FORENSIC ANALYSIS

of

THE HEALTH CARE PROVIDERS SELF INSURANCE TRUST

for

THE NEW YORK STATE WORKERS' COMPENSATION BOARD

by

BOLLAM, SHEEDY, TORANI & CO. LLP, CPAs

September 21, 2010

BST

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EXECUTIVE SUMMARY

The New York State Workers' Compensation Board (WCB) regulates and monitors programs that offer workers' compensation insurance to employers in New York State, including group self-insurance trusts. WCB regulations require the WCB to ensure that the group self-insured trusts are financially viable and have remediation plans in the event a trust's financial stability needs to be restored. Primarily as a result of financial concerns regarding several group self-insured trusts, the WCB began a process of seeking an independent assessment of the financial and operational aspects of certain group self-insured trusts, and the entities responsible for the administration and management of these trusts.

The WCB retained BST through a competitive procurement process in June 2008 to provide an independent assessment of several group self-insured trusts.[1] BST was engaged to perform a review of the Health Care Providers Self-Insurance Trust (HCPSIT) on December 21, 2009.

HCPSIT was created on April 19, 1993, and was governed by a Board of Trustees and managed by Program Risk Management, Inc. (PRM) - the Trust Administrator whose duties were overseen by the Board of Trustees.[2] The WCB revoked HCPSIT's self-insurance status effective June 30, 2009, and the WCB began working with the Trustees to administer the affairs of the Trust and to liquidate the Trust's assets with a new Trust Administrator appointed by the WCB. This report addresses the issues and circumstances surrounding the formation and operation of HCPSIT and its $114,372,159 audited member deficit as of October 31, 2009.

Our independent assessment of HCPSIT's operation began with a review of documents provided by the WCB, including the documents relating to the Trust's formation, e.g., Trust Agreement, Service Agreement, and By-Laws. We subsequently read and analyzed thousands of documents.

We also read and analyzed the audit work papers relating to the audited financial statements provided by HCPSIT's financial statement auditor, and we engaged an independent actuary to provide an independent assessment of the Trust's claim liabilities.

We met with or interviewed by phone former and current PRM officials, the independent accounting firm that audited the Trust's financial statements (DeChants, Fuglein & Johnson, LLP), both of the Trust's two former Counsels and the President of the New York State Association of Health Care Providers (Association), the Trust's sponsoring organization. The Trust's actuary (Stergiou & Gruber, a.k.a. SGRisk, Inc.) declined to meet with us and/or be interviewed as we were unable to agree on the specific conditions set forth by SGRisk through their attorney.

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[1] The term "audit" was used to describe the services being sought by the WCB. However, BST did not conduct the type of attestation work commonly associated with an audit of financial statements. The services provided by BST were essentially an independent assessment of the duties, responsibilities, and actions of the Trust Administrator and the Trustees, and a financial analysis of the Trust's assets and liabilities. We did not provide any attestation services with regard to the Association and/or the WCB.

[2] The initial Trust Administrator was Jardine Insurance Brokers New York, Inc. followed briefly by Naples Risk Management, Inc. PRM assumed that role in September 1995.

We met with and/or interviewed by phone three Trustees of the Trust's Board of Trustees. A fourth Trustee responded to a written questionnaire furnished by BST at her request. Three other Trustees requested questionnaires, which were provided, but they failed to respond. Two additional Trustees did not respond to BST's request for an interview, and one Trustee in our Trustee sample could not be located.

Additional information may become available and, accordingly, we reserve the right to modify our report.

Based on our inquiries, observations, document analysis, and discussions to date, we have determined that: 1) the Trust incurred expenses that did not relate to the goals and mission of the Trust; 2) the Trust was used as a revenue stream to support the administration and operation of its sponsoring organization, the Association; 3) the Association and PRM may have engaged in a series of transactions on behalf of HCPSIT which constitute a conflict of interest, and 4) the Association, the Trustees, and PRM did not take sufficient measures to ensure that HCPSIT remained in a fully (or adequately) funded condition. The failure of these parties to recognize adequate reserves and maintain sufficient contribution rates eventually resulted in the acceleration of HCPSIT's deficit and the ultimate dissolution of HCPSIT.

<u>Observations</u>:

1) Phyllis Wang, as Association President, formed HCPSIT with the assistance of Thomas Arney whose firms, including Program Risk Management, Inc. (PRM), served continuously as Trust Administrator from the Trust's inception to dissolution, a period of approximately 16 years. There is no evidence that any other administrators were solicited or considered by Ms. Wang or the Trustees to ensure Arney's firms' fees or services were competitive. Arney's firms provided other insurance products to the Association's members.

2) Ms. Wang executed contracts with another firm formed by Mr. Arney, PRM Claim Services, Inc. (PRMCS), to serve as the Trust's Claims Administrator. The Trustees' appointment of a Claims Administrator with common ownership of the Trust's Program Administrator created a possible conflict-of-interest situation whereby claims reserves could be established for the financial benefit of PRM and not the Trust.

3) Phyllis Wang served concurrently in leadership and decision-making roles within the Association, HCPSIT, and the Association's affiliate, HCP Resources, Inc. (Resources), allowing her to use HCPSIT for the Association's maximum financial benefit and not merely as a workers' compensation program for Association members. These overlapping roles may have constituted a conflict of interest.

4) Resources provided services to HCPSIT that are typically performed by self-insured group administrators. The fees paid by HCPSIT to Resources were not consistent with

the terms of the written agreements between HCPSIT and Resources and constituted a significant portion of the Association's total non-member dues revenue.

5) The Trustees approved an aggressive investment strategy that exposed the Trust's investments to volatile market conditions resulting in a substantial loss of the Trust's financial assets and repeatedly failed to ensure the Trust's timely compliance with WCB regulations with respect to allowable Trust investments.

6) The Trustees approved the use of HCPSIT financial resources to support the creation and ongoing operation of the Health Care Providers Disability Benefits Trust (HCPDBT). For example, the Trustees approved the subsidizing by HCPSIT of HCPDBT member premium financing costs which inequitably required HCPSIT members not participating in HCPDBT to subsidize the premium financing costs of members belonging to both Trusts. HCPSIT's financial support of HCPDBT was not consistent with the purposes of HCPSIT, offered no apparent financial or other benefit to HCPSIT, and placed HCPSIT member assets at unnecessary risk.

7) The Trustees approved the use of approximately $870,000 of HCPSIT funds for political donations and lobbying expenses in support of the Association's larger legislative and political agenda in violation of 12 NYCRR 317.8 (a) which restricts the use of group self-insured trust funds to purposes directly relating to the operation and financial obligations of the trust. Additional HCPSIT funds of $111,000 were donated to a scholarship fund in the name of a former HCPSIT Trustee.

8) The Trustees implemented a loss-sensitive Retention Plan without membership consent as a marketing tool to attract larger health care providers into the Trust. The Retention Plan financially benefitted a select group of Trust members but reduced the Trust's overall cash flow to the detriment of the remaining Trust membership, which contributed to the Trust's member deficit.

9) Beginning in 2001, the Trust and those responsible for administering the Trust reported loss reserves on the Trust's financial statements that were less than the actuary's best estimate. There is no documentation or basis to support the use of these reported amounts, and the amounts, which were audited by the Trust's financial statement auditor, may have created a misleading impression about the financial well-being of the Trust.

10) Members with high experience modification rates were allowed to join the Trust, and members with consistently high experience modification rates were allowed to stay in the Trust, including certain members whose rates increased in 3 or more successive years.

11) Despite statutory requirements to levy an assessment to address the member deficit, the Trustees and PRM failed to bill Retention Plan members in a timely fashion, and then only at the direction of the WCB.

I. INTRODUCTION

A. Background

Every employer in New York State is required by the laws of New York to secure workers' compensation coverage for its employees. Employers essentially have four options, joining a group self-insured trust, obtaining insurance from the New York State Insurance Fund, individually self-insuring, or obtaining insurance from a private insurance carrier.

With regard to the formation of group self-insured trusts, each group of employers must establish a trust fund that is financed by contributions from and assessments of its members. Title 12, Chapter 5, Subchapter B of the New York Codes, Rules and Regulations (NYCRR) establishes the procedures, qualifications, and responsibilities for any group of employers that wishes to become, or which has been approved by the WCB to operate as a group self-insurer.[3] Every group self-insurer must also have a set of documents that govern all aspects of the group's existence, which may include a trust agreement and by-laws.

On September 17, 1992, certain members and Trustees of the New York Association of Health Care Providers, Inc. signed a Self-Insurance Agreement and Declaration of Trust (Trust Agreement) establishing the Health Care Providers Self-Insurance Fund. Among the signatories were Association President, Phyllis A. Wang, and Jardine Insurance Brokers New York, Inc. (Jardine) Chairman, Thomas B. Arney.[4]

Also on September 17, 1992, the signatories to the Trust Agreement also signed and executed an Indemnity Agreement that, inter alia, established the joint and several liability of the Trust's members, and designated as Trustees signatories Edna Lauterbach, Joel Schwartz, and Thomas Arney on behalf of Jardine, Phyllis Wang on behalf of the Association, and Thomas J. Gosdeck, Esq. as Counsel to the Association.

On September 24, 1992, Arney submitted an application for group self-insurance for HCPSIT to the WCB. The application was subsequently accepted by the WCB on May 11, 1993, pursuant to Section 50, Subdivision 3-a, Part 316 (Group Self Insurance) of the New York State Workers' Compensation Law with a retroactive effective date of April 19, 1993.

HCPSIT was established to provide workers' compensation coverage through a self-insurance program to employers engaged in the business of providing home health care services and facility based health care services. Each Trust member must be a member in good standing of

[3] The rules applying to the group self-insured trusts were originally covered under NYCRR Title 12, Chapter 5, Subchapter B, Section 316. Beginning January 31, 2001, the rules were modified and expanded.
[4] Arney left Jardine in 1994 and moved to Naples Risk Management. On July 25, 1995, Arney formed Program Risk Management, Inc. (PRM). Arney served as the Trust's Program Administrator while at each of the aforementioned three firms.

the Association and be classified with Standard Industrial Classification (SIC) Code in the Major Group Indexes of 80-Health Services and 83-Social Services.[5] Also, an entity that is a parent or subsidiary of, or owned in common with an Association member and whose business is related or incidental to the business of the Association member is eligible for membership in the HCPSIT. From April 19, 1993 through June 30, 2009, over 330 Association members and affiliates joined HCPSIT.

HCPSIT's financial statements reported net losses during its fiscal years ended October 31, 1993, 1994, 1995, 1996, 2001, and 2002. The Trust members' regulatory deficit as of October 31, 2008, was $27 million. Despite various remediation plans and actions, the WCB revoked HCPSIT's self-insurance status effective June 30, 2009, and the WCB began working with the Trustees to liquidate the Trust's assets with a new Trust Administrator appointed by the WCB.[6]

PRM and its predecessor firms, Jardine Insurance Brokers New York, Inc. and Naples Risk Management, charged HCPSIT approximately $13.8 million in management fees during the sixteen-year period ended October 31, 2008. This amounted to approximately 7.4% of HCPSIT's members' gross contributions written ($186,610,732) during the same period. In addition, a PRM affiliate, PRM Claim Services, charged HCPSIT a total of approximately $6.4 million for the period November 1, 1998 through October 31, 2008, for claims administration services. Also, HCP Resources, Inc., a for-profit Association affiliate, charged HCPSIT approximately $9.4 million in management fees during the sixteen-year period ended October 31, 2008. This amounted to approximately 5% of HCPSIT's members' gross contributions written ($186,610,732) during the same period.

The WCB engaged Bollam, Sheedy, Torani & Co. LLP, CPAs (BST) on December 21, 2009 to perform an operational assessment of HCPSIT and to assist the WCB in the financial reconstruction of HCPSIT's financial position as of October 31, 2009, and a roll-forward date that has yet to be determined. Since then, BST and other parties have assisted the WCB in its efforts to identify the reason(s) for HCPSIT's deficit financial condition and to determine whether PRM and HCPSIT's Trustees prudently exercised their fiduciary and legal responsibilities, including actions to preserve the integrity of HCPSIT's funds. Our methodology and observations are detailed on the following pages.

B. Methodology

BST staff began their analysis by meeting with WCB officials to gain an overview of HCPSIT's financial condition and its history. We also spoke with members of NCA Comp, the third-party administrator hired by the WCB when it assumed control of the Trust's assets and management of the Trust's liabilities.

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[5] Includes the following SIC Codes: 8082 - Home Health Care Services, 8049 – Offices and Clinics of Health Care Practitioner, 8059 - Nursing and Personal Care Facilities, 8361 - Residential Care, 8322 - Individual and Family Social Services.

[6] The WCB's new Administrator, NCAComp, Inc. assumed responsibility for the Trust's runoff on October 13, 2009.

BST engaged an independent actuary, a legal consultant, and a claims auditor to assist in our analysis of the loss reserves, legal responsibilities, and claims handling process, respectively.

BST subsequently reviewed thousands of Trust documents, including but not limited to, the member files, trust formation documents, New York State Department of State records, audit reports, actuarial reports, Trustee meeting minutes, and correspondence. In addition, we interviewed 16 individuals to date.

C. Chronology of Key Events

May 26, 1976 - New York State Association of Health Care Providers, Inc. registers as a domestic not-for-profit corporation with the New York State Department of State - Division of Corporations.

August 31, 1989 - Community Health Care Services Foundation, Inc. (CHCSF) registers as a domestic not-for-profit corporation with the New York State Department of State - Division of Corporations. Process address is listed as New York State Association of Health Care Providers, Inc.

September 14, 1992 - Letter Agreement signed by Phyllis A. Wang, Association President, and as Trustee on behalf of the Health Care Providers Self-Insurance Trust (HCPSIT), and Thomas B. Arney, Chairman, Jardine Insurance Brokers New York, Inc. (Jardine) to perform several joint and separate duties regarding the formation and management of HCPSIT, including Jardine's serving as the HCPSIT's insurance broker and Program Administrator. Letter further notes that the Association has recently endorsed Jardine as a provider of Statutory Disability Insurance programs.

September 17, 1992 - HCPSIT created; Trust Agreement and Indemnity Agreement signed by Association members Edna Lauterbach and Joel Schwartz and Association Trustees - Phyllis Wang, Thomas B. Arney, Thomas Gosdeck (Association Counsel) , Edna Lauterbach (President of Health Savers, Inc. of Newburgh, NY), and Joel Schwartz (Chairman of Comprehensive Home Care Services of Smithtown, NY).

September 22, 1992 - HCP Resources, Inc., an Association affiliate, registers as a domestic business corporation with the New York State Department of State - Division of Corporations. Phyllis A. Wang identified as Chairman/Chief Executive Officer.

September 23, 1992 - HCPSIT By-laws approved by Trustees.

September 24, 1992 - Arney submits application for group self-insurance for HCPSIT to the WCB.

October 27, 1992 - First documented meeting of HCPSIT Trustees (Wang, Arney, Gosdeck, Lauterbach, and Schwartz) held "for purposes of preliminary activities to activate the trust." Wang given authority to execute documents on behalf of the Trust.

January 29, 1993 - Second documented HCPSIT Trustees meeting held. Trustees advised that Cannanwill, Inc. (a premium financing company) was willing to enter into an agreement to finance the premium due during the first year to provide the Trust funds to purchase a bond.

March 1, 1993 - Thomas Gosdeck elected Secretary of HCPSIT at third documented Trustee meeting.

April 19, 1993 - Effective date of HCPSIT as per WCB Chair's approval of May 11, 1993. Four health care providers join the Trust.

May 17, 1993 - WCB sends letter to Arney transmitting WCB Chair's approval of HCPSIT's application for group self-insurance effective April 19, 1993.

May 20, 1993 - Wang, HCPSIT Chair, signs Contract for Services with Gallagher Bassett Services, Inc. for claims and loss control services for the period April 21, 1993 through April 21, 1994.

July 14, 1993 - Upon the advice of Jardine's counsel, Arney tenders his resignation as HCPSIT Trustee due to the potential for conflict of interest and indicates that he will continue to represent Jardine as Program Administrator. Jardine retains right to select another Trustee. Trustees told that the HCPSIT has an accrued management fee owed to Resources in accordance with the terms of a management agreement approved by the HCPSIT Trustees and by Resources. Trustees approve underwriting standards for Trust.

August 25, 1993 - Resources enters into Management Agreement with HCPSIT to provide general management, staffing, and business accounting services to HCPSIT. Agreement signed by Phyllis Wang, Chairperson on behalf of HCPSIT, and by Thomas Gosdeck, Secretary of the Board of Resources. Agreement is retroactive to January 1, 1992. *Note: This Agreement remains in effect in its entirety until new Agreement executed on November 1, 2007.*

February 1, 1994 - Michael Reda introduced to HCPSIT Trustees as Jardine's designated HCPSIT Trustee. Joel Hodes, Esq. introduced as General Counsel to the Association and HCPSIT, replacing Gosdeck. By-laws amended removing the designation of HCPSIT Trustee by Jardine and adding that three of the five HCPSIT Trustees shall be designated by the Association Chairperson. The HCPSIT Trustees approve financial statements and auditor's report for the year ended October 31, 1993.

April 1, 1994 - Letter Agreement signed by Wang, HCPSIT President, and Arney, now President, Naples Risk Management, Inc. (Naples) appointing Naples as HCPSIT's new Program Administrator and providing Naples "a fee equal to 7% of the gross written contributions made by the members to the Trust for as long as this agreement remains in effect."

April 24, 1994 - Charles Gruber of SGRisk presents the Actuary's Report for the year ending October 31, 2003 to the HCPSIT Trustees.

May 6, 1994 - Wang, HCPSIT Chair, signs and renews a Contract for Services with Gallagher Bassett Services, Inc. to provide claims services for the period April 19, 1994 through April 19, 1995.

September 26, 1994 - Arney presents to the HCPSIT Trustees the Actuarial Report of SGRisk and reports that the Trust will, for quality assurance purposes, periodically seek independent review of the actuary's methodology assumptions and projections.

November 28, 1994 - Milliman and Robertson, Inc. (M&R) issues a report to Naples Risk Management concerning "Review of Actuarial Workpapers." Their report is prepared on behalf of the Trust and indicates that the Trusts' current contribution rate is "likely to be inadequate."

December 7, 1994 - Arney presents to Trustees the report of M&R, consulting actuaries. Arney states that he is satisfied with SGRisk's methodology and recommends that the Trust continue to retain SGRisk as its actuary, with periodic reviews of their work by outside auditors. Trustees amend by-laws increasing number of HCPSIT Trustees from five to seven. The two new HCPSIT Trustees are to be appointed by the HCPSIT Trustees themselves.

