



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

REPORT OF EXAMINATION OF THE
HPHC INSURANCE COMPANY, INC.

Wellesley, Massachusetts

As of December 31, 2016

NAIC GROUP CODE 0595

NAIC COMPANY CODE 18975

EMPLOYERS ID NUMBER 04-3149694

HPHC INSURANCE COMPANY, INC.

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GARY D. ANDERSON
COMMISSIONER OF INSURANCE

May 30, 2018

The Honorable Gary D. Anderson
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, Chapter 175, Section 4 and other applicable statutes, an examination has been made of the financial condition and affairs of

HPHC INSURANCE COMPANY, INC.

at its home office located at 93 Worcester Street, Wellesley, Massachusetts, 02481. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

HPHC Insurance Company, Inc. ("Company") was last examined as of December 31, 2013 by the Massachusetts Division of Insurance ("Division"). The current examination was also conducted by the Division and covers the three-year period from January 1, 2014 through December 31, 2016, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The 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 Laws. 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 ("D&T"), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for calendar years 2014 through 2016. A review and use of the Certified Public Accountants' work papers were made to the extent deemed appropriate and effective.

Representatives from the firm of KPMG LLP ("KPMG") were retained by the Division to assist in the examination by performing certain examination procedures at the direction of and under the overall management of the Division's examination staff. KPMG's Health Actuaries were involved in the performance of those procedures to the extent that such procedures related to the Company's reserves for unpaid claims and loss adjustment expenses and provider risk sharing settlements as of December 31, 2016.

KPMG's Information Technology Advisory Services personnel were engaged to review the Company's Information Technology environment to assist in determining the level of reliance to be placed on the information generated by the data processing systems.

SUMMARY OF SIGNIFICANT FINDINGS OF FACT

There were no significant findings identified during the examination.

COMPANY HISTORY

HPHC Insurance Company, Inc., a Massachusetts Corporation, is a wholly owned, for profit subsidiary of Harvard Pilgrim Health Care, Inc. ("HPHC, Inc.") a Massachusetts not-for-profit health plan. The Company was incorporated on September 27, 1991, and commenced underwriting accident and health risks on January 1, 1992. The Company underwrites health benefit plans for groups and individuals in Massachusetts, New Hampshire, Connecticut and Maine for Preferred Provider Organizations ("PPO") and Medicare products. The Company also administers comprehensive health benefit plans and underwrites excess risk coverage for certain self-insured employer groups. The Company also underwrites health risks related to out-of-network coverage for HPHC, Inc. members.

On November 9, 2016, the HPHC, Inc. Board of Directors approved certain changes to the Company's governance structure, which were approved by the Division of Insurance of the Commonwealth of Massachusetts on December 23, 2016. Effective January 1, 2017, HPHC, Inc. formed New HPHC Holding Corporation ("NEWCO") as a new wholly owned Delaware C corporation. All of HPHC's for-profit entities were contributed to NEWCO. NEWCO's Board of Directors consists entirely of HPHC, Inc. management.

The Company received \$22 million, \$40 million and \$75 million capital contributions from HPHC, Inc. during years 2014, 2015, and 2016 respectively.

MANAGEMENT AND CONTROL

Board of Directors Minutes

The minutes of meetings of the Board of Directors ("Board") and its Committees for the period under examination were read and they indicated that all meetings were held in accordance with the Company's bylaws and the laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at meetings of the Board.

Articles of Organization and Bylaws

The articles of organization and bylaws of the Company were reviewed. There were no changes to the articles of organization or the bylaws during the exam period.

Board of Directors

The affairs of the Company shall be managed by the Directors who shall have and may exercise all the powers of the Company. At the annual meeting of stockholders, such stockholders as have

HPHC Insurance Company, Inc.

the right to vote for the election of Directors, shall fix the number of Directors at not less than five, and shall elect the number of Directors so fixed.

At December 31, 2016, the Company's Board was comprised of five persons, which is in compliance with the Company's bylaws and the General Laws of Massachusetts.

The members of the Board at December 31, 2016, are as follows:

<u>Director</u>	<u>Title</u>
Charles R. Goheen	Chief Financial Officer and Treasurer Harvard Pilgrim Health Care, Inc.
Tisa K. Hughes	Chief Legal Officer and Clerk Harvard Pilgrim Health Care, Inc.
Eric H. Schultz	President and Chief Executive Officer Harvard Pilgrim Health Care, Inc.
Michelle J. Clayman	Assistant Treasurer Harvard Pilgrim Health Care, Inc.
Beth A. Roberts	SVP Enterprise Sales & Marketing Harvard Pilgrim Health Care, Inc.

