

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
SAINT PAUL, MINNESOTA

REPORT OF EXAMINATION
OF
SOUTH COUNTRY HEALTH ALLIANCE
OWATONNA, MINNESOTA
AS OF
DECEMBER 31, 2009



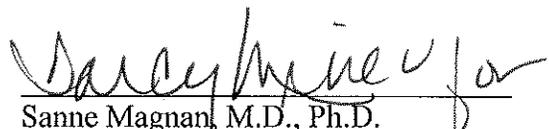
Protecting, maintaining and improving the health of all Minnesotans

The attached report of examination made of the condition and affairs as of December 31, 2009 of:

SOUTH COUNTRY HEALTH ALLIANCE
Owatonna, Minnesota

was recently completed by duly qualified examiners of the State of Minnesota.

Due consideration has been given to the comments of the examiners regarding the operations of South Country Health Alliance and its financial condition, as reflected in this report. This report is hereby, as of this date, approved, adopted, filed and made an official record of this Department.



Samne Magnan, M.D., Ph.D.
Commissioner of Health

Dated: 9/23/10

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Protecting, maintaining and improving the health of all Minnesotans

September 15, 2010

The Honorable Sanne Magnan
Commissioner of Health
State of Minnesota
Department of Health
85 7th Place East, Suite 400
St. Paul, Minnesota 55101

The Honorable Glenn Wilson
Commissioner of Commerce
State of Minnesota
Department of Commerce
85 7th Place East, Suite 500
St. Paul, Minnesota 55101

Dear Honorable Commissioners:

Pursuant to your instructions and the statutory requirements of the State of Minnesota, a comprehensive examination has been made of the books, records, business affairs and financial condition of

South Country Health Alliance
110 West Fremont St.
Owatonna, Minnesota 55060

The following examination report is respectfully submitted.

SCOPE OF EXAMINATION

The examination was a comprehensive examination, conducted by the Minnesota Department of Commerce, observing the applicable guidelines and procedures in the *NAIC Financial Condition Examiners' Handbook*. The Department of Commerce Examination Order #10-012 directed that the examination include a determination of the financial condition of South Country Health Alliance (hereinafter referred to as the Company) and a general review of its corporate affairs and insurance operations to determine compliance with statutes.

The examination covered the three-year period from January 1, 2007 through December 31, 2009. In accordance with the *NAIC Financial Condition Examiners' Handbook*, the examination included significant transactions and/or events occurring subsequent to December 31, 2009, to the date of this examination report, which were noted during the course of this examination.

The Company has adequately addressed the findings from the prior examination report.

HISTORY

The County Boards of Commissioners of Brown, Dodge, Freeborn, Goodhue, Kanabec, Sibley, Steele, Wabasha and Waseca Counties (hereinafter referred to as Member Counties) executed a Joint Powers Agreement in 1998. Under authority granted by Minnesota Statute Section 471.59, the Member Counties agreed to establish a Joint Powers board of directors to organize, govern, plan and administer a multi-county, county-based purchasing program for Medical Assistance and General Assistance Medical Care services as authorized by Minnesota Statute Section 256B.692. Effective on January 1, 2007, the Counties of Cass, Crow Wing, Morrison, Todd and Wadena were added as new members of the Company.

The Minnesota Department of Health, by letter dated February 13, 2001, found that the Company met the requirements for a county-based purchasing arrangement. Effective November 1, 2001, the Company began coverage for enrollees under Medicaid and General Assistance Medical Care in the Member Counties. Effective in 2006, the Company began issuing coverage to enrollees in MinnesotaCare and certain additional Medicare and Medicaid programs provided through the Centers for Medicare and Medicaid Services.

SUBSEQUENT EVENTS/CONTINGENT LIABILITIES

The Counties of Cass, Crow Wing and Freeborn have given notice that they will be withdrawing from the Joint Powers Agreement effective January 1, 2011.

The Company had no contingent liabilities at year end 2009 that are considered outside the normal course of business.

MANAGEMENT

Board of Directors

The Company is governed by the Joint Powers Board of Directors which is made up of one County Commissioner from each of the Member Counties. Board and/or Executive Committee meetings are currently held monthly.

