

Report  
of the  
Examination of  
First Commonwealth Limited Health Service Corporation  
Milwaukee, Wisconsin  
As of December 31, 2005

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Jim Doyle**, Governor  
**Jorge Gomez**, Commissioner

**Wisconsin.gov**

November 16, 2006

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Honorable Jorge Gomez  
Commissioner of Insurance  
Madison, Wisconsin

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

FIRST COMMONWEALTH LIMITED HEALTH SERVICE CORPORATION  
Milwaukee, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of First Commonwealth Limited Health Service Corporation (the company) was conducted in 2001 as of December 31, 2000. The current examination covered the intervening period ending December 31, 2005, and included a review of such 2006 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Provider Contracts
- Territory and Plan of Operations
- Affiliated Companies
- Growth of the company
- Financial Statements
- Accounts and Records
- Data Processing
- Enrollee Complaint Procedure
- Underwriting

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## II. HISTORY AND PLAN OF OPERATION

The First Commonwealth Limited Health Service Corporation is described as a for-profit individual practice association (IPA) model, limited service health organization (LSHO) insurer. A LSHO insurer is defined by s. 609.01 (3), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that makes available to its enrolled participants, in consideration for predetermined fixed payments, a limited range of health care services performed by providers selected by the organization." Under the IPA model, the company provides care through contracts with otherwise independent physicians operating out of their separate offices. LSHOs compete with traditional fee-for-service health care delivery.

The company was incorporated March 12, 1996, and commenced business June 17, 1996. The company is owned by First Commonwealth, Inc., (FCW) a Delaware corporation. The Guardian Life Insurance Corporation of America (Guardian) obtained control of the company pursuant to an Agreement and Plan of Merger between Guardian, Floss Acquisition Corp. and FCW. Guardian, acting through Floss Acquisition Corp., agreed to purchase all of the issued and outstanding stock of FCW for \$25 per share. Floss merged into FCW immediately after the sale of the shares.

The company entered into an administrative master contract with First Commonwealth of Illinois, Inc., (FCI) dated July 12, 1996, under which FCI agrees to provide the following services:

- Investigate and endeavor to resolve any and all complaints
- Contract with providers at appropriate locations
- Inform the company when providers terminate their contracts
- Negotiation of provider agreements and reimbursement terms
- Administer payments to providers
- Make covered services available to the company's members through the contracting provider selected by the member
- Quality assessment programs

The company is required to provide an eligibility list each month that specifies names and other identifying data for members for the succeeding month. The company has sole responsibility for determination of member eligibility.

As compensation for services provided the company pays the total of 1) all capitation amounts due to dentists for dental services and 2) an allocation of costs plus 10% incurred by FCI in administering the agreement. The capitation payment is due by the 30<sup>th</sup> day of each month prior to the effective date of coverage. Administrative costs are billed monthly and payment is due within 30 days. The company is responsible for payment for covered and approved services provided by non-contracting providers.

The contract was effective on June 17, 1996, and had a term of one year. The parties may renew the contract at the end of the term and by mutual consent modify its terms. Any such modifications are required to be in writing. FCI may terminate the agreement upon 30-day prior notice.

The company contracts with 115 general dentistry and specialty locations in southeastern Wisconsin. The company's products are designed to allow the enrollee to select the doctor of choice.

Providers maintain, at their cost and expense, an insurance policy providing coverage for provider's general liability and professional liability in the minimum amount of \$200,000 per claim and \$600,000 aggregate for general dentists and a minimum amount of \$1 million per claim for specialists, to protect the provider and provider employees, agents, or representatives.

Providers are compensated on a capitation basis for services rendered. FCI and the provider agree that in no event (including, but not limited to, non-payment by or insolvency of the company) shall FCI or any provider have a right to bill members for covered services. The member will be responsible for payment for non-covered services and applicable co-payments.

According to its business plan, the company's service area is comprised of the following counties: Brown, Dane, Kenosha, Milwaukee, Outagamie, Ozaukee, Racine, Walworth, Washington, and Waukesha.

The company currently markets to groups only. The company uses outside agencies and pays commissions of 10% for the dental HMO product and 7% for the point-of-service product for new and renewal business.

