

COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION OF THE
HNE INSURANCE COMPANY

Springfield, Massachusetts

As of December 31, 2015

NAIC GROUP CODE 04756

NAIC COMPANY CODE 14198

EMPLOYER ID NUMBER 45-4462433

HNE INSURANCE COMPANY

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COMMONWEALTH OF MASSACHUSETTS
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ACTING COMMISSIONER OF INSURANCE

May 31, 2017

The Honorable Gary D. Anderson
Acting Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner:

Pursuant to your instructions and in accordance with Massachusetts General Laws, and Chapter 175, Section 4, an examination has been made of the financial condition and affairs of

HNE INSURANCE COMPANY

at its home office located at One Monarch Place, Springfield, MA 01144. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

HNE Insurance Company ("Company" or "HIC") commenced business effective 1/1/2013. This is the first examination of the Company by the Massachusetts Division of Insurance ("Division"). The examination covers the 3-year period from January 1, 2013 through December 31, 2015, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The current examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners ("NAIC") Financial Condition (E) Committee and prescribed by the current NAIC *Financial Condition Examiners Handbook*, the examination standards of the Division and with Massachusetts General Law. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, as mentioned in the Massachusetts General Laws, Chapter 175, Section 4 and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g. subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

The Company is audited annually by Deloitte & Touche LLP ("Deloitte"), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2013 through 2015. A review and use of the Certified Public Accountants' work papers was made to the extent deemed appropriate and effective.

Baker Tilly Virchow Krause, LLP ("Baker Tilly") was engaged to perform certain agreed upon procedures, which are in compliance with the NAIC *Financial Condition Examiners' Handbook*. The assistance included a review of accounting records, information systems and investments. Lewis & Ellis, Inc. were contracted by Baker Tilly to perform a review of the actuarially determined loss and loss adjustment expense reserves, as well as other significant actuarial estimates.

HNE Insurance Company

SUMMARY OF SIGNIFICANT FINDINGS OF FACT

Please refer to the “Comments on Financial Statement Items” and Summary of Recommendations” sections at the conclusion of the Report.

COMPANY HISTORY

The Company was incorporated in the State of Massachusetts effective February 15, 2012 as a for-profit insurance company and commenced business on January 1, 2013.

The Company is a direct subsidiary of HNE Holding Company, a subsidiary of Health New England, Inc. (“HNE”). The ultimate controlling entity is Baystate Health, Inc. Funding for this new corporation occurred on February 24, 2012 when HNE paid \$5,000,000 for 100,000 shares in HIC. During the examination period, the shares of HIC were transferred from HNE to HNE Holding Company as part of the reorganization of the holding company structure. This restructure was concurrent with HNE’s application to convert to a non-profit entity and transfer ownership of its direct subsidiaries to the newly formed HNE Holding Company.

HIC is based in Springfield, Massachusetts and primarily operates in the four counties (Berkshire, Franklin, Hampden, and Hampshire) of Western Massachusetts providing Medicare Supplement insurance.

MANAGEMENT AND CONTROL

Board of Directors

According to the bylaws, the Company's business shall be managed by a Board of Directors (“Board”) which may exercise all of the powers of the Company, except as otherwise provided by the articles of organization, by law, or the bylaws. “There shall be a Board consisting of not fewer than three (3) directors, except that whenever there shall be fewer than three (3) shareholders, the number of directors may be not less than the number of shareholders”. As of December 31, 2015, the Company's Board of Directors consisted of the following individuals:

<u>Name of Director</u>	<u>Title</u>
Maura C. McCaffrey	President & Chief Executive Officer, Health New England, Inc.
Jody Gross	Vice President of Sales, Health New England, Inc.
James Kessler, Esq.	Vice President & General Counsel, Health New England, Inc.

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Officers

According to the Company's bylaws, "the officers shall consist of a President, a Treasurer, a Secretary and such other officers as the Board of Directors may determine. The President, Treasurer, and Secretary shall be elected by the Board of Directors at any meeting thereof. Other officers shall be elected by the Board of Directors or by the Executive Committee."

Officers of the Company as of December 31, 2015 were as follows:

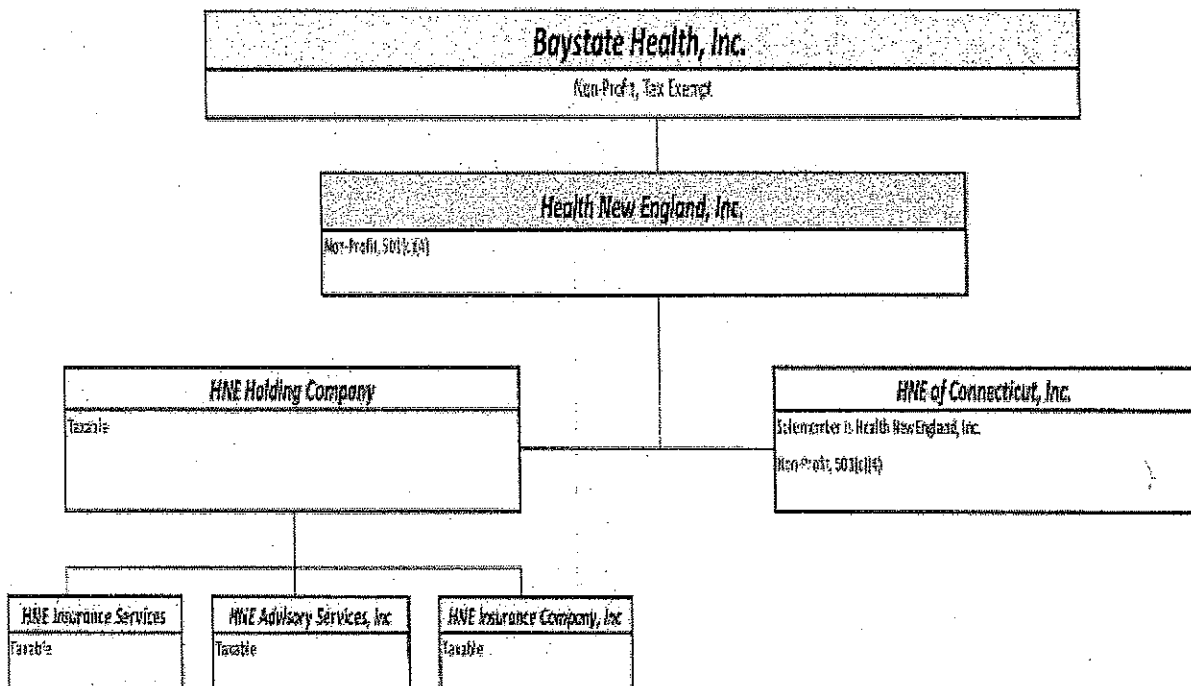
<u>Name of Officers</u>	<u>Title</u>
Maura C. McCaffrey	President/Treasurer
Judith M. Danek	Secretary

Holding Company

As stated in the Insurance Holding Company System Form B and Form C as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of Massachusetts General Law, Chapter 176G, Section 28 and Regulation 211 CMR 7.00. Baystate Health, Inc. is the "ultimate controlling person" of the Holding Company System.

Organizational Chart

The following documents the Company's organizational chart as of December 31, 2015:



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Transactions and Agreements with Subsidiaries and Affiliates

Intercompany Services Agreement: Through this agreement HNE provides various services to its subsidiaries, including all services required by the Company. The Company pays HNE a proportional share of HNE's total administrative costs on a monthly basis determined by assessing whether the Company incurred a particular expense and the proportion of each expense that is attributed to the Company.

Other Transactions: On January 1, 2014 HNE transferred and assigned to HNE Holding Company all the shares outstanding of the Company, as well as HNE Advisory Services, Inc., HNE Insurance Services, Inc. and the recently dissolved Health New England of Connecticut (replaced by the formation of HNE of Connecticut, Inc.). This transition of shares was to organize all the for profit entities under one downstream holding company, HNE Holding Company.

TERRITORY AND PLAN OF OPERATION

The Company is only licensed in Massachusetts and during the period covered by this examination only wrote Medicare Supplement insurance. The Company reported \$363,000 of 2015 direct written premium.

REINSURANCE

The Company is not a party to any assumed or ceded reinsurance agreements.

HNE Insurance Company

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements prepared by management and filed by the Company with the Division and present the financial condition of the Company for the period ending December 31, 2015. The financial statements are the responsibility of Company management.

Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2015

Statement of Revenue and Expenses for the Year Ended December 31, 2015

Reconciliation of Capital and Surplus for Each Year in the Three-Year Period Ended December 31, 2015

HNE Insurance Company

Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2015

	Per Annual Statement
Assets	
Cash, cash equivalents and short-term investments	\$ 4,970,461
Subtotals, cash and invested assets	4,970,461
Premiums and considerations:	
Uncollected premiums and agents' balances in the course of collection	7,054
Total Assets	<u>\$ 4,977,515</u>
Liabilities, Capital and Surplus	
Claims unpaid	\$ 45,243
General expenses due or accrued	9,800
Premiums received in advance	20,668
Amounts due to parent, subsidiaries and affiliates	429
Total liabilities	<u>76,140</u>
Common capital stock	2,000,000
Gross paid in and contributed surplus	3,000,000
Unassigned funds (surplus)	(98,625)
Total capital and surplus	<u>4,901,375</u>
Total liabilities, capital and surplus	<u>\$ 4,977,515</u>

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Statement of Revenue and Expenses For the Year Ended December 31, 2015

