STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE
BUREAU OF SECURITIES REGULATION

IN THE MATTER OF:	)	
	)	Case No.: C-2011000036
Local Government Center, Inc.; et al.	)	

LGC'S POST-HEARING BRIEF REGARDING COUNT II

Local Government Center, Inc. and related entities ("LGC") submits this Post-Hearing Brief concerning Count II of the Amended Petition. LGC also adopts the arguments concerning Counts I, and Counts III-V, in the briefs filed by Peter Curro and Maura Carroll.

I. INTRODUCTION.

In advance of the Hearing, LGC argued that the Count II charges brought by the Bureau of Securities Regulation ("Bureau") lacked legal merit, as the Bureau sought to impose a method for calculating reserves, and requirements regarding the return of surplus, absent from RSA 5-B.

Now the Hearing is complete, the evidence vindicates LGC. The Bureau failed to submit evidence that rebutted the Board's sound business judgment on these crucial issues of management of the risk pool program. Consequently, the Bureau's effort to penalize the entity and its Directors should be rejected. LGC's Board exemplifies an engaged, dedicated group of public officials, who sought at all times to comply with the statute while pursuing their mission to help the entity's Members provide better government at the least possible cost to the taxpayers. Their work should be applauded, not castigated.

II. RSA 5-B GIVES THE BOARD DISCRETION TO MANAGE ITS RESERVES, AND IT DID SO, EXERCISING SOUND BUSINESS JUDGMENT.

Count II alleges that LGC "used an inappropriate actuarial method for calculating reserves" under RSA 5-B:5, and that its level of reserves "exceeds prudent levels ...." (Am. Pet.

¶92.) The Bureau suggests a number of alternative actuarial methods and reserve level targets it believes LGC *could* have used, but RSA 5-B mandates no such particular methods or targets.

A. LGC Performed All the Mandatory Steps Required by RSA 5-B.

The statute has very few specific mandates. Regarding reserves, RSA 5-B:5, I(f) provides that a risk pool's governing board, in consultation with a qualified actuary, shall:

> [P]rovide for an annual actuarial evaluation . . . . The evaluation shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan. The annual actuarial evaluation shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated . . . .

The Bureau's actuary, Howard Atkinson, acknowledged that HealthTrust has satisfied these requirements: its actuary, Peter Reimer, is a member of the American Academy of Actuaries (Transcript of Administrative Hearing (hereafter, "Tr.") 753); HealthTrust conducted an annual actuarial evaluation (Tr. 753); and the evaluation assessed the adequacy of contributions required to fund the program, the reserves necessary to meet expenses of all incurred and incurred but not reported claims, and other projected needs of the plan. Tr. 753-759. Attorney McCue, LGC's corporate counsel, testified that LGC has complied with the requirements of RSA 5-B in setting its reserves. Tr. 1614.

B. The Statute Leaves to the Board the Method of Calculating Reserves.

The Bureau's actuary acknowledged that RSA 5-B "does not specify any specific actuarial method to calculate reserves." Tr. 707:15-19. He testified that, accordingly, a risk pool could use the risk-based capital approach, a Stochastic Model approach, a percentage of claims model, or a percentage of premium model. Tr. 707-08; *see also* Tr. 752 ("it is up to the actuary to choose one of the different methods to calculate reserves…"). Because RSA 5-B neither requires nor favors any particular method of calculating reserve levels, Atkinson's company was retained in 2010 to make a recommendation to the Legislature. Tr. 711. That recommendation is still pending. Tr. 713-14; 732.

Further, Atkinson confirmed that the Legislature knows full well how to set minimum and maximum reserve levels in a statute governing insurance-providing entities. Tr. 767; *see also* LGC Ex. 459. Indeed, legislation was introduced in 2010 to limit the level of reserves maintained by risk pools, but the proposed bill failed to pass. Tr. 737-738. In short, RSA 5-B, as it now reads, imposes *no* maximum reserve level on risk pools, and if the Bureau wished to require a specific method for calculating reserves and/or a maximum reserve level, it could have and should have done so via rule-making, or by seeking appropriate legislation.[1]

The open-ended nature of RSA 5-B's reserve requirement was underscored when the Bureau's counsel acknowledged that a key provision of the statute "isn't clear." During LGC's examination of the Bureau's actuary, Attorney Volinsky objected to a question about the reserves necessary to meet the plan's "other projected needs," a term found in RSA 5-B:5, I(f). "The statute isn't clear . . . I don't think there's anything else in the set of statutes that identifies that piece." Tr. 758. Indeed, the Bureau's own actuary admitted at the hearing: "I'm not sure what 'other projected needs' are" (Tr. 757), and agreed that "projected needs of the plan can include the net assets[.]" Tr. 758. If the "other projected needs" provision is so unclear that neither the

[1] *See* LGC's *Motion to Dismiss Count II of the Amended Petition on the Grounds that the Bureau of Securities Regulation Has Improperly Failed to Promulgate Rules under RSA 5-B, and the Statute Unconstitutionally Delegated Unlimited Legislative Authority to the Bureau and Is Unconstitutionally Vague.* LGC hereby reasserts and incorporates herein the arguments in that motion. To the extent that the Hearing Officer declined to grant the motion based on inferences he believed could be drawn at that preliminary stage of the proceeding (*see, e.g*., Order Dismissing Respondents' Motions to Dismiss and Dismissing Respondent Carroll's Motion for Summary Judgment at 15-16 ("[A] reasonable inference can be made that RSA 5-B:5, I (c) does not lack sufficient detail on its face . . . . [I]t can be reasonably inferred that it is within the BSR's administrative discretion to decide whether to address violations of RSA 5-B:5, I (c) through adjudication rather than through the rule-making process . . . .")), LGC requests that the Hearing Officer revisit the arguments, now that the evidence is in. The arguments advanced in LGC's dispositive motions are *legal* arguments, on which the role of the Hearing Officer is not to draw inferences, but to determine what the law requires.

