STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE

IN THE MATTER OF:	)	Case No: C2011000036
Local Government Center, Inc., et al.	)	

BUREAU OF SECURITIES REGULATION'S REQUEST FOR FINDINGS OF FACT AND RULINGS OF LAW

NOW COMES Petitioner, the New Hampshire Bureau of Securities Regulation (the "Bureau" or the "Petitioner"), through counsel Bernstein, Shur, Sawyer & Nelson, P.A., and respectfully requests that the Hearing Officer make the following Findings of Fact and Rulings of Law.

A. Rulings of Law

1. R.S.A. 5-B:5 requires that each separately formed pooled risk management program have its own independent board of directors and set of bylaws. *See* R.S.A. 5-B:5, I(b) & (e).

2. Local Government Center HealthTrust, LLC operates a single, distinct pooled risk management program for purposes of R.S.A. ch. 5-B.

3. Local Government Center Property-Liability Trust, LLC operates a single, distinct pooled risk management program for purposes of R.S.A. ch. 5-B.

4. A parent-subsidiary corporate structure where the parent company's board of directors purports to govern pooled risk management programs housed in single-member limited liability company subsidiaries violations the intent and meaning of R.S.A. 5-B:5.

5. A pooled risk management program under R.S.A. ch. 5-B may retain no more than the amount of net assets required to operate the risk pool, as established annually by an actuary. R.S.A. 5-B:5, I(c).

6. Stochastic modeling at a 95% confidence level is an appropriate actuarial calculation of required net assets for a pooled risk management program.

7. Member contributions to a pooled risk management program may not be used for purposes unrelated to the provision of risk coverage to the Members of the program.

8. Member contributions to a pooled risk management program may not be used to subsidize separate and distinct pooled risk management programs.

9. Benefits unjustly obtained from a pooled risk management program are held in a constructive trust. *See* Clapp v. Goffstown School District, 159 N.H. 206, 210-11 (2009).

10. Excess net assets must be returned to Members annually in cash, dividends or their equivalents. R.S.A. 5-B:5, I(c).

11. Participation Agreements in the Local Government Center Health Trust, LLC and the Local Government Center Property Liability Trust, LLC are securities under New Hampshire law. R.S.A. 421-B; *see* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

B. Findings of Fact

1. The LGC operates two risk pool management programs.

2. Michael Coutu has extensive experience as a banker and insurance run off specialist. HT 69-68 and 77.

3. "Runoff" requires intimate knowledge of the financial side of an insurance carrier and includes consideration of liquidity to pay claims as they come due and then enough surplus to avoid presumption of insolvency. HT 74.

4. Mr. Coutu also has experience relevant to his expert opinions related to his service as an appointed and elected official for the town of North Hampton. HT 98-100.

5. Mr. Coutu has experience with applying and understands the NAIC system of risk based capital. HT 88.

6. A company is deemed to be sufficiently capitalized if its RBC ratio is 200 percent or higher. HT 83. RBC at 200 is the same as an RBC of 2.0 *Id.*

7. A higher level may be used for insurers that fail to pass a trend test, in which case the required RBC is 300 or 3.0. HT 171-73. LGC Health Trust passes the trend test and, if an insurance carrier, would not be subject to the higher RBC level. *Id.*

8. If an RBC of 2.0 was used, LGC Health Trust risk pool management program maintained excess net assets of $43,706,000 in 2010. HT 220, Exh. BSR- 70

9. LGC's HealthTrust "claims manifestation period is generally two years or less." HT 134 *and see also* Exh BSR 69 at 836. Health insurance is a "very short tail line" of insurance coverage. HT 146. *See also* HT 1341-42.

10. Considering cash and cash equivalents of $52 million, HT 160, HealthTrust is over capitalized. Over capitalized means that there is more surplus on the balance sheet than what is necessary to support the financial operation known as HealthTrust. HT 160-61. Holding investments with durations longer than five years for a short tail line is "not necessary." HT 162.

11. Money held in investments of a duration beyond the claims cycle for Health Trust total approximately $35.7 million. HT 225. Subtracting $83.438 minus $35.7 means Health Trust should hold $47,700,000 in net assets based on a balance sheet calculation. HT 226. This equates to an RBC of 2.4. HT 229. *See also* Exh. BSR 71.

