding the standard that the Audit Committee be directly involved relative to the hiring, job evaluations and determination of the job compensation and annual salary adjustments of the Director of Internal Audit and/or Chief Audit Executive.

It is further recommended that IHBC ensure that IHA's Audit Committee is the sole decision-maker, relative to the termination of employment of the Director of Internal Audit or Chief Audit Executive.

As a result of the restructuring of IHA's Internal Audit Department in 2012, the Director of Internal Audit position was elevated to Vice President and Chief Audit Executive ("CAE"). In addition, the CAE now reports directly to the Chairman of the Audit Committee with an informal reporting line to IHA's CEO. It was noted that during the process of selecting an employee to fill the CAE position, both IHA's management and the Audit Committee Chairman, collectively, participated in the process of interviewing the candidates. IHA subsequently filled its CAE position during the first quarter of 2012.

(3) Model Audit Rule ("MAR")/Department Regulation No. 118 (11 NYCRR Part 89)

As of December 31, 2010, IHBC, under the management of IHA - except for not having its own Audit Committee as mentioned in item A(2) above - was in compliance with the audit and reporting standards of the Department's Regulation No. 118 (11 NYCRR Part 89.0).

B. Territory and Plan of Operation

As of December 31, 2010, IHBC provided comprehensive hospital and medical, prescription drug, vision and dental benefits, under various health plans offered by IHBC, including preferred provider organizations (PPO) point of service (POS), exclusive provider organization (EPO), traditional indemnity and direct payments. In addition to IHBC commercial related plans, IHBC also marketed a Medicare PPO to qualifying members pursuant to Title XVIII of the Social Security Act.

The summary below reflects IHBC's total annual premium income and member enrollment between December 31, 2006 and December 31, 2010:

Year	Premium Income	Enrollment
2006	$134,746,394	53,482
2007	$219,240,981	83,200
2008	$411,259,827	142,845
2009	$470,047,614	123,537
2010	$477,937,156	115,656

Between the period December 31, 2006 and December 31, 2010, IHBC reported significant increases in its annual total premium income and member enrollments. The Plan's total annual premium income increased during the period from $134,746,394 in 2006 to $477,937, 156 in 2010, an increase of approximately 255%. The Plan's total enrollment during that period increased 116.3%, from 53,482 to 115,656 members. Such increases stemmed from a decision by the parent, IHA, to grow its IHBC subsidiary by switching/migrating over the majority of IHA's commercial (non-government) business members to IHBC for their health insurance coverage.

The migration of the HMO's members for enrollment in the Plan's POS and direct payment products resulted in the two IHBC product lines having the largest growth. The two lines combined accounted for 82% and 96%, respectively, of the overall increase to IHBC's premium income and member enrollments during the examination period.

POS and direct pay products were lines of business with the greatest number of enrollees migrating from IHA to IHBC.

It was noted that Medicare business comprised approximately 11% and 3.6%, respectively, of the Plan's total premium income written and member enrollment, as of December 31, 2010.

During the examination period, the sales and marketing of IHBC's commercial health insurance business were facilitated via a network of independent agents and brokers. IHBC's Medicare business consisted of Medicare Advantage and Medicare Part D contracts with the Centers for Medicare and Medicaid Services ("CMS"). IHBC provides comprehensive medical, hospital and prescription drugs benefits to senior citizens age 65 and over and some disabled individuals under the age of 65. In turn, CMS pays IHBC a monthly premium payment, per member, which is calculated on a monthly rate, per person, for each county. Higher rates are paid for less healthy members. CMS utilizes a risk-adjustment score methodology, which includes such factors as the age, gender, health status and actual claims experience per member, to retroactively adjust IHBC's current year premiums in the subsequent year.

C. Reinsurance

As of December 31, 2010, the Plan maintained the following ceded reinsurance program with its wholly-owned affiliate, Mason Insurance Company, Ltd. of Hamilton, Bermuda ("Mason"), which is an unauthorized reinsurer:

Covered services	**Reinsurance limits**
Inpatient hospital services only, that include sub-acute facility services, skilled nursing facility services, inpatient rehabilitation services, hospice services and home health care agency services	First Layer (Specific Retention): $750,000 - Non- Medicare Members, per member, per year $500,000 – Medicare Members, per member, per year Excess of Loss: All losses above the first layer
IHBC's retention / Mason's liability	IHBC pays initial $200,000 deductible and thereafter 15% of the losses incurred per member. Mason pays 85% after IHBC's retention. IHBC and Mason share the same 15% and 85% ratios under the excess of loss layer

The reinsurance agreement contained the standard insolvency wording required by Section 1308(a) (2) (A) (i) of the New York Insurance Law.

