Expert Witness Report
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February 17, 2012
In Re: Case # C-3011000036

I. Background and Experience

I have had a 26-year career in property and casualty insurance. For most of that career, I served as the CEO and/or Chairman of the Board of insurance companies in financial distress arising from failed underwriting platforms, uncollectible reinsurance and/or mass tort and latent claims. The management of such companies became known in the US as "voluntary runoff" and provided regulators with an alternative to placing a failing insurance company in a formal proceeding of rehabilitation or insolvency.

My involvement with the insurance industry dates back to 1984. I was asked by American Express Company ("AMEX") to assist Fireman's Fund Insurance Company, then a wholly owned subsidiary of AMEX, in connection with a large surety and cash flow ("paid loss") property and casualty exposure to a Fortune 500 manufacturer of agricultural machinery which was teetering on bankruptcy. In early 1985, AMEX transferred me to Fireman's Fund on a full-time basis.

My initial involvement in insurance focused on financial guarantees issued in concert with tax-exempt municipal and revenue bond obligations and a mix of taxable and tax-exempt corporate structured financings ("Credit Enhancement Transactions"). Prior to giving effect to reinsurance, Fireman's exposure, based on the face value of guarantees issued and outstanding, totaled $26 billion measured against Fireman's then Policyholders' Surplus of $750 million. My mission was to substantially reduce Fireman's exposure. This led to the formation of Municipal Bond Insurance Corporation, successor to Municipal Bond Insurance Association, in which Fireman's was a 30% risk participant. Structured financings primarily involved low to moderate income housing, the construction of which was financed by savings and loan associations ("S&Ls"). The "long term takeout" of the construction loan was effected by issuing bonds through local housing authorities and similar agencies. Fireman's guaranteed repayment of these bonds. Fireman's exposure was reduced by "unwinding" the transactions through the application of collateralized securities pledged by the S&Ls against the guaranteed obligations. In addition to managing the Financial Guarantee Division, I also served as Fireman's Chief Credit Officer with overall responsibility for credit-sensitive insurance products including financial guarantees, performance sureties, retrospectively rated insurance products and ceded reinsurance.

Following the sale of Fireman's via an IPO in the fall of 1985, I joined the private investment firm of Glucksman & Company specializing in non-judicial restructurings and bankruptcy. My primary responsibility included advising corporations undergoing restructuring outside of a

Mr. Reimer has it correct; Ms. Keeffe does not. State regulated insurance companies be it life, property and casualty, or health insurers, properly record loss reserves as a liability on the balance sheet. Indeed, HT (as do the other LGC risk pools) follows this accounting practice and records reserves on its balance sheet as a liability.

As an example, HT recorded reserves on its financial statements for years 2008, 2009 and 2010, at $23.9 million, $23.6 million and $19.6 million respectively. The fundamental purpose of reserves is to provide for known and unknown (IBNR) losses. In contrast, net assets or surplus is intended to provide a cushion against insolvency for a variety of business risks including poor underwriting results, uncollectible reinsurance, investment losses, extraordinary claims and other business risks.

Indeed the risk of insolvency is borne by the members/participants not LGC and not Anthem. As in the case of stockholders of a corporation, they as stakeholders are the legal owners of the Risk Pools. That LGC serves as a holding company over the Risk Pools does not constitute legal ownership of such Pools. Thus, the member stakeholders own the risk pools, and if the risk pools were to be dissolved, the remainder net assets, if any, would be distributed to them after satisfaction of all liabilities and obligations. LGC's assertion that net assets are not surplus is a distinction without merit. HT has invested in securities well beyond its claims payout pattern; that is clear evidence that excess surplus exists.