	As Reported by the Company
Member Months	<u>2,513</u>
Net premium income	<u>\$ 362,584</u>
Total revenues	362,584
Hospital and Medical:	
Hospital/medical benefits	<u>304,039</u>
Subtotal	304,039
Less:	
Net reinsurance recoveries	<u>0</u>
Total hospital and medical	304,039
General administrative expenses	<u>22,515</u>
Total underwriting deductions	326,554
Net underwriting gain (loss)	36,030
Net income or (loss) after capital gains tax and before all other federal income taxes	36,030
Federal income taxes incurred	<u>0</u>
Net Income (loss)	<u><u>\$ 36,030</u></u>

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Reconciliation of Capital and Surplus For Each Year in the Three-Year Period Ended December 31, 2015

	2015	2014	2013
Capital and surplus prior reporting year	\$ 4,866,547	\$ 4,738,687	\$ 4,996,526
Net income or (loss)	36,030	(56,593)	(49,447)
Change in net deferred income tax	11,413	0	0
Change in nonadmitted assets	(12,615)	184,453	(208,392)
Net change in capital and surplus	34,828	127,860	(257,839)
Capital and surplus end of reporting year	<u>\$ 4,901,375</u>	<u>\$ 4,866,547</u>	<u>\$ 4,738,687</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION

There have been no changes made to the Financial Statements as a result of this examination.

COMMENTS ON FINANCIAL STATEMENT ITEMS

As a result of this examination, no issues with non-compliance, adverse findings, or material, changes to the financial statements were identified.

The Company uses estimates for determining its claims incurred but not yet reported which are based on claim payment patterns, healthcare trends and membership and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years may vary from previously eliminated liabilities as the claims are ultimately settled.

Lewis & Ellis, Inc. prepared independent estimates of unpaid claim liabilities ("UCL") as of December 31, 2015. For December 31, 2015, completion factors for the projection of ultimate claims were developed using historical payment patterns and actuarial judgment. "Low" and "High" estimates were developed by subtracting the claims paid-to-date from the actuarial range of incurred estimates. The actuarial estimates, as determined by Lewis & Ellis Inc., indicate that HIC's UCL estimates are reasonable as of December 31, 2015. The Company's assumptions and methodologies used for the premium deficiency reserve ("PDR") are accurate and appropriate. The computations appear to be performed correctly, and the selected estimates appear reasonable. The Company maintains adequate PDR.

SUBSEQUENT EVENTS

Identified Material Weakness and Significant Deficiency

As a member of the HNE group of companies, HIC falls under the same system of internal controls as HNE. In 2016, during HNE's annual MAR controls assessment, HNE identified numerous deficiencies related to the preparation/approval of journal entries and maintaining proper supporting documentation. In 2017, during the annual audit of the Company's statutory financial statements, Deloitte, the Company's independent auditors requested the 2016 MAR findings. Based on the significance of the deficiency, Deloitte determined that the Company's internal controls over manual journal entries did not operate effectively and considered the deficiency to be a Material Weakness as of December 31, 2016. The control deviations encompass management's override of controls, lack of segregation of duties, and lack of documentation, and when considered in the aggregate were indicative of a material weakness in the operating effectiveness of the internal controls over recording of manual journal entries. In addition, Deloitte determined that the Company's internal controls over account balances including monthly reconciliations of all balance sheet accounts to be a Significant Deficiency, as there were noted instances where monthly account reconciliations were not prepared and reviewed timely and did not include adequate support for all reconciling items.

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Once identified, the Company along with Deloitte and other consultants worked to identify and test each effected transaction and determined there were no instances of fraud or other irregularities. The Company has implemented numerous improvements which are in various stages of completion to mitigate the risks associated with these identified control weaknesses.

SUMMARY OF RECOMMENDATIONS

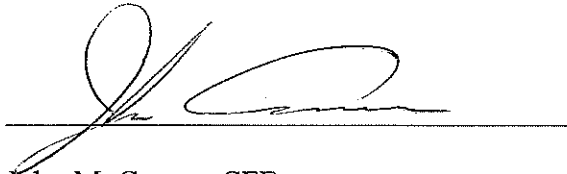
The Division recommends management continue to implement all identified internal control improvements to assure the noted material weaknesses and significant deficiencies are successfully mitigated. The effectiveness of these new internal controls should be tested and the controls should be incorporated into the annual MAR Controls Assessment process.

HNE Insurance Company

SIGNATURE PAGE

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by Baker Tilly and Lewis & Ellis Inc. who participated in the examination is hereby acknowledged.

A handwritten signature in black ink, appearing to read "John M. Curran", is written over a horizontal line.

John M. Curran, CFE
Supervising Examiner
Examiner-In-Charge
Commonwealth of Massachusetts
Division of Insurance