Bureau's counsel nor its actuary understands what it means, and projected needs of the plan can include net assets as a component of reserves, LGC's board is fully justified in exercising its business judgment regarding those projected reserve needs – indeed, it has no alternative.

C. LGC's Board Exercised Its Business Judgment to Implement a Policy for Setting Reserves, Based on the Advice of Its Counsel and Consultants.

Under New Hampshire Law, the directors of a corporation must discharge their duties (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner they reasonably believe to be in the best interests of the corporation. RSA 293-A:8.30(a). Pursuant to the business judgment rule, there is "a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be 'attributed to any rational business purpose.'" *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993); *see also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373 (Del. 1995) ("The business judgment rule is a 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'"). The burden is on the party challenging an exercise of business judgment – here, the Bureau -- to rebut the presumption in favor of directors who have acted in good faith and with ordinary care. *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000). The business judgment rule thus "operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation." *Cede*, 634 A.2d at 360.

Under RSA 5-B, it falls to the Board of Directors—exercising their reasonable business judgment—to establish an appropriate reserve level. Tr. 323:8-13. The Bureau's own (putative) insurance industry expert, Michael Coutu, testified that "[i]t's their [the Board's] prerogative to set a [reserve] level they deem prudent." Tr. 323:3-4.

i. The Board was Fully Engaged in Setting Reserves.

Several witnesses testified that LGC's Board played a fully active role in exercising its discretion to set reserve levels. As Peter Riemer put it, "throughout the period that I've worked with HealthTrust, the board has been keenly interested in the question of how much surplus, how much capital should this organization hold." Tr. 1257-5-8; *see also* Tr. 1273:16-17 (capital adequacy has been "a continuous item of interest" to the Board, on which Riemer has made detailed presentations and provided regular updates); LGC Hearing Exhibit (hereafter "LGC Ex.") 177. LGC's Executive Director, Maura Carroll, agreed:

> [E]ach year when the board sets the rates, there is a determination of whether there is surplus, and the board makes the determination about the surplus being put into the rates to stabilize the rates. I think the board has had wonderful discussion about that. . . . They are fully aware of their responsibilities in the rate setting process about return of surplus, and it comes up every single time that the board sets rates.

Tr. 1842:9-22; *see also* Tr. 1185-89 (describing a robust, active Board); LGC Exs. 115, 119, 125 (discussing rate setting and return of surplus). Attorney McCue characterized the Board as being "very careful," focused on being "compliant with good corporate governance as well as [the] statute," and understanding the issues related to pooled risk management programs. Tr. 1369-71. According to Jenny Emery, an expert on risk pool practices who has worked with at least 30 different risk pools (Tr. 2165:14-20), LGC ranks at the top of all the pools she has worked with in terms of the engagement of its Board and the expertise of its management. Tr. 2170:3-10.

LGC's rate-setting process begins with staff level consultation with LGC's actuary and actuaries from Anthem and Caremark. Tr. 1398:6-1399:7. Recommendations are made to the Board's Finance Committee, where there is significant discussion and debate. Tr. 1404-1405; *see, e.g.*, LGC Exs. 115, 119, 125. A public hearing is held. Tr. 1405. The full Board then meets, and again discusses rates and the return of surplus. Tr. 1407-09. These meetings are "intense," with "often very differing opinions on the Board[.]" Tr. 1409:10-15; *see, e.g.*, LGC Exs. 66, 69, 84, 90 (minutes discussing rates, return of surplus, and risk). In addition to the statutory mandate, directors focus on this process, for many of them are political subdivision employees who must justify the rates once they return to their communities. Tr. 1409-1410.

ii. The Board Relies on Well Qualified Experts When Setting Reserves.

In discharging their responsibility and discretion to set reserve levels, the Board relies on the advice of legal counsel and outside experts. *See* Tr. 1573-74; RSA 293-A:8.30(b)(2)(in discharging his duties, a director is "entitled to rely on information, opinions, reports, or statements" prepared by "legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence . . . ."). LGC has an attorney at "every Board meeting and every committee meeting and at pertinent staff meetings" to ensure compliance with the law and to answer any questions Board members may have. Tr. 1567. Each year LGC's attorney reviews with the directors their statutory and fiduciary obligations under RSA 5-B, including the provisions pertaining to surplus. Tr. 1205-1206; *see, e.g.*, LGC Exs. 087, 112, 122, 130 (Board minutes wherein Attorney McCue discusses statutory and fiduciary obligations).

The Board relied on the recommendations and analysis of its actuary, Peter Riemer, in adopting an RBC ratio of 4.2.[2] Tr. 2340:8-11; *see, e.g.*, LGC Exs. 34, 36. "The ratio of 4.2 was selected after reviewing the level other health insurers maintain, the level used by the Blue Cross and Blue Shield National Association, as well as the RBC level of health insurers with similar asset levels to LGC HealthTrust." Bureau Trial Exhibit "BSR Ex.") 69/LGC Ex. 159 at 807.

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[2] Contrary to the Bureau's contention that the 4.2 RBC target was adopted in 2002 to double LGC's net assets, the 4.2 figure represents about 20% of claims, which had been HealthTrust's longstanding capital adequacy target. *See* LGC Ex. 34.

The Board arrives at a capital level by "looking at comparison groups of insurers and thinking about the particular characteristics of their operation and setting a level that they felt appropriate for the features of their program." Tr. 1256:13-16. Every year, the Board revisits the reserve level and affirms that it is the appropriate level for HealthTrust. Tr. 1616:6-14.

Riemer testified that the "target capital levels held by LGC are reasonable, prudent, and necessary for the successful operation of the program." Tr. 1252:13-16; *see also* Tr. 1317:13-14 (RBC 4.2 is "a reasonable, prudent target capital level"). In the view of risk pool practices expert Jenny Emery, the level of net assets held by LGC's HealthTrust—based on "a process that they have been through to set the target that has relied on benchmarks for other similar organizations"—is "reasonable" and "appropriate," and "seemed like a very sound policy."[3] Tr. 2280:12-20.