Non-Financial Findings

- **LGC Bylaws as amended through December 15, 2011**

  - Board of Directors

    The Bylaws provide that LGC Board of Directors (the "Board") shall be comprised of 12 Municipal Public Officials, 12 School Public Officials, 6 Employee Officials and 1 County Public Official. In addition to serving as directors for the governance of LGC 's corporate interests, the Board also serves as the fiduciaries for the Risk Pools which do not have separate boards or trustees. The requirements under Chapter 5 – B:5 (I)(b) clearly state that "Each pooled risk management program shall [B]e governed by a board the majority of which is composed of elected or appointed officials." (Emphasis added.) As currently constituted, LGC's Board does not meet the requirements of the aforementioned RSA. The inherent insurance characteristics of healthcare, property liability and workers' compensation are indeed separate risk management programs based on the underwriting requirements and claims adjustment protocols necessary to properly manage each such program.

    LGC's "one size fits all" approach may provide certain operating efficiencies but places in peril the fiduciary duties and obligations that a dedicated board (with respect to the Risk Pools) would be required to fully discharge as a matter of law.

Further, the current board construction is fraught with conflicts. The LGC Board's practice of pulling cash out in the form of distributions from HT to subsidize the losses in WCT, is a boldfaced example of the board's failure to meet its obligations to the members of the HT risk pool. Had HT had its own dedicated board or trustees, it is reasonable to conclude that such board would not have approved $27.7 million in cash distributions from 2004 through 2010 to subsidize WCT which has been losing money since its formation in 2000 and which, absent the subsidies, would have been insolvent.

The breach of fiduciary duty is further exacerbated by the fact that the members of any specific LGC risk pool are not the same members in each of the three risk pools. If, for example, the members of the HT pool were also the same members as in the WCT pool, it might argued that the distributions from HT and the contributions to WCT benefited the members of each pool equitably. However, the members of each of the Risk Pools are not the same and their interests therefore are not aligned or identical.

LGC defends its practice of inter-pool transfer of cash as necessary to compete in the marketplace against other pool competition. Whatever may or may not be "good" for LGC, it does not necessarily follow that its actions are in the best interest of all pool members and the argument of competitive requirements does not relieve the Board of its fiduciary duties to the Risk Pools individually.

The mere fact that the aforementioned distributions from HT were made, in and of itself, makes the compelling point that excess earning and surplus existed within HT, and the failure to make dividend distributions to the members of HT pursuant to RSA Chapter 5 –B:5 (I)(c) is yet another breach of fiduciary duty .

Cash distributions made from HT and PLT to the Real Estate subsidiary -- primarily in 2008 totaling $3.5 million and the $4.5million non-cash distribution in 2003 for which HT and PLT received no consideration notwithstanding the payment of a substantial rental fee annually -- are further evidence of the Board's breach of fiduciary duty owed to the these two risk pools.

Lastly, on information and belief, LGC has served from time to time as an executive recruiting firm where it has assisted municipalities in finding qualified candidates to fill vacant positions, such as a Town Administrator and other positions, some of whom sit on LGC's Board. Such recruited professionals serving on the Board raises potential concerns with respect to the duty of loyalty to LGC versus the risk pool members who employ them. This conflict of interest may go beyond the notion of simply creating an appearance of a conflict.

- Dividends to Members

  Article V, Section 5.1 "Net Income to Accrue to Members" provides that net income shall accrue to the Members as it is earned. The bylaws further provide that "net income" shall be determined by the Internal Revenue Code of 1986. Section 5.2 provides for the method of allocation to Members of any net income declared by the Board. The two sections provide additional conditions with respect to the declaration of net income and its distribution to members.

  What is noteworthy about this provision of the bylaws is that it only provides for the possible distribution of net income to Members. It is absolutely silent on the obligation imposed under RSA 5-B:5(I)(c) which requires that each risk pool "return all earnings and <u>surplus</u> in excess of any amount required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions." (Emphasis added.)