The company analyzes provider capitation rates and historical out-of-network utilization in premium determination. This rate is adjusted to reflect the age, sex, occupation, and coverage characteristics for new groups. Experience is reviewed for renewal groups and, based on this review, a recommendation is made regarding adjusting the rate or cancelling the group. The base rate is adjusted quarterly for inflation and other trending factors.

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of three members. Directors are elected at the annual meeting of the stockholders and hold office until his/her successor is elected and qualified. Officers for the board are elected at the board's annual meeting and hold office until his/her successor is elected and qualified. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

| <b>Name and Residence</b>                            | <b>Principal Occupation</b>   |
|--|---|
| Richard A. Goren, D.D.S.<br>Agoura Hills, California | Second Vice President, Group Dental<br>The Guardian Life Insurance Company of America       |
| Thomas A. McInteer, FSA<br>Bethlehem, Pennsylvania   | Vice President, Group Life and Disability<br>The Guardian Life Insurance Company of America |
| Karen G. Adams<br>Center Valley, Pennsylvania        | Actuary, Group Dental<br>The Guardian Life Insurance Company of America                     |

#### Officers of the company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

| <b>Name</b>              | <b>Office</b>  | <b>2006 Compensation*</b> |
|--------------------------|----------------|---------------------------|
| Richard A. Goren, D.D.S. | President      | \$240,095                 |
| Faith M. Drennan         | Secretary      | 136,924                   |
| Barry I. Belfer          | Treasurer      | 404,920                   |
| Andrew M. Kahn           | Controller     | 176,846                   |
| Salvatore Bondi          | Vice President | 264,362                   |

\* The officers' salaries are paid by The Guardian Life Insurance Company of America, through a management agreement with the company. The above represents the full officers' salaries as paid by Guardian.

The company has no employees. Necessary staff is provided through a management agreement between First Commonwealth, Inc., Dental Plan Administrator, and First Commonwealth Limited Health Service Corporation, effective July 10, 1996. The agreement is in effect until one party provides the other party 90-day written notification it wishes to terminate the

contract. The company grants First Commonwealth, Inc., the authority to supervise and manage day-to-day operations of the company's business.

First Commonwealth, Inc., is required to:

- Review the short-, medium-, and long-range objectives, formulating recommendations.
- Assure that the company complies with all governmental regulations.
- Apply for, obtain and maintain all licenses and permits required for operation.
- Prepare annual budgets that set out major operating objectives, anticipated revenue, expenses, and cash flow at least 60 days prior to commencement each fiscal year.
- Prepare a balance sheet and statement of revenue and expenses within 25 days of the ending of the month and 120 days following the end of the fiscal year.
- Deposit all money derived from operations in the company's accounts, including payments sent to First Commonwealth as part of the Group Master Contract for monthly billing charges. All payments necessary for operations will also be made out of the company's accounts.
- First Commonwealth of Illinois, a wholly owned subsidiary of First Commonwealth, Inc., will develop the company's dental network. Any claims arising from out-of-network providers will be adjudicated, processed, and remitted for payment on behalf of the company by First Commonwealth, Inc.