The Joint Powers Board of Directors consisted of the following fourteen individuals at December 31, 2009:

<u>Commissioner</u>	<u>County</u>
Andrew Lochner	Brown
Jim Dowson	Cass
Paul Thiede	Crow Wing
David Erickson	Dodge
Glen Mathiason	Freeborn
Ted Seifert	Goodhue
Kathi Ellis	Kanabec
Don Meyer	Morrison
Harold Pettis	Sibley
Tom Shea	Steele
Gary Kneisl	Todd
Merl Norman	Wabasha
Bill Stearns	Wadena
Jim Peterson	Waseca

Officers

The following individuals served as principal officers of the Company at December 31, 2009:

<u>Name</u>	<u>Position</u>
Brian Nasi	Chief Executive Officer
Leota Lind	Chief Operating Officer
Brian Hicks	Chief Financial Officer

Conflict of Interest

The Company's Board of Commissioners and management staff complete conflict of interest statements annually. The executed statements for the years under examination were reviewed with no material conflicts noted.

Corporate Records

Effective 1/1/07 the Joint Powers Agreement was amended to add five additional new counties and to clarify the distribution of excess surplus back to the member counties. In July 2008, the

Joint Powers Agreement was amended to require the affirmative vote of two-thirds of the member county boards before authorizing a capital call. Effective January 5, 2010, the Joint Powers Agreement was amended to change the timing for notice of withdrawal.

The Company's By-laws were amended effective January 8, 2007 to set forth the procedures by which capital/surplus is calculated and may be distributed back to the members. The 2007 amendment was amended effective May 12, 2008 to address procedures by which capital/surplus is computed and may be distributed.

The Company's Board, Executive Committee and Finance Committee meeting minutes were reviewed and found to be in order.

AFFILIATED ENTITIES

The Company has an affiliated relationship with the member Counties under the Joint Powers Agreement. One of the member Counties served as the Company's fiscal agent, providing certain administrative services to the Company on a cost basis through 2008. The Company assumed these administrative functions internally during 2009.

The member Counties have executed agreements that guarantee the required statutory capital and surplus of the Company. The Company's By-laws require that, if its capital and surplus drops to a level lower than 200% of the Company's RBC ratio, the Company will take the necessary actions to regain a 200% RBC level as soon as possible. The Company's year end 2009 RBC level was 107%. Company management has instituted cost reduction measures that project the RBC level to exceed 200% by the end of 2011.

Capital transactions during the period under examination include: 1) a capital distribution of \$7,225,473 to the original nine member Counties to equalize the capital contributions after admitting five new member Counties in 2007, 2) a capital contribution in 2007 of \$7,595,737 by the five new member Counties, 3) a contribution in 2008 of \$10,980,961 from all of the member Counties to offset operating losses.

EMPLOYEE WELFARE

Company employees are provided a traditional employee benefit package including pension coverage through the Public Employees Retirement Association. No other deferred benefit or employment contracts are currently in effect. The Company does not offer any post retirement benefits other than the pension plan.

STATUTORY DEPOSITS

Minnesota Statutes 256B.692 require county based purchasing units to comply with the net worth requirements of the HMO statutes (62D). Until January 1, 2013, the CBP's can satisfy net worth requirements by use of the provisions of Minnesota Statutes 62N.28 and 62N.29.

Minnesota Statutes 62N.29 allows the Department of Health to allow guaranteeing organizations to guarantee the net worth/deposit requirements of CBP's. The Member Counties Boards passed resolutions stating that the Member Counties will be the guaranteeing organizations for the Company's net worth and deposit requirements.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company contracts with the Minnesota Department of Human Services (DHS) and the Center for Medicare and Medicaid Services (CMS) to provide health care services to qualified enrollees in certain DHS and CMS programs. These coverages are provided to qualified residents of the member Counties.

Coverage plans available through the Company include:

- Prepaid Medical Assistance Program (PMAP) – this program provides certain family and child health care coverage to those eligible enrollees under the age of 65.
- General Assistance Medical Care (GAMC) – this program provides certain health care coverage to adults under the age of 65.
- MinnesotaCare (MNCare) – this program provides certain health care coverage to any eligible Minnesota resident under the age of 65.
- Minnesota Senior Care Plus (MSC+) - this program provides PMAP type coverage to eligible enrollees age 65 and over.
- Minnesota Senior Health Option (MSHO) – this is a dual Medicare/Medicaid eligible program, on a voluntary basis, which includes Medicare Part D coverage.
- AbilityCare – this program is designed to meet the health care needs of eligible enrollees who are disabled and qualify for Medicare. The program is voluntary and includes Medicare Part D coverage.

The Company receives monthly capitation payments from DHS and CMS for all enrollees.

The Company staff administers the program and contracts with third-party administrators to process and pay claims.