12. From 2003 through 2010 Health Trust transferred to the LGC Parent $31 million. HT 196-97. $18.3 million of this amount was used as a subsidy to the Workers Compensation program over the same time frame. HT 198.

13. About $2 million was transferred from Property Liability Trust to LGC Parent during the same time frame. *See* HT 200.

14. Howard Atkinson is an actuary specializing in healthcare work and is qualified to give an expert opinion in that area. HT 645-650.

15. Mr. Atkinson relied on the audited financial statements for his opinions. HT 654 Mr. Atkinson utilized an approach routinely used for the purpose of actuarially calculating required net assets for a health care insurance concern called "stochastic modeling." HT 654. The stochastic modeling completed by Mr. Atkinson involved a lot of input items specific to LGC Health Trust. *Id*.

16. In the healthcare insurance industry, it is common to use a confidence level of 90-95%. HT 656. Mr. Atkinson used the conservative end of the common range in that he used a 95% confidence level. HT 657.

17. When using a 95% confidence level, the remaining 5% could be off by as little as a penny and likely closer to a penny than a larger number. HT 657. Further the deviations within the 5% could be higher or lower that the actual projection of required net assets. HT 658.

18. Mr. Atkinson's expert opinion with respect to the Local Government Center Health Trust pool is that, for 2010, they held $86.8 million and "our analysis demonstrated that $41.4 would be sufficient, based on our analysis." HT 653. In his opinion, the term "sufficient" means "appropriate." *Id.*

19. Mr. Atkinson's actuarial calculation of a sufficient and appropriate quantity of net assets that should have been held by the Health Trust is reasonable based on his explanation and the information upon which he relied and is adopted by the Presiding Officer.

20. Mr. Atkinson is familiar with and understands the NAIC's RBC methodology for healthcare insurers and testified that an RBC below 2.0 results in a request for a plan for improvement. HT 659. The genesis for the NAIC's RBC approach is in stochastic modeling, HT 660, however the RBC approach is more conservative than stochastic modeling. HT 661.

21. A 95% confidence level of stochastic modeling approximates an RBC of 2.1.

22. Mr. Atkinson was familiar with and testified knowledgeably about the "law of large numbers" as it applies to healthcare insurers. HT 675-77.

23. The law of large numbers applies to LGC Health Trust. HT 675. HT 1364-65. HT 423-26.

24. The law of large numbers depresses the unit cost of health insurance as it applies to Health Trust. HT 1457-58.

25. The law of large numbers means that claims are more accurately predicted and decreases the need for net assets. HT 676-77.

26. The New Hampshire State Employees Benefits Plan is similar in size, plan design and membership to the LGC's Health Trust. HT 688-93. The State plan has never been required to dip into its reserves which are the equivalent of its net assets to pay unexpected claims or costs. HT 693.

27. Mr. Reimer, the actuary for the LGC HealthTrust, is very conservative in his claims and IBNR reserving practices. HT 682-85.

28. The LGC Health Trust, while maintaining an ostensible target of RBC 4.2 in 2010, changed its methodology for calculating the target resulting in a larger amount of net assets being required. HT 678-79.

29. The LGC Health Trust changed its method of computing its IBNR reserve for 2010 which should have resulted in a decrease in the added 10% margin, but did not decrease the margin. HT 685.

30. The 10% margin added to his IBNR calculation is analogous to a second reserve. HT 1347.

31. The LGC Health Trust changed its method of computing its administrative reserves for 2010 from holding 0.05% in net assets to holding $500,000. HT 170-71.

32. Health Trust member balance is free surplus not associated with reserves for claims. This was true in 1997 and is true now. HT 1526.

33. Peter Reimer, the LGC Health Trust's consulting actuary, has no experience with other risk pools. HT 1325. Mr. Reimer never made a study of capital assets or reserving practices of other risk pools before offering his expert opinion in this case. *Id.*

34. Mr. Reimer's analysis of Mr. Atkinson's opinions are inaccurate and unreliable. *See* HT 1294 and 1322.

35. The genesis for the LGC Health Trust's adoption of a target RBC of 4.2 is unclear, but appears to relate to the risk corridor retained by the program in the early 2000s. *See* HT 1259-63 and 1331-32.