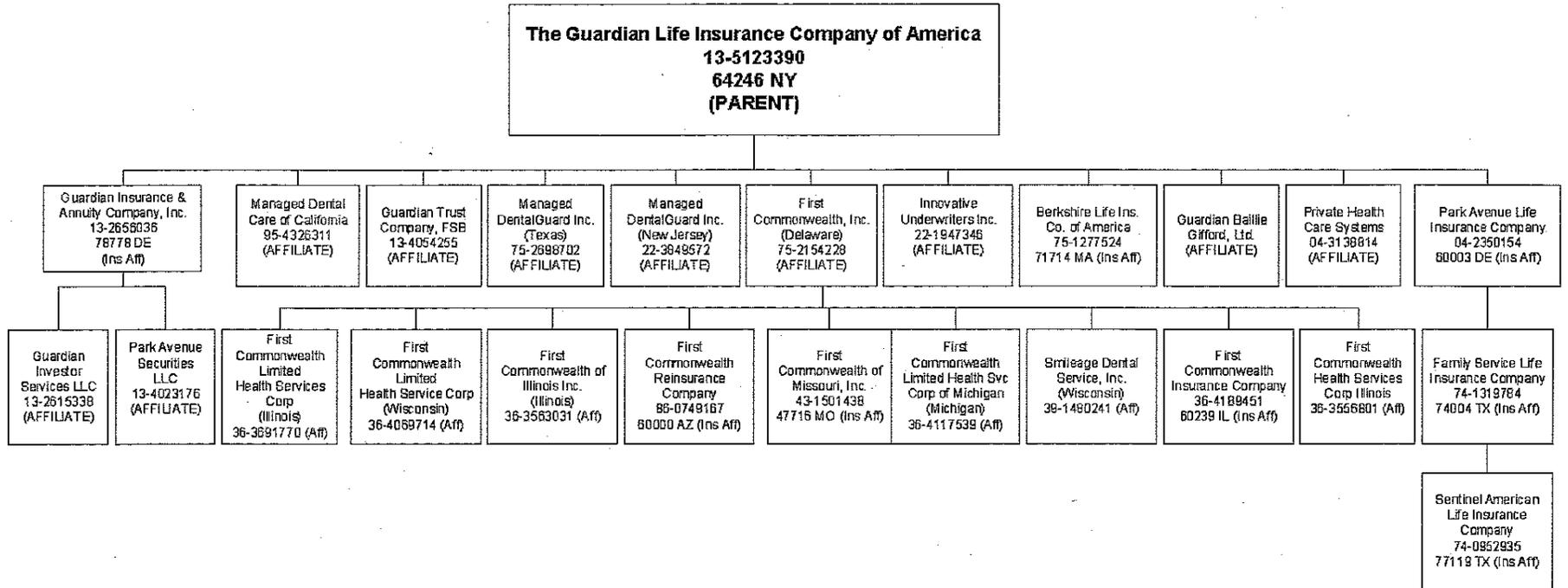
Compensation: Marketing and Sales-Related Fees – First Commonwealth's variable and fixed costs associated with marketing, solicitation, and enrollment of the company's members will be reimbursed at cost + 10% by the company. Variable costs include marketing commissions, marketing materials, and distribution of materials. Fixed costs include apportioned salaries, rent, development costs, and other miscellaneous costs.

Administrative Expenses – First Commonwealth's variable and fixed administrative costs will be reimbursed at cost + 10% by the company. Variable costs include data processing, postage, forms, supplies, etc., directly attributable to the company's members. Fixed costs include apportioned salaries, rent, development costs, and other miscellaneous costs.

#### **IV. AFFILIATED COMPANIES**

First Commonwealth Limited Health Service Corporation is a member of a holding company system. Its ultimate parent is Guardian Life Insurance Company of America. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of First Commonwealth Limited Health Service Corporation follows the organizational chart.

**Holding Company Chart  
As of December 31, 2005**



## **The Guardian Life Insurance Company of America**

Founded in 1860, The Guardian Life Insurance Company of America (Guardian) is the fourth largest mutual insurance company in the United States. Guardian and its subsidiaries provide life and disability income insurance, retirement services and investment products such as mutual funds, securities, variable life insurance and variable annuities. Guardian also supplies employee benefit programs including life, health and dental insurance, as well as qualified pension plans. As of December 31, 2005, Guardian's audited financial statement reported assets of \$24.81 billion, liabilities of \$21.65 billion, and capital and surplus of \$3.16 billion. Operations for 2005 produced net income of \$375 million.

### **First Commonwealth, Inc.**

First Commonwealth, Inc., (FCW) is a wholly owned subsidiary of Guardian that serves as a holding company for the group's dental insurance operations. FCW, through its subsidiaries, provides dental managed care, indemnity and dental PPO benefits to over 640,000 enrollees. As of December 31, 2005, FCW's GAAP audited financial statement reported assets of \$77.2 million, liabilities of \$5.3 million, and capital and equity of \$71.9 million. Operations for 2005 produced net income of \$87,000.