The Company does not market its products through traditional insurance sales channels. Coverage is available to enrollees only through that person's eligibility for one of the aforementioned public programs, within the stated geographical regions. The Company has no appointed agents or agency contracts and has no liability for commissions.

REINSURANCE

The Company cedes eligible hospital and physician services, on an excess basis to a reinsurer authorized in the State of Minnesota. 2009 reinsurance coverage was on a co-insurance basis

after application of a per member per year deductible of \$100,000. The maximum reinsurance coverage payable per member per year is \$1,000,000 with no lifetime limit. The reinsurance contract effectively passes risk. Effective November 1, 2009, the Company deductible was increased to \$175,000 and the co-insurance provision increased from 10% to 25%.

ACCOUNTS AND RECORDS

Financial Reporting

The Company assumed the preparation of its regulatory financial reporting statements, from its independent auditing firm, beginning in 2010. The financial database is maintained on Company owned information systems. An independent actuarial services firm is contracted to generate and to attest to its reported loss and LAE reserves.

Third Party Administrators

The Company contracts with a claims servicing organization, a pharmacy benefits provider, a chiropractic servicer/provider and a dental services administrator for various network management, claims administration, data reporting services and other related functions.

Independent Certified Public Accountant

The Company was audited annually, for the years 2007 through 2009, by the accounting firm of Larson, Allen, Weishair & Co., LLP. An unqualified opinion was received in all three years. Certain audit work papers of the accounting firm were reviewed and relied upon in conjunction with this examination.

FINANCIAL STATEMENTS

Following are the Company's statutory statements of admitted assets, liabilities and capital and surplus for the calendar years ending 2007 through 2009. Comparative statements of operations, reconciliation of surplus and cash flow for those years follow the statements. No adjustments have been made to the Company's reported financial statements as a result of this examination.

**SOUTH COUNTRY HEALTH ALLIANCE
STATEMENT OF ASSETS, LIABILITIES AND SURPLUS
AS OF DECEMBER 31,**

<u>ADMITTED ASSETS</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash and short-term investments	\$ 19,179,645	\$ 22,283,198	\$ 39,203,998
Subtotals, Cash and Invested Assets	19,179,645	22,283,198	39,203,998
Investment income due and accrued	0	0	159,503
Uncollected premiums	13,677,579	7,834,451	5,318,991
Reinsurance recoverable	1,352,135	1,251,000	1,190,347
Electronic data processing equipment	146,999	110,273	245,820
Receivable from affiliates	0	0	1,893,866
Health care receivables	1,214,801	600,850	67,411
Total Admitted Assets	\$ 35,571,159	\$ 32,216,772	\$ 48,079,936
<u>LIABILITIES</u>			
Claims unpaid	\$ 22,976,340	\$ 19,203,900	\$ 17,636,031
Unpaid claims adjustment expenses	689,290	576,117	529,081
Aggregate health policy reserves	532,242	498,000	7,391,917
Advance premiums	0	0	8,785,005
General expenses due or accrued	593,429	605,733	1,138,161
Amounts due to affiliates	77,776	8,073	876,599
Liability for uninsured plan amounts	2,372,310	0	3,529,133
Total Liabilities	\$ 27,241,387	\$ 20,891,823	\$ 39,885,927
Paid-in and contributed surplus	18,576,698	18,576,698	7,595,737
Unassigned funds (surplus)	(10,246,926)	(7,251,749)	598,272
Total - Capital & Surplus	\$ 8,329,772	\$ 11,324,949	\$ 8,194,009
Total Liabilities, Surplus & Other Funds	\$ 35,571,159	\$ 32,216,772	\$ 48,079,936