36. The LGC's use of the RBC methodology is a means to "back-in" to a pre-determined amount of net assets and is not an actuarily determined amount of net assets required by the operations of the HealthTrust. HT 1335.

37. The LGC board never requested or relied upon an actuarially determined analysis of the net assets specifically required to support its risk pool management programs.

38. Peter Reimer never completed a specific analysis of the required net assets of the Health Trust risk pool management programs.

39. Per Mr. Reimer, a part of RBC deals with investment risk, but this could be addressed by buying less volatile investments. HT 1348

40. The LGC claims to mitigate its "credit risk by limiting investments to the safest types of securities and diversifying the portfolio." Exh BSR 69 at 348 (consolidated 2010 Financial Statement).

41. Per Mr. Reimer, a part of RBC deals with business risk, but this is largely irrelevant because he is aware of no New Hampshire municipality that has failed and therefore been unable to pay its bills. HT 1349.

42. The LGC's use of 0.5% for administrative expenses was not an "actuarial use of risk-based capital." HT 1330.

43. Mr. Reimer gives the study of Massachusetts based insurers "a lot of weight," HT 1316, but Mr. Reimer is unaware if Masschusetts carriers were subject to an RSA 5-B duty to return surplus. HT 1340-41.

44. John Andrews was the executive director of the LGC or its predecessor for 34 year, retiring in September 2009. HT 400

45. Mr. Andrews drafted the language that became RSA 5-B to confirm then existing risk pool practices. HT 409-10.

46. Mr. Andrews was unaware of any other risk pool using the parent subsidiary model at the time of the re-organization in 2003 and the LGC did not follow any risk pool when it adopted the model. Instead, the idea was from the LGC's lawyers. HT-506& 507.

47. Mr. Robert Lloyd was the lawyer with whom the LGC consulted at the time of its reorganization.

48. Although each entity had different interests at the time of the re-organization, Mr. Lloyd simultaneously represented the health and property liability programs and the NHMA.

49. Mr. Lloyd's representation of these entities was burdened by an ethical conflict of interest.

50. The former entities were re-organized by registrations in the state of Delaware in 2003 and, as evidenced by his signature on relevant documents, Mr. Andrews was aware of the filings in Delaware.

51. Mr. Andrews was further consulted about the Delaware filings in 2006 by Mark McCue, the attorney who replaced Mr. Lloyd.

52. Paul Genovese was hired by John Andrews by the New Hampshire Municipal Association approximately four years after Mr. Andrews was hired, HT 451, and after few years, Mr. Andrews was convinced that Mr. Genovese suggest to the board a split of the workers compensation program to form Comp Funds of NH, and that organization later became Primex. HT 451 Genovese then headed Primex. *Id*

53. Mr. Andrews felt personally betrayed by Mr. Genovese and called him "traitor" to the board. HT-452.

54. In 1997, Primex was almost exclusively a workers compensation program and Mr. Andrews heard it was planning to offer property and casualty coverage. HT 452 Mr. Andrews and his board considered that Primex was using member balances from workers compensation to subsidize property liability rates. *Id*. Mr. Andrews considered this activity clearly improper and described it as such to his board. HT 453 This was improper because "risks should be underwritten based on their merits, and not based on using other money to come in and buy market share…." HT 455

55. When Mr. Andrews and his board believed that Primex would enter the healthcare insurance field, the board worked with Rep. Wheeler to introduce legislation to strip Primex of its surplus because it considered the surplus to be an improper hoarding of public money. Exh BSR 22 and HT 472-76.

56. When the legislation failed, Mr. Andrews and his board decided to double the net assets of the Health Trust program to compete with Primex.

57. The Board specifically determined to use some of the increased net assets to subsidized LGC's workers compensation rates because workers compensation was one of Primex's strongest programs. HT 492.