D. The Board Chose a Level of Reserves That is Consistent with Reasonable and Appropriate Business Judgment.

In using the RBC metric to set its reserves, LGC was travelling down a well-worn path. The Bureau's actuary, Atkinson, acknowledged that "RBC is the *de facto* standard for measuring the adequacy of reserves for health insurance entities." Tr. 752:3-6. The Bureau's industry expert, Michael Coutu, testified that RBC is a "perfectly acceptable method" for LGC to use in

[3] According to the Bureau, much of the capital held by LGC is "excess capital or surplus" because it is "held in instruments with maturities that far exceed the turn rate for health claims." (Am. Pet. ¶98.) The argument fails. While *claims reserves* (which exist to cover known liabilities) perhaps should be held in instruments with maturities that correspond to the time horizon on which the liabilities are expected to come due, *capital* is held to ensure the overall financial soundness of the company, and thus need not be invested in instruments that line up with specific anticipated liabilities. The Bureau's insurance industry expert conceded this crucial point at the hearing, agreeing that "the nature of capital adequacy is not dictated by duration or investments . . . ." Tr. 301-02; *see also* Tr. 302 (agreeing that "there is no linkage necessary between the amount and the investment in capital, whether it's got to be invested in securities of some specific duration"; Tr. 303:6-9 ("The investment period is not driven by the capital needs[.]"). This testimony by the Bureau's own expert disposes of the Bureau's complaint about the duration of LGC's investments.

determining the adequacy of its capital. Tr. 321:8-11. This should put to rest any question as to the propriety of LGC's decision to use the RBC method to set reserves.

The RBC level selected by LGC's Board is also eminently reasonable, as measured by industry standards. In 2002, in connection with LGC's adoption of the RBC method, Riemer "presented comparison data on levels that other insurers were holding, which were generally higher – much higher than 2.0 and certainly higher than the 4.20 that was provisionally adopted." Tr. 1262:23-1263:3. Mr. Coutu acknowledged that Blue Cross/Blue Shield has maintained an "RBC of 4 to 5, or in percentage speak, 400 to 500." Tr. 324:17; *see also* Tr.776 (surplus levels have produced RBC ratios for Blue Cross/Blue Shield plans in the range of 500 to 900 percent); Tr. 770, 781 (Milliman USA recommends maintaining capital of 20 to 25 percent of premium revenue; for accounting year 2010, LGC HealthTrust is at 21 percent).

Mr. Coutu acknowledged RBC ratios in Massachusetts are "600 to 700 percent." Tr. 325. Pennsylvania looks for RBC ratios to be in the range of 5.0 to 7.0. Tr. 1290; *see also* Tr. 741-72 (Pennsylvania study (LGC Ex. 355) found RBC of 5.5 to 7.5 is appropriate for nonprofit organizations). Peter Riemer testified that "Michigan has a maximum capital limit expressed as an RBC ratio [of] 10.0." Tr. 1290:6-7; *see also* LGC Ex. 269, Add. 1 (summarizing this data). A document created by the Bureau itself declares that an RBC of 4.2 "is not out of line with the range of RBC ratios used in other jurisdictions." Tr. 745:11-15; *see also* LGC Ex. 356 (*Study of the Reserves and Surpluses of Health Insurers in Massachusetts*). Rather, an RBC of 4.2 falls near the low end of the range cited in the testimony.

E. The Board's Manner of Choosing Its Reserve Level is Consistent with the Bureau's Agreement with PRIMEX.

The Bureau permits LGC's competitor to maintain the reserve levels it sees fit. *See* Tr. 1600; *see also* Risk Pool Agreement with PRIMEX, LGC Ex.334 § 3.4 ("Contingent Reserves shall be based for each coverage line on Risk Based Capital principles, at a target level not to exceed 3.0 *as determined by Primex*.") (Emphasis supplied). The Agreement is contractual, and its terms not statutorily mandated, testified Attorney McCue. Tr. 1599:16-18. The Bureau further permits the Board of PRIMEX to set a reserve level *above* RBC 3.0, based upon its sound business judgment. Tr. 1600-01; LGC Ex. 334 § 3.1. Attorney McCue testified that this treatment of reserves is consistent with RSA 5-B, "which puts the power and the responsibility to determine appropriate reserve levels in the Board of Directors after deliberation and actuarial analysis," and is also consistent with LGC's practices. Tr. 1601:11-16, 1602. The Bureau's agreement with PRIMEX, consistent with RSA 5-B, contradicts its case against LGC.

F. The 2010 Results Are Consistent with the Board's Target.

The Bureau alleges that "[e]ven using LGC's RBC method . . . LGC failed to return surplus funds accumulated above and beyond its chosen RBC of 4.2 . . . ." Am. Pet. ¶94. But the Bureau's actuary testified that the actual RBC for the last year that audited financials are available (2010) was 4.3—that is, just 0.1 above the target RBC of 4.2. Tr. 788:9-12. LGC submits that an actual RBC ratio of 4.3, after setting a target of 4.2, is a function of good luck and no large variances from predictions, not evidence of wrongdoing warranting the sanctions the Bureau seeks to impose.[4]

[4] The Bureau alleges that "the LGC Board Unrestricted asset fund, which was wiped out the year before regulation, was clearly surplus money that should have been returned to Members. When it became apparent that the Bureau would be given regulatory authority over LGC, this $25 million fund promptly consumed [sic]." Am. Pet. ¶96. The "Unrestricted asset fund" is identified as the "Net assets (deficit) Unrestricted" line on page 759 of HealthTrust's 2009 financial statement (LGC Ex. 158), which declined approximately $25 million from 2008 to 2009. The Bureau focuses on one line of many in the financial statements, ignoring the greater context. For example, contrary to the Bureau's insinuation of a scheme by LGC to spend away its assets, HealthTrust's "Total net assets" declined in 2009 by just $13 million, not $25 million (*see id*.). Further, HealthTrust sustained a $14 million loss in 2009, contributing to the diminished unrestricted assets. *See* LGC Ex. 158 at 760. Part of that loss was due to rate credits given to members, as a means of returning surplus. *See* LGC Ex. 301/BSR 69, at 733.