Officers

The Company's officers consist of a President, Treasurer, Clerk and such other officers, if any, as the Directors may determine. The Clerk shall be a resident of the Commonwealth of Massachusetts unless the Company has appointed a resident agent to receive service of process.

The officers of the Company at December 31, 2016, are as follows:

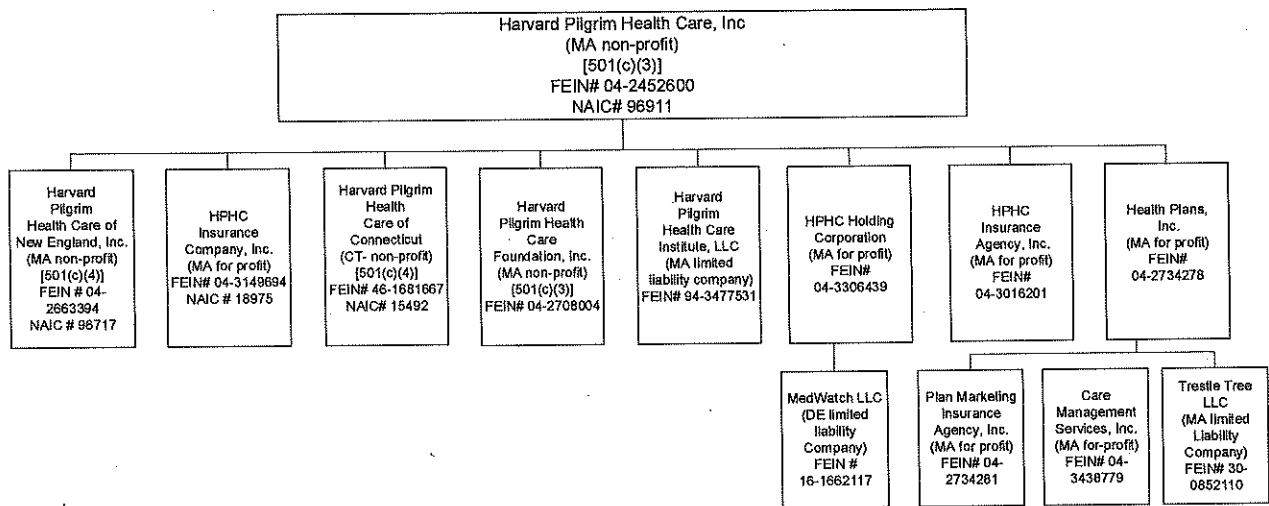
<u>Officer</u>	<u>Title</u>
Eric H. Schultz	President & Chief Executive Officer
Charles R. Goheen	Chief Financial Officer and Treasurer
Tisa K. Hughes	Chief Legal Officer and Clerk

Affiliated Companies

As stated in the Insurance Holding Company System Form B, Form C and Form F 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. HPHC, Inc. is the "ultimate controlling person" of the Holding Company System.

HPHC Insurance Company, Inc.

Organization Chart



Transactions and Agreements with Subsidiaries and Affiliates

Guaranty and Indemnity Agreement

The Company, HPHC, Inc., and Harvard Pilgrim Health Care of New England, Inc. participate in a Guaranty and Indemnity agreement ("G&I Agreement"). In 2014 the agreement was amended to include Harvard Pilgrim Health Care of Connecticut, Inc. Under the terms of the G&I Agreement, each entity guarantees the payment and performance of the other. In addition, each entity is jointly and severally liable for all obligations that may arise out of this G&I Agreement. The Company has no contingent liabilities related to the G&I Agreement as of December 31, 2016.

Administrative Services Agreement

The Company has no employees and, accordingly, HPHC, Inc. provides all administrative services to the Company, including premium collection, claims payments and operational management. Administrative expenses are allocated to the Company based on HPHC, Inc.'s departmental cost allocation methodology.

Health Plans, Inc. ("HPI"), a wholly owned subsidiary of HPHC, Inc., administers a certain product on behalf of the Company. HPI performs administrative functions associated with the product including enrollment, premium billing, and claims adjudication. The Company pays a per-member per-month ("PMPM") fee to HPI for the services performed.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in four states; Connecticut, Maine, Massachusetts and New Hampshire. The Company reported \$395 million of 2016 direct premium written in Massachusetts.