January 16, 1995 - HCPSIT's financial statement auditors, Roth & DeChants (R&D), conclude that HCPSIT's financial statements for the periods ended October 31, 1993 and October 31, 1994 were presented fairly, in all material respects, and reveal a members' deficit of $43,051 as of October 31, 1994.

March 2, 1995 - Arney comments to the HCPSIT Trustees that the Trust may want to look into a more aggressive investment strategy that would still protect the principal and yet provide a higher return on investment. HCPSIT Trustees approve formation of an Investment Committee. Trustees approve that the Trust will make available funds necessary to secure a letter of credit for the formation of a new disability benefits trust, if and when, the Association Board votes approval and creation of a disability trust.

April 30, 1995 - Trustees approve a $5,000 contribution to the Health Care Providers Political Action Committee (HCP PAC).

June 15, 1995 - Wang, HCPSIT Chair, sends letter to Arney, President, Naples Risk Management, Inc. agreeing to pay Naples $6,000 a month for HCPSIT Loss Control Services, through October 31, 1995.

June 23, 1995 - Wang, Association Counsel Joel Hodes, and HCPSIT members Todd Brason, Jordan Shames, and Michael Reda sign Trust Agreement and Indemnity Agreement establishing the Health Care Providers Disability Benefits Trust (HCPDBT).

June 28, 1995 - Trustees advised of a one-time adjustment of $500,000 to the IBNR Claims expense line in the April interim financial statement recommended by SGRisk. Trustees approve Wang's recommendation to use HCPSIT's funds to demonstrate the financial integrity of the newly created HCPDBT by allowing HCPDBT to submit HCPSIT's certified financial statements to demonstrate the financial integrity of HCPDBT.

July 19, 1995 - Wang, HCPSIT Chair, signs and renews Contract for Services with Gallagher Bassett Services, Inc. (GB) for claims services for the period April 19, 1995 through November 1, 1996.

July 25, 1995 - Program Risk Management, Inc. (PRM) registers as a domestic business corporation with the New York State Department of State - Division of Corporations.

August 1, 1995 - Agreement signed by Wang and Arney appointing PRM as HCPSIT's Program Administrator. The Agreement provides that PRM's compensation will be "a fee equal in amount to seven percent (7%) of the gross written contributions made by the Members to the Trust during the term of this Agreement." The term of the Agreement is August 1, 1995 through July 31, 1998, and automatically renews for successive terms of two (2) years unless either party gives notice to the other of its intention to terminate the Agreement.

August 7, 1995 - Wang as HCPDBT Chair submits an application for group self-insurance for HCPDBT to the WCB. The application is subsequently accepted by the WCB.

September 6, 1995 - Arney advises the WCB by letter that he has separated from Naples and that PRM will assume the role of HCPSIT's Program Administrator.

September 29, 1995 - Charles Gruber, SGRisk, presents the Actuary's Report to the Trustees. Trustees amend by-laws creating the office of President of the Trust and separating the functions of Chairman and President. A participant in the Trust would serve as Chairman, and the President would serve as its chief executive officer. Trustees approve a "moderate principal risk" investment strategy. Arney reports that HCPDBT is underway.

October 25, 1995 - HCPSIT Trustees vote to contribute to the cost of a federal lobbyist, and to contribute $25,000 to the Association's lobbying efforts.

November 14, 1995 - HCPSIT Trustees vote to accept HCPDBT's liability, until such time as HCPDBT is adequately capitalized to support its own letter of credit.

November 29, 1995 - Memorandum from Arney to Wang indicating the need to arrive at a "new" arrangement for Loss Control Services and suggesting the Trust pay $5,000 a month plus expenses.

January 22, 1996 - HCPSIT's financial statement auditors, R&D, conclude that HCPSIT's financial statements for the periods ended October 31, 1994 and October 31, 1995, were presented fairly, in all material respects, and reveal a members' deficit of $136,799 as of October 31, 1995.

January 30, 1996 - Trustees approve a large deductible (retention) program for members with larger premiums to attract bigger health care providers into the Trust. HCPSIT Trustees vote to make a $5,000 contribution to the HCP PAC (State).

April 28, 1996 - Association Marketing Director reports to HCPSIT Trustees that approximately 50% of eligible Association members are participants in HCPSIT, and that 20% of new Association members are joining to participate in HCPSIT.

August 5, 1996 - Memorandum sent from Arney to Wang discussing Loss Control Services activities and cost considerations. A handwritten notation on the memo reads "11/1/96-10/31/97 $60,000."

October 22, 1996 - HCPSIT Trustees approve Wang motion that the Trust extend a line-of-credit to the HCPDBT for up to $150,000 for twelve months with interest to be paid at prime rate.

November 4, 1996 - HCPSIT Trustees approve having HCPSIT partially subsidize the financing costs of Trust participant contributions.

January 14, 1997 - HCPSIT's financial statement auditors, R&D, conclude that HCPSIT's financial statements for the periods ended October 31, 1995 and October 31, 1996, were presented fairly, in all material respects, and reveal a members' deficit of $353,955 as of October 31, 1996.

January 21, 1997 - HCPSIT Trustees vote to change the Trust's investment objective to require $1 million in cash equivalents instead of $3.5 million.

January 22, 1997 - Wang signs and renews Contract for Services with Gallagher Bassett Services, Inc. for claims services for the period November 1, 1996 through November 1, 1997.

June 27, 1997 - PRM Claim Services Inc (PRMCS) registers as a domestic business corporation with the New York State Department of State - Division of Corporations.

September 10, 1997 - Milliman and Robertson, Inc. (M&R) issues report to Trust of HCPSIT's loss and allocated loss adjustment expense ("ALAE") reserves as of April 30, 1997 for which M&R's "selected ultimate losses were $0.9 million or 3.8% below the ultimate losses estimated by SGRisk in their report to PRM."

September 23, 1997 - Charles Gruber of SGRisk reviews the mid-year Actuarial Report with HCPSIT Trustees. Arney recommends to Trustees renewal of Gallagher Bassett contract but suggests that the Trust needs to research the market for an alternative claims administrator.

HCPSIT Trustees vote to extend Trust's loan to HCPDBT. M&R report shared with Trustees.

October 14, 1997 - Memorandum from Arney to Wang transmitting Gallagher Bassett Services, Inc. proposal for claims services for the period November 1, 1997 through November 1, 1998. Arney recommends renewal of the contract "at the present time."

December 16, 1997 - HCPSIT Trustees approve appointment upon Wang's recommendation to increase Resource's management fee from 3% to 5 % effective November 1, 1997. Trustees vote to extend Trust's note to HCPDBT from November 15, 1997 to November 15, 1998.

January 20, 1998 - HCPSIT's financial statement auditors, Roth, DeChants, Fuglein & Johnson (RDF&J), conclude that HCPSIT's financial statements for the periods ended October 31, 1996 and October 31, 1997, were presented fairly, in all material respects.

March 23, 1998 - Wang reports that the current note of $150,000 with HCPDBT will not be sufficient to get HCPDBT through the slow activity of the winter months. HCPSIT Trustees approve increase of note to HCPDBT to $250,000.

May 20, 1998 - HCPSIT Trustees vote to increase the line-of-credit extended by the Trust to HCPDBT to $300,000 with a payment of interest only through May 1, 1999.

June 25, 1998 - HCPSIT Trustees approve the Trust subsidizing contribution financing costs for HCPDBT participants retroactively to the beginning of the fiscal year, November 1, 1997.

August 1, 1998 - Agreement signed by Wang and Arney, PRM President, appointing PRM as the HCPSIT's Program Administrator. The Agreement provides that PRM's compensation will be "equal in amount to seven percent (7%) of the gross written contributions made by the Members to the Trust during the term of this Agreement."

August 8, 1998 - HCPSIT Trustees approve to allow members of other associations, which are allied members of the Association, to participate in HCPSIT.

October 18, 1998 - HCPSIT Trustees advised of Arney's proposal for PRMCS to take over claim services for the HCPSIT. Trustees vote to approve undertaking of negotiation with and oversight of PRMCS as the Claims Administrator.

November 1, 1998 - Agreement signed by Wang and Arney appointing PRMCS as the Trust's Claims Administrator for the period November 1, 1998 through October 31, 2001.

January 6, 1999 - HCPSIT's financial statement auditors, RDF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 1997 and October 31, 1998, were presented fairly, in all material respects.

January 13, 1999 - HCPSIT Trustees approve to begin the process of investigating the consolidation of HCPSIT and HCPDBT.

June 24, 1999 - HCPSIT Trustees amend By-laws expanding number of Trustees from seven to eleven. HCPSIT appointments increased from two to four and Association appointments from three to five. Trustees approve increase of the HCPSIT's loan to HCPDBT from $450,000 to $600,000 through October, 2000. Trustees approve establishment of Edna Lauterbach Scholarship Fund and authorize a $10,000 HCPSIT donation.

August 25, 1999 - Tillinghast Towers & Perrin (TTP) issues Claims Practices Review to Wang on behalf of the Trustees relating to PRMCS's claim handing and administration for the previous six months. TTP found that "the quality of PRMCS's claim handling was not consistent with performance levels expected of similar third-party administrators handling workers' compensation claims."

August 31, 1999 - A TTP representative meets with the HCPSIT Trustees to discuss PRMCS as requested by the Trustees. HCPSIT Trustees vote that a follow-up audit of PRMCS be scheduled in January 2000 for claims through December 1999.

September 29, 1999 - HCPSIT Trustees approve reduction in debt for HCPDBT to the extent that the HCPSIT has a surplus at the October 31, 1999, year end.

January 13, 2000 - HCPSIT's financial statement auditors, DeChants, Fuglein & Johnson (DF&J), conclude that HCPSIT's financial statements for the periods ended October 31, 1998 and October 31, 1999, were presented fairly, in all material respects.

January 13, 2000 - HCPSIT Trustees approve to forgive HCPDBT interest due to HCPSIT through October 31, 1999, and HCPDBT debt to HCPSIT for a combined total of $75,000.

February 25, 2000 - TTP issues follow-up report of PRMCS TTP reports: "Although the quality of claim handling has improved, it has not improved to a Best Practices performance level and, based on our experience, is still below average performance for similar third-party administrators handling workers compensation claims."

March 3, 2000 - HCPSIT Trustees adopt TTP report and recommendations, request a third audit to be performed in July 2000, expect that any claims administrator for the Trust meet "best industry practice," and require monthly management reports beginning April 1.

July 2000 - TTP issues follow-up report of PRMCS. TTP reports: "PRM's claim handling performance is moving closer to a reasonable quality level as compared to similar third-party administrators handling workers compensation claims. Although there are still areas that need to improve, PRM has made significant progress in the last six months."

July 26, 2000 - HCPSIT Trustees discuss TTP report and that a new contract with PRMCS must include performance measures and require monthly reports.

October 18, 2000 - HCPSIT Trustees discuss increase in fees requested by PRM for Loss Control Services. Trustees vote to extend the date on the note between HCPSIT and HCPDBT to October 31, 2001. Trustees approve $10,000 HCPSIT donation to Lauterbach Fund. Additional $10,000 annual donations ensue.

January 20, 2001 - HCPSIT's financial statement auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 1999 and October 31, 2000, were presented fairly, in all material respects.

January 30, 2001 - HCPSIT Trustees discuss ongoing contract claims and loss control contract negotiations with PRM. Trustees approve audited financial statements for the year ended October 31, 2000.

January 31, 2001 - Effective date of new WCB regulations.

April 24, 2001 - Wang discusses with HCPSIT Trustees the investment guidelines included in the new WCB regulations. Minutes note that the Trust will eventually need to meet with the WCB to establish a plan to come into compliance with the limit on equity investments. Investment manager, Chase Bank, indicates that at least a time frame of 12-18 months to comply would help limit the losses that the Trust would incur.

August 22, 2001 - TTP issues follow-up report on PRMCS. TTP reports: "In our opinion, PRM's claim handling performance is at a best practices quality level as compared to similar TPA's handling workers compensation claims. PRM has made significant, ongoing progress to become a high quality/high service organization."

September 13, 2001 - HCPSIT Trustees approve change to the interest rate on the loan to the HCPDBT to the lowest allowed IRS rate and to reduce the HCPSIT participant discount from 30% to 25% and to charge the full NYS Assessment (14.4%).

October 11, 2001 - Trustees approve the extension of the note to the HCPDBT through October 31, 2002.

November 1, 2001 - Agreement signed by Wang and Arney re-appointing PRM as the Trust's Program Administrator. The term of the Agreement is November 1, 2001 through October 31, 2004.

November 1, 2001 - Agreement signed by Wang and Arney for PRM to provide Loss Control Services to the Trust for a monthly fee of $7,500 plus reasonable and necessary incidental expenses. The term of the Agreement continues to October 31, 2004.

November 1, 2001 - Agreement signed by Wang and Arney appointing PRMCS as the Trust's Claims Administrator for the period November 1, 2001 through October 31, 2004.

January 29, 2002 - TTP issues a draft report to Wang and notes that the 8% rate used by the Trust for discounting to present value may be aggressive.

February 6, 2002 - Trustees reviewed recently finalized contracts with PRM. Trustees vote to discontinue paying the cost of financing subsidy for HCPDBT members by November 1, 2004, or upon full pay-down of the outstanding HCPDBT loan, if sooner.

February 8, 2002 - HCPSIT's financial statement auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2000 and October 31, 2001, were presented fairly, in all material respects, and reveal a members' deficit of $1,454,871 as of October 31, 2001.

May 2, 2002 - Wang reports to HCPSIT Trustees that WCB recognizes Trust is not in compliance with the maximum 25% equity investment limit. PRM tells Trustees that out of 70 trusts in NYS only one other trust is in HCPSIT's position with respect to equity investments.

August 23, 2002 - HCPSIT Trustees vote to reduce the portion of HCPSIT participant contribution financing paid by the Trust to no more than 1% and cease subsidizing participant financing costs for HCPDBT, effective November 1, 2002.

October 2, 2002 - Wang reports to HCPSIT Trustees that the current loan balance due from HCPDBT was approximately $139,000 which had been reduced substantially by assessment payments and the forgiveness of fees from Resources and commissions from PRM. Trustees approve a one-year extension of the HCPDBT note to October 31, 2003. The note was ultimately extended by the Trustees to October 31, 2005. Minutes reflect a letter from Wang to the Trust's investment manager outlining the Trustees' "decision to reduce equities for reasons of compliance" with the new regulations.

November 5, 2002 - John Conroy, Senior Vice President, PRM, sends an email to John Yonkunas at TTP relating to TTP's actuarial review and asking for TTP to consider "positive developments" undertaken by the Trust after the review period.

January 16, 2003 - HCPSIT's financial statement auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2001 and October 31, 2002, were presented fairly, in all material respects and reveal a members' deficit of $4,600,256 as of October 31, 2002.

May 5, 2003 - Investment Manager Search Committee recommends to the HCPSIT Trustees that Morgan Stanley/Neuberger Berman be engaged as HCPSIT's new investment manager.

May 9, 2003 - PricewaterhouseCoopers (PwC) issues a report to the WCB relating to the Trust's Reserves as of October 31, 2002. The report finds that the Trust was underfunded as defined by 12 NYRCC 317.

May 21, 2003 - HCPSIT Trustees amend by-laws making Association President and Association Counsel non-voting Trustees. Two new Trustee positions, one Association-appointed and one HCPSIT-appointed are added.

August 2003 - TTP issues Claims Practice Review relating to PRM Claim Services in follow-up to TTP's report issued August 2001. TTP reports: "In our opinion, PRM's claim handling performance remains at a best practices quality level as compared to similar third-party administrators handling workers' compensation claims. PRM continues to maintained (sic) a high level of service on HCP/SIT claims."

August 20, 2003 - HCPSIT Trustees approve a 5% reduction in the discount rate effective January 1, 2003. Investment/Finance Committee reports it has requested Morgan Stanley/Neuberger Berman to provide the Trust with recommendations on how to best meet the WCB regulation for targeted equities (25% maximum) by 2005. Trustees vote to extend the note to the HCPDBT by one year to October 31, 2004.

September 22, 2003 - Trust's investment manager recommends to the Investment/Finance Committee to maintain a portfolio of 45% equities and take "as long as possible to reach the 25% equity threshold in order to achieve the greatest probability of earning a 5% return." Committee approves giving investment manager flexibility to recognize additional losses prior to October 31, 2003, and "use their discretion to ultimately reach a 25% equity position by April 2005."

October 27, 2003 - Trustees vote to maintain the 20% participant discount. Wang compliments Conroy for excellent review TTP gave to PCS. WCB representatives attend meeting to discuss results of PwC audit.

February 20, 2004 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2002 and October 31, 2003, were presented fairly, in all material respects.

April 28, 2004 - Trustees approve Loss Control, Program Administration, and Claims Management contracts with PRM/PRMCS for three-year terms.

July 26, 2004 - The WCB issues Level I Review Report advising that as of October 31, 2003, HCPSIT has a regulatory deficit of $20,776,674 and is deemed underfunded. The report notes, inter alia, that the Trust's investments are not in compliance with WCB's Rules and Regulations and that the Trust has not submitted a written plan to address this issue as requested by the WCB. The report further addresses WCB concerns relative to the Trust's large receivable resulting from the Trust's Retention Program.

October 11, 2004 - HCPDBT's Program Administrator, PRM President John M. Conroy, submits to the WCB a notice indicating HCPDBT would terminate on October 31, 2004.

October 12, 2004 - HCPSIT Trustees vote to discontinue the Trust's responsibility for paying a portion of the financing supplement. Trustees vote to extend the note to the HCPDBT by one year to October 31, 2005.

October 29, 2004 - Internal WCB memorandum expressing concerns relating to the Trust's Retention Program and the potential financial burden the Program may have on the Trust's nursing home members.

November 1, 2004 - Agreement signed by Wang and John Conroy, PRM President, appointing PRM as the Trust's Program Administrator. The term of the Agreement is November 1, 2004 through October 31, 2007.

November 1, 2004 - Agreement signed by Wang and John Conroy, PRM President, appointing PRM to provide Loss Control Services to the Trust for a monthly fee of $7,500 plus reasonable and necessary incidental expenses. The term of the Agreement continues to October 31, 2007.

November 1, 2004 - Agreement signed by Wang and John Conroy, President, PRM Claim Services, Inc. (PRMCS) appointing PRMCS as the Trust's third party administrator with regard to claims for the period November 1, 2004 through October 31, 2007.

January 21, 2005 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2003 and October 31, 2004, were presented fairly, in all material respects.