To the extent that actual RBC ratios may have exceeded the 4.2 target at other times in the past, Peter Curro explained that "the concept of RBC" is "a moving target," one that fluctuates with membership levels and claims experience (Tr. 2366-67); Peter Riemer testified similarly (Tr. 1286-8). To expect an insurance provider to hit its RBC target with perfect accuracy every year is to misunderstand the nature of insurance.

G. An RBC Near the Range of 2.0 is Inappropriate.

There was extensive testimony that an RBC ratio of 2.0 would be far too low to permit the LGC Board to fulfill its fiduciary duties to the organization. Such an RBC ratio -- 2.0 -- is understood in the industry as a "solvency trigger." (Tr. 1277:20). LGC's actuary testified:

> [A]t the inception of the RBC process [with LGC], I made it clear to the board in, first of all, talking specifically about that critical 2.0 measure, that that was in no way regarded in any quarter as adequate capital. That in fact, its whole genesis was as a regulatory alert to insurance departments. And so it had to be considered as just that. It's a level at which you don't want to be because it invites regulatory attention .

Tr. 1261:10-20; *see* LGC Ex. 34, p. 5. The Bureau's insurance expert agreed that the 2.0 RBC threshold was designed, not as a measure of prudent capital reserves, but as a level below which regulatory intervention would be triggered: "the presumption is that in an RBC of 200 percent *or better*, the regulatory community . . . would determine or conclude that the level of capital is sufficient." Tr. 88:16-19. The 2.0 RBC ratio is nothing more than a starting point for an analysis of appropriate capital levels; it is not a proper end point.

This was made clear at the Hearing by a document captioned "Regulatory Guidance on the Misuse of RBC in Ratemaking" adopted in 2008 by the National Association of Insurance Commissioners' Casualty Actuarial and Statistical Task Force, which declares:

> The Casualty Actuarial and Statistical Task Force wishes to re-emphasize its previous statements that capital levels indicated by the Risk-Based Capital (RBC)

> formula should not be used as, or assumed to be, measures of adequate capital. This would be an erroneous and therefore inappropriate use [of the RBC formula].

LGC Ex. 357. The Guidance observed that "[t]here seems to be a common and persistent misconception that … 200% [or an RBC ratio of 2.0] … is somehow a measure of 'adequate' capital." The 2.0 level "is frequently misconstrued as an 'adequate' surplus level that can be used to establish limits on permitted profit levels, surplus accumulation, or leverage ratios." *Id*.

The Regulatory Guidance sought to correct this "common and persistent misconception":

> It is appropriate to think of the capital level of 200% of the Authorized Control Level RBC requirement as the minimum capitalization level above which an insurer can operate without regulatory intervention . . . . It cannot reasonably be concluded, however, that this minimum level of capital is "adequate," because a very small decline in surplus could be enough to trigger regulatory intervention. There is no evidence that companies that are consistently operating at or near this surplus level are sound or that consumers would be well served by having this level as a regulatory goal. In fact, it would seem logical, in theory, that an adequate level of surplus would be one that would ensure that there would be a very low probability of insurer insolvency, and a relatively low probability that an adverse event or events could result in a reduction in a company's surplus to a level that would put it in an RBC action level.

LGC Ex. 357. As Peter Riemer explained, "[t]hey specifically say that there should be a very low probability that whatever your target capital is, your actual capital level is, there should be a very low probability that an impairment event, an adverse experience, would put you down at the 2.0 solvency trigger level. … [T]hey're saying you don't want to be anywhere near the trigger level." Rather, "you want to be … well above 2.0." Tr. 1283:20-1284:4, 10-11. *See also* Tr. 1284:12-17 ("Q. And so the State of New Hampshire would encourage an insurance company to be well above 2.0? … The NAIC would encourage insurers to be well above 2.0? A. Yes.").

Given that LGC is analogous in many respects to an insurance company, it is instructive that RSA 404-F ("Risk-Based Capital (RBC) for Insurers"), which establishes RBC thresholds for regulatory action in New Hampshire (*see* RSA 404-F:1, X), includes an express provision

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that "[a]n *excess* of capital over the amount produced by the risk-based capital requirement contained in this chapter . . . is desirable . . . ." RSA 404-F:2, IV (emphasis added). The statute declares: "Accordingly, insurers should seek to maintain capital *above* the RBC levels required by this chapter." *Id*. (emphasis added). "Additional capital is used and useful . . . and helps to secure an insurer against various risks inherent in, or affecting, the business of insurance and not accounted for or only partially measured by the risk-based capital requirements contained in this chapter." *Id*.; *see also* Tr. 1278:4-9 ("[T]he law itself states that 2.0 is . . . a minimum acceptable level of capital," and that "insurers would be expected to hold more than that level.").

The reasons a 2.0 RBC ratio is inadequate for an insurance company apply with even greater force to LGC. Peter Riemer explained that HealthTrust is "even more of what I call a closed system risk operation than even an insurance company," in that it "relies totally and entirely on its premium income and its assets to sustain itself." Tr. 1281:1-3; 8-10. Whereas insurance companies have "outside source[s] of capital," and there are "various other forms of relief" available to an insurance company, such as "a solvency or a state guaranty association," HealthTrust "has no such safety valve and so must operate entirely within its own pool of premium income and assets." Tr. 1281:11-18. Thus LGC could reasonably determine that its capital requirements *exceed* those of insurance companies offering the same coverages.[5]

In Riemer's view—and the view of the National Association of Insurance Commissioners (*see supra*)—the RBC ratio of 2.0 suggested by the Bureau is "simply too