Treatment of Policyholders – Market Conduct

During the course of the examination, a general review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to members and claimants. This review was limited in nature and was substantially narrower than a full scope market conduct examination. No significant adverse practices were identified.

REINSURANCE

The Company carries reinsurance against excessive utilization on a per-member basis. Under the policy, the Company is reimbursed 100% of certain hospital inpatient, outpatient and pharmacy claims in excess of the policy deductible, which is \$1.5 million (except for Maine which is \$1.0 million). The maximum recoverable under the reinsurance agreement is \$5.0 million per member per policy period. The impact of reinsurance recoveries on the statutory financial statements was immaterial for the years under exam for all three entities.

HPHC Insurance Company, Inc.

FINANCIAL STATEMENTS

The following financial exhibits 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, 2016. The financial statements are the responsibility of Company management.

Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2016

Statement of Income for the Year Ended December 31, 2016

Reconciliation of Capital and Surplus for Each Year in the Three Year Period Ended December 31, 2016

HPHC Insurance Company, Inc.

Statement of Assets, Liabilities, Capital and Surplus As of December 31, 2016

	Per Annual Statement
Assets	
Bonds	\$184,338,273
Cash, cash equivalents and short-term investments	8,811,340
Aggregate write-ins for invested assets	1,407,392
Subtotals, cash and invested assets	194,557,005
Investment income due and accrued	830,249
Premiums and considerations:	
Uncollected premiums and agents' balances	27,239,118
Accrued retrospective premium and contracts subject to redetermination	4,719,694
Reinsurance:	
Amounts recoverable from reinsurers	18,621,736
Amounts receivable relating to uninsured plans	6,177,778
Receivables from parent, subsidiaries and affiliates	4,994,674
Health care and other amounts receivable	11,738,055
Total assets	\$268,878,309
Liabilities	
Claims unpaid	\$83,684,939
Unpaid claims adjustment expenses	1,102,514
Aggregate health policy reserves	65,801,448
Premiums received in advance	15,814,641
General Expenses due or accrued	11,923,177
Ceded reinsurance premiums payable	15,754,308
Amounts due to parent, subsidiaries and affiliates	37,857
Liability for amounts held under uninsured plans	4,149,243
Total liabilities	198,268,127
Common capital stock	1,067,000
Gross paid in and contributed surplus	162,334,000
Unassigned funds (surplus)	(92,790,818)
Total capital and surplus	70,610,182
Total liabilities capital, and surplus	\$268,878,309

HPHC Insurance Company, Inc.

Statement of Income For the Year Ended December 31, 2016

	Per Annual Statement
Member Months	<u>2,431,288</u>
Net premium income	\$749,171,443
Change in unearned premium reserves and reserve for rate credits	<u>25,330,455</u>
Total revenues	<u>\$774,501,898</u>
Deductions:	
Hospital/medical benefits	531,024,011
Other professional services	23,743,827
Outside referrals	16,667,248
Emergency room and out-of-area	7,532,200
Prescription drugs	132,724,962
Incentive pool, withhold adjustment and bonus amounts	<u>(2,741,785)</u>
Subtotal	<u>708,950,463</u>
Net reinsurance recoveries	<u>19,101,690</u>
Total hospital and medical	<u>689,848,773</u>
Claims adjustment expenses	34,561,846
General administrative expenses	102,967,657
Increase in reserves for life and accident and health contracts	<u>8,547,875</u>
Total underwriting deductions	<u>835,926,151</u>
Net underwriting gain or loss	(61,424,253)
Net investment income earned	3,619,123
Net realized capital gains less capital gains tax	<u>14,027</u>
Net investment gain	3,633,150
Aggregate write-ins for other income or expenses	<u>625</u>
Net income, after capital gains tax and before all other federal income taxes	<u>(57,790,478)</u>
Federal and foreign income taxes incurred	<u>0</u>
Net income	<u><u>(\$57,790,478)</u></u>

HPHC Insurance Company, Inc.

Reconciliation of Capital and Surplus For Each Year in the Three-Year Period Ended December 31, 2016

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Capital and surplus, December 31 prior year	\$51,797,279	\$51,135,227	\$42,016,355
Net income	(57,790,478)	(37,304,213)	(12,145,996)
Change in nonadmitted assets	1,603,381	(2,033,735)	(735,132)
Surplus adjustments: Paid in	75,000,000	40,000,000	22,000,000
Net change in capital and surplus for the year	<u>18,812,903</u>	<u>662,052</u>	<u>9,118,872</u>
Capital and surplus, December 31 current year	<u>\$70,610,182</u>	<u>\$51,797,279</u>	<u>\$51,135,227</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 the examination.