February 2, 2005 - The Association's Executive Vice President advises HCPSIT Trustees that the issue of retention plans remains an unresolved issue with the WCB but it is now on record that the Trust can write these types of plans again. Trustees vote to engage counsel and other consultants to enlist the cooperation and assistance of the New York State Legislature and the Executive to obtain administrative or regulatory redress from the "unreasonable, inequitable and adverse consequences" of the application to the Trust and its Participants of certain provisions of the Self-Insurance Regulations promulgated by the WCB.

May 10, 2005 - The WCB issues Level I Review Report advising that as of October 31, 2004, HCPSIT has a regulatory deficit of $21,337,669 and is deemed underfunded. The report notes, inter alia, that the Trust's investments are not in compliance with Section 317.8 of the WCB's Rules and Regulations. The report states that the receivable resulting from the Trust's Retention Program was nearly $14 million.

July 29, 2005 - WCB meets with HCPSIT Trustees to discuss Consent Agreement. Trustees agree to sign Agreement. Minutes state that "the Trust was permitted to continue offering retention plans."

August 4, 2005 - Consent Order signed by WCB Executive Director executing a Consent Agreement whereby the Trust acknowledges it is underfunded as defined in 12 NYCRR 317 and agrees to certain procedures to remediate the Trust's underfunded condition, including acknowledging that the receivable associated with the retention program is not recognized as an acceptable asset as defined in 12 NYCRR Part 317, limiting new members into the retention program and submitting a written re-investment plan committing the Trust to compliance with NYCRR Part 317 investment standards.

September 27, 2005 - Charlie Gruber and David Royce from SGRisk discuss and distribute Actuarial Report to HCPSIT Trustees.

November 1, 2005 - Wang sends letter to investment manager instructing them comply with the investment provisions of the Consent Agreement.

November 11, 2005 - Trust sends letter to the WCB reiterating its intention to be in compliance with the investment requirements under the Rules and Regulations and that new, retiring, and maturing investments would be invested in approved investment vehicles.

January 12, 2006 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2004 and October 31, 2005, were presented fairly, in all material respects, and the footnotes to the auditor's report reveal that the Trust is considered "under funded" as defined in the Workers' Compensation regulations.

May 23, 2006 - The WCB issues Level I Review Report advising that as of October 31, 2005, HCPSIT has a regulatory deficit of $22,992,244 and is deemed underfunded. The report notes, inter alia, that the Trust's investments are not in compliance with Section 317.8 of the WCB's Rules and Regulations and that the Trust has stated by letter dated November 1, 2005, its intent to be in compliance with Section 317.8. The Report further addresses WCB concerns relative to the Trust's large receivable resulting from the Trust's Retention Program, legislative and regulatory expenses, donations and political contributions.

September 28, 2006 - TTP issues Claims Practice Review relating to PRM Claim Services in follow-up to TTP's report issued August 2003. TTP reports: "Overall, PRM continues to perform at a high level compared to similar third-party administrators handling WC claims."

October 24, 2006 - Charlie Gruber and David Royce from SGRisk discuss and distribute Actuarial Report to Trustees.

January 7, 2007 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2005 and October 31, 2006, were presented fairly, in all material respects and as of October 31, 2006 and 2005, the Trust is considered "under funded" as defined in the Workers' Compensation regulations.

February 22, 2007 - Charles Gruber, SGRisk President, sends letter to the WCB protesting WCB's planned independent actuarial review of SGRisk's actuarial reports for the Trust by PwC.

April 18, 2007 - Trustees approve a Conflict-of-Interest Policy and submit signed ethics disclosures for the current year. President Wang does not submit signed disclosure. Wang thanks Trustees for support of political fundraiser.

June 13, 2007 - PwC issues to the WCB an Analysis of Trust's Actuarial Report. The report states the Trust's recorded reserves were significantly below actuarial indications, and it is uncertain whether the recorded reserves should be discounted if assets are not held to support the liabilities.

June 19, 2007 - The WCB issues Level I Review Report advising that as October 31, 2006, HCPSIT has a regulatory deficit of $24,334,856 and is deemed underfunded. The report notes, inter alia, that the Trust's investments are not in compliance with Section 317.8 of the WCB's Rules and Regulations and that despite the Trust's stated intent to be in compliance with Section 317.8, unapproved investments continued to be purchased. The report further addresses WCB concerns relative to the Trust's large receivable resulting from the Trust's Retention Program, legislative and regulatory expenses, donations and political contributions.

October 16, 2007 - Wang reports to the HCPSIT Trustees that based on the drop in revenue affecting commissions and management fees paid to both Resources and PRM as a result of Workers' Compensation Reform, the Investment/Finance Committee recommends that an additional fee of 1% be paid to Resources and PRM for fiscal year 2007-08. Trustees approve this recommendation. Charlie Gruber and David Royce from SGRisk discuss and distribute Actuarial Report to Trustees.

November 1, 2007 - Resources enters into Management Agreement with HCPSIT to provide general management, staffing, and business accounting services to HCPSIT. Agreement signed by Todd Brason, Chairperson on behalf of Trust, and by Phyllis Wang, President of the HCP, Resources, Inc.

November 1, 2007 - Agreement signed by Wang and John Conroy appointing PRM as the Trust's Program Administrator. The term of the Agreement is for five year, November 1, 2007 through October 31, 2012.

November 1, 2007 - Agreement signed by Wang and Conroy appointing PRMCS as the Trust's third-party claims administrator for the period November 1, 2007 through October 31, 2012.

November 1, 2007 - Agreement signed by Wang and Conroy for PRM to provide Loss Control Services to the Trust. The term of the Agreement continues to October 31, 2012.

January 11, 2008 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2006 and October 31, 2007, were presented fairly, in all material respects.

January 23, 2008 - Trustees informed that although the market is currently volatile, the Finance Committee is confident in the Trust's investment strategy.

February 25, 2008 - Consent Order signed by WCB Executive Director executing a Consent Agreement whereby the Trust acknowledges it is underfunded as defined in 12 NYCRR 317 and agrees to certain procedures to remediate the Trust's underfunded condition, including allowing the acceptance of no more than 20 new members into the Trust, achieving agreed-upon breakeven results for the 2008 Contribution Year, billing retention plan claims to members, active and inactive, for the program years to date, and providing additional financial reporting to the WCB.

May 8, 2008 - WCB issues Level I Review Report that concludes that as of October 31, 2007, HCPSIT has a regulatory deficit of $26,588,134 and is deemed underfunded.

July 23, 2008 - Wang thanks Trustees for their support of a fundraiser for the Senate Republicans and notes that of the Association's $40,000 commitment, $25,000 has been turned over to the campaign. Wang adds that there is still $3,550 yet to raise.

August 29, 2008 - SGRisk issues report to PRM relating to an *Analysis of Rates Effective November 1, 2008*.

September 12, 2008 - Trustees meet with WCB representatives to review WCB's 2007 Level 1 Review.

September 25, 2008 - Trustees approve Wang's recommendation to increase Resources' management fee by 1% "to help absorb the dramatic impact of rate reductions in WC Reform on HCPR." Trustees informed that some of the investments labeled as foreign by the WCB may be in a "grey Category and that the Trust is seeking clarification from the WCB on this." Investment manager "has been instructed not to purchase any foreign investments until they are further notified by the Trust."

October 26, 2008 - David Royce from SGRisk discusses and distributes Actuarial Report to Trustees.

February 5, 2009 - HCPSIT's auditors, DF&J, conclude that HCPSIT's financial statements for the periods ended October 31, 2007 and October 31, 2008, were presented fairly, in all material respects. As of October 31, 2008 and 2007, the Trust is considered "under funded" as defined in the Workers' Compensation regulations.

February 5, 2009 - Conroy reports to Trustees he is analyzing opportunities for a captive insurance program for Trust participants.

March 24, 2009 - WCB Preliminary Level I Review Report concludes that as of October 31, 2008, HCPSIT has a regulatory deficit of $27,414,548 and is deemed underfunded.

April 14, 2009 - Trustees vote to approve moving forward with captive insurance option for Trust participants.

April 23, 2009 - Trustees approve that investment managers suspend all purchases - bond or equity - until further notice to keep things liquid. Conroy reviews and discusses captive insurance with Trustees.

April 24, 2009 - Letter to HCPSIT members sent by Wang and Todd Brason, HCPSIT Chairperson, updating members on Trust's status. Issues discussed included, inter alia, opposition to WCB's action to close down the Trust, seeking of NYS Governor's Office and State Legislature intervention, dispute with WCB's accounting methodology for determining the Trust's underfunded status, "increasingly hostile" relationship between WCB and the Trust, and exploration of a captive workers' compensation insurance alternative for members.

April 27, 2009 - Meeting held between WCB and HCPSIT representatives concerning transition process to be followed when Trust closes on June 30, 2009. Trustees address concerns regarding impact on participants.

April 30, 2009 - Meeting held between HCPSIT representatives, Governor's Office, WCB Chair, and Senate majority's Counsel concerning Trust status. Trust proposes a new remediation plan that includes collection of $16 million from employer members. WCB agrees to consider such a plan.

May 1, 2009 - Wang, Brason, Conroy, and Trust's lobbyist report to Trustees the result of their meeting with Governor's Office, et al. the previous day.

May 4, 2009 - WCB sends letter to HCPSIT Trustees requesting remediation plan from Trust within two weeks.

May 11, 2009 - Trustees meet to develop proposal to the WCB. Trustees vote to submit a proposal to the WCB to collect $16 million through a capital contribution from current and past Trust participants and by selling investments disallowed by the WCB, and to communicate to the WCB that the Trust commits to evaluate reducing expenses overall by 10%.

May 28, 2009 - Letter to HCPSIT members sent by Wang and Brason updating members on Trust's status. Issues discussed included, inter alia, the availability of a captive insurance product for members as well as coverage from a standard insurance carrier and the State Insurance Fund, possible assessments should the Trust continue, and post-dissolution oversight of the Trust.

May 29, 2009 - Trustees vote to ask Trust participants to engage in grassroots efforts to gain the support of legislators to stop the Trust's closure and to request letters of intent from participants to pay the $16 million capital contribution upon condition of Trust's continuance.

June 12, 2009 - Letter to HCPSIT members sent by Wang and Brason updating members on Trust's status. Issues discussed included, inter alia, the discontinuance of the Trust after June 30, 2009, continued handling of claims by HCPSIT and PRM after June 30, 2009, the Association's finalizing of its captive insurance program for HCPSIT members, and PRM's furnishing of premium cost estimates for this new program to all HCPSIT members.

June 30, 2009 - HCPSIT's status as a group self-insurer revoked by the WCB.

October 8, 2009 - The WCB informs the Trust that the Trust has failed to demonstrate its ability to properly administer its liabilities and, accordingly, the WCB would terminate the Trust and assume the administration and final distribution of the Trust's assets pursuant to 12 NYCRR 317.20(c) effective not later than October 26, 2009.

October 13, 2009 - NCAComp, Inc. assumes responsibility for the Trust's runoff on behalf of the WCB.

October 26, 2009 - HCPSIT Trustees pass a resolution transferring the management and administration of the Trust from the Trustees and PRM and its subsidiaries and affiliates, and all their powers, duties, authority, and responsibility to the WCB and its contracted administrator effective immediately, reassign their position as Trustees effective midnight, October 26, 2009.

II. OBSERVATIONS

A. Trust Formation

The New York State Laws governing the formation of group self-insured trusts indicate that the group self-insured trust be formed by a group of employers in a similar industry. The Trust was formed on or about September 1992 through a relationship between The New York Association of Health Care Providers, Inc. (the "Association")[7] and Thomas B. Arney, Chairman of Jardine Insurance Brokers New York, Inc. (Jardine).

Arney told BST that he was contacted by Thomas J. Gosdeck, Esq. who indicated that the Association was looking for workers' compensation coverage for its members. Gosdeck was the Association's Counsel and was involved in some other insurance work with Arney. Arney said he made a presentation to Association President Phyllis Wang. As a result of the meeting, Arney undertook an analysis of compensation class codes and loss histories for Association members and presented this to the Association's Board of Directors who liked the idea of forming a self-insured trust. Arney indicated that he "fronted" $125,000 from his own 401(k) as security deposit to form the Health Care Providers Self Insured Trust (HCPSIT or Trust).[8]

Wang advised BST that Association members had approached her over the years looking for a less expensive workers' compensation insurance alternative. She confirmed that Gosdeck put her in touch with Arney, and they agreed to perform a survey of Association members to determine the level of interest in forming a trust. The response was favorable, and they proceeded. Wang said she consulted with another health care association in New Mexico that had a trust to get some additional insight. A decision was made to move forward, and she negotiated an agreement with Arney in 1992 to get the Trust underway. Wang noted that in addition to Arney, she and Trust co-founders Edna Lauterbach and Joel Schwartz also committed funds to get the Trust underway[9].

On September 14, 1992, a Letter Agreement was executed by Wang as Association President and HCPSIT Trustee and Arney as Jardine Chairman to perform several joint and separate duties regarding the formation and management of HCPSIT, including Jardine's serving as the Trust's insurance broker and Program Administrator. The letter further noted that the Association had recently endorsed Jardine as a provider of Statutory Disability Insurance programs. Wang told BST that she negotiated the terms of this document directly with Arney.

On September 17, 1992, certain members and Trustees of Association signed a Self-Insurance Agreement and Declaration of Trust (Trust Agreement) establishing the Health Care Providers

[7] Founded in 1974, the Association is an East Greenbush, New York-based trade organization representing approximately 600 home care and community-based health providers. Association affiliates include HCP Resources, Inc., Community Health Care Services Foundation, Inc. and InPro (the Association's new captive workers' compensation program).
[8] Gosdeck confirmed to BST that Arney performed the member loss analysis and provided the Trust's security deposit.
[9] We did not verify what, if any, funds were committed.

Self-Insurance Fund. The signatories included Edna A Lauterbach and Joel Schwartz as Association members[10] and Wang, Arney, Gosdeck, and Lauterbach as Association Trustees (see Exhibit 1). Also on September 17, 1992, the signatories to the Trust Agreement also signed and executed an Indemnity Agreement that, inter alia, established the joint and several liability of the Trust's members (see Exhibit 2). Wang and Gosdeck advised BST that Gosdeck prepared the aforementioned documents.

On September 22, 1992, HCP Resources, Inc. (Resources) registered as a domestic business corporation with the New York State Department of State - Division of Corporations. Phyllis A. Wang is identified as Resources' Chairman/Chief Executive Officer (see Exhibit 3). Gosdeck advised BST that the Association's setting up a related for-profit entity "made sense" as the Association had limitations on what it could do as a 501(c)(6) entity.[11] Wang noted that the Association had thought about setting up a for-profit affiliate for many years to do some things not directly related to the Association and to serve as a "firewall" for the Association. She said Gosdeck suggested it. Wang said the timing of setting up Resources at the time of the Trust's formation was "coincidental" and that the Trustees approved Resource's subsequent contract with the Trust.[12]

Trust records provided to BST reflect that HCPSIT By-laws were approved by the HCPSIT Trustees on September 23, 1992 (see Exhibit 4). Gosdeck prepared this document as well.

On September 24, 1992, Arney submitted an application for group self-insurance for HCPSIT to the WCB (see Exhibit 5). Chase Lincoln First National Bank, NA was identified as the group's banking institution and Gallagher-Bassett Services, Inc. was listed as the group's licensed third-party claims administrator. The application was subsequently accepted by the WCB on May 11, 1993, pursuant to Section 50, Subdivision 3-a, Part 316 (Group Self Insurance) of the New York State Workers' Compensation Law with a retroactive effective date of April 19, 1993.

Trust records show that on October 27, 1992, Wang, Arney, Gosdeck, Lauterbach, and Schwartz held the first documented meeting of HCPSIT Trustees "for purposes of preliminary activities to activate the trust."

Records reveal that during a conference call meeting on January 29, 1993, Arney advised the Trustees that Cannanwill, Inc.[13] was willing to enter into an agreement to finance the premium due during the first year in order to provide the Trust funds to purchase a bond.

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[10] Lauterbach, since deceased, was President of Health Savers, Inc. of Newburgh, NY, and Schwartz was Chairman of Comprehensive Home Care Services of Smithtown, NY. Both entities participated in the Trust's Retention Program to be discussed later in this report. Though Health Savers, Inc. was a Retention Plan participant, BST could not locate a signed retention agreement for this entity.

[11] Gosdeck did not specify these limitations.

[12] Trustee meeting minutes for July 14, 1993, refer to the Trustees' approval of Resources' "management agreement." Trustees included Wang, Gosdeck, Arney, Lauterbach, and Schwartz.

[13] Cannanwill, Inc. subsequently provided premium financing to Trust members for which Arney's firms received a commission.

Trust records indicate that four members joined the Trust, effective, April 19, 1993.[14] By the end of 1993, the Trust had attracted more than 30 members.

On May 20, 1993, HCPSIT Chairperson Phyllis Wang executed a Contract for Services with Gallagher-Bassett Services, Inc. (GB) for claims and loss control services for the period April 21, 1993 through April 21, 1994. This will be discussed in more detail later in this report.

On July 14, 1993, Arney tendered his resignation as an HCPSIT Trustee due to the potential for conflict of interest upon the advice of counsel to his company, and indicated that he would remain as HCPSIT's Program Administrator.[15] The Trustees were also advised that HCPSIT had accrued a management fee owed to Resources in accordance with the terms of a management agreement approved by the HCPSIT Trustees and by Resources. However, the referenced management agreement between HCPSIT and Resources was not formally executed until August 25, 1993 (see Exhibit 6).

The executed Agreement stated that Resources would provide general management, staffing, and business accounting services to HCPSIT. The Agreement was signed by Wang as Association Chairperson and Gosdeck on behalf of Resources and was deemed to have been in force and effect on and after January 1, 1992. Schedule 1 of the Agreement indicated that HCPSIT would reimburse Resources "for that pro rata portion of the share of the salaries paid to officers, directors, employees, and agents of Resources for that time which was expended by them in furtherance with the purposes of this Agreement" and "for its pro rata share of the operating expenses attributable to Trust (sic) including all state taxes, fees, accounting charges, bank fees and the like." This Agreement remained in effect without formal amendment until a new Agreement was executed on November 1, 2007.