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[5] By maintaining a RBC ratio above the minimum 2.0 threshold required to fend off regulatory intervention, LGC also saved its members money by avoiding the need to purchase reinsurance to guard against unexpected adverse events. *See* Tr. 1242:20-1243:9 ("We have had considerable discussion about lessening our dependence on reinsurance and taking on more of the risk ourselves. And what gives us the capability to do that is our asset base, our reserves . . . . [O]ver the long haul, that saves our members money," as it permits LGC to "use our asset base" to cover the "reinsurance issue and still retain the value of that asset base."); *see also* Tr. 2371:13-16 (LGC doesn't need aggregate stop loss today because "reserves are sufficient . . . in the long term [to] cover . . . what we might call catastrophic or major claims"); Tr. 2238-2243 (LGC has saved taxpayers millions of dollars by not having to purchase reinsurance); Tr. 1390-1391 (not purchasing reinsurance was determined to be a benefit to the members).

low" (Tr. 1289:8), and would "present[] a risk to the operation that's too great, that's inconsistent with the promises that LGC HealthTrust makes to its members when it issues coverage at given premium rates." Tr. 1289:9-12. The problem with an RBC ratio of 2.0 is that "it could be easily breached and, in some cases, possibly exhausted." Tr. 13-15. Riemer explained that the "level of adversity" a risk pool can withstand "if it's at 2.1" RBC is "virtually none. It might be called noise." Tr. 1295; *see also id*. ("The difference between 2.1 and 2.0 would amount to about a day and a half of claim payments. It's scant. It's nil. It's virtually no difference at all."). With RBC at 2.1, even a small miscalculation could cause LGC to quickly fall below the regulatory trigger. *Id*.

H. Using its Business Judgment, LGC's Board Chose an RBC of 4.2.

Rather than live on the edge of insolvency, LGC's Board made the prudent business decision—in line with what other insurers typically do (*see supra*)—to achieve a margin of safety by targeting an RBC ratio of 4.2. Peter Curro testified that an RBC of 1.0 "would mean you are basically insolvent"; 2.0 would mean "you are near insolvency"; "3 RBC is . . . you're okay, but you're . . . one step from getting into trouble"; 4.0 means "you're fine"; and "5 RBC is . . . where Anthem would like its affiliates to get to, for a variety of reasons." Tr. 2336-37. The Board chose 4.2 because it was an acceptable mid-point. Tr. 2339-40.

As the Bureau's industry expert acknowledged, "[o]ne of the things for which you set aside capital is for unexpected business risks." Tr. 306. As "unexpected business risks" are, by their nature, unexpected, LGC's former Executive Director John Andrews testified that risk "was a factor … that was built into the rates to take into account … any unforeseen circumstances or … surprises, or … things changing dramatically in the health field." Tr. 418-419. The idea was "to create a . . . surplus that you could rely on in an emergency." *Id*. The Bureau's own actuary concedes that it is "better to be conservative in making estimates," as with the setting of reserves. Tr. 721. LGC prudently erred on the conservative side because, in setting its rates and reserves, LGC is making a "$625 million bet" that it will have sufficient funds to cover its commitments. Tr. 1305.[6]

LGC's Enright offered further insight into LGC's conservative risk-management:

> I've lived through two sessions where banks have failed in my life. Insurance companies have failed. Recently we've all seen auto company bailouts. . . . I watched a report on Michigan, practically every city in Michigan's in receivership. . . . [E]verything was fine with the New Hampshire retirement system. It was a $4 billion program. And I woke up one morning and was told it's $2.4 billion underfunded . . . .
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> Undercapitalization, it seems to me, is one of the biggest problems that we have in this country. And so my perspective is that this company is not going to fail on my watch. That I am going to be conservative and that I should be conservative. When the weight on my shoulders is to make sure there's a reserve level that's adequate on a horizon for 70,000 people, I am going to be conservative. I'm not going to undercapitalize this company. . . .

Tr. 1197-1200. Given the razor-thin margin of error an RBC ratio of 2.0 would provide, Enright explained that if LGC were required to maintain an RBC of 2.1, "I do not think I could serve on that Board of Directors. I do not think I could fulfill my fiduciary responsibilities. They would be taken away from me." Tr. 1204. Confronted with this responsible, sound, prudent exercise of

[6] In response to the suggestion by the Bureau's actuary that a 95% degree of confidence in LGC's capital level is sufficient, Riemer testified that this standard implies "a 5 percent likelihood, the complement of 95 percent, that capital at that level would not be sufficient." Tr. 1293. Riemer explained:

> A. Well, if they're saying that 5 percent of the time that reserve is not sufficient, it means it's exhausted.
> Q. It means it goes away?
> A. It goes away. And that's an unacceptable probability of what might be called ruin, in the insurance industry.
> Q. Is that a technical term: ruin?
> A. It is. So as I understand Mr. Atkinson's 95 percent representation, it's basically expressing a 5 percent probability of ruin over some time horizon.

Tr. 1294. LGC submits that, as the representative of its members' interests, it was a reasonable exercise of its business judgment to decline to run a five percent chance of ruin.

judgment, the Bureau offered no rebuttal, instead inexplicably characterizing this prudence as a scheme concocted by LGC to "amass[] enormous wealth . . . ." Am. Pet. ¶ 92.

I. The Bureau's Proffered Industry Expert Has No Relevant Experience.

The Bureau's insurance expert, Michael Coutu, concludes LGC can operate with an RBC ratio of just 2.0. How does Coutu arrive at an opinion so at odds with the balance of the evidence in this case?

The explanation is that Coutu is a run-off specialist. *See* Tr. 77:16-18 (Coutu considers himself a run-off specialist); Tr. 283 (run-off has been his focus since 1992). In a run-off situation, Coutu acknowledged, the objective is not to plan for and maintain a sound insurance underwriting business over the long term, but simply "to have enough continuing surplus to avoid the presumption of being insolvent, requiring the regulatory domicile regulator from intervening into the business." Tr. 74: *see also* Tr. 284, 286. Rather than building a foundation for successful underwriting down the road, "the mission of a runoff is to curtail underwriting altogether . . . ." Tr. 77. Run-off skills differ from the skills required for "general underwriting and [to] service new business . . . ." Tr. 288:14-17. Coutu also conceded that "companies in runoff are . . . held to a less high standard than companies in underwriting." Tr. 288.