### **First Commonwealth of Illinois, Inc.**

First Commonwealth of Illinois, Inc., (FCI) is an Illinois third-party administrator. As of December 31, 2005, the unaudited financial statement of FCI reported assets of \$5.077 million, liabilities of \$927,000, and equity of \$4.15 million. Operations for 2005 produced net income of \$91,000.

## **V. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2005, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company for the period under examination. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Net Worth per Examination."

**First Commonwealth Limited Health Service Corporation**  
**Assets**  
**As of December 31, 2005**

|   | <b>Assets</b>             | <b>Nonadmitted Assets</b> | <b>Net Admitted Assets</b> |
|---|---------------------------|---------------------------|----------------------------|
| Cash, cash equivalents and short-term investments                     | \$2,897,961               | \$ 0                      | \$2,897,961                |
| Investment income due and accrued                                     | 3,027                     | 0                         | 3,027                      |
| Uncollected premiums and agents' balances in the course of collection | 1,267,407                 | 0                         | 1,267,407                  |
| Net deferred tax asset  | 7,561                     | 7,561                     | 0                          |
| Receivables from parent, subsidiaries and affiliates                  | <u>505,655</u>            | <u>505,655</u>            | <u>0</u>                   |
| <b>Total assets</b>   | <b><u>\$4,681,611</u></b> | <b><u>\$513,216</u></b>   | <b><u>\$4,168,395</u></b>  |

**First Commonwealth Limited Health Service Corporation**  
**Liabilities and Net Worth**  
**As of December 31, 2005**

|   |                  |                           |
|---|------------------|---------------------------|
| Claims unpaid   |                  | \$ 134,647                |
| Premiums received in advance  |                  | 912,540                   |
| General expenses due or accrued                                     |                  | 21,805                    |
| Current federal and foreign income tax payable and interest thereon |                  | 85,743                    |
| Remittance and items not allocated                                  |                  | 771                       |
| Amounts due to parent, subsidiaries and affiliates                  |                  | <u>77,150</u>             |
| <b>Total liabilities</b>  |                  | <b>1,232,656</b>          |
| Common capital stock  | \$ 1,000         |                           |
| Gross paid in and contributed surplus                               | 99,000           |                           |
| Unassigned funds (surplus)  | <u>2,835,740</u> |                           |
| <b>Total capital and surplus</b>                                    |                  | <b><u>2,935,740</u></b>   |
| <b>Total liabilities, capital and surplus</b>                       |                  | <b><u>\$4,168,396</u></b> |

**First Commonwealth Limited Health Service Corporation**  
**Statement of Revenue and Expenses**  
**For the Year 2005**

|  |                  |                   |
|--|------------------|-------------------|
| Net premium income                               |                  | \$11,065,686      |
| Fee-for-service [net of \$(1) medical expenses]  |                  | <u>6,109</u>      |
| Total revenues                                   |                  | 11,071,795        |
| Medical and hospital:                            |                  |                   |
| Other professional services                      | \$8,417,635      |                   |
| General administrative expenses                  | <u>1,709,759</u> |                   |
| Total underwriting deductions                    |                  | <u>10,127,394</u> |
| Net underwriting gain or (loss)                  |                  | 944,401           |
| Net investment income earned                     | <u>19,172</u>    |                   |
| Net investment gains or (losses)                 |                  | <u>19,172</u>     |
| Net income or (loss) before federal income taxes |                  | 963,573           |
| Federal and foreign income taxes incurred        |                  | <u>336,639</u>    |
| Net income (loss)                                |                  | <u>\$ 626,934</u> |

**First Commonwealth Limited Health Service Corporation**  
**Capital and Surplus Account**  
**As of December 31, 2005**

|   |                    |                    |
|---|--------------------|--------------------|
| Capital and surplus prior reporting year  |                    | \$3,579,157        |
| Net income or (loss)                      | \$ 626,934         |                    |
| Change in net deferred income tax         | (61)               |                    |
| Change in nonadmitted assets              | (269,740)          |                    |
| Dividends to stockholders                 | <u>(1,000,000)</u> |                    |
| Net change in capital and surplus         |                    | <u>(643,417)</u>   |
| Capital and surplus end of reporting year |                    | <u>\$2,935,740</u> |