Evidence suggests that HCPSIT was established not only to provide low cost workers' compensation coverage to Association members, but also to create a new revenue stream for the Association, through Resources, in support of HCPSIT's activities. As discussed in greater depth later in this report, Resources was a major source of non-fee revenue for the Association to support its personal services and non-personal services expenses. Wang's overlapping leadership and decision-making roles within the Association, Resources, and HCPSIT allowed her to use HCPSIT for the Association's maximum benefit and not only as a workers' compensation program for members. Wang's actions may have been influenced by her position as the Association's President rather than as a workers' compensation insurance consumer. HCPSIT could easily be viewed as an extension of the Association rather than as an independent trust.

There is no evidence that anyone other than Arney was ever solicited to serve as HCPSIT's Program Administrator, which is largely reinforced by subsequent events where HCPSIT's

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[14] Records show that an additional member, George A. Rossi, had a membership date of July 1, 1992, but this could not be confirmed.

[15] It is unclear why Gosdeck, the legal counsel to both HCPSIT and the Association and the reported author of the Trust formation documents, did not recognize the apparent conflict.

program administrative functions followed Arney to two other firms. The close and evolving business interrelationship between the Association and Arney and Arney's successor, John Conroy, will be discussed this report.

Furthermore, there is no evidence that Wang solicited the Trustees' input when negotiating the initial Service Agreement with Arney, which also may have served as the basis for Wang's future business relationship with Arney and his successor companies.

In May 4, 2009, in a letter to the HCPSIT Trustees, the WCB stated:

> *Due to the significant financial deficit, and as stated in earlier correspondence from the WCB, the Trust is prohibited from paying dividends, refunds and credits, returns of contribution or adjustments of any kind, to members without prior approval of the WCB.*

Despite this statement, and according to WCB officials, refunds/credits were subsequently given to Trust members without the approval of WCB officials, who eventually assumed control of the Trust's assets and payment of its liabilities on June 30, 2009.

B. Board of Trustees

BST interviewed a sample of HCPSIT Trustees about their roles, interactions with PRM, and understanding of their fiduciary duties. HCPSIT President Phyllis Wang, HCPSIT Counsel Joel Hodes, Esq. and Trustees Todd Brason, Thomas Buckley, Richard Swanson, and Robert Kolb graciously granted extensive interview time.[16] President Wang and Trustee Swanson furnished numerous documents to BST. Trustee Phyllis Raymond responded to a written questionnaire furnished by BST at her request. Trustees Carmen Flitt, Jordan Shames, and D. Scott Tooker did not respond to written questionnaires provided by BST at their request.[17] Trustees Ronald Field, Bert Johansmeyer, and Gwen Eichorn did not respond to BST's request for an interview. Input from the cooperating Trustees is reflected below and in the appropriate sections of this report.

BST also obtained and reviewed official Trustee and sub-committee meeting minutes for the period October 27, 1992 through October 9, 2009, as well as other documents relating to the activities of the Board of Trustees.

As detailed above, the HCPSIT Trust Agreement was executed on September 17, 1992. The two founding members were Comprehensive Home Care Services of Smithtown, New York and

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[16] Wang and Hodes both initially had voting authority as Trustees.

[17] Flitt, representing Upstate Homemakers Group, Inc., served as HCPSIT Chair and attended/participated in over 30 Trustee meetings/conference calls. Flitt now serves on the Board of Managers of InPro, a captive workers' compensation insurance provider managed by PRM on behalf of the Association. Shames served as the HCPSIT's Secretary Treasurer and attended/participated in over 50 Trustee meetings/conference calls. Shames is a member of the Association's Board of Directors.

Health Savers, Inc. of Newburgh, New York both with April 19, 1993, membership effective dates. The Trustees also adopted By-laws on September 23, 1992.[18]

Article II, Section 1 of the By-laws and Article III of the Trust Agreement state that the Trust was formed to provide to provide Workers' Compensation Insurance coverage in the State of New York to employers in the home care industry.

Article IV, Section I of the Trust Agreement states, "The operation and administration of the Trust Fund shall be the joint responsibility of a Board of Trustees consisting of a number of trustees which shall be composed of five persons appointed as provided in this Article." Section II provides that two Association members be designated to serve as trustees by the Association Chairman, and that the Association President, the Association Counsel, and a representative of Jardine Insurance Brokers New York, Inc. also shall serve as Trustees.[19] On its face, it would appear to be a conflict of interest for the Program Administrator (Jardine Insurance Brokers New York, Inc.) to serve as a voting member of the HCPSIT Board of Trustees where it is in a position to influence decisions regarding its fees and scope of services.

Trustee meeting minutes for March 1, 1993, reflect that Gosdeck was elected as HCPSIT Secretary.[20] While meeting minutes and Trust documents indicate that Wang served as HCPSIT Chair early in the Trust's existence and was given authority to sign documents on behalf of the Trust as per the minutes of October 27, 1992, BST could find no official document appointing her to that position. Wang told BST that she assumed the Chair's role initially to get the Trust underway and relinquished that role once there were a sufficient number of qualified Trustees in place.

As noted previously, Arney resigned his position as Trustee in 1993 upon the advice of corporate counsel. Jardine then designated another representative from among the Trust's member employers. On February 1, 1994, the Trustees passed a resolution amending the By-laws removing the designation of a HCPSIT Trustee by Jardine (the Program Administrator) and adding that three of the five HCPSIT Trustees shall be designated by the Association Chairperson.[21]

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[18] BST did not identify any Trustee meeting minutes for either September 17, 1992 or September 23, 1992.

[19] In accordance with this provision, the Trust Agreement was signed by Edna Lauterbach (Health Savers, Inc.) and Joel Schwartz (Comprehensive Home Care Services) as Association member designees, Thomas Arney on behalf of Jardine, Phyllis Wang as the Association's President, and Thomas J. Gosdeck, Esq. as the Association's Counsel. Parallel provisions are contained in Article IV, Section 1 of the By-laws.

[20] The By-laws and Trust Agreement provide that a Chairman and Secretary shall be elected annually from among the Trustees.

[21] In 1999, the By-laws were amended expanding the number of Trustees to no fewer than seven (7) and no more than eleven (11) Trustees. No fewer than three (3) and no more than five (5) Trustees, each of whom shall be a member of the Association and a participant in this Trust, shall be designated by the Association Chairperson. In 2003, the By-laws were again amended requiring that no fewer than four (4) and no more than six (6) Trustees, each of whom shall be a member of the Association and a Participant in this Trust, shall be designated by the Association Chairperson. The Trustees shall, by vote of a majority of them, designate no fewer than three (3) and no more than five (5) additional Trustees, each of whom shall likewise be a member of the Association and a Participant in the Trust.

Trustee meeting minutes for September 29, 1995, report that the Trustees amended the By-laws creating the office of President of the Trust and separating the functions of Chairman and President. A participant in the Trust would serve as Chairman, and the President would serve as its chief executive officer.[22] It is interesting to note that prior to this date, Wang signed documents as HCPSIT President although the official title of HCPSIT President had not yet been officially created.[23] As noted above, Wang said she relinquished her role as Chairman as a sufficient number of qualified Trustees were now in place to govern the Trust.

Article VI of the Trust Agreement specifies the powers and duties of the Trustees. The Trustees are "charged with the duty of general supervision and operation" of the Trust which includes consideration of new members, establishment of funds, posting of security deposit, filing of required reports, asset protection, and promulgating rules and regulations. Our review found that the Trustees largely fulfilled these general responsibilities, but they authorized certain transactions that might not have been in the Trust's best interest as detailed later in this report.

Documents reviewed and interviews conducted show that the Trustees were actively engaged in the operation and management of the Trust. In person and conference call meetings were held at least two times a year as required by the Trust Agreement and By-laws and were summarized in written minutes. Records show that over 100 in-person and conference call meetings involving the Trustees occurred from October 27, 1992 to October 9, 2009, with many averaging 2-3 hours' duration. Records and interviews confirm that an annual Trustees' meeting was held each fall at locations outside the Albany area where presentations were made by the Trust's actuary, independent auditor, and investment manager.[24] Also, additional meetings of the Finance/Investment Committee[25], Safety Committee[26] and other sub-committees[27] occurred during this period and similarly were documented in written minutes. Agendas were provided to the Trustees in advance of the meetings, and Trustees had the opportunity to add agenda items.

Trustees were also provided with a briefing binder prior to each meeting. BST obtained a sample binder for the April 30, 2008, Trustee meeting. The binder contained a meeting agenda, minutes from the previous Trustees meeting, the Trust's investment account summary from Morgan Stanley, a Profit & Loss Previous Year Comparison November 2007 through March 2008, Profit & Loss Budget vs. Actual November 2007 through March 2008, Balance Sheet as of March 31, 2008, Profit & Loss Budget vs. Actual March 2008, revenue/expense comparison April 2006 - March 2008, memorandum from the Program Administrator re NYS Assessment, Program Administrator's Report, Claims Administration Report, and Policy on Ethical Conduct.

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[22] The President retained its status as a voting Trustee of the Board.
[23] For example, on April 1, 1994, Wang signed a Letter Agreement as HCPSIT President appointing Naples Risk Management as the Trust's new Program Administrator.
[24] Trustee minutes reflect that the 2008 annual meeting was held on October 26, 2008 at the Hyatt Regency in Montreal, Quebec, Canada.
[25] Approximately sixty (60) Investment/Finance Committee meetings were documented.
[26] Six (6) Safety Committee meetings were documented.
[27] Four (4) Special Purpose Committee meetings were documented.

The Trust's Program Administrator, Claims Administrator, and independent auditor[28] regularly attended the Trustee meetings. The Trust's actuary and investment advisors also attended on an as needed basis.

Beginning in or about 2000, new Trustees were provided with a comprehensive Board of Trustees Manual prepared by the Program Administrator and the Association. BST obtained an electronic version of this comprehensive document from the Association. The Manual contained organizational information, corporate and program documents (including by-laws, trust agreement, and indemnity agreement), NYS statutes and regulations, service contracts and insurance coverage, program information, financial information and general information. The Manual's table of contents is included as Exhibit 7.

BST was advised by multiple sources that the Manual was presented to new Trustees as part of a training session presented annually for new Trustees by the Program Administrator and Wang. Attendance was mandatory for new Trustees and optional for existing Trustees.

All Trustees interviewed indicated they were provided with sufficient information to effectively perform their fiduciary duties as Trustees and had the opportunity to voice their concerns and opinions. All evidence suggests that Trustees were well informed and actively engaged in the activities of the Trust. Equally evident was the prominent role Wang played in the recruitment/selection of Trustees, coordination of Trustee meetings, and setting of the meeting agendas. It is noteworthy that such duties in similar organizations are typically performed by the Board Chair.

Minutes indicate that Wang routinely brought new Trustee candidates to the Trustees' attention for their consideration for appointment and, invariably, such candidates were selected by the Trustees. Also, Wang was instrumental in identifying candidates selected by the Association Chair. Moreover, minutes reveal that Wang typically announced to the Trustees the Trustees who were interested in serving as Chair and Secretary. Again, those candidates were typically approved by the Trustees. There is no evidence that Wang exerted undue pressure on the Trustees in this regard, however, it is clear she "seeded" the Board with individuals she favored.[29]

From October 1992 through May 2003, Wang and HCPSIT's Counsel were both voting members of the Board. Her voting authority along with that of HCPSIT's Counsel, who also served as the Association's Counsel, gave Wang tremendous control over the Trustees, the decisions they made, and the direction they moved the Trust.

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[28] The Trust's independent auditor, David Johnson, CPA, was also the auditor for the Association, Resources, Community Health Care Services Foundation, Inc. (CHC), HCP Disability Benefits Trust (HCPDBT) and the Health Care Providers Political Action Committee and PRM, the Trust's program administrator.

[29] A number of Trustees played a prominent role in the Association as Board and/or committee members. More importantly, many of the Trustees represented employers participating in the Trust's Retention Plan which offered substantial premium discounts to a select group of Trust participants. The Retention Plan and its major impact on the Trust's financial insolvency will be discussed in detail later in this report.

Minutes for the Trustee meeting of October 2, 2002, reveal that the HCPSIT Counsel explained to the Trustees that the current HCPSIT By-laws required that Counsel and the President serve as Trustees. He added that "having these individuals serve as advisors rather than voting Trustees may now be more prudent" and recommended that the Trustees "amend the bylaws to remove these individuals as Trustees." On May 21, 2003, the Trustees approved a resolution removing the Counsel as a Trustee and changing the President to a non-voting Trustee. Two new Trustee positions were created, one appointed each by the HCPSIT Board and Association Board, to replace the President's and Counsel's voting authority.

Hodes stated to BST that once the number of Trustees grew sufficiently he felt that he, as Counsel, and Wang should no longer have a vote to avoid a conflict of interest by voting on issues directly impacting them, and he recommended the by-laws be changed. BST concurs with Hodes' rationale for recommending the by-law revision, but questions why this action was not taken earlier, rather than ten years after the Trust's formation. Moreover, despite Wang's non-voting role, Wang remained in a position to influence the Board of Trustees' actions through direct Association Trustee appointments and attendance at regular and investment/finance committee meetings. Wang's continued influence is best exemplified by the Trustee minutes that consistently reflect her recommendations on the full range of Trust issues being approved by the Trustees, most often unanimously.

Trustee meeting minutes for April 18, 2007 state that Wang "explained the significance of having a conflict-of-interest policy to protect the organization in situations where there may be doubt about a Board member's ability to act objectively with regard to HCPSIT's interests in today's business climate." The Trustees then approved a Conflict-of-Interest Policy and handed in signed disclosures for the current year. Wang and Hodes noted that the Conflict-of-Interest form came about by Sarbanes-Oxley considerations[30] and that Wang signed such a form internally for the Association but not in her capacity as Trust President. Evidence strongly suggests that the prominent roles Wang played concurrently in the Association, Resources, and HCPSIT, constituted a conflict of interest in appearance, if not in fact. As such, it would have been both appropriate and prudent for Wang to also execute a Conflict-of-Interest form.

In summary, BST found that there was a strong management organization by the Association via Resources supporting the activities and operation of the HCPSIT Board of Trustees. There appears to have been excellent information flow among the Trustees, Wang, and the Trust's professional consultants. The Trustees were well informed of their fiduciary duties as Trustees and the details of the Trust's investments, new member underwriting, member claims histories, and overall financial condition.[31] Trustee activities were well documented. Much of this was a result of Wang's hands-on involvement in the day-to-day operations of the Trust, role in recruiting qualified Trustees, and direct involvement in the Trustees' decision-making process.

[30] The Sarbanes-Oxley Act was enacted almost five years earlier.

[31] A cogent argument could be made that the Trustees may not have been truly objective given Wang's influence in the Trustee selection process, the Trustees' participation in the Trust's Retention Program, and the non-competitively awarded contract with Resources.

Wang was very astute in using the formal HCPSIT Board of Trustees structure to move the Trust in a direction that not only benefited HCPSIT, but also the Association and its affiliates which, in some instances, were the primary benefactors. A detailed discussion of this follows.

HCP Resources, Inc.

As discussed previously, on September 22, 1992, HCP Resources, Inc. (Resources) registered as a domestic business (for-profit) corporation with the New York State Department of State. Phyllis A. Wang was identified as Resource's Chairman/Chief Executive Officer (see Exhibit 3). This occurred within 5 days of the creation of the HCPSIT and the signing of HCPSIT's Indemnity Agreement on September 17, 1992. As mentioned previously, Wang asserted to BST that the timing of creating Resources at the time of the Trust's formation was "coincidental."[32] BST finds this assertion somewhat disingenuous.

On August 25, 1993, Wang, as HCPSIT Chairperson, and Thomas Gosdeck, as Secretary of the Resources' Board, executed a written Agreement (Resources Agreement) between HCPSIT and Resources providing for Resources to provide general management, staffing, and business accounting services to HCPSIT (see Exhibit 6). The Resources Agreement was deemed to have been in force and effect retroactive to January 1, 1992, approximately 20 months prior to the signing of the Resources Agreement and more than 8 months before execution of the Trust Agreement. Resources was to fulfill the following responsibilities:

- Designate a member of its staff to serve, subject to the approval of Trust, as the Manager of Trust.
- Provide staff as shall be necessary, in the sole discretion of Resources, to allow Trust to fulfill its activities in a timely and professional manner.
- Enter into the contracts necessary or desirable to fulfill the functions of Trust.
- Perform such other services as may from time to time be agreed upon.
- Keep, in a manner mutually acceptable, true and complete books of account and records of all business conducted under and pursuant to this Agreement.
- Not less than quarterly, render a report to Trust covering financial statements, including a balance sheet and profit and loss statement, all in such form as may be agreed upon from time to time between Resources and Trust.
- Prepare and file all governmental reports including tax reports, on the basis of information generated or made available to it.
- Open, maintain, and operate bank accounts in the name of Trust, and make deposits therein and disbursements therefrom.

[32] Article IX, Section 1 of the Trust's By-laws, dated September 23, 1992 states, in part: "A Management Agreement shall be negotiated with the New York State Association of Health Care Providers, Inc., hereinafter the "Association," for the purposes of efficiently securing the benefits for which the group self-insurance Trust was established and to carry out the intent of the Workers' Compensation Law. The Association shall have custody of all official records of the group insurance Trust. The Association shall provide the employees of the group insurance Trust and shall perform all necessary and incidental tasks necessary for the orderly functioning of the trust." This provision would strongly suggest that Resources was established for this expressed purpose.

- Engage, as an independent contractor, any person, services or other organization to perform any functions agreed by Resources.

The execution of the Resources Agreement by Wang and Gosdeck, in BST's view, constitutes a less-than arm's length transaction. Specifically, by signing on behalf of the Trust, Wang committed the Trust to financial obligations to Resources, a subsidiary entity of the Association, of which she was President. In addition, BST must question how Gosdeck could objectively create and vet a document on behalf of HCPSIT, for which he was both Counsel and Trustee, and then sign on behalf of Resources. How Wang and Gosdeck could simultaneously represent the best interests of the contractor, Resources, and contracting party, HCPSIT, remains unclear.[33]

In essence, Resources served as the HCPSIT's staff support arm using existing Association staff. The Resources Agreement had no stated termination date but could be terminated by either party in writing at the end of a fiscal year. BST found that the original resources Agreement remained in effect without formal amendment until a new, essentially identical Agreement was executed on November 1, 2007, almost 14 years later.

Schedule 1 of the Resources Agreement provided that HCPSIT would reimburse Resources a management fee as follows:

1. Trust shall reimburse Resources for that pro rata portion of the share of the salaries paid to officers, directors, employees, and agents of Resources for that time which was expended by them in furtherance with the purposes of this Agreement. Trust shall further reimburse Resources for its pro rata share of the operating expenses attributable to Trust including all state taxes, fees, accounting charges, bank fees, and the like.