HealthTrust is not in run-off. Tr. 291. Not only is Coutu's experience limited to run-off situations, Coutu has no experience *at all* running health insurance companies. Tr. 292. As such, his opinions as to the management of an active health insurance operation are of questionable value. Indeed, when asked during the Hearing about the "Regulatory Guidance on the Misuse of RBC in Ratemaking," in which the National Association of Insurance Commissioners flatly declared that "[i]t cannot reasonably be concluded . . . that [an RBC ratio of 2.0] is 'adequate,' because a very small decline in surplus could be enough to trigger regulatory intervention[]" (LGC Ex. 357)—Coutu, the putative expert on the level of capital insurers should maintain, admitted this was the first time he had seen the document. Tr. 339.

In sum, while an RBC ratio of 2.0 may have been adequate for the companies Coutu worked for—non-health-related lines of coverage that were in run-off, and thus concerned simply with avoiding insolvency while winding down their businesses—nothing in his testimony suggests that an RBC ratio of 2.0 would be appropriate for an ongoing business such as LGC, or that Coutu himself has any relevant expertise on that topic.

J. Conclusion: As to the Level of Reserves, the Bureau Failed to Prove A Violation of RSA 5-B.

Given that the statute is silent on how to set reserves, LGC's Board of Directors had a duty to set reserves pursuant to its best business judgment. The Bureau's experts agreed. Based on the abundant evidence that LGC used an industry-standard method for setting reserves, and set them at a level that falls well within the range established by insurance providers and regulators around the nation, and the presumption created by the business judgment rule that directors have made business decisions on an informed basis and in good faith (*Unitrin*, 651 A.2d at 1373), LGC submits that the Bureau has utterly failed to meet its burden to prove that LGC violated RSA 5-B in its reserve policies. *See McMullin*, 765 A.2d at 916-17 (burden is on party challenging exercise of business judgment to rebut presumption in favor of directors who acted in good faith and with ordinary care); *Cede*, 634 A.2d at 361.

III. LGC CHOSE AN APPROPRIATE METHOD TO RETURN SURPLUS.

Count II alleges that LGC "failed to return surplus funds accumulated" as the statute requires. (Am.Pet. ¶94.) Contrary to what the Bureau suggests, RSA 5-B prescribes no specific method for returning surplus to members, and the evidence demonstrated irrefutably that LGC's members prefer surplus return in the form of rate reductions, as is and has been the practice of RSA 5-B risk pools in New Hampshire.

A. LGC's Members Prefer Surplus Return Via Rate Reduction.

LGC has been returning surplus to its members via rate reduction since 1996. Tr. 1487-88; *see also* Tr. 817:8-15 (since at least 1999 HealthTrust's bylaws have said "return may be by means of reduction in contributions due in the subsequent fund year unless such member elects otherwise by notice"). LGC's members prefer this, as LGC's Executive Director testified: "The information that I had received both from members of the board and members of local officials in our member communities was that … our members … saw the benefit of returning surplus through rate stabilization. I saw no need, nor was I asked by any member, to suggest otherwise." Tr. 1843; *see, e.g.,* LGC Ex. 125, p. 2. At one time HealthTrust's surplus was returned to LGC's members in the form of dividends, but as Peter Curro explained, "we were told by the members, don't ever do that again to us." Tr. 2380.

> [W]hen that [surplus] comes back in that form [dividends], the school district or town or whatever has to then go through a minutiae of calculations and determine what employees get what small dollar amount, and in this case issue about 150 checks for small dollars to go back to the employees. That was one of the reasons that the members said that's – that's not going to help us. . . . [T]hey would much rather have it as a rate reduction or stabilization the following years to avoid what's termed as spikes . . . in the rates. And that makes it a whole lot easier . . . in the budgeting process going forward . . . .

Tr. 2381; *see also* Tr. 1446-47 (rate stabilization benefits members). The Bureau failed to offer any contrary evidence.

B. Returning Surplus by Rate Reduction is Appropriate Under RSA 5-B.

LGC's corporate counsel analyzed RSA 5-B and its legislative history, and opined in writing concerning the proper method of returning surplus/member balance; he testified that RSA 5-B is silent as to how and when surplus is to be returned. Tr. 1616-1617; LGC Ex. 381;

Tr. 2379. Indeed, RSA 5-B does not even define "surplus." Tr. 1604. Attorney McCue advised LGC that returning surplus via rate credits over multiple years was consistent with RSA 5-B, and risk pool practices around the country. Tr. 1616-1620; *see* LGC Ex. 381.

Based on this advice, LGC's Board opted to return surplus to members over multiple years via rate reduction, Tr. 2381, consistent with other risk pools across the nation, Tr. 1605, and consistent with the practices of its competitors. *See, e.g.,* LGC Ex. 323, at 25; s*ee also,* Risk Pool Practices Agreement between the Bureau and PRIMEX (LGC Ex. 334) ("Primex believed it complied with RSA Ch. 5-B's provisions concerning surplus by choosing to return … surplus to members in the form of cash, and in recent years, Crediting Rates.")(§3.0); Tr. 1605. In the Risk Pool Practices Agreement, the parties agree that Primex will implement "the Bureau's *preferred* surplus return methodology" (emphasis added) – something called the "Premium Holiday" method (§ 4.0) – but nothing in the Agreement indicates that this "preferred" methodology is *required* by RSA 5-B. LGC is at a loss to understand how it could have violated RSA 5-B by failing to adhere to a method for returning surplus that is "preferred" by the Bureau, but not required by the statute.

The Bureau's own actuary's report further supports this method of returning surplus. Tr. 793; *see also* Segal Report (commissioned by the Bureau), LGC Ex. 360 at 9 ("Prudent underwriting would call for trying to achieve the reduction over multiple (2-3) years during the rate revisit process.").

Finally, the Bureau has not explained how it knows—or how LGC could have known—that LGC's method does not qualify as "[r]eturn[ing] … surplus" within the meaning of the statute. Am. Pet. ¶ 99. The statute lacks sufficient detail for the Bureau to charge LGC with having an illegal method for returning surplus, without having first promulgated rules to provide notice of its interpretation, or securing appropriate legislation on the topic. (*See footnote 1, supra.*) As the statute is silent on this point, LGC's Board exercised its business judgment regarding a mechanism for return of surplus, based on the advice of its counsel and consultants. The Bureau has failed to meet its burden to prove this violates the statute. *See McMullin*, 765 A.2d at 916-17; *Cede*, 634 A.2d at 361.