**First Commonwealth Limited Health Service Corporation**  
**Statement of Cash Flows**  
**As of December 31, 2005**

|   |                  |                     |
|---|------------------|---------------------|
| Premiums collected net of reinsurance                                     |                  | \$10,957,997        |
| Net investment income   |                  | 17,184              |
| Miscellaneous income  |                  | <u>6,109</u>        |
| Total   |                  | <u>10,981,290</u>   |
| Less:   |                  |                     |
| Benefit- and loss-related payments  | \$8,482,438      |                     |
| Commissions, expenses paid and aggregate write-ins for deductions         | 1,760,074        |                     |
| Federal and foreign income taxes paid (recovered)                         | <u>84,005</u>    |                     |
| Total   |                  | <u>10,526,517</u>   |
| Net cash from operations  |                  | <u>454,773</u>      |
| Proceeds from investments sold, matured or repaid:                        |                  |                     |
| Net gains (losses) on cash, cash equivalents, and short- term investments | \$15,442         |                     |
| Total investment proceeds   |                  | 15,442              |
| Cost of investments acquired - long-term only:                            |                  |                     |
| Miscellaneous applications  | <u>15,442</u>    |                     |
| Total investments acquired  |                  | <u>15,442</u>       |
| Net cash from investments   |                  | 0                   |
| Cash provided/applied:  |                  |                     |
| Dividends to stockholders   | 1,000,000        |                     |
| Other cash provided (applied)   | <u>(352,148)</u> |                     |
| Net cash from financing and miscellaneous sources                         |                  | <u>(1,352,148)</u>  |
| Net change in cash, cash equivalents, and short-term investments          |                  | (897,375)           |
| Cash, cash equivalents, and short-term investments: Beginning of year     |                  | <u>3,795,337</u>    |
| End of year   |                  | <u>\$ 2,897,962</u> |

## Growth of the Company

The following schedules reflect the growth of the company during the examination period:

| Year | Assets      | Liabilities | Capital and Surplus | Premium Earned | Medical Expenses Incurred | Net Income |
|------|-------------|-------------|---------------------|----------------|---------------------------|------------|
| 2005 | \$4,168,395 | \$1,232,656 | \$2,935,740         | \$11,071,795   | \$8,417,635               | \$ 626,934 |
| 2004 | 4,978,420   | 1,399,264   | 3,579,156           | 10,823,232     | 7,550,578                 | 1,181,353  |
| 2003 | 3,389,153   | 1,366,117   | 2,023,036           | 10,463,814     | 7,595,905                 | 674,616    |
| 2002 | 3,157,839   | 1,395,588   | 1,762,251           | 9,839,457      | 7,973,117                 | 169,114    |
| 2001 | 2,996,046   | 1,319,503   | 1,676,543           | 9,221,060      | 6,725,936                 | 457,091    |
| 2000 | 2,411,225   | 1,157,385   | 1,253,840           | 9,987,312      | 7,453,153                 | 595,463    |

| Year | Profit Margin | Medical Expense Ratio | Administrative Expense Ratio | Enrollment | Change in Enrollment |
|------|---------------|-----------------------|------------------------------|------------|----------------------|
| 2005 | 8.5%          | 76.1%                 | 15.4%                        | 38,017     | -4.8%                |
| 2004 | 13.2          | 69.8                  | 17.0                         | 39,942     | -5.1                 |
| 2003 | 10.2          | 72.6                  | 17.2                         | 42,074     | 0.9                  |
| 2002 | 1.9           | 81.0                  | 17.1                         | 41,683     | -18.4                |
| 2001 | 6.0           | 73.0                  | 21.0                         | 51,100     | -12.0                |
| 2000 | 5.0           | 75.0                  | 20.0                         | 58,087     |                      |

### Per Member Per Month Information

|                                 | 2005           | 2004           | Percentage Change |
|---------------------------------|----------------|----------------|-------------------|
| Premium                         | \$23.73        | \$22.69        | 4.6%              |
| <b>Expenses:</b>                |                |                |                   |
| Other professional services     | 18.05          | 15.83          | 14.0              |
| General administrative expenses | <u>3.67</u>    | <u>3.86</u>    | -4.9              |
| Total underwriting deductions   | <u>\$21.72</u> | <u>\$19.69</u> | 10.3              |