2. Resources shall develop and implement procedures necessary to apportion the time expended by Resources officers, directors, and employees on activities which may be reimbursed in accordance with these provisions.

3. All fringe benefits of Resources personnel rendering Trust under this Agreement shall be apportioned in the same ratio as are apportioned the salaries of such person. (sic)

4. Trust shall reimburse Resources for all costs, expenses, and charges incurred in the performance of this Agreement including but not limited to printing costs, office supplies, photocopies, and other reproduction charges, facsimile transmission charges, telephone charges, filing and examination fees, and that portion of Resources lawyers' and accountants' expenses which are attributable to the activities of Trust. Prior to reimbursing Resources for any extraordinary expenses, which shall mean expenses not reasonably anticipated as necessary for the operation and management of the Trust, Resources shall receive the prior approval of the Trustees of the Trust.

[33] The Trust's audited financial statements refer to HCPSIT and Resources as "related entities."

5. In addition, Resources shall be entitled to be reimbursed for such expenses incurred by it in the performance of service hereunder as necessary travel, including meals and accommodations, and the time charges and expenses of affiliated subcontractors and consultants retained to advise or assist Resources, but only if such engagement have been approved in advance by Trust. (sic)

6. Reimbursable expenses shall include a sum which shall represent reasonable reimbursement for rent, utilization of office equipment, conference rooms, and other facilities as are directly attributable to the use of Trust. (sic)

7. Within thirty (30) days after the end of each month, Resources shall render a statement to Trust setting forth the expenses incurred by Resources during the immediately preceding month in accordance with the foregoing provisions. Payment by Trust of the amount set forth in a statement rendered shall be due thirty (30) days subsequent to the delivery of this statement unless the parties agree to less frequent, but not less than annual payments.[34]

By terms of the Agreement, HCPSIT reimbursed the Association, through Resources, for all salary-related and non-personal services costs attributable to the operation of the Trust. As noted above, Resources was specifically required to "develop and implement procedures necessary to apportion" personal services costs attributable to HCPSIT activities.

During the period 1992-2008, the Trust's audited financial statements report that Resources received total management fees in excess of $9.3 million,[35] plus over $200,000 in marketing and promotion fees.[36] In addition, during the period 1999-2008, HCPSIT paid fees in excess of $250,000 to a non-profit Association affiliate, Community Health Care Services Foundation, Inc.[37] (CHC) for training and other services.

BST found that despite the contracted "pro rata" method of compensation to Resources, HCPSIT paid fees to resources based on a percentage of gross written contributions (premiums) written. Specifically, Note 6 of the report prepared by the Trust's auditor Roth & DeChants (R&D) for the periods ended October 31, 1993 and October 31, 1994, reads as follows:

> The Trust pays a 2% management fee on gross contributions written to HCP Resources, Inc., a related entity. In addition an extra 1/3% of gross commissions is to be used for marketing expenses. Any unused marketing money is paid to HCP Resources, Inc. at the

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[34] The 2007 Agreement provided for an additional fee to be paid to Resources for the first year of the Agreement in an amount equal to one percent (1%) of the gross written contributions made by the Members to the Trust for and during such year.
[35] This represented 5% of total contributions written.
[36] These fees are in addition to the fees paid during the same period to the Program Administrator and Claims Administrator. PRM also paid Resources monthly fees pursuant to a Marketing Services Agreement to be discussed later in the Marketing Section of this report.
[37] CHC registered as a domestic not-for-profit corporation with the NYS Department of State on August 31, 1989. Fees paid to CHC will discussed later in the Safety/Loss Control Section of this report.

end of the year as additional management fees. Management fee expense was $182,486 and $38,005 for 1994 and 1993, respectively.

The auditor's reports for the years ended October 31, 1995 and October 31, 1996, show a management fee of 3% paid on gross written contributions. Beginning with the auditor's report for the year ended October 31, 1997, and continuing through October 31, 2008, only the total fees paid to resources were reported and not the percentage methodology as previously reported.

Trustee meeting minutes for December 16, 1997 reveal that the Trustees approved, upon Wang's recommendation, to increase Resources' management fee from 3% to 5% effective November 1, 1997, noting that the Investment/Finance Committee unanimously approved this recommendation at their meeting earlier that day. The referenced Investment/Finance Committee meeting minutes state:

> Wang explained that the Trust's management fees have remained at 3% of contributions since its inception. However, while HCPSIT participant numbers are increasing, the dollar value of each of the participants is decreasing because of cost savings and thus management fees are decreasing. Wang recommended increasing the management fee from 3% to 5% effective November 1, 1997 noting that this is still below the industry norm. This recommendation was unanimously approved by the Trustees.

It is clear from these passages that Wang proposed the increase in fees to Resources, and it is noteworthy that her focus of concern was the decrease in management fees to Resources rather than the savings these decreasing fees would bring to the Trust's members. It is interesting to note that the minutes reflect neither a discussion of finding another provider, nor that the Association's financial issues should not be of concern to HCPSIT's members.

Wang's concerns about fee revenue were highlighted again during a Trustee meeting on October 16, 2007 where minutes state the following:

> Wang reported that WC Reform, while beneficial to Trust participants, will have an immediate and adverse affect on both HCP Resources and PRM based on the significant and precipitous drop in revenue effecting commissions and management fees paid to both organizations in the coming year. This drop in revenue is too great to be absorbed in one year without significant elimination of services and personnel. Therefore, the Investment/Finance Committee recommended that: fees paid to HCPR and PRM in the current year not be reduced to reflect the rate change prior to the 10/31/07 year-end: and that an additional fee of 1% be paid to Resources and PRM for fiscal year 2007-08 to help both organizations absorb the sudden impact, dynamic impact of WC Reform.[38]

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[38] Minutes show that the Investment/Finance Committee discussed this issue at a meeting on September 24, 2007. In addition to approving the 1% increase upon Wang's recommendation, the minutes note that the additional 1% would be offset by a reduction in tax liability equal to $145,000 for a net reduction in proposed income equal to $225,000 on the 07/08 proposed budget. Four Trustees approved this increase, and one was opposed. Wang was a regular, non-voting, attendee of the Investment/Finance Committee.

> These recommendations have been incorporated in the revised 10/07 Year-end Projections and 2007-08 Budget being presented today. MOTION: by Fraher and seconded by Tim McGorry to approve the management fee proposal for 2008 as presented. RESOLUTION: Unanimously approved.

It appears that the Trustees shared Wang's view that the Trust's financial resources should be used to ensure that PRM and Resources did not sustain a financial loss, as opposed to insisting that PRM and Resources explore cost-cutting measures to reduce expenses.

BST spoke to David Johnson, CPA, a partner in the Trust's long-time auditing firm concerning the Resources Agreement.[39] Johnson said he did not recall the specifics of the written agreement between Resources and HCPSIT. Johnson indicated that Resources provided marketing, advertising, accounting, and staff support services to HCPSIT and used Association staff for this purpose, as Resources had no staff of its own. He indicated that HCPSIT was Resources' largest single source of revenue, but he respectfully declined to furnish any further specifics as Resources is also his audit client.[40]

Johnson was asked to explain the apparent inconsistency between the resources' Agreements that indicate Resources was to be paid for a pro rata share of Association expenses attributable to HCPSIT activities and financial statements and meeting minutes that indicate that Resources was compensated on a flat percentage of HCPSIT's total written contributions. Johnson had no recollection of this being reflected in the financial statements but did acknowledge that HCPSIT paid fees to Resources on a percentage of premium contributions. He recalled that this percentage increased from 3% to 5% over the years. He said that the percentage reflected the pro rata share of Association expenses attributable to HCPSIT, but he did not verify this during his audit as HCPSIT paid to Resources whatever the established percentage was.[41]

BST did not find any evidence that the original Trustees, other than Wang and Gosdeck, participated in preparing the initial Resources Agreement, which essentially remained in effect for over fifteen years - January 1, 1992 through October 31, 2007.[42] The 2007 Resources Agreement was signed by Todd Brason as HCPSIT Chairman and Wang as Resources' President, and was included in the Trustee Manual referenced earlier in this report (see Exhibit

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[39] As noted previously, Johnson is also the auditor for Resources, CHC, and the Association.

[40] BST obtained a copy of the Association's financial statements (unaudited) for the periods ended October 31, 2003 and 2002 which show that the Association received management fees from resources of $788,430 and $643,394 for 2003 and 2002, respectively. Corresponding financial statements for HCPSIT for the periods ended October 31, 2003 and 2002 show that HCPSIT paid to resources management fees of $795,238 and $647,657 for 2003 and 2002, respectively. Accordingly, HCPSIT fees paid to resources represented 99% of the total management fees paid by Resources to the Association for 2003 and 2002.

[41] Trustee minutes for October 26, 2008, reflect that as follow up to discussions regarding the use of staff time on HCPSIT, Wang explained the process that has been conducted for more than a decade to track staff time across entities. After discussion, it was agreed not to conduct a staff time study for HCPSIT.

[42] Arney stated to BST that he was not sure specifically what Resources did and he viewed the Association and Resources as one and the same. He felt that Resources was a way for Wang to keep the Trust's expenses straight. He recalled that his fee was 10% of gross contribution, and the Association received 3% for the first 3-5 years of the Trust. He said 10% was a normal fee and comparable to what he received for the other trusts he managed.

8). It is interesting to note that despite the fact that Resources' fees were 5% of written contributions, the 2007 Agreement contained the identical Schedule 1 as the 1993 Resources Agreement reflecting a pro rata basis of compensation with the exception of a supplementary item referencing the additional one percent (1%) of the gross written contributions to be paid the first year of the Agreement as approved by the Trustees.

BST spoke to the Trustees concerning Resources' scope of services and fees. Former HCPSIT Chair Brason[43] stated that Resources is a management organization that supported the Association and its affiliates and coordinated interrelationships of the affiliated organizations, and the flow of services and funds. He did not know how Resources was initially formed. He noted that as time went on Resources' fees went from a staff allocation reimbursement method to a percentage basis. He noted that Resources was paid a monthly stipend based on premium projection. Brason stated that Resources was a "non-dues revenue" component of the Association. He added that the Association does not have extra income and is now impacted by lower non-dues revenue. Brason was satisfied with the services Resources provided to HCPSIT.

Trustee Swanson advised BST that Resources staffed the Trust and was "responsive, respectful and professional" in its dealings with the Trustees. He was not sure how Resources was being compensated and did not recall approving a contract.

Trustee Buckley indicated that Resources provided support services to HCPSIT in such areas as accounting and marketing. He stated that "Resources helped offset the cost of the Association" but did not recall the basis for calculating fees paid by HCPSIT to Resources.

Concerning Resources, PRM President John Conroy advised BST that he knew Resources earned a fee for their services to the Trust but he never saw Resources' contract with the Trust and was not privy to Resources' fee arrangement with the Trust. Of special note, Conroy stated that some members objected to Resources' fees as they felt they were already paying for these services as members of the Trust.

Wang confirmed to BST that Resources has no personnel itself and is staffed by the Association. Wang stated that Resources was reimbursed by the Trust for services on a percentage of completion basis, but acknowledged that there were no records documenting what percentage of time Association staff spent on Trust issues. She said that the percentage was based on the value of services provided to the Trust. She noted that Resources was also reimbursed for expenses such as telephones, conference rooms, etc. Wang estimated that the Trust was about 80% of Resources' total revenue stream. She indicated that Resources previously did work for the Disability Benefits Trust (discussed below) and receives fees from the Association's non-profit affiliate, CHC.

BST obtained and examined a copy of the Association's 2002-2003 financial statements and accountant's report prepared by David Johnson. We compared this document to the Trust's audited financial statements for the same years. We found that the Association's total reported

[43] Brason was also a Trustee for the Association's Disability Benefits Trust.

revenues for 2002 and 2003 were $1,267,482 and $1,477,200, respectively. Resources' reported fees from HCPSIT totaled $647,657 in 2002 and $795,238 in 2003, representing 51% and 54% of the Association's total revenue for 2002 and 2003, respectively. In addition, Resources' management fees exceeded the Association's membership fees by $103,265 and $212,227 in 2002 and 2003, respectively. Moreover, the Association's total reported functional expenses for 2002 and 2003 were $1,128,751 and $1,277,704, respectively. The Association's revenues from Resources' HCPSIT fees covered 57% of the Association's expenses in 2002 and 62% in 2003. Clearly, the fees Resources derived from HCPSIT and the decisions made with respect to the relationship between Resources and HCPSIT had a direct impact on the Association's financial bottom line.

Concerning the quality of work performed by Resources on behalf of the Trust, evidence shows that services appear to have been executed in the "responsive, respectful and professional" manner as suggested by Trustee Swanson. This being said, however, BST has the following concerns about Resources based on the evidence presented above:

1. Resources was established at the time of HCPSIT's formation, suggesting that Resources was to play a prominent role in the operation of HCPSIT;

2. Resources performed administrative functions typically performed by self-insured trust program administrators;

3. Resources was the Association's primary, non-dues revenue stream, with HCPSIT serving as Resources' primary revenue source generating over $9.3 million in fees;

4. Wang recommended Resources' fee increases as the Association relied upon Resources and HCPSIT to generate revenue to support the Association's overall operation;

5. In the absence of records allocating Association/Resources expenses allocable to Trust operations, it is possible the Trust paid a disproportionate share of the Association's overall operating expenses, and

6. Wang's multiple roles as Association President, Resources President, and HCPSIT President constituted a possible conflict of interest as she was in the position to influence decisions relating to HCPSIT that financially benefited Resources and the Association, and not necessarily the Trust.

Disability Benefits Trust

On June 23, 1995, Wang, Association Counsel Joel Hodes, and HCPSIT members Todd Brason, Jordan Shames, and Michael Reda[44] signed a Self-Insurance Agreement and Declaration of Trust (Trust Agreement) and Indemnity Agreement establishing the Health Care Providers Disability Benefits Trust (HCPDBT). In August 1995, Wang, in the capacity of HCPDBT Chair, submitted

[44] Reda was a HCPSIT Trustee at the time and would later become HCPSIT Chair. Brason and Shames later were appointed as HCPSIT Trustees and served as Chair and Secretary-Treasurer, respectively.

an application for group self-insurance for HCPDBT to the WCB (see Exhibit 9).[45] Hodes was reflected as HCPDBT Secretary and Brason, Shames, and Reda as HCPDBT Trustees. Gallagher-Bassett Services, Inc. was listed as the group's licensed self-insurance representative. The application was subsequently accepted by the WCB.

On October 11, 2004, HCPDBT's Program Administrator, PRM President John M. Conroy, submitted to the WCB a Notice of Termination of Employer's Participation in Self-Insured Association, Union or Trustees Plan indicating the HCPDBT would terminate on October 31, 2004.

Interviews and documents revealed that HCPSIT financial resources played a prominent role in the formation, operation and subsequent termination of HCPDBT. HCPSIT Trustee minutes for March 2, 1995 reflect that HCPSIT Program Administrator Thomas Arney summarized previous discussions about the possibility of forming a separate trust to provide disability benefits coverage to its members. It was proposed that HCPSIT make available funds necessary to secure a letter of credit for such a disability benefits trust. In return, the HCPSIT's members would get a preferred rate for disability benefits coverage. The Trustees unanimously resolved that HCPSIT make available funds necessary to secure the required letter of credit for the formation of a new disability benefits trust if and when the Association Board approved the creation of the HCPDBT. It is interesting that formation of a disability benefits trust was addressed at an HCPSIT Trustees' meeting rather than at an Association Board of Directors' meeting.

At the HCPSIT Trustee meeting of June 28, 1995, Wang recommended that the HCPSIT Trustees consider authorizing the use of HCPSIT's resources to demonstrate the financial integrity of the new disability benefits program. The HCPSIT Trustees approved allowing HCPDBT to submit the certified financial statements of HCPSIT on HCPDBT's behalf. On November 14, 1995, the HCPSIT Trustees approved to modify the existing Letter of Credit (Pledge of Assets) agreement with Chase Bank to specifically acknowledge the HCPSIT Trustees' acceptance of the HCPDBT's liability until such time as the HCPDBT was adequately capitalized to support its own letter of credit with Chase Bank.

At the HCPSIT Trustee meeting of October 22, 1996, Wang reviewed a proposal for relieving the "temporary cash flow predicament" of HCPDBT as a result of difficulties with their Claims Administrator and requested the HCPSIT Trustees consider providing the HCPDBT with either guarantees for a bank loan or a direct loan at a reasonable rate of return. The HCPSIT Trustees unanimously approved extending a line-of-credit to the HCPDBT for up to $150,000 for twelve months with interest to be paid at prime rate.[46] Repayment of the loan was subsequently extended on December 16, 1997, by the HCPSIT Trustees to November 15, 1998.

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[45] The document was notarized by Carolyn S. Arney, believed to be the wife of Thomas Arney.

[46] Note 3 to the Trust's financial statement for the period ended October 31, 1997, reports that "The Trust provides a $150,000 line-of-credit, maturing November 15, 1997, to Health Care Providers Disability Benefits Trust, a related party. Interest on the unpaid principal balance is the prime rate (prime rate being 8.50% as of October 31, 1997). Interest income on this note was $7,336 and $99 for 1997 and 1996, respectively."

On March 23, 1998, Wang reported to the HCPSIT Trustees that the current note of $150,000 with HCPDBT would not be sufficient to get HCPDBT through the slow activity of the winter months and that the HCPSIT Finance/Investment Committee recommended an increase of the note to $250,000.[47] The HCPSIT Trustees unanimously approved the increase to $250,000, effective February 19, 1998. Shortly thereafter, on May 20, 1998, Wang and Arney explained the current cash needs of HCPDBT to the HCPSIT Trustees and a recommendation from the HCPDBT Trustees to increase the HCPSIT loan from $250,000 to $300,000 with a payment of interest only through May 1, 1999.[48] This was approved by the HCPSIT Trustees.[49] It remains unclear why Wang did not request from the Association's Board of Directors that the Association offer financial assistance to HCPDBT.

On June 25, 1998, Wang reported to the HCPSIT Trustees that the HCPDBT Trustees[50] were requesting consideration by the HCPSIT Trustees to subsidize the cost of premium financing for HCPDBT members. The Trustees unanimously approved this request retroactively to the beginning of the fiscal year (November 1, 1997).[51]

On January 13, 1999, the Trustees unanimously approved that Wang, Hodes, Shames, Reda, and Arney begin the process of investigating the consolidation of HCPSIT and HCPDBT. At the June 24, 1999, HCPSIT Trustees meeting, Wang recommended that the principal amount of the HCPSIT loan to HCPDBT of $450,000 be increased to $600,000 through October of 2000.[52] The Trustees unanimously approved Wang's recommendation.