IV. LGC'S ADMINISTRATIVE COSTS ARE REASONABLE, AS CONCEDED BY THE BUREAU'S EXPERTS.

Count II alleges that LGC "improperly inflated its administrative costs . . . ." (Am. Pet. ¶95.) Once again, the evidence fails to support the Bureau's claim.

RSA 5-B:5, I(c) permits risk pools to retain "any amounts required for administration," but offers no definition of such. In determining those amounts "required for administration," the LGC Board was left to exercise its business judgment. The Bureau's actuary examined HealthTrust's administrative expenses and found them to be reasonable. Tr. 733-34. LGC's total administrative expenses were approximately 7.7 percent of claims, and he noted that the Bureau had recommended to the Legislature that risk pool administrative expenses be capped at "10 percent of total claims for each plan." Tr. 735. LGC's administrative expenses were more than two percent *below* the Bureau's proposed cap. Tr. 736.

Attorney McCue testified that LGC complied with RSA 5-B in setting a 0.5 RBC reserve for administrative expenses. *See* Tr. 1615 ("it's within the purview and within the obligation of a Board of Directors . . . to determine what administrative expenses are required to anticipate larger infrastructure improvements and have set-asides."). McCue explained that the Board appropriately reserved funds for ongoing projects, like replacing computers or supporting infrastructure. Tr. 1615; *see also* Tr. 1512-14. While in place, the reserve was fully disclosed to the membership. *See, e.g.,* LGC Ex. 301/BSR Ex. 69 at 687 and 707. Once the projects were complete, the reserve disappeared. Tr. 1514-15; c*ompare*, BSR Ex. 69 at 766, *with* 822.

Finally, the Bureau appeared to waive any complaint concerning the John B. Andrews Scholarship Fund. At no time was any member money ever used for the scholarship program. Tr. 1466-67; *see also* Tr. 1072-73, 1081. The Bureau also appeared to waive any complaint as to the real estate entity created for the benefit of all the pools, as it stipulated that the pools paid far below fair market value rent for the space they occupy in the building. Tr. 2296; Joint Ex. 3. The Bureau's expert, Coutu, offered no more opinion than that he could find no statement of consideration in the reports he reviewed, Tr. 213; Coutu conceded that the below market rent was an economic benefit to HealthTrust. Tr. 320-21.

V. THE STRATEGIC SUPPORT OF THE WORKERS' COMPENSATION POOL WAS A PERMITTED AND APPROPRIATE DECISION.

According to the Bureau, HealthTrust's strategic support to LGC's workers' compensation pool "unequivocally demonstrates that those funds were not needed to maintain a prudent reserve . . . ." Am. Pet. ¶ 97. This argument neglects the sound business conclusion by the Board that supporting the workers' compensation program was in the best interests of LGC's members. Such support was therefore an important and permissive use of available funds, not the dissipation of assets the Bureau perceives.

A. Both an Independent and a Joint Board Made the Business Judgment To Support the Workers' Compensation Pool.

The initial decision for HealthTrust to subsidize the workers' compensation program was approved by an independent HealthTrust board in 1999. (*See* LGC Exs. 3, 7.) That entity judged that such support was in HealthTrust's own best interests, based on (*inter alia*) the belief that PRIMEX was consistently denying legitimate workers' compensation claims, which then got passed on to HealthTrust and other health insurers (*see supra*). The HealthTrust board expected cost savings of 20 to 30 percent (*see* LGC Ex. 007, p. 4), or at least eight to fourteen percent. *See* LGC Ex.002, p.1).

When the Board of the reorganized entities initiated its strategic support of the workers' compensation pool in 2004, the primary provider of workers' compensation insurance was still PRIMEX. The perception remained that PRIMEX made a practice of denying workers compensation claims "in hopes that the … claim would then be funded through health insurance." Tr. 2351; *see also* Tr. 2392-93 ("it was frustrating to submit workers' comp. claims and then constantly getting them denied and denied. …[S]ome of them were clearly a workers' comp. and they would deny it and … it would go to the health insurer ...); *see, e.g.*, LGC Ex. 62 (minutes discussing PRIMEX business practices).

B. The Board saw a Benefit to <u>All</u> Members from an Integrated Approach.

The Board also viewed workers' compensation as part of the "long-term vision of integrated risk management and health management for employees." "Through a combination of Workers' Compensation programs, short and long-term disability benefits, and health benefits, LGC's members . . . essentially are financially responsible for the total health of the people they employ and their families." LGC Ex. 425. Pursuant to this approach, the Board "envisioned a strong, viable Workers' Compensation program to be an integral complement to the HealthTrust coverage with a resulting benefit to the health and welfare of employees and their families and to the finances of LGC members and their taxpayers." *Id*.

The decision to provide strategic support for the workers compensation program was part of a broader initiative by the Board to "focus[] on the benefits and efficiencies of integrated risk management and administration for all of the LGC coverage pools." LGC Ex. 425; *see also* LGC Exs. 62, 63, 67-8, 70. Key to this approach was the Board's recognition that, as one program with multiple risk pools, it had the flexibility and responsibility to administer a program that was best for all members. *See* Tr. 2196:9-13 ("They are one organization with one board, one set of bylaws, one formal participation agreement with a variety of different products and services that members could take advantage of at different times."); Tr. 2203 ("[E]verybody understood the efficiencies that could be achieved through one-stop shopping."); *see also* LGC Exs. 62, 63, 67-8, 70 (minutes discussing importance of workers' compensation to LGC members and mission). According to risk pool practices expert Jenny Emery, "those that have embraced an integrated philosophy to managing employee health would tell you that they know it has improved the health and productivity of their population and they would never go back." Tr. 2210-11. In fact, Emery testified:

> Q. Could and did the board conclude that the support and the growth and the progress in the workers' compensation program was good for all the members of LGC, whether not they were particularly purchasing workers' comp?
>
> A. Absolutely. They – they concluded that in part because they were told that by members who were not members of work comp. The preponderance of input from members were we like your products and services and we want you as an option in all of these areas.