The company's assets increased 73% to \$4,168,395 over the five-year period under examination while liabilities increased by 6% to \$1,232,656. Although the company paid a \$1 million dividend in 2005, capital and surplus increased 135% to \$2,935,740 over the five-year examination period. The company's enrollment has decreased 34.5% during the examination period largely due to reductions in employment in the manufacturing industry in Milwaukee. The company has remained profitable despite a drop in enrollment due to its risk transfer to contracted providers and improved claim experience with nonparticipating providers.

### Reconciliation of Capital and Surplus per Examination

There were no changes made to the company's December 31, 2005, capital and surplus balance of \$2,935,740 due to the examination; however, there were two adjustments made that had no impact on surplus. The following schedule shows the adjustments made:

|   | <b>Debit</b>     | <b>Credit</b>     |
|---|------------------|-------------------|
| Uncollected premiums and agents' balances in course of collection | \$               | \$906,279         |
| Premiums received in advance                                      | <u>906,279</u>   | <u>          </u> |
| Total reclassifications   | <u>\$906,279</u> | <u>\$906,279</u>  |

## VI. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were ten specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company conduct its annual meeting of the board of directors in accordance with its articles of incorporation.

Action—Noncompliance. Further comment on this finding can be found in the Summary of Current Examination Results section of this report.

2. Management and Control—It is recommended that the company have its corporate minutes signed by the appropriate corporate officials.

Action—Compliance

3. Management and Control—It is recommended that the company establish procedures for the annual completion of a conflict of interest questionnaire by the appropriate persons.

Action—Partial compliance. Further comment on this finding can be found in the Summary of Current Examination Results section of this report.

4. Management and Control—It is recommended that the company file biographical information for any newly appointed officer or director within 15 days of such appointment as required by s. Ins 6.52, Wis. Adm. Code.

Action—Noncompliance. Further comment on this finding can be found in the Summary of Current Examination Results section of this report.

5. Financial Reporting—It is recommended that the company respond promptly to OCI inquiries as required by s. 601.42 (4), Wis. Stat.

Action—Compliance

6. Financial Reporting—It is recommended that the company amend the 2000 annual statement so that the balances reported in the prior year columns agree to those reported in the 1999 annual statement.

Action—Compliance

7. Financial Reporting—It is recommended that the company include capitation payments in Schedule H and the Underwriting and Investment Exhibit – Part 2 of the NAIC Annual Statement in the future.

Action—Compliance

### Compliance with Prior Examination Report Recommendations (cont.)

8. Financial Reporting—It is recommended that the company classify payments made to intermediaries on the appropriate line in Schedule L of the NAIC Annual Statement in the future.

Action—Noncompliance. Further comment on this finding can be found in the Summary of Current Examination Results section of this report.

9. Cash and Short-Term Investments—It is recommended that the LSHO comply with ch. 177, Wis. Stat., as regards unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

Action—Compliance

10. Cash and Short-Term Investments—It is recommended that the company report the gross amount of interest earned on Schedule E and report bank fees as an expense in Part 3 of the Underwriting and Investment Exhibit of the annual statement.

Action—Compliance

## **Summary of Current Examination Results**

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

## **Management and Control**

The company's articles of incorporation require the company to present a full and clear statement of business and condition of FCW at each annual meeting. The previous examination report disclosed that the company was not performing this required task. The current examination noted that the minutes of the annual meetings did not reflect that the company's board was reviewing the required information. It is again recommended that the company conduct its annual meeting of the board of directors in accordance with its articles of incorporation.

The examination noted that the board of directors of the First Commonwealth Limited Health Service Corporation is not reviewing the financial performance and stability of the company, not approving material transactions, and not approving material agreements with affiliates. Section 611.51 (6), Wis. Stat., states that the board of directors shall manage the business and affairs of the company. It is recommended that the board of directors meet on a quarterly basis, actively manage affairs of the corporation, and maintain meeting minutes to document the board's active governance in accordance with s. 611.51 (6), Wis. Stat.