The examiner verified that the Plan's actual settlement of its recoverable reinsurance payments that are due from Mason occurred semi-annually, in May and November, of each year. IHBC only collected payments semi-annually from Mason. This resulted in IHBC routinely 'non-admitting' company recoverable balances. The Plan's entire 2010 year-end balance of $4,480,000.00 was not admitted due to such accounts exceeding ninety (90) days of non-collection.

Under IHBC's and Mason's existing Reinsurance Agreement, IHBC is required to provide Mason with various claims information, including monthly paid and incurred claims reports, at various time periods during the year. However, the Agreement does not indicate a specific date or period with respect to Mason being required to reimburse IHBC, as indicated in the following language to Article VI of the Agreement:

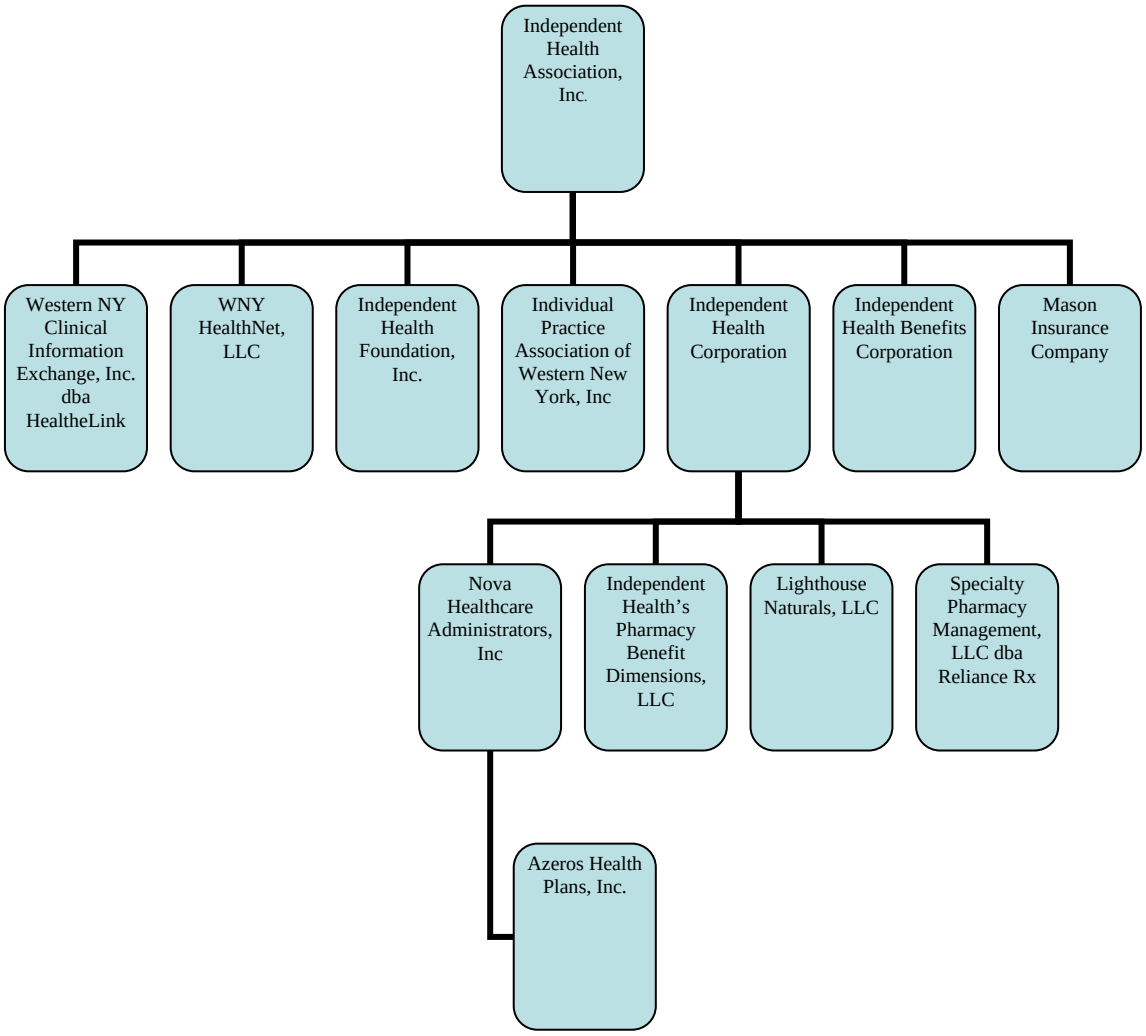
> "Upon receipt in the home office of the Corporation of satisfactory evidence that the Reinsured has incurred and Paid the Loss, and any other information required by the Corporation to determine its liability, if any, under the terms of this Agreement, the Corporation shall reimburse the Reinsured for Loss with respect to which this Agreement affords indemnity."