Tr. 2224-25; *see also id.* at 2266 ("HealthTrust line of business got stronger during the same period of time that the workers' compensation program got stronger.").

By the end of the 2004 process, "the board came to a very clear conclusion that they owed it to their members to not only stay in the workers' compensation business but [to] embark on the right path to bring it to a point where . . . it would no longer be sustaining operating losses," and "could stand on its own." Tr. 2184:15-21; *see also* LGC Ex. 425 ("The addition of new members enhances the viability of the pools by allowing risks to be spread and managed across a larger population, and eventually will achieve the goal of self-sustainability for the Workers Compensation program.”).

For the Bureau to seize on the Board’s strategic support for the workers’ compensation program as evidence that the funds in question “were not needed to maintain a prudent reserve” improperly denies the Board the discretion to use its business judgment to design and run its programs within the broad parameters the statute sets. *See* Tr. 1625-27 (purpose of strategic support initiative was for LGC to become stronger and more efficient integrated entity, sharpen focus on wellness and prevention, and offer workers compensation program to its members.); LGC Ex. 3 at 2-3 (minutes of NHMA Health Insurance Trust Board of Trustees Meeting, July 13, 1999) (discussing potential benefits of an “Integrated Benefits Management program”); LGC Exs. 6 & 7 (same); Tr. 2182-84 & Exs. 67, 70, 72, 74 & 76 (detailing depth and scope of Board’s analysis of strategic support).

C. Stray Remarks Do Not Undercut the Overall Board Policy.

The Bureau charges improper motives on the part of LGC personnel, vis-à-vis LGC’s competitor, actually drove this policy. Supporting evidence for this charge was scant, at best. Instead, the evidence revealed a Board that knew healthy competition made LGC stronger. *See, e.g.*, LGC Ex. 30, p. 5 (“Keith Burke commented, ‘thank goodness for PRIMEX. They have kept us on the ball. It is good to have a competitor out there that we can balance against.’”). Former Executive Director John Andrews confirmed that, amongst the possible motivations for supporting the workers’ compensation program, “doing what was best for the members” trumped competition with PRIMEX or any personal conflicts. Tr. 1099-1100. Occasional stray comments in a vast documentary record – especially when contrasted with years of specific, transcribed decision-making -- do not evidence improper Board policy.

D. The Strategic Support Was Appropriately Disclosed.

BSR's financial examiner conceded that LGC's financial statements fully accounted for the funds that were transferred from HealthTrust and other entities to LGC, Inc., and then to the Workers' Compensation Trust. Tr. 1066-1068. Mr. Bannon also admitted that LGC's auditors confirmed that "the information within the financial statements were fairly stated in all material respects." Tr. 1062, 1079. The charge that support of the program was somehow improper conflicts with the thorough discussion and full public disclosure given the subject by the Board.

VI. THE BUREAU CANNOT SEEK PENALTIES FOR CONDUCT PRE-DATING JUNE 14, 2010.

Part I, Article 23 of the New Hampshire Constitution and New Hampshire common law prohibit the Bureau from imposing penalties stemming from conduct predating June 14, 2010, the effective date of RSA 5-B:4-a, as set forth in LGC's Motion to Dismiss Counts I & II of the Amended Petition to the Extent They Allege Conduct Which Occurred Prior to June 14, 2010. LGC hereby reasserts and incorporates those arguments herein.[7]

There are three key practical implications to the rule against retroactive legislation in this case. First, even if the Hearing Officer was somehow to conclude that transfers between HealthTrust and Workers' Compensation Trust were improper, sanctions cannot be imposed on LGC for transfers made before June 14, 2010.[8] Second, the Bureau cannot sanction LGC in connection with real estate transfers that were completed before that date. Third, if the Hearing

[7] To the extent that the Hearing Officer declined to grant that motion based on "inferences" he believed could be drawn at that preliminary stage of the proceeding, LGC requests that the Hearing Officer revisit the arguments. Whether RSA 5-B:4-a creates new obligations or requirements, or is substantive or procedural in nature, are legal questions for the Hearing Officer to decide based on the law, not based on inferences.

[8] The Bureau disputes the entire amount of support for the workers' compensation line of business. Only the amount of support provided to the program by HealthTrust after June 14, 2010 is subject to the Secretary's power to order disgorgement or restitution, however. While the *total* amount of 2010 support to the workers' compensation program was $3,360,780, *see* LGC Ex.305/BSR Ex. 69 at 1224, the Bureau established neither the particular entity which was the source of those funds, nor the amount that occurred subsequent to June 14, 2010.

Officer somehow concludes that LGC's capital levels were excessive, LGC cannot be sanctioned for excess capital levels that may have existed prior to June 14, 2010, and the Hearing Officer may look only to the level that existed on December 31, 2010.

VII. CONCLUSION.

For the foregoing reasons, and the reasons given in the briefs filed by Maura Carroll and Peter Curro, which are adopted herein as the arguments of LGC, the Hearing Officer should rule in favor of LGC on all Counts of the Amended Petition.

Respectfully submitted,
LOCAL GOVERNMENT CENTER, INC., et al.

By Their Attorneys:
PRETI FLAHERTY BELIVEAU &
PACHIOS, PLLP

Dated: June 4, 2012

By: __/s/ William C. Saturley ___________
William C. Saturley, NHBA #2256
Brian M. Quirk, NHBA #12526
P.O. Box 1318
Concord, NH 03302-1318
Tel: 603-410-1500
Fax: 603-410-1501
wsaturley@preti.com

CERTIFICATE OF SERVICE

I certify that on the 4th day of June, 2012, I filed two printed copies with the Office of the Secretary of State, and forwarded copies of this pleading *via* e-mail to all counsel of record.

______/s/ William C. Saturley__________