**SOUTH COUNTRY HEALTH ALLIANCE
STATEMENT OF REVENUE AND EXPENSES
FOR PERIOD ENDING DECEMBER 31,**

<u>STATEMENT OF REVENUE AND EXPENSE</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net premium income	\$ 202,361,332	\$ 169,695,686	\$ 154,505,822
Aggregate write-ins for other health care revenue	57,817	82,395	14,570
Total Revenues	\$ 202,419,149	\$ 169,778,081	\$ 154,520,392
Hospital/medical benefits	118,802,366	101,528,646	94,164,283
Other professional services	11,434,817	17,989,872	16,927,035
Emergency room and out-of-area	13,231,798	11,218,641	7,064,176
Prescription drugs	19,429,023	17,213,659	15,211,448
Aggregate write-ins for other medical and hospital	27,221,755	20,516,896	11,915,609
Less: Reinsurance recoveries	1,842,153	2,319,610	0
Total Medical and Hospital	188,277,606	166,148,104	145,282,551
Claims adjustment expenses	689,290	576,117	529,081
General administrative expenses	17,904,693	16,901,447	14,278,309
Change in reserves	0	(6,668,000)	6,668,000
Total Underwriting Deductions	206,871,589	176,957,668	166,757,941
Net Underwriting Gain or (Loss)	(4,452,440)	(7,179,587)	(12,237,549)
Net investment income earned	93,184	860,150	2,318,210
Net Income	(\$ 4,359,256)	(\$ 6,319,437)	(\$ 9,919,339)
 <u>CAPITAL & SURPLUS ACCOUNT</u>			
Capital & Surplus, prior reporting year	\$ 11,324,949	\$ 8,194,009	\$ 18,453,876
Net income	(4,359,256)	(6,319,437)	(9,919,339)
Change in non-admitted assets	1,364,079	(1,530,584)	(710,792)
Surplus paid-in	0	10,980,961	7,595,737
Aggregate write-ins for surplus adjustments	0	0	(7,225,473)
Net change in surplus for the year	(2,995,177)	3,130,940	(10,259,867)
Capital & Surplus End of Reporting Year	\$ 8,329,772	\$ 11,324,949	\$ 8,194,009

**SOUTH COUNTRY HEALTH ALLIANCE
STATEMENT OF CASH FLOWS
FOR PERIOD ENDED DECEMBER 31,**

<u>Cash from Operations</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Premiums collected net of reinsurance	\$ 195,940,118	\$ 157,823,632	\$ 153,629,209
Net investment income	93,184	860,150	2,318,210
Miscellaneous income	57,817	82,395	14,570
Total Income from Operations	196,091,119	158,766,177	155,961,989
Benefit and loss payments	184,505,166	164,580,235	140,855,929
General administrative expenses	14,493,320	22,216,205	13,424,161
Total Expenses from Operations	198,998,486	186,796,440	154,280,090
Net Cash from Operations	<u>(\$ 2,907,367)</u>	<u>(\$ 28,030,263)</u>	<u>\$ 1,681,899</u>
<u>Cash from Financing</u>			
Surplus paid-in	0	10,980,961	5,701,871
Other cash provided (applied)	(196,186)	128,502	(7,669,282)
Net Cash from Financing	<u>(\$ 196,186)</u>	<u>\$ 11,109,463</u>	<u>(\$ 1,967,411)</u>
<u>Reconciliation of Cash & ST</u>			
<u>Investments</u>			
Net change in cash and ST investments	(3,103,553)	(16,920,800)	(285,512)
Cash and short-term investments			
Beginning of year	22,883,198	39,203,998	39,489,510
End of period	<u>\$ 19,179,645</u>	<u>\$ 22,283,198</u>	<u>\$ 39,203,998</u>

EXAMINATION NOTES TO FINANCIAL STATEMENTS

Invested Assets

The Company's invested assets consist of funds invested in the Minnesota Association of Governments Investing for Counties Fund. This fund is a pooling of invested assets from participating Minnesota county governments. The Company moved its invested assets from a general investment portfolio to the fund in 2008 during the transition to in-house financial management.

Underwriting Results

Large underwriting losses were incurred during the examination years due to a combination of: 1) adverse underwriting losses, 2) premium capitation payments that were not adequate for the risks assumed and 3) start up costs related to adding additional member Counties and bringing certain operations functions in-house.

Reserves for Losses and Loss Adjustment Expenses

Review of reserve factors utilizing procedures prescribed in the *NAIC Financial Condition Examiners Handbook*, and other procedures as determined necessary, were performed by the Minnesota Department of Commerce actuary.

The Minnesota Department of Commerce developed reserve projections and compared them to values carried by the Company at December 31, 2009. The examination consisted of a review of testing done by the Company's independent auditors on the underlying data and other procedures as determined necessary by the department actuary to provide adequate validation of reserves. Based on the procedures applied, the Loss and Loss Adjustment Expense reserves, in total, appear to be reasonably stated and have been accepted for the purposes of this report.

Taxation

The Company, as a government program, is subject neither to federal or state income taxation nor to state premium taxation.

Statutory Net Worth Requirement

The Company met the net worth requirement of Minnesota Statute 62N.28 at December 31, 2009.

Capital and Surplus

Fluctuations in capital and surplus balances during the examination period were due to adverse underwriting results offset by member County capital contributions.

CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by the personnel of South Country Health Alliance during the course of this examination.

Participating in the examination were M. James Carr and Daniel Vogelgesang of the Minnesota Department of Commerce.