It is recommended that IHBC amend its existing reinsurance agreement with Mason to require Mason to settle all outstanding reinsurance balances payable to the Plan at least quarterly during the calendar year (No more than 90 days).

IHBC's implementation of such an amendment to its Mason reinsurance agreement will mitigate the practice of the Plan routinely non-admitting its recoverable reinsurance balances due from Mason.

D. Holding Company System

The following chart depicts IHBC's holding company system as of December 31, 2010:



Below is a description of the organizational structure and operating activities for select members within the holding company system:

Independent Health Association, Inc. ("IHA")

IHA is a not-for-profit corporation and the ultimate parent within the holding company system. IHA provides various management and administrative services to its holding company affiliates, including IHBC.

Independent Health Corporation ("IHC")

IHC, a New York for-profit company, is a wholly-owned subsidiary of IHA. IHC, in turn, has 100% direct control of several for-profit subsidiaries listed within IHA's holding company system. IHC, together with its subsidiaries, administer the self-funded plans offered by entities such as employer groups that provide health care coverage for their members. Additionally, based on IHC's existing inter-company administrative services agreement with IHBC, IHC provides for the creation and administration of debit cards for enrollees to use in conjunction with the benefits provided by IHBC and a network contract.

Mason Insurance Company, Ltd. of Bermuda ("Mason")

Mason, an unauthorized reinsurer and wholly-owned subsidiary of IHA, is a Bermuda domiciled captive insurance company that reinsures, on an excess of loss basis, the claims of IHBC.

IHBC had the following inter-company agreements with its affiliates at December 31, 2010 which were initially submitted and approved by the Department:

(i). Administrative Services Agreement with IHA effective January 1, 2007 and as amended on January 1, 2009

IHA provides IHBC with various management, consultative and administrative services, including the following: financial (i.e. claims, underwriting and investments), legal, internal operations, management information services, marketing consultation, health care services, including developing, revising, and refining new health care products, systems, policies, procedures and support to enhance the business of IHBC. Such agreement was last approved by the Department effective on September 5, 2007.

(ii). Administrative Services Agreement with IHC Inc. effective January 1, 2007 and as amended on January 1, 2009

IHC provides IHBC with access to provider networks, administration of debit cards issued to members covered under certain IHBC products and such other services as needed by IHBC from time-to-time. Such agreement was last approved by the Department effective on September 5, 2007.

(iii). Reinsurance Agreement with Mason Insurance Company, Ltd. of Bermuda effective January 1, 2010 through January 1, 2011

IHBC and Mason have an existing reinsurance agreement as of the examination date of December 31, 2010. The details of such reinsurance agreement are included with the Reinsurance section of this report.

Section 1505(d) (3) 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 or systematic basis;…"

It was noted that IHBC's approved administrative service agreements with IHA and IHC include a provision to allow IHA and IHC to charge IHBC a "reasonable profit" above the cost to the affiliates for providing IHBC with contracted services. On April 20, 2010, IHBC submitted the executed amendments to the Department for review. The amendments consisted of a revision of the method in which IHA and IHC were to calculate the amount of profit that they charged to IHBC.

It is recommended that IHBC comply with the requirement of Section 1505(d) (3) of the New York Insurance Law by obtaining the Department's prior approval or non-objection when implementing amendments to its inter-company agreements with affiliates.

Subsequent to the examination date, IHBC entered into administrative service agreements with IHA and IHC effective January 1, 2013, which replaced the above referenced agreements IHBC had with IHA and IHC. Paragraphs 3B and 4B under the compensation section of IHA's and IHC's agreements with IHBC, respectively, state that administrative services provided by IHA and IHC to IHBC will be priced based on the "approximate costs" to IHA and IHC. The

Department approved (non-disapproved) these agreements on March 19, 2013. The Department's approval of these administrative service agreements was based on its understanding that "approximate cost" represents IHA's and IHC's best estimate of the actual cost of providing services to IHBC and that "approximate cost" does not allow for an additional charge or profit. Any charge for a profit component contravenes the basis for the Department approving these administrative services agreements.