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation of the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted a procedure for disclosing potential conflicts of interest; however, company personnel was unable to produce signed conflict of interest questionnaires for 2001 and 2002 to indicate that this is performed annually. It is again recommended that the company establish procedures for the annual completion of a conflict of interest questionnaire by the appropriate persons.

Section Ins 6.52 (5), Wis. Adm. Code, requires insurers file biographical information with respect to the appointment or election of any new director, trustee or officer elected or appointed within 15 days after such appointment or election. The company did not file the required information for directors appointed in 2006. It is again recommended that the company file biographical information for any newly appointed officer or director within 15 days of such appointment as required by s. Ins 6.52, Wis. Adm. Code.

### **Financial Reporting**

The examination noted that the company does not pay providers directly. The company is paying provider capitation through First Commonwealth of Illinois (FCI). FCI meets the definition of an intermediary for the purposes of annual statement reporting and payments made by the company should be reported on Exhibit 7-Part 2, which has been designated for payments to intermediaries. The previous examination noted this and recommended that the company correct this reporting. The company failed to comply with the recommendation. It is again recommended that the company classify payments made to intermediaries on Exhibit 7-Part 2 of the annual statement in the future.

### **Agent Listing**

The examination's review of the company's agent listing against the listings filed with the Office of the Commissioner of Insurance (OCI) noted that the company's listing had agents with a different last name. The company should maintain an accurate agent listing that includes the correct license number, agent name, appointment date, and residency in order to monitor its agents in an effective and efficient manner. It is recommended that the company establish and implement procedures to ensure that its agent listing is complete and accurate.

### **Premium Reporting**

The examination noted that the company is reporting \$906,279 in premium accounts billed in December but not due until January as an asset in Uncollected Premiums and Agents' Balance In Course of Collection and also as an offsetting liability in Premiums Received in Advance. Per SSAP No. 4, one characteristic in the definition of an asset is that the transaction giving rise to the entity's right to or control of the asset must have already occurred. Since the

premium is for January coverage, the right to control the asset has not taken place and therefore should not be recorded as an asset. Accordingly, the company should not be reporting the offsetting liability since the premium has not, in fact, been received. An adjustment was made to reduce the asset by \$906,279. Another adjustment was made to remove \$906,279 from premiums received in advance. It is recommended that the company discontinue the practice of including premium billed in advance as Uncollected Premium and Agents' Balances In Course of Collection in future annual statements.

### **Unpaid Claim Reserves**

The examination's review of the company's unpaid claims reserves noted that the company reported their claims paid as of December 31 of the prior year incorrectly on the Underwriting and Investment Exhibit – Part 2B Analysis of Claims Unpaid Prior Year of the annual statement. The purpose of the exhibit is to show the development of the prior years' unpaid claim liability by comparing claims paid in 2005 with 2004 dates of service to the liability. The company reported that 2004 claims paid in 2005 matched the 2004 unpaid claim liability exactly. Outside of a fully capitated LSHO it is extremely unlikely the two amounts would match. The company determined that an error was caused by a Freedom Software Crosscheck oversight and the company failed to correct the error on the annual statement. It is recommended that the company report the claim reserve and claim liability as of December 31 of the current year on claims unpaid as of December 31 of the prior year correct on Underwriting and Investment Exhibit – Part 2B Analysis of Claims Unpaid Prior Year of the annual statement in the future.

### **Financial Requirements**

The financial requirements for First Commonwealth Limited Health Service Corporation under an order dated June 17, 1996, are as follows:

**Amount Required**

- |    |                                      |  |
|----|--------------------------------------|--|
| 1. | Minimum capital or permanent surplus | Not less than \$100,000  |
| 2. | Security deposit                     | Each LSHO is required to maintain a deposit of securities with the State Treasurer or an acceptable letter of credit on file with the Commissioner's office. The amount of the deposit or letter of credit shall not be less than \$75,000. The letter of credit must be payable to the Commissioner whenever liquidation or rehabilitation proceedings are initiated against the company. |
| 3. | Compulsory surplus                   | Not less than the greater of:<br>3% of the premiums earned by the company in the previous 12 months<br>or<br>\$75,000<br><br>The Commissioner may accept the deposit or letter of credit under par. 2. to satisfy the compulsory surplus requirement if the company demonstrates to the satisfaction of the Commissioner that all risk for loss has been transferred to the providers.     |
| 4. | Security surplus                     | The company should maintain a security surplus to provide an ample margin of safety and clearly assure a sound operation. The security surplus should not be less than 110% of compulsory surplus.   |

The company's calculation as of December 31, 2005, as modified for the examination adjustments is as follows:

|  |                |                    |
|--|----------------|--------------------|
| Assets   | \$ 3,262,116   |                    |
| Less:  |                |                    |
| Liabilities  | <u>326,377</u> |                    |
| Net amount available to satisfy surplus requirements |                | \$2,935,739        |
| Net premium earned                                   | 11,065,686     |                    |
| Compulsory factor                                    | <u>3%</u>      |                    |
| Compulsory surplus                                   |                | <u>331,971</u>     |
| Compulsory Excess/(Deficit)                          |                | <u>\$2,603,768</u> |
| Net amount available to satisfy surplus requirements |                | \$2,935,740        |
| Compulsory surplus                                   | 331,971        |                    |
| Security surplus factor                              | <u>140%</u>    |                    |
| Security surplus                                     |                | <u>464,759</u>     |
| Security Excess/(Deficit)                            |                | <u>\$2,470,981</u> |

## **VII. CONCLUSION**

First Commonwealth Limited Health Service Corporation is a for-profit individual practice association model, limited service health organization. The company was incorporated on March 12, 1996, and commenced business June 17, 1996. The company is a wholly owned subsidiary of The Guardian Life Insurance Corporation of America.

The company reported profits in each of the years during the examination period. Enrollment, however, decreased 34.5% over the five-year examination period. The decrease in enrollment is due primarily to the reduction of the manufacturing industry workforce in Milwaukee. The company was able to remain profitable during this time due to its risk transfer to providers.

The examination resulted in eight recommendations and two adjustments which had no effect on surplus. The recommendations related to the areas of management and control, financial reporting, agents, premium reporting, and loss reserve reporting. The company failed to comply with three of the ten prior examination recommendations and partially complied with one other recommendation.

## VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 20 - Management and Control—It is again recommended that the company conduct its annual meeting of the board of directors in accordance with its articles of incorporation.
2. Page 20 - Management and Control—It is recommended that the board of directors meet on a quarterly basis, actively manage affairs of the corporation, and maintain meeting minutes to document the board's active governance in accordance with s. 611.51 (6), Wis. Stat.
3. Page 20 - Management and Control— It is again recommended that the company establish procedures for the annual completion of a conflict of interest questionnaire by the appropriate persons.
4. Page 21 - Management and Control—It is again recommended that the company file biographical information for any newly appointed officer or director within 15 days of such appointment as required by s. Ins 6.52, Wis. Adm. Code.
5. Page 21 - Financial Reporting—It is again recommended that the company classify payments made to intermediaries on Exhibit 7-Part 2 of the annual statement in the future.
6. Page 21 - Agent Listing—It is recommended that the company establish and implement procedures to ensure that its agent listing is complete and accurate.
7. Page 22 - Premium Reporting—It is recommended that the company discontinue the practice of including premium billed in advance as Uncollected Premium and Agents' Balances In Course of Collection in future annual statements.
8. Page 22 - Unpaid Claim Reserves—It is recommended that the company report the claim reserve and claim liability as of December 31 of the current year on claims unpaid as of December 31 of the prior year correct on Underwriting and Investment Exhibit – Part 2B Analysis of Claims Unpaid Prior Year of the annual statement in the future.

## IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

| <b>Name</b>   | <b>Title</b>                                 |
|---------------|--|
| Stephen Elmer | Insurance Financial Examiner                 |
| Victoria Chi  | Insurance Financial Examiner – IT Specialist |

Respectfully submitted,

Angela J Graff  
Examiner-in-Charge