During this time period, discussions ensued concerning the possibility of reducing HCPDBT's debt to HCPSIT in light of HCPSIT's reported strong financial condition. On September 29, 1999, the HCPSIT Trustees approved that "if, and to the extent that the HCPSIT has a surplus at the 10/31/99 year end, that among the options the Trust consider would be the reduction of debt due from the HCPDBT, and to authorize (Dave) Johnson and Arney to prepare reports on the projected surplus." On January 13, 2000, the HCPSIT Trustees unanimously approved to forgive

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47 Investment/Finance Committee Minutes provided to BST by the Association do not reflect such a recommendation being made.

48 Note 3 to the Trust's financial statement for the period ended October 31, 1998, reports that "The Trust provides a $300,000 line-of-credit, maturing May 1, 1999, to Health Care Providers Disability Benefits Trust, a related party. Interest on the unpaid principal balance is the prime rate (prime rate being 8.25% as of October 31, 1998). Interest income on this note was $16,841 and $7,336 for 1998 and 1997, respectively."

49 Records show and Wang confirmed to BST that there was some overlapping membership on the HCPSIT and HCPDBT Boards of Trustees.

50 Records show that Wang was the HCPDBT Chair and a Trustee.

51 Members of the HCPSIT and HCPDBT entered into individual agreements with a premium financing firm selected by the Program Administrator to provide low interest financing for premiums due to the respective trusts. HCPSIT subsidized premium financing expenses for both HCPSIT and HCPDBT members. HCPSIT financial statements show the Trust incurred financing supplement expenses totaling over $1.8 million from 1997 through 2004.

52 Note 3 to the Trust's financial statements for the period ended October 31, 1999, reports that "The Trust provides a $600,000 line-of-credit, maturing October 31, 2000, to Health Care Providers Disability Benefits Trust, a related party. Interest on the unpaid principal balance is the prime rate (prime rate being 8.25% as of October 31, 1999). Interest income on this note was $9,851 and $16,841 for 1999 and 1998, respectively. During the current year, the Trust modified the debt by $75,000 which included $23,186 of accrued interest."

HCPDBT's interest due to HCPSIT through October 31, 1999, and HCPDBT debt to HCPSIT for a combined total of $75,000. On October 18, 2000, the HCPSIT Trustees approved extending the date on the note between HCPSIT and HCPDBT to October 31, 2001.[53]It is important to note that a number of the HCPSIT Trustees, including Shames and Reda, authorizing the use of HCPSIT funds for the benefit of HCPDBT, were participants in HCPDBT, and were acting in their own self-interest in these related party transactions and not necessarily in the interest of other HCPSIT members, particularly those not participating in the HCPDBT program.

On January 31, 2001, new WCB regulations became effective that, inter alia, prohibited self-insured trusts from making loans similar to HCPSIT's loan to HCPDBT.[54] In response, on April 24, 2001 the Trustees authorized a joint task force with members of the HCPDBT Board to discuss the loan from HCPSIT to HCDBT and to make recommendations for resolution. On July 26, 2001, HCPSIT Board Chair Brason reported on discussions of the task force and that the option "currently being evaluated (based on a total rounded debt of $500,000) included a $275,000 assessment to HCPDBT participants (through a premium increase on the HCPSIT side) and deferral of management fees to Resources and PRM of $225,000." PRM was requested to run numbers on both two and four-year scenarios for the assessment and upon further evaluation, a recommendation would be provided to the HCPSIT Board.

On September 13, 2001, Wang explained to the HCPSIT Trustees that the interest rate on the HCPDBT loan could be changed to the minimum required by the IRS. The HCPSIT Trustees approved to change the interest rate on the loan to HCPDBT to the lowest allowable IRS rate. On October 11, 2001, Wang reported to the HCPSIT Trustees that the HCPDBT Board was requesting an extension of the current note for another year to October 31, 2002. The HCPSIT Trustees voted to extend the note to HCPDBT through October 31, 2002.[55]

BST obtained a letter dated October 25, 2001, from HCPDBT Chair John Fraher[56] to an HCPDBT member relating to a deficit assessment to be levied to HCPDBT members. The letter noted that from November 1, 1995 through June 1, 1999, HCPDBT was "subject to an unexpectedly high number of claims, particularly as the unemployment rate fell. Maternity leaves, which constitute the largest segment of claims, increased dramatically." The letter further indicated that HCPDBT "was forced to borrow from its sister organization…HCPSIT"

[53] Note 3 to the Trust's financial statements for the period ended October 31, 2000, reports that "The Trust provides a $600,000 line-of-credit to Health Care Providers Disability Benefits Trust, a related party. Interest on the unpaid principal balance is at 8.25% and the note matures October 31, 2001. Interest income was $39,618 and $9,851 for 2000 and 1999, respectively. The Trust modified the debt by $75,000 which included $23,186 of accrued interest in 1999."

[54] NYCCR Title 12, Section 317.8a prohibits the use of funds collected from members for any purpose not directly related to the trust, loans, or issuance of debt instruments.

[55] Note 4 to the Trust's financial statements for the period ended October 31, 2001, reports that "The Trust provides a $600,000 line-of-credit to Health Care Providers Disability Benefits Trust, a related party. Interest on the unpaid principal balance is at the IRS Short-Term Applicable Rate (the rate being 3.52% for October 31, 2001) and the note matures October 31, 2002." Interest income was $17,497 and $39,618 for 2001 and 2000, respectively.

[56] Fraher later became an HCPSIT Trustee.

and that the "loan reached $500,000 plus interest." Fraher also stated that PRM and Resources had agreed to provide up to one-half of the repayment amount but that the balance had to be assessed to the participating members at the time the deficit occurred.

On February 6, 2002, John Conroy from PRM told the HCPSIT Trustees that very few HCPDBT participants had objected to the assessment either because of the short time they participated during the assessment period or the amount of the assessment relative to their annual contribution. Also, Wang reported about some concerns being expressed about HCPSIT covering the cost of the premium financing subsidy for HCPDBT. The HCPSIT Trustees voted to discontinue paying the cost of the financing subsidy for the HCPDBT by November 1, 2004 or upon full pay-down of the outstanding loan, if sooner.

On August 23, 2002, the HCPSIT Trustees voted to cease subsidizing participant financing costs for HCPDBT effective November 1, 2002.[57] During the HCPSIT Trustees meeting of October 2, 2002, Wang reported that the current loan balance due from HCPDBT was approximately $139,000 which had been reduced substantially by assessment payments and the forgiveness of fees from Resources and commissions from PRM. The HCPSIT Trustees voted to extend the note from October 31, 2002 to October 31, 2003. The note was ultimately extended by the Trustees to October 31, 2005.[58]

BST spoke to former PRM President Thomas Arney about HCPDBT which he described as "a good idea, bad format." He said they wanted to market this new trust to Association members but it never got "enough traction" and had a very short life cycle. Arney said he was not aware of any loan made by HCPSIT to HCPDBT.

PRM President Conroy recalled that HCPDBT was created by Arney before he (Conroy) became involved with HCPSIT. Conroy characterized HCPDBT as a "companion" to HCPSIT. Conroy noted that all HCPDBT members belonged to HCPSIT, but the reverse was not true. Conroy said the loan from HCPSIT to HCPDBT was necessary to pay for the latter's claims run-off and was not prohibited by law or regulation.[59]

Concerning the appropriateness of HCPSIT loaning funds to HCPDBT, Wang stated to BST that the loan was not prohibited by law and occurred before the WCB regulations went into place. She said the loan was paid back in full with the exception of some interest being forgiven. Wang said that some Association members belonged to only HCPDBT which had about 52 members compared to the Trust's 150 or so.[60] Wang confirmed that if an Association member was in

[57] At that time, HCPSIT also covered 3-4% of participants' premium financing costs. Minutes indicate that Conroy told the Trustees that "in his experience, it's not typical for Trusts to cover financing costs." The Trustees voted to reduce the portion of participant contribution financing paid by the Trust to no more than 1%. This will be discussed later in this report.
[58] A WCB Level I Review Report of HCPSIT as of October 31, 2004, noted that based on information available, the $600,000 line-of-credit extended by HCPSIT to HCPDBT appeared "to be inappropriate."
[59] Although it did place excess burden on those Trusts members that were not in HCPDBT.
[60] BST did not have access to any HCPDBT records to confirm this or other verbal representations concerning HCPDBT.

HCPSIT and HCPDBT, HCPSIT would pay for a portion of the premium financing for the HCPDBT portion. Wang further acknowledged that HCPSIT also paid a portion of HCPSIT members' financing but noted that this practice was later discontinued. Wang noted that some HCPSIT Trustees, especially those not in the HCPDBT, complained that it was not appropriate to subsidize financing fees for HCPDBT members.

Based on the foregoing discussion relating to HCPDBT, the following observations are offered:

1. Wang, Counsel Hodes, and various HCPSIT member representatives served simultaneously as Trustees or officers with HCPSIT and HCPDBT allowing them to make or influence decisions for both entities whose individual interests might not be mutually inclusive. BST found no evidence that the aforementioned persons serving simultaneously in official capacities within HCPSIT and HCPDBT recused themselves from votes or decisions involving both entities. At a minimum, this presents an appearance of conflict of interest.

2. The diversion of approximately $500,000 in HCPSIT assets to support the operation of HCPDBT was not consistent with the purposes of HCPSIT, offered no apparent financial or other benefit to HCPSIT, and placed HCPSIT member assets at unnecessary risk. This included the Trustees forgiving $70,000 in interest owed by HCPDBT to HCPSIT.

3. The subsidizing by HCPSIT of HCPDBT member premium financing costs was not consistent with the purposes of HCPSIT and inequitably required HCPSIT members, not participating in HCPDBT, to subsidize the premium financing costs of members belonging to both trusts.

Political Contributions/Legislative/Regulatory Expenses
BST found that HCPSIT Trustees authorized the use of Trust funds for political contributions and legislative/regulatory expenses. Reported political contributions for the years 1995 through 2008 totaled approximately $70,000, and legislative/regulatory expenses were in excess of $800,000 for the years 1996 through 2008.

Trustee meeting minutes show that discussion about political contributions began early in the Trust's history as reflected in the minutes for the March 2, 1995, meeting as follows:

> Ms. Wang asked the Trustees if they would support a Trust contribution of $5,000 (the maximum donation allowable to a PAC from a single entity) to the HCP PAC.[61] Wang explained that what occurs in the industry will directly affect the Trust. If members cannot afford to stay in business, they will not be able to stay in the Trust. There are no legal problems associated with contributing, and it would be a precedent decision for the Trust. The Trustees asked staff to research and see if other Trusts make this kind of contribution. Motion by Mr. Reda for the Board to approve a $5,000 contribution to the

[61] Wang advised BST that the HCP PAC is operated by the Association and overseen by a committee of Association members. HCP PAC has its own Chair, and Wang serves as the Treasurer.

> HCP PAC pending verification that a Trust has done so in the past. If so, let the Trustees know. If not, the Trustees would like to rediscuss the issue. Seconded by Mr. Braun. Resolution: Passed, 4 - support, 1 - oppose.

Minutes for the following meeting on April 30, 1995, contain the following:

> At the March 2, 1995 meeting, a motion was made for the Board to approve a $5,000 contribution to the HCP PAC pending information regarding actions of other PACs. Phyllis Wang reported that it is clearly not illegal, but of the PACs consulted none had actually made such a contribution. MOTION: by Edna Lauterbach that the Trust make the $5,000 contribution to the HCP PAC, seconded by Michael Reda. RESOLUTION: Unanimously approved.

By successfully encouraging the HCPSIT Trustees to take this action, Wang essentially doubled the Association's annual contribution limit to the HCP PAC.[62] It is not clear to BST what action, if any, the HCP PAC took specifically on behalf of HCPSIT. Based on this unique precedent setting action, the HCPSIT Trustees approved subsequent annual donations to the HCP PAC[63] and other political organizations. This was done despite the WCB's repeated reminders to the Trust that these types of self-insured trust expenditures were improper.

In addition, HCPSIT Trustees approved the expenditure of Trust funds for lobbying purposes. On October 25, 1995 the Trustees approved retaining Patton Boggs, LLP as the Trust's lobbying firm and for HCPSIT to contribute $25,000 to the Association's lobbying efforts. BST did not identify specific Trustee approvals for subsequent HCPSIT payments for lobbying/regulatory expenses which totaled over $800,000 through 2008.[64]

On February 2, 2005, the Trustees approved to engage counsel and consultants to provide necessary assistance to the Board to enlist the cooperation and assistance of the New York State Legislature and the Executive "to obtain administrative or regulatory redress from the unreasonable, inequitable and adverse consequences of the application to the Trust and its Participants of certain provisions of the Self-Insurance Regulations heretofore promulgated by the New York State Workers' Compensation Board ("WCB") and the policies and practices of the WCB purportedly in furtherance of the said Self-Insurance Regulations."

On April 18, 2007, Board of Trustees meeting minutes indicate that Wang explained "the importance of annual member support of the HCP PAC - especially by those in leadership positions of HCP and affiliated entities as an example for other members." She asked the

[62] BST was unable to determine if HCPDBT also contributed to the HCP PAC.

[63] Subsequent minutes reflect Trustee approvals of additional donations to the HCP PAC. Wang told BST that the Trust made annual contributions to HCP PAC.

[64] HCPSIT's legislative/regulatory expenses totaled $297,130 for the period 11/1/05-10/31/08 while the Association's legislative expenses for the same period as reported on Form 990, Return of Organization Exempt From Income Tax, was $340,202. Therefore, for this three-year period, HCPSIT expended approximately 87% as much as its parent entity on legislative activities. In its review of numerous other trusts on behalf of the WCB, BST did not identify any other trusts incurring similar legislative expenses.

Trustees to consider making a donation to the HCP PAC and pledge forms were distributed. Minutes for July 23, 2008, reflect that Wang thanked the Trustees for their support of a fundraiser held recently for the NYS Senate Republicans. She advised the HCPSIT Trustees that of the Association's $40,000 commitment, $25,000 had been turned over to the campaign.[65]

Wang confirmed to BST that political donations were made each year to the HCP PAC to gain support for workers' compensation related issues. Wang noted that most lobbying efforts by their paid lobbyist, Weingarten, Reid & McNally, were directed at the New York State and not the federal government.[66] She said lobbying fees were apportioned between HCPSIT and the Association.

PRM President John Conroy informed BST that he made donations to the HCP PAC to support the health care industry and received no pressure from anyone to do so. NYS Board of Elections (NYSBOE) records show that PRM made contributions to the HCP PAC totaling $26,623 for the period April 26, 1999 through May 23, 2008. NYSBOE records further reflect PRM Claim Services made contributions to the HCP PAC totaling $6,573 for the period March 10, 2000 through January 22, 2009. In addition, Federal Election Commission records reflect PRM made contributions to the HCP Federal PAC totaling $3,750 for the period March 1, 1999 through March 28, 2008.

BST recognizes that the Association, as a trade organization, has the obligation to promote the best interests of its health care provider members through the political process. Association members pay annual dues to the Association for advocacy and related purposes. However, BST questions the appropriateness of Wang and the Trustees using HCPSIT and participants' premium contributions as a funding source to further the Association's broader, albeit legitimate, political interests.

Edna Lauterbach Scholarship Fund

HCPSIT's audited financial statements reflect expenses relating to donations to charitable organizations totaling over $111,000 for the period 1999 through 2008. Trust records and interviews revealed that the primary beneficiary of these donations was the Edna Lauterbach Scholarship Fund (Scholarship Fund) established in 1999 by HCPSIT. HCPSIT Trustee meeting minutes for June 24, 1999 report the following relating to establishment of the Fund:

> Wang and Dave Johnson, CPA, reported on their findings for a charitable foundation in memory of Edna Lauterbach and distributed donor fund material.

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[65] HCPSIT and NYS Campaign Finance records show a HCPSIT donation to the NYS Senate Republican Campaign Committee in the amount of $8,500 on June 19, 2008.

[66] Wang did not bring to BST's attention the existence of the NYS Association of Health Care Providers, Inc. Federal PAC (HCP Federal PAC) formed in 1995. A Statement of Organization Form, dated October 22, 1995, filed with the Federal Election Commission (FEC) identifies Edna Lauterbach as HCP Federal PAC's Treasurer and Wang as Assistant Treasurer. A Statement of Organization Form, dated May 5, 2009, filed with the FEC identifies Wang as Assistant Treasurer.

> MOTION: By Joel Hodes for the Trust to donate $5,000 to establish an Edna Lauterbach Foundation with Reda and Wang to set up the appropriate objectives and work with the fund to finalize a plan. Seconded by Tom Buckley. Charles Lauterbach will be consulted on this plan. Tom Arney volunteered that PRM would donate $1,000. Reda indicated that the Erie County Consortium would also make a donation. Reda requested Hodes to amend his motion to reflect a $10,000 donation. Seconded by Tom Buckley. RESOLUTION: Unanimously passed.

On October 18, 2000, HCPSIT Board of Trustees meeting minutes reflect that the Trustees approved to donate $10,000 to the Scholarship Fund, and that an annual donation to the Scholarship Fund be addressed earlier in the calendar year. Records show that annual Trust donations in the amount of $10,000 ensued.

Arney told BST that PRM made the first contribution to the Scholarship Fund for $5,000 (contrary to the minutes of June 24, 1999) and made additional $5,000 annual contributions to the Scholarship Fund. He made the contributions voluntarily because he wanted to honor Lauterbach who was an original Trustee.

Wang said the Scholarship Fund was sent up to honor Lauterbach who was a former Association Board Chair and co-founder of the Trust whose untimely death was "devastating" to people in the health care industry. Wang noted that the funds are for an educational scholarship for nursing students going into the home care field. The funds are administered by the Community Fund for the Capital District (a well-respected Albany, New York based regional center for philanthropy)[67] and are not handled by the Association, according to Wang. The Community Foundation determines who gets the scholarship and in what amount.[68] Interestingly, Wang advised that the Association does not donate to the Fund itself.

BST fully appreciates the important role Ms. Lauterbach played in the Association and the formation of the Trust, and her untimely death was obviously a tragic loss to her family and those in the health care profession. However, BST again must question the appropriateness of the use of over $111,000 in HCPSIT participants' premium contributions for purposes not directly related to the purpose of the Trust. It would seem more appropriate that donations to the Fund should have come directly from the Association, with which Ms. Lauterbach had such a long-standing and reportedly outstanding relationship. Further, WCB regulations adopted in 2001 would appear to prohibit these types of expenditures. Despite WCB objections, the Trust continued incurring these expenditures.