E. Allocation of Expenses

Joint personnel and other operating expenses incurred by IHBC during the examination period were allocated by IHA to its affiliates, including IHBC, based on the following expense allocation methods:

(i) Internal consulting charges (i.e. direct time charged and indirect time charged);

(ii) Administrative expense allocation; and

(iii) Expense reimbursement (i.e. expensed to the appropriate entity via an inter-company journal entity).

Under the "direct time" charge allocation procedure, IHBC's personnel costs, including employees' fringe benefits, are determined on the basis of the number of hours worked by IHA's employees, broken down by cost centers and products (e. g. HMO, PPO, Medicare, etc.) times the employees' pay rates. For each employee, his or her pay rate (adjusted to include a midpoint rate based on the lowest and highest salaries within each person's job title/position) is utilized in calculating the allocation amount. It is noted that the midpoint pay rates include an additional charge above the actual costs of IHA charges for the services provided to primarily cover the cost of IHA employees' fringe benefits. The additional charge or profit was determined based on

a calculation of applying an IHA employee's average midpoint salary by title and pay grade multiplied by a factor of 150%.

The indirect personnel costs entail a "discussion-based" determination that involved a general assessment of the time spent by IHA's employees attending corporate meetings/retreats and performing duties relative to corporate-wide projects and general administrative functions. Such generic "discussion-based" allocation was deemed by the examiner to be neither substantially quantifiable nor traceable to any specific product lines of IHA and its affiliates.

Paragraph 6 of SSAP No. 70 of the National Association of Insurance Commissioners Accounting Practices and Procedures Manual states the following:

> "Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios or similar analyses."

It is recommended that IHBC, relative to the allocation of its indirect personnel expenses, comply with Paragraph 6 of SSAP 70 and implement a methodology that yields optimal results and appropriately includes pertinent factors or ratios.

3. SECTION 1307 SURPLUS LOANS / AND CAPITAL CONTRIBUTION

IHBC, with the approval of the Department, received the following surplus loans from IHA during the examination period, pursuant to Section 1307 of the New York Insurance Law for purposes of the Plan meeting its statutory reserve fund requirement as required under Section 4310(d) of the New York Insurance Law and for funding the Plan's growth.

DFS Approval Date	Sub-total
December 21, 2006	$ 4,000,000
December 19, 2007	17,755,000
June 30, 2008	7,000,000
September 29, 2008	15,000,000
Total	$43,755,000

As of December 31, 2005, IHBC had an outstanding balance of $8,245,600 in previously approved surplus loans based on IHBC's past borrowing of funds from IHA. This prior balance, added to IHBC's $43,755,000 in total approved surplus loans received during the current examination period, combined for a total outstanding surplus loan balance of $52 million, as of the December 10, 2008 settlement date of the loans between IHBC and IHA.

In conjunction with the Department's approval on December 10, 2008 under an agreement between IHA and IHBC dated November 12, 2008, the Department permitted IHA to provide IHBC with a cash capital contribution in the amount of $100 million. Such approval was conditioned on IHBC simultaneously repaying IHA from the $100 million cash capital contribution the Plan's full outstanding principal surplus note balance of $52 million plus accrued interest payable to IHA.

4. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities, capital and surplus as determined by this examination as of December 31, 2010. This statement is the same as the balance sheet reported by the Plan in its filed annual statement as of December 31, 2010:

Assets	Examination	Plan
Bonds	$56,038,983	$56,038,983
Cash, cash equivalents & short-term investments	77,260,931	77,260,931
Interest income due and accrued	684,763	684,763
Uncollected premiums and agents' balances in the course of collection	5,900,532	5,900,532
Accrued retrospective premiums	790,942	790,942
Amounts receivable related to uninsured plans	421,300	421,300
Current federal and foreign income tax recoverable	1,046,001	1,046,001
Net deferred tax asset	1,725,000	1,725,000
Receivables from parents, subsidiaries and affiliates	5,812,921	5,812,921
Healthcare and other amounts receivable	113,514	113,514
Total assets	$149,794,887	$149,794,887