COMMENTS ON FINANCIAL STATEMENT ITEMS

As a result of the examination, no adverse findings or changes to the financial statements were identified.

The Company uses estimates for determining its claims incurred but not yet reported which are based on historical 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 estimated liabilities as the claims are ultimately settled.

KPMG Health Actuaries prepared independent estimates of the Unpaid Claim Liabilities (“UCL”) as of December 31, 2016 and prior periods. For December 31, 2016, 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 KPMG Health Actuaries, indicate that the Company’s UCL are reasonable as of December 31, 2016. The Company’s premium deficiency reserve calculation was reviewed and found to be reasonable as of December 31, 2016.

On January 1, 2014, the Company became subject to an annual fee under section 9010 of the ACA. This annual fee was allocated to individual health insurers based on the ratio of the amount of the entity’s net premiums written to the amount of health insurance for any U.S. health risk that is written during the preceding calendar year. A health insurance entity’s portion of the annual fee becomes payable once the entity provides health insurance for any U.S. health risk for each calendar year beginning on or after January 1 of the year the fee is due. In December 2015, the Federal Government passed a budget bill imposing a one-year moratorium on the collection of the annual fee for 2017. In April 2016, the NAIC adopted Interpretation 16-01: *ACA Section 9010 Assessment 2017 Moratorium*, to clarify that a reporting entity will need to accrue a liability on January 1, 2016 for the fee paid in September 2016, but that the monthly segregation of surplus and the liability recognition on January 1, 2017 will not be required. Accordingly, there is no estimated health insurance fee payable reflected in special surplus.

As of December 31, 2016, the Company has written health insurance subject to ACA assessment and expects to conduct health insurance business in 2017. The assessment is expected to have no impact on the Company’s risk based capital (“RBC”) due to the one-year moratorium on the collection of the annual fee for 2017 noted above.

SUBSEQUENT EVENTS

Effective January 1, 2017, HPHC, Inc. formed New HPHC Holding Corporation ("NEWCO") as a new wholly owned Delaware C corporation. All of HPHC, Inc.'s for-profit entities were contributed to NEWCO. NEWCO's Board of Directors consists entirely of HPHC, Inc. management.

On January 1, 2018, the Company will be subject to an annual fee under Section 9010 of the ACA. This annual fee is allocated to individual health insurers based on the ratio of the amount of the Company's net premiums written during the preceding calendar year to the amount of health insurance for any U.S. health risk that was written during the preceding calendar year. A health insurance entity's portion of the annual fee becomes payable once the entity provides health insurance for any U.S. health risk for each calendar year beginning on or after January 1st of the year the fee is due. As of December 31, 2017, the Company has written health insurance subject to the ACA assessment, expects to conduct health insurance business in 2018, and estimates its portion of the annual health insurance industry fee to be payable on September 30, 2018 to be \$12.4 million. This amount is reflected in special surplus. This assignment is expected to impact RBC by 45.1 percentage points. Reporting the ACA assessment as of December 31, 2017, would not have triggered an RBC action level.

In February 2018, the Company signed a partial settlement agreement with the Massachusetts Department of Revenue for the years 2011 through 2013 premium tax abatement refunds and received a \$6.6 million payment. This was not recorded for the year ended December 31, 2017, or in earlier financial statements as this represented a gain contingency and, therefore, has been recognized in February 2018.

In May 2018, certain media outlets reported that Harvard Pilgrim Health Care, Inc. and Partners Healthcare, Inc. have been engaged in exploratory conversations regarding a potential alliance. As of the date of this Report, the Company has indicated that no agreement has been reached between the two parties.

SUMMARY OF RECOMMENDATIONS

There were no significant recommendations noted by the examination team for improvements in process, activities and/or controls that should be noted in this report.

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 KPMG LLP and the following Division examiners who participated in this examination hereby is acknowledged:

Maria Gannon Supervising Examiner

Quangping Wei Examiner III

A handwritten signature in cursive script, reading "R. J. Ciaramella, Jr.", written over a horizontal line.

Raffaele J. Ciaramella, Jr., CFE
Supervising Examiner & Examiner-In-Charge
Commonwealth of Massachusetts
Division of Insurance