58. The plan to subsidize the workers compensation rates originated with Jenny Emery HT 496-97 Peter Curro was present at the board retreat where this aspect of the strategic plan adopted. HT 497. Mr. Curro voted for subsidization, HT 498, and voted for annual subsidy payments thereafter. *Id.*

59. The workers compensation subsidy was less transparent than could have been. HT 501 The payments could have gone directly from Health Trust to workers compensation and could have been labeled a "subsidy" instead of strategic plan distribution.   HT 500-501.

60. The LGC has an inter-company loan policy that provides for interest on such loans, yet the loan adopted by the LGC board to repay the workers compensation subsidy does not provide for interest. HT 1542 Curro opposed a note to document the duty to repay the subsidy. HT 1543.

61. Members never voted to approve the workers compensation subsidy. HT 1537. The Board could have figured out a sufficient premium rate for workers compensation, but chose not to intentionally. HT-1538. The premium for workers compensation are deficienct. HT 1539-40. Premium deficiencies must be reported in the financial statements, but none are. Exh. BSR 69.

62. Members who want to buy insurance from LGC must belong to NHMA and pay dues to it.   HT 407-08.

63. The re-organized LGC cannot fill its 31 board seats.   HT 462-63. It has difficulty filling seats.   HT 544. There are currently only 26 board members.   HT 1881. There are currently problems with the level of engagement of board members at the LGC. HT 1877.

64. Maura Carroll was a member LGC's leadership team before becoming interim executive director and in that capacity provided advice and counsel to Andrews. HT 1825. A part of Ms. Carroll's job before becoming interim executive director was to watch accuracy of publications. HT 1828. This included the accuracy of Town and City magazine. Id. Nonetheless, when promoted to interim executive director, Ms. Carroll claims the Town and City magazine about her in terms of her being the former general counsel for the LGC were inaccurate. Ex 36 Ht 1856-57. Ms. Carroll is not credible in this regard.

65. Mr. Andrews duties as executive director were same as Ms. Carroll's duties. HT 1533. Audited financial statements are the responsibility of members of management including Ms. Keeffe and Ms. Carroll. HT 1535.

66. Although Ms. Carroll recommended action to repay the workers compensation subsidy, she never recommended action to reduce 4.2 RBC, HT 1842, to return member balance *Id*, to return surplus through means other than multi-year rate stabilization, HT 1843, and she never recommended separate boards or separate bylaws for the risk pool management programs. HT 1844.

67. However good or bad workers the finances of workers compensation currently are, the workers compensation program could not have gotten to its current status without the payment of subsidies over the years from 2004 through 2010. HT 1860.

68. The Health Trust pool contributed approximately 75% of the value of real estate at the time the LGC Real Estate, Inc. was created. The Property Liability pool contributed the remaining amount. Neither risk pool management program was compensated for its contribution.

69. All LGC entities are charged the lease rates which are less than fair market value. HT 1530-31. Health Trust is not given any financial benefit for having contributed its share of the real estate at the time of re-organization. HT 1038.

70. The Property Liability risk pool management program returned surplus as dividends in 2002-03, HT 1531, and switched later to rate credits. HT 1532

71. The Property Liability risk pool management program rate stabilization fund is surplus and was $3.1 million in 2010. HT 1533.

72. Over a 10 year history, Exh. BSR 48, HealthTrust returned only 2.72% of premiums as rate credits. HT 1031.

73. Rate crediting was explained to Mr. Bannon by Wendy Parker and she said it was pro rata. HT 1032. Based on her description of when rates were credited, there should have been a related decrease in net assets. HT 1034. Mr. Bannon did not find such a decrease. HT 1035.

74. Given the way that the Health Trust does its rate crediting, rates decreases may be intentionally offset by other factors. *See* HT 421.

75. By value, the LGC's investment are not compliant with Insurance Laws in an amount of 16.9%, HT 1052-53, and non-compliant with municipal laws in an amount of 17.8%. *Id.*

Respectfully submitted,
The Bureau of Securities Regulations
State of New Hampshire
By its attorneys,
Bernstein, Shur, Sawyer & Nelson, P.A.

Dated this 4th day of June, 2012

_______/s/ *Andru H. Volinsky*________
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Certificate

I hereby swear that the foregoing proposed findings and rulings was provided to counsel of record on the below service list electronically, this 4th day of June, 2012.

_______*/s/ Andru H. Volinsky*____