Liabilities	Examination	Plan
Claims unpaid	$ 32,372,843	$ 32,372,843
Unpaid claims adjustment expenses	2,600,000	2,600,000
Premiums received in advance	5,739,845	5,739,845
General expenses due and accrued	3,963,276	3,963,276
Current federal and foreign tax	115,000	115,000
Amounts due to parent, subsidiary and affiliates	5,330,767	5,330,767
Total liabilities	$50,121,731	$ 50,121,731
Gross paid-in & contributed capital	$100,000,000	$100,000,000
Statutory reserve fund	59,742,144	59,742,144
Unassigned funds (surplus)	(60,068,988)	(60,068,988)
Total capital and surplus	$ 99,673,156	$ 99,673,156
Total liabilities, capital and surplus	$149,794,887	$149,794,887

Note

The Internal Revenue Service has not audited the Plan. The examiner is unaware of any potential exposure of the Plan to any tax assessment and no liability has been established herein relative to any contingency.

B. Statement of Revenue and Expenses and Capital and Surplus

Capital and surplus increased $87,849,134 during the five-year examination period, January 1, 2006 through December 31, 2010, detailed as follows:

Net premium income		$1,713,231,972
Expenses		
Hospital/ medical benefits	$1,211,810,974	
Other professional services	12,980,309	
Prescription drugs	266,465,855	
Aggregate write-ins for other hospital and medical	62,268,501	
Subtotal	$1,553,525,639	
Less: Net reinsurance recoveries	23,139,028	
Total hospital and medical	$1,530,386,611	
Claims adjustment expenses, including $34,483,838 cost containment expenses	68,291,221	
General administrative expenses	117,949,987	
Total underwriting deductions		1,716,627,819
Net underwriting loss		($ 3,395,847)
Net investment income earned	5,198,461	
Net realized capital losses	(1,076,534)	
Net investment gains		$ 4,121,927
Aggregate write-ins for other expenses		(33,904)
Net income, after capital gains tax and before all other federal income taxes		692,176
Less: Federal income taxes incurred		145,193
Net income		$ 837,369

Changes in Capital and Surplus

Capital and surplus, per report on examination, as of December 31, 2005			$ 11,824,022
	Gains in Surplus	Losses in Surplus	
Net income	$ 837,369		
Net change in deferred tax	624,999		
Cash capital contribution from IHA	100,000,000		
Change in non-admitted assets		5,368,234	
Change in surplus notes		8,245,000	
Total change in capital and surplus	101,462,368	13,613,234	
Net change in capital and surplus			87,849,134
Capital and surplus, per report on examination, as of December 31, 2010			$ 99,673,156

5. CLAIMS UNPAID

The examination liability of $32,372,843 for the above captioned account is the same amount as reported by the Plan in its filed annual statement as of December 31, 2010.

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 Plan'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 Plan's experience in projecting the ultimate cost of claims incurred on or prior to December 31, 2010.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2005, contained four (4) comments and recommendations pertaining to the financial portion of the examination (page number refers to the prior report on examination):

ITEM NO.		PAGE NO.
	Management	
1.	It is thus recommended that the number of directors on the Plan's board representative of subscribers and the number of directors representative of the public be as equal as possible in compliance with Section 4301(k)(1)(A)&(B) of the New York Insurance Law.	6
	The Plan has complied with this recommendation.	
2.	It is recommended that the Plan fill the position of Vice-Chairperson in accordance with its by-laws.	6
	The Plan has complied with this recommendation.	
	Reinsurance	
3.	It is recommended that IHBC comply with the requirements of NAIC SAP 61 non-admit reinsurance recoverable from Mason Insurance Company, an unauthorized reinsurer, in its future annual statement filings.	6
	The Plan has complied with this recommendation	
	Accounts and Records	
4.	It is once again recommended that the HMO make appropriate studies relative to the allocation of expenses in future statements to this Department.	15
	The Plan has not fully complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM **PAGE NO.**

Respectfully submitted,

_____/S/_____
Kenneth I. Merritt
Associate Insurance Examiner

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

_____/S/_____
Kenneth I. Merritt

Subscribed and sworn to before me
this _____ day of_____2014.

Appointment No. 30757

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:

Kenneth Merritt

as a proper person to examine into the affairs of the

Independent Health Benefits Corporation

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 29th day of August, 2011

James J. Wrynn
Superintendent of Insurance