Conflicting Roles of Program Administrator and Claims Administrator

Article VI[69], Powers and Duties of the Trustees, Section 6c of the Trust Agreement provides that the Trustees "take all necessary precautions to safeguard the assets of the Fund" including but

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[67] The Community Foundation is a BST client.

[68] The Community Foundation and the Association websites confirm the Foundation's role with respect to the Fund.

[69] The Trust Agreement contains two Articles entitled "Article VI."

not limited to the "(d)esignation of a third party administrator" to resolve and pay claims pursuant to the Workers' Compensation Law.

As noted above, and as will be discussed in more detail later in this report, the Trust initially engaged Gallagher Bassett as claims administrator upon Arney's suggestion. On June 27, 1997, PRM Claim Services, Inc. (PRMCS) was formed by Arney and on November 1, 1998, Arney and Wang signed an Agreement appointing PRMCS as HCPSIT's new third-party claims administrator.[70] Wang informed BST that Arney requested of her that PRMCS be retained.

Trustee meeting minutes report that on October 18, 1998, the Trustees approved Trustee Reda "to undertake negotiations of cost, oversight, etc with PRM Claim Services." There is no evidence that any other qualified firms were ever solicited or considered by the Trustees to serve as third-party claims administrator. Evidence suggests that Arney, Conroy, and their firms provided quality claims services to HCPSIT after exhibiting some initial struggles, however, a competitive process may have promoted even better quality and lower costs to the Trust.

Additionally, the appointment of PRMCS may not have been in conformance with the requirements of Article V; Section 5 of the Trust Agreement referenced above that states, in part:

> The trustees may designate a fiscal agent and/or an administrator to administer the financial affairs of the Fund, provided, however, such fiscal agent or administrator shall not be an owner, officer, or employee of a third party administrator.

At first blush, this provision appears to be a prudent principle that the roles of program administrator and claims administrator be separate to ensure claims are administered independently of any financial incentives the program administrator might realize from the deliberate under-reserving of claims. However, when asked about the identity of the "fiscal agent" referenced in this provision, Wang advised BST, through Counsel, that the "fiscal agent" referred to "banks and professional investment counselors."

The intent of this provision notwithstanding, the fact remains that PRM and PRM Claims Services, two privately-held firms controlled by the same person, Thomas Arney, and later John Conroy, served concurrently as the Trust's Program Administrator and third-party Claims Administrator.[71] BST believes this circumstance constituted a potential conflict of interest. It appears that the HCPSIT Trustees had concerns about this relationship as they did engage a

[70] BST identified a contract signed by Wang and Arney between the Trust and PRMCS effective November 1, 1997. The circumstances behind this contract remain unclear as evidence indicates that Gallagher-Bassett performed claims services for the period November 1, 1997-November 1, 1998.

[71] Joel Hodes, Esq., HCP's Counsel, offered the following opinion regarding the relationship of the two firms: "I believe that the two companies are independent, freestanding corporate entities that perform entirely different functions for the trusts (including HCPSIT) that have contracted with either or both of them. Moreover, as far as I know, neither company is a parent or subsidiary of the other. That fact alone would place them entirely outside the purview of Article V, §5 of the HCPSIT Trust Agreement." BST found that Page 10 of HCPSIT's 1998 Annual Report identifies PRM Claim Services, Inc. as a PRM subsidiary.

consultant[72] to conduct an independent review of PRMCS's claims handling practices. However, evidence indicates that the focus of the consultant's review was from a procedural and not a claims reserves perspective. As will be discussed in detail in the Claims Handling section of this report, BST's own independent consultant has determined that claims were being under-reserved by PRMCS, contributing to the $114,372,159 member deficit as of October 31, 2009. Therefore, the failure of the Trustees to ensure the true independence of the program administrator and claims handling functions may have had a material impact on the extent of the ultimate member deficit.

Fidelity Bonds

Article VI, Section 6 of the Trust Agreement requires that the Trust's fiscal agent and/or an administrator and third-party administrator (claims administrator) furnish a fidelity bond with the Trustees as obligee, in an amount sufficient to protect the Trust against the misappropriation or misuse of any moneys or securities held by or in the name of the Trust. Evidence of such bond is to be filed with the appropriate governmental agencies and departments.

12NYCRR 317.11 enacted in 2001 in conjunction with WCB's new regulations requires the following:

> Every group self-insurer shall be required to file with the chair evidence that it has obtained a Blanket Fidelity Bond providing coverage for theft, disappearance or destruction of money, securities, or other property, in an amount acceptable to the chair. Such Bond shall provide coverage for dishonest acts of the group administrator, or a trustee, employee or agent of the group, whether identified or not, while acting alone or in collusion with others, and shall name the group self-insurer as loss payee. Such Bond shall be maintained at all times during the existence of the group self-insurer.

Wang advised BST that she believed the Program Administrators posted a bond but she wasn't sure. Arney stated that he never posted a fidelity bond with the Trust and was never asked to do so. The WCB advised BST that they had no record of these bonds being filed by HCPSIT and BST could find no evidence that they had been filed pursuant to the Trust Agreement and 12NYCRR 317.11. The Trustees' failure to ensure that such bonds be obtained and filed exposed HCPSIT to unnecessary financial risk in the event of defalcation of the Trust's assets.

Selection of Financial Institution/Investments

Article VI, Section 1 of the HCPSIT By-laws requires that all funds of the Trust are to be "deposited in banks or trust companies designated by the Trustees." Trust funds remained deposited in Chase Manhattan Bank, NA and its successor bank, J.P. Morgan Chase & Company (Chase)[73] until 2008 or 2009 when the account was moved to Pioneer Savings Bank. Concerning the selection of Chase, Wang noted that initially no banks were interested in handling the Trust's

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[72] The Trustees retained Tillinghast-Towers Perrin (TTP) to perform claims administration/handling audits as opposed to performance audits which check reserve adequacy.

[73] Chase Manhattan Corporation merged with J.P. Morgan & Company in 2000 to form J.P. Morgan Chase & Company.

banking as a letter of credit was needed. She said that she and Arney visited various banks including Chase that showed an interest. This was confirmed by Arney who added that Chase handled his business banking as well. Trustee meeting minutes do not reflect any formal vote being taken on the retention of Chase to handle the Trust's banking.[74]

Wang noted that Chase's investment arm later moved back and forth from New York City, and the Trust decided to move its investments elsewhere. Wang said that 5-6 other investment firms were solicited and made presentations. She said that Richard Hartnett and Preston McSwain from Morgan Stanley/Neuberger Berman[75] made a great presentation, and they were unanimously selected by the Trustees. Wang noted that Hartnett agreed to place fixed investments without a fee.

Article VI,[76] Powers and Duties of the Trustees, Section 6g of the Trust Agreement provides that the Trustees "take all necessary precautions to safeguard the assets of the Fund" including but not limited to investing "any surplus moneys not needed for current obligations in accordance with the Rules for Self-Insurance, or applicable federal or state statutes or regulations."[77]

The sound management of investments is important to the financial stability of any self-insured trust as returns on these investments are a potential source of revenue to help offset a trust's administrative costs and claims expenses exceeding established cash reserves. Interviews and documents reveal that Chase was selected as HCPSIT's investment manager contemporaneous with its selection as the Trust's banking institution and remained the Trust's investment advisor until 2003 when the Trustees moved the Trust's investments to a joint venture team from Morgan Stanley-Neuberger Berman (MSNB). Interviews and documents show that the Trustees and Wang provided direction to the investment managers with respect to the Trust's investments and remained well informed of the Trust's investment portfolio performance.

Effective January 31, 2001, new WCB regulations[78] restricted the investments of self-insured trusts to Government Obligations, Obligations of American Institutions, Preferred Shares of

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[74] Minutes for the July 14, 1993, meeting note the following: "Phyllis Wang reported that Chase Manhattan Bank would be running a "Tombstone Ad" in the local newspapers during July advertising the relationship between the Trust and itself. Copies of the ad were distributed to the Trustees."

[75] Trustee minutes show that Hartnett was a Senior VP for Morgan Stanley, and McSwain a Regional VP for Neuberger Berman.

[76] The Trust Agreement contains two Articles entitled "Article VI."

[77] Article VII, Section 5 of the HCPSIT By-laws gave broad powers to the Trust's officers, the Chairman, and Secretary-Treasurer, "to invest and reinvest all funds of the said Trust in housing, mortgages, and in Government and other securities as they may in their sole discretion, select and to purchase, lease for any term of years, sell, exchange, convey or dispose of any property, whether real or personal, or any interest therein, all of which shall be at such prices and upon such terms and conditions as said officers may deem advisable to carry out the purposes of the Trust and whether or not any of the foregoing are authorized by law for the investment of trust funds generally; to borrow money in such amounts and upon such terms and conditions as shall be deemed advisable by the officers to carry out the purposes of the Trust and to pledge any securities and to mortgage any property, real or personal, or any interests therein, for the payment of any such loan, to lend moneys upon such terms and conditions as they may deem advisable; and to do all acts whether or not expressly authorized herein, which the officers may deem necessary or proper to effectuate the foregoing and for the protection of the property held hereunder."

[78] NYCRR Title 12, Sections 317.8c and 317.8d.

American Institutions, and Equity Interests. In addition, investments could not exceed five percent (5%) of total trust assets in any one American Institution. Also, total equity investments could not exceed twenty-five percent (25%) of total trust assets and those investments must maintain adequate ratings in order to be recognized as an acceptable asset.[79]

HCPSIT audited financial statements show that in the early years of the Trust, investments were limited to low risk instruments such as bond funds and U.S. Treasury and Agency obligations. This conservative strategy was reflected in the Trustee meeting minutes. Minutes for March 2, 1995 report that Arney suggested that the Trustees look "into a more aggressive investment strategy that would still protect the principal and yet provide a higher return on investment."

The Trustees formed an Investment Committee in 1995 to focus specifically on the Trust's investments. Minutes reflect that the Investment Committee met with Chase advisors over the following months[80] and decided to seek a higher return on the Trust's investments. The Committee recommended an asset mix of bonds and equity securities, and a "moderate principal risk" investment strategy was approved by the Trustees on September 29, 1995. The Trust's audited financial statements for the year ended October 31, 1995, showed that $1,352,675 had been invested in equity securities and $50,367 in corporate obligations which comprised approximately 27% of the Trust's total investment value. By October 31, 1996, equity securities and corporate obligations had grown to 60% of the value of the Trust's total investments. As of October 31, 2001, following enactment of the new WCB regulations, equity securities and corporate obligations had increased to 72% of the Trust's total investment value.

Minutes for the April 24, 2001 Trustee meeting note that Wang commented to the Trustees about the new WCB investment guidelines and indicated that the Trust would "eventually need to meet with the WC Board to establish a plan to come into compliance with the limit on equity investments." She further commented that Chase had indicated that "at least a time frame of 12-18 months to comply would help limit the losses that the Trust would incur."

Official minutes reflect no further discussion by the Trustees regarding investment compliance until one year later on May 1, 2002, when Investment/Finance Committee minutes reflect Wang reporting that she had been in contact with Chase "to discuss that the WC Board requirements on self insurance investment equity position." Wang further noted that the WCB had "approved a three year plan for compliance, but the WC Board appeared to be willing to stretch that to four."

HCPSIT Board of Trustees meeting minutes for May 2, 2002 include the following comments regarding investments:

> Wang reported that the WCB has recognized that the Trust is not in compliance with the max 25% equity investment requirement. A 3-year reduction plan has been developed by HCPSIT and communicated to JP Morgan Chase and there are indications that a 4-year plan may be allowed. It was noted that there is question about how corporate/government

[79] The equity investments must also be with American Institutions.
[80] Minutes show that the Investment Committee met with Chase investment advisors on a regular basis.

bonds will be handled. There was discussion of the possibility of challenging the requirement. *Conroy noted that out of 70 trusts in NYS only 1 other trust is in our position with respect to equity investments.(emphasis added)*

HCPSIT Board of Trustees meeting minutes for October 2, 2002 refer to a letter from Wang to Chase outlining the Trustees' "decision to reduce equities for reasons of compliance" with the new regulations. Based on the above discussion, it is clear that by October 2002, Wang, the Trustees, and Chase, the Trust's investment manager, were cognizant of the new WCB investment guidelines and that a compliance plan would be necessary.[81]

Also at the October 2, 2002 meeting, the Trustees discussed that a Request for Proposal (RFP) would be sent shortly to a list of investment managers to handle the Trust's investments. Previous minutes note interest by the Trustees of seeking other firms to handle the Trust's investments. Minutes for January 23, 2003, report that "the HCPSIT RFP Committee will meet next week to review the proposals" and that the "Committee will likely schedule in-person meetings with 3-4 final candidates with recommendations to be presented at the May Board meeting." Minutes reflect that at the Trustee meeting of May 5, 2003 Wang shared the Investment Manager Search Committee's recommendation to the Trustees that "Morgan Stanley/Neuberger Berman be engaged as the Trust's new investment manager." The Trustees unanimously approved the recommendation.[82]

Investment/Finance Committee minutes for May 13, 2003 report that representatives from Morgan Stanley/Neuberger Berman (MS/NB)[83] joined Committee members by phone to discuss a transition plan. The Committee members requested MS/NB "to identify possible changes to the portfolio, based on changing investment strategy." The minutes further note that the Committee addressed the equity compliance issue with MS/NB and advised MS/NB of the following three-year plan that was in place:

Current position 40% equities
Target position 35% equities by April 04
Target position 25% equities by April 05

The minutes report that McSwain from Neuberger Berman advised the Trustees "that based on the current market, the slower the transition to the 25% the greater the positive impact on the portfolio."

[81] A WCB Level I Review Report for the period ended October 31, 2003, noted the following: "On many occasions, the WCB has requested a written plan to divest the investments that exceed the limits prescribed in the Rules and Regulations. As of the date of this report, no such plan has been submitted by the Trust."

[82] BST requested from the Association copies of minutes of all Trustee, Investment/Finance, and all special committee meetings. Minutes of the HCPSIT RFP Committee, if they exist, were not provided. Therefore, BST was unable to thoroughly review the deliberative process used to select Morgan Stanley/Neuberger Berman as the Trust's new investment manager. The Investment/Finance Committee minutes provided by the Association and reviewed by BST make no reference to this process.

[83] The representatives were Richard Hartnett from Morgan Stanley and Preston McSwain from Neuberger Berman.

On August 18, 2003 the Investment/Finance Committee requested MS/NB to draft recommendations for changes to the Trust's investment portfolio. This action was reported to the full Board of Trustees on August 20, 2003. On September 22, 2003, McSwain recommended to the Investment/Finance Committee to maintain a portfolio of 45% equities and take "as long as possible to reach the 25% equity threshold in order to achieve the greatest probability of earning a 5% return." The Committee approved to give MS/NB flexibility to recognize additional losses prior to October 31, 2003, and "use their discretion to ultimately reach a 25% equity position by April 2005" and that MS/NB "will continue to reduce the portfolio to reach a maximum of 45% equities within a reasonable period of time."[84] Minutes show that McSwain presented to the Investment/Finance Committee on January 26, 2004, "changes to the portfolio to reflect Neuberger Berman Investment Strategy" but no detail of that "Strategy" was included in the minutes.[85]

Though subsequent Investment/Finance Committee minutes reflect the Committee's review of portfolio performance reports, there appears to not have been any discussion of investment mix or strategy until a special meeting of the Investment/Finance Committee was held on February 9, 2006, at which the Committee approved the transfer of fixed income items to Morgan Stanley from Neuberger Berman that would generate approximately $22,000 annually in cost savings.[86] This action had no apparent impact on the Trust's investment mix. Investment/Finance Committee minutes through May 14, 2009, do not reflect any specific discussion relating to investment compliance.

Discussion of investment compliance at Trustee meetings as per the official minutes appears to have been limited at best from mid-1993 to July 29, 2005 when a joint meeting with the Trustees and the WCB was convened to discuss a final Consent Agreement between the WCB and the Trust. The Consent Agreement addressed a number of issues of concern to the WCB, including compliance with investment regulations.[87] The minutes report that it was agreed by all parties that "Trust investments should come into regulatory compliance not by selling off, but by investment of new monies and reinvestment of matured vehicles."[88]

With respect to investments, the Consent Agreement stated the following:

> That the Trust, within ninety (90) days of the execution of this Consent Agreement, will submit a written re-investment plan which addresses the Trust's commitment to invest

[84] Trustee meeting minutes do not reflect a discussion of this with the full Board of Trustees. Also, it is unclear how they could have planned to reduce to 45% equities when the current position was identified as 40% in May 2003, as previously noted.

[85] Trustee meeting minutes do not reflect a discussion of this with the full Board of Trustees.

[86] Wang advised BST that Richard Hartnett from Morgan Stanley agreed to administer fixed income instruments without a fee.

[87] For purposes of determining the Trust's funding position, a WCB Level 1 Review Report, dated May 10, 2005, of HCPSIT as of October 31, 2004, disallowed $2,833,667 of corporate investments that exceeded the 25% limitation of the WCB regulations. These investments included those in four corporations deemed by the WCB to be foreign and not permissible as they were not American Institutions as required by Section 317.8.

[88] The Consent Agreement was signed by the Trustees on July 29, 2005 and by the WCB Executive Director on August 4, 2005.

new and maturing trust assets over a ten year period in accordance with the standards outlined in NYCRR Part 317.

Wang sent a letter to McSwain dated November 1, 2005 instructing him to have MS/NB comply with the investment provisions of the Consent Agreement, a copy of which was attached. Wang specifically directed the following:

> Henceforth, profits/surplus identified in year end audited statements will be invested in approved fixed income vehicles and returns from existing investments that retire or mature will likewise be reinvested in approved fixed income vehicles until such time as balance between approved fixed income investments and equity investments meets the NYS workers compensation self insured trust regulatory requirements. Approved vehicles are those identified in the NYS rules and regulation for self insured workers compensation trusts.

In a letter to the WCB dated November 11, 2005, the Trust reiterated its intention to be in compliance with the investment requirements under the Rules and Regulations and that new, retiring and maturing investments would be invested in approved investment vehicles.[89] Trustee minutes for January 25, 2006 state "There was discussion of fixed vs. equity investments and plans to comply with regulations" but offered no specifics of this discussion.

A WCB Level 1 Review Report, dated June 18, 2007, of HCPSIT as of October 31, 2006 found that \$3,766,961 of the Trust's corporate investments that exceeded the 25% limitation of the WCB regulations.[90] These investments included investments in five corporations deemed by the WCB to be foreign. The report noted that investments in four foreign corporations totaling \$776,497 were purchased on or after November 3, 2005, more than three months after the Consent Agreement was executed, and as late as February 17, 2006, more than six months after the Trust agreed not to purchase foreign investments.