  The bylaws limit the amount of money which could be returned to the Members. Net income is residue of revenues after giving effect to expenses. Surplus relates to the amount of Members' Balance or Net Assets on the balance sheet. On the basis of dollars, net profits generated in any given fiscal year pales in comparison to the amount of money in the surplus account, to wit: In 2009 and 2010, HT's operations resulted in a net loss of $13.2 million after a distribution to LGC of $4.4 million and a net profit of $7.3 million net of $3.9 million distribution, whereas the net assets were $79.5 million and $86.8 million in the year to year comparison. It appears that the bylaws seek to limit the amount which could be distributed to the member political subdivisions, in violation of the relevant RSA.

- Fairness and "Involuntary" Surrender of Economic Entitlement

  Section 4.8(a) of the bylaws provides that if "A Participant [Member] is terminated or withdraws from one or more Trusts (risk pools) [that Member] shall thereupon and at all times thereafter have no right to, or claim on, without limitation, any of the assets, income, distributions (whether past, present or future), reserves or property, whether or not then owned of after acquired, of the Trust from which it is terminated or withdraws." There is an identical provision if a Participant is terminated or withdraws from LGC.

  If a participant/member decides to withdraw from any of the Risk Pools, LGC or New Hampshire Municipal Association ("NHMA"), that Member forfeits any economic benefit it may have otherwise received had the Board timely paid a dividend to the relevant risk pool members arising from excess earnings and surplus. By not returning excess earnings and surplus where distributions could have been made to the members, the "forfeited" amounts serve to increase the Risk Pools' net assets which, among other things, contributes to the overcapitalization of the pools (principally HT), thus further enabling LGC to make inter-pool transfers of cash by taking form the strong and giving it to the weak (WCT).

Members who do not wish to sustain a potential economic impact with respect to contributions made to a risk pool are thus "forced" or "coerced" to remain participants of the Trusts, LGC and NHMA. Contributing to this notion of "perpetual" membership is the two-year "lockout" that is exacted should a participant cancel, terminate or withdraw from HT or is involuntarily terminated for not continuing as a participant in NHMA. Unless waived by the Board, any such member is "locked out" for two full years from the date of cancellation, withdrawal, termination or other cessation of participation in medical benefits coverage.

- Rate credits

  LGC argues that it is making and has made distributions to members with respect to excess earnings and surplus through a mechanism described as a "Rate Credit." LGC amended its bylaws in 2007 to provide that if the Board declares a distribution of net income "[s]uch return may be by means of the rating formula used to establish rates for each such program of coverage, and/or reduction in Contributions due in subsequent Fund Years or Pool Years unless such Member elects otherwise by notice." On the basis of information circulated by LGC and labeled "10-Year History of Surplus Applied as Rate Credits, 2002-2012," the data included in the exhibit for years 2003, 2007, 2008 and 2009 (medical) and for 2008 and 2009 for dental, indicates that LGC as applied $30.2 million as a rate credit against premiums of $1.1 billion for the same periods, representing a 2.72% reduction in what the rates would have been had the crediting feature not been applied. However, notwithstanding these de minimis actions to reduce rates, a rate crediting feature is not transparent nor reliable as to amount or timing and does not satisfy the provisions of RSA Chapter 5-B:5(I)(c) with respect to the return of excess earnings and surplus.

  Additionally and historically, the LGC provides premium quotes in two tranches: First, what is called the Guaranteed Maximum Rate or "GMR" which is provides that premium increases will not exceed that quoted as the GMR. Later in time and typically after the municipal budget process is completed, LGC provides the final or actual rate increase which rate will be the applicable rate in the following underwriting year coinciding with the new fiscal year budget. With few exceptions, the actual rate has been lower than the GMR causing the budget to be "artificially inflated" for the difference between the budgeted cost based on the GMR versus the actual cost. This has created a "windfall" in the budget in violation of the NH Municipal Budget law. When I served as a Select Board member for the Town of North Hampton, this issue was recognized and a non-lapsing fund was established and approved by the voters. This fund, the Healthcare Stabilization Account, is used to capture any windfall resulting from the difference between the GMR and the