Despite the findings of the June 18, 2007 report, a Level 1 Review Report, dated May 7, 2008, of HCPSIT as of October 31, 2007 found that \$6,581,879 of the Trust's corporate investments that exceeded the 25% limitation of the WCB regulations. In addition, one investment was found to exceed the 5% limit in any one American Institution.[91] These investments included investments in five corporations deemed by the WCB to be foreign. In addition to the investments totaling \$776,497 purchased during 2005-2006 as noted in the previous year's Level 1 report, the WCB reported that the Trust made three additional foreign investments totaling \$573,396 during from November 1, 2006 through October 31, 2007.

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[89] A WCB Level 1 Review Report, dated May 22, 2006, of HCPSIT as of October 31, 2005, identified \$412,783 of corporate investments that exceeded the 25% limitation of the WCB regulations. WCB also identified \$850,677 in foreign corporation investments.
[90] The disallowance related to assets that could be counted as helping the Trust meets its 90% funding ratio requirement.
[91] That investment was also deemed a foreign investment by the WCB.

Despite consistent investment findings by the WCB, Trustee minutes after January 25, 2006, reflect no further discussion of investment compliance by the full Board of Trustees until September 25, 2008 when the Trustees were advised that "some of the investments labeled as foreign by the WCB may be in a grey category. The Trust is seeking clarification from the WCB on this. Neuberger Berman has been instructed not to purchase any foreign investments until they are further notified by the Trust."[92] Seeking clarification at this juncture is a rather startling comment given the two prior years' findings by the WCB. Trustee minutes reflect no further discussion of the Trustees regarding investment compliance through the termination of the Trust.

Concerning the Trust's management of its investment portfolio, Wang told BST that she believed the Trustees took prudent and reasonable steps to come into compliance with its investments. She recalled that after the regulations were changed, the WCB told them to move their investments, and the Trust took a $1 million loss.[93] She said the Trust was then criticized by the WCB at a meeting and then told to make the changes more slowly. Wang said the WCB said one thing to them verbally and something else in writing, and she felt the Trust was getting "jerked around" by the WCB.

Former HCPSIT Board Chair Brason stated that the Trustees were conscious of the new WCB regulations and that the Trust was given time to divest itself in some investments to come into compliance. Brason felt the Trust was always in compliance with the Consent Agreement and that their investment advisor acted responsibly. Brason suggested that there may have been misunderstanding on the part of the Trust concerning what was a domestic or foreign equity.[94]

Trustee Swanson indicated that some Trustees wanted more conservative investments with the stock market's downturn. He recalled that the WCB had concerns that the Trust was taking longer to move investments than it should have. Swanson indicated that some Trustees questioned the WCB's position, while others agreed with the WCB. Swanson suggested that perhaps the Trust did not react quickly enough in response to the WCB's investment concerns.

Trustee Buckley similarly recalled there being an issue with the definition of a foreign investment. He cited the dispute over the Trust's investments as being a major issue leading to the Trust's demise.

Based on the foregoing discussion, the Trustees' decisions relating to the management of the Trust's investments contributed to the Trust's ultimate member deficit. The Trustees chose a more aggressive approach to investing than is typically the case with group self-insured trusts as articulated to the Trustees by John Conroy, Program Administrator, on May 2, 2001, when he

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[92] Minutes for January 23, 2008, indicate that the Trustees were advised by the HCPSIT Board Chair "that although the market is currently volatile, the Finance Committee is confident in the Trust's investment strategy." At this meeting, the Chair also reported to the Trustees that "(w)ith the recent market issues, there will be increased focus by the Board and Finance/Investment Committee on the Trust's investment performance and strategies."

[93] A 2004 informational brochure prepared by HCPSIT stated that "The Trust lost approximately $900,000 in fiscal 2003 due to the requirement to divest equities."

[94] David Johnson, CPA stated to BST that there was some confusion amongst the Trustees concerning what constituted a foreign investment. He cited HSBC as an example of an equity considered to be a foreign investment.

advised them that "out of 70 trusts in NYS only 1 other trust is in our position with respect to equity investments."[95] Clearly, this statement should have given the Trustees some pause that their investment strategy was not the norm. However, the Trustees continued to pursue their more aggressive investment approach and took deliberate steps to achieve compliance with the new WCB regulations as slowly as possible. Their failure to move expeditiously in divesting their equity position more quickly may have resulted in the Trust realizing smaller losses on its during 2007 and 2008, which probably resulted from the 2007 economic downturn.[96] Trustee interviews even suggested that some Trustees were not comfortable with the Trust's aggressive investment strategy.

The Trustees' investment approach to apparently seek maximum investment returns may have been driven, in part, by the need to "cover" various expenses not directly related to the Trust's purpose, such as political donations, lobbying fees, scholarship donations, and premium financing subsidies, and reduced premium revenues from Retention Plan participants. Certainly, the Trustees participating in the Retention Program had a vested interest in ensuring the Trust had sufficient revenue to maintain the viability of the Retention Program from which they financially benefited.

In summary, the documents reviewed and the interviews conducted show that:

1. The Trustees pursued an investment strategy that was unlike investment strategies typically adopted by group self-insured trusts and that unnecessarily exposed the Trust's investments to volatile market conditions resulting in a substantial loss of the Trust's financial assets.

2. The Trustees failed to ensure the Trust's timely compliance with 12NYCRR Part 317.8 with respect to allowable Trust investments.

C. Program Administrators – Jardine, Naples, PRM

Article IX, Section 2 of the Trust's By-laws provides for the appointment of a Program Administrator for the Trust, as follows:

> Section 2. A Program Administrator under the supervision of the Chairman shall be employed to act as manager of the group self-insurance program. Such person shall work with the trustees and the third party administrator to establish an accident prevention program. He shall meet with the trustees as often as practicable to review the experience of the members so as to prevent recurrence of accidents and review and revise safety Rules and Regulations to be carried out by the members.

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[95] The basis for Conroy's comment is unclear as the WCB has advised BST that the WCB did not publish this information.

[96] The Trust lost approximately $739,000 on the sale of certain equity securities during 2008, and approximately $161,000 during 2007.

As noted above, the Trust was formed essentially through the collaborative efforts of Association President, Phyllis Wang, and Jardine Insurance Brokers New York Chairman, Thomas Arney. Arney remained the Trust's Program Administrator from 1992 until his retirement from Program Risk Management, Inc. in 2003. When asked why Arney remained as Program Administrator when he moved from Jardine to Naples Risk Management and then to Program Risk Management, Wang stated that Arney was "The Guy."

Evidence indicates that Wang relied on Arney and his insurance expertise to guide her and the Trustees in the formation and operation of the Trust. As noted above, Arney reportedly committed $125,000 of his own funds as security for the Trust and obviously would not have done so without the belief that he would play a continued role as the Program Administrator, the Trust would experience financial success, and he could favorably impact the Trust's operation. As will be noted later, Arney and his firms played a broader role with the Association with respect to insurance issues well beyond HCPSIT.

The Trust's audited financial statements report[97] that from 1993 through 2008, the Trust paid approximately $13.8 million in program administration fees to Thomas Arney, John Conroy, and their related firms.[98] Also, the Trust paid over $9.3 million in management fees to the Resources during the same period. Over that same period, member contributions were approximately $186 million.

Jardine was engaged as Program Administrator by a Letter Agreement dated September 14, 1992, and signed by Wang and Arney (Jardine Agreement).[99] The Jardine Agreement outlined the Association's (HCP's), Jardine's, and Joint Responsibilities, as follows (see Exhibit 10):

HCP RESPONSIBILITIES:

1. Draft the Trust Agreement and related documents including those necessary for the establishment of a for-profit subsidiary of HCP, the trust agreement, indemnity agreement; the by-laws for the trust and a description of the business activities of the HCP membership.
2. Assure that the trust has a depository bank for trust assets and appoints a certified public accountant for the trust financial records.
3. Create a for-profit subsidiary corporation to manage the activities of the trust.
4. Execute a management agreement with the for-profit subsidiary.
5. Appoint four trustees.

[97] These fees are reported as Administration Commissions in the Statements of Income and Participants' Equity in the Financial Statements and not on the Statements' Schedule of General and Administration Expenses. The Trust's accountant advised BST that this method of presentation was done at Arney's suggestion based on Arney's insurance industry background.
[98] The Program Administrator also received separate fees for loss control services and commissions for premium financing and other insurance placements on behalf of the Trust and its participants.
[99] Arney recalled that he had a general discussion with Wang concerning what duties the Program Administrator would perform for the Trust and what the Association would do. He said they "split up" the duties between them.

6. Appoint a licensed insurance agent to serve as an officer or director of the for-profit subsidiary within six months of the formation of the subsidiary.

JARDINE RESPONSIBILITIES:

1. Act as broker to provide the insurance services required by the trust.
2. Act as the program manager for the trust. In acting as program manager, Jardine will perform duties including managing the activities of the third-party administrator, develop loss control programs and risk management programs for the trust, coordinate actuarial services relating to prospective members of the trust, recommend experience ratings to be required of participants, market the trust, serve as liaison with the Workers' Compensation Board and related services.
3. Promote and market the self-insurance program to HCP membership.
4. Design and develop safety programs and training for members participating in the activities of the trust and, in addition, present such programs to membership at regularly scheduled meetings and conventions and such other times and places as the Trust, HCP, and Jardine may agree.
5. Appoint one trustee to the Trust.

JOINT RESPONSIBILITIES:

1. Complete the application to the Workers' Compensation Board for approval of a group self-insurance trust.
2. Develop a mechanism for the determination of each participant's equitable share of responsibility for claims.
3. Select and negotiate a contract with a third-party administrator who shall be responsible for management and payment of claims, the establishment of the duties of the third-party administrator, the development of loss control programs for participants, and the negotiation of a contract with such third-party administrator.
4. Establish guidelines for the activation of the trust, including the development of experience rating standards and safety and financial standards for participation.
5. Establish standards for the management of claims.

On September 24, 1992, Arney submitted an application for group self-insurance for HCPSIT to the WCB. Article IV, Section 1 of the Trust's By-Laws provided that a person designated by Jardine would serve as an HCPSIT Trustee. Arney served in this capacity and was a voting Trustee until he voluntarily resigned as Trustee on July 14, 1993, upon the advice of his firm's counsel to avoid the appearance of a conflict of interest. Jardine then appointed another representative.[100]

The Jardine Agreement provided for Jardine to collect all premiums and pay 2% of premium collections to the for-profit corporation created by the Association (Resources) for administrative

[100] It is unclear how Arney's resignation and Jardine retaining a Board of Trustees' appointment ameliorated the appearance of a conflict of interest.

fees, despite contractual language that suggested the allocation of actual expenses. An annual review of revenue allocation among the parties would be undertaken and revenues would be adjusted as mutually accepted. The Association also granted Jardine “the first opportunity to submit proposals for endorsement for other insurance and benefit programs as it has recently endorsed Jardine as a provider of statutory Disability Insurance programs.

In April 1994, Arney left Jardine and became President of Buffalo-based Naples Risk Management.[101] A Letter Agreement, dated April 1, 1994 (see Exhibit 11), was executed between Wang and Arney for program administration services (Naples Agreement). The Naples Agreement specifically required that the services be provided by Arney “personally” or under his “direct supervision.” Naples’ duties included managing the activities of the third-party administrator; developing loss control, risk management and safety programs; coordinating administrative claims and actuarial services; acting as the Trust’s liaison with the Workers’ Compensation Board; evaluating the suitability of prospective Trust members; monitoring the Trust's financial condition and activities; making recommendations to the Trustees relating to policies, programs, investments, contribution rates; and marketing the Trust’s programs to present and prospective members of the Association. For these services, Naples received a fee of 7% of gross written contributions. Naples would also serve as “broker to provide the insurance services required by the Trust.”

Despite Naples’ loss control responsibilities under the Naples Agreement, Wang, as HCPSIT Chair, transmitted a letter to Arney, dated June 15, 1995, agreeing to pay Naples $6,000 a month for Loss Control Services to HCPSIT, through October 31, 1995. This will be discussed further in the Safety/Loss control section of this report.

On July 25, 1995, Program Risk Management, Inc. (PRM) registered as a domestic business corporation with the New York State Department of State - Division of Corporations (see Exhibit 12). John M. Conroy is identified as the corporation’s Chairman/Chief Executive Officer.[102] Public records identify Arney as PRM Chairman/Chief Executive Officer, and Carolyn Arney as Treasurer.

On August 1, 1995, an Agreement signed by Wang as HCPSIT President and Arney as PRM President, appointing PRM as the HCPSIT’s new Program Administrator (PRM Agreement). The PRM Agreement (see Exhibit 13) provides that PRM’s compensation would be “a fee equal in amount to seven percent (7%) of the gross written contributions made by the Members to the Trust during the term of this Agreement.” The term of the Agreement was August 1, 1995 through July 31, 1998, and automatically renewed for successive terms of two (2) years, unless either party gave notice to the other of its intention to terminate the Agreement.

As Program Administrator, PRM would manage the activities of the third-party claims administrator, develop loss control programs and risk management programs for the Trust, coordinate actuarial services relating to prospective and present Members of the Trust,

[101] Conroy advised BST that Arney left Jardine after Jardine was acquired by Marshall & Sterling.
[102] Conroy advised BST that he worked with Arney at Jardine and accepted Arney’s offer to join him at PRM.

recommend experience ratings of Members, serve as liaison with the Workers' Compensation Board, evaluate and make recommendations regarding the suitability for participation in the Trust of prospective Members thereof, monitor the financial condition and activities of the Trust, make recommendations to the Trustees of the Trust concerning, inter alia, the adoption and/or amendment of Trust policies, programs, by-laws, investments, contribution rates, insurance policies, procedures and forms; promote and market the self-insurance program to the Association.

One month after the PRM Agreement was executed, on September 6, 1995, Arney advised the WCB by letter that he had separated from Naples and that his newly formed firm, PRM, would assume the role of HCPSIT's Program Administrator.[103] Concerning this new role Arney noted: "In addition to the maintenance and processing of Trust records, PRM will provide in-house Loss Control and Claim Supervision (not actual claim handling) to assist our clients in the prevention and management of risks and risk cost."[104]

Wang advised BST that she negotiated all program administrator contracts directly with Arney, and subsequently Conroy, and brought the recommended contracts to the Trustees for approval. Wang said that early on she contacted Tillinghast Towers & Perrin (TTP) to obtain some guidance on what the industry standard was for program administrators' fees. Minutes do reflect discussions of the program administrator contracts but detailed discussions would have been done in Executive Session for which no minutes were provided to BST.[105] Trustees interviewed confirmed that the PRM Agreements were discussed with and approved by the Trustees. One Trustee confirmed that Wang "spearheaded" contract negotiations but that the Trustees granted final approval. He recalled there were "lively" contract discussions with Arney and the Trustees. Another Trustee indicated he was on a sub-committee to renegotiate PRM's contract.[106] All Trustees were satisfied with the work Arney, and later Conroy performed as Program Administrator.[107]

After the initial PRM Agreement, four additional contracts were executed for the following periods: August 1, 1998-July 31, 2001,[108] November 1, 2001-October 31, 2004, November 1, 2004-October 31, 2007, and November 1, 2007-October 31, 2012.[109] PRM's scope of services remained essentially unchanged from the 1995 PRM Agreement. Most noteworthy, beginning in 1998 there was an added responsibility to "manage the activities of the loss control consultant retained by the Trust," a new provision that the Program Administrator "shall continue to be

103 Arney advised BST that he left Naples as his relationship with that firm did not work out satisfactorily.

104 On November 29, 1995, Arney transmitted a memorandum to Wang indicating the need to arrive at a "new" arrangement for Loss Control Services and suggesting the Trust pay $5,000 a month plus expenses. PRM and HCPSIT subsequently entered into a series of separate Loss Control Agreements.

105 The Program Administrator was excluded from Executive Session.

106 Investment/Finance Committee minutes reflect some discussion on PRM Agreement negotiations but are not very detailed in this regard.

107 As noted previously, PRM also provided services to HCPDBT.

108 The Trustees voted on April 24, 2001, to extend the PRM Agreement beyond July 31, 2001.

109 The 1998-2001 and 2001-2004 PRM Agreements were executed by Wang and Thomas Arney. The 2004-2007 and 2007-2012 PRM Agreements were executed by Wang and John Conroy; however, Conroy advised BST he was not involved in the negotiation of 2004-2007 PRM Agreement.

mentioned in any written materials relating to the Trust," and a new requirement that the Program Administrator's contact/liaison with the Trust be a "senior member of the Program Administrator's executive staff."

Fees paid to the Program Administrator for the 1998-2001 PRM Agreement remained at seven percent (7%) of the gross written contributions. The 2001-2004, 2004-2007, and 2007-2012 PRM Agreements included the following fee provision:

> (a) In consideration of the full and faithful performance of the services to be rendered by the Program Administrator hereunder, the Trust shall pay to the Program Administrator an annual fee equal in amount to six percent (6%) of the first Eight Million Dollars ($8,000,000) of gross written contributions[110] made by the Members to the Trust during each year of the term of this Agreement; seven percent (7%) of the next Two Million Dollars ($2,000,000) of such gross written contributions made during such year; and eight percent (8%) of any amount of such gross written contributions made during such year in excess of Ten Million Dollars ($10,000,000).[111]

The 2007-2012 PRM Agreement included the following additional fee provision:

> provided, that in addition to any amounts otherwise due the Program Administrator as its annual fee in and for the first year of the term of this Agreement only, the Trust shall pay to the Program Administrator as additional compensation for its services (the "Additional Compensation") an amount equal to one percent (1%) of the gross written contributions made by the Members to the Trust for and during such year. The Additional Compensation shall be payable in the same manner and at the same time as the monthly installments of the annual fee due the program Administrator, as hereinafter set forth.

As noted above, this provision was included upon Wang's recommendation and paralleled a similar fee increase to Resources.

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[110] The 2001-2004 PRM Agreement defined "gross written contributions" as payments actually received from Members (or, in the case of Members whose contribution payments are financed by or through the Trust, on such Members' accounts) as contributions required to be made to the Trust in accordance with the provisions of such Members' Coverage Certificates issued by the Trust; but shall not mean any payments received from Members (or on Members' accounts) of amounts assessed by the Trust pursuant to applicable provisions of the Trust's By-laws. The 2004-2007 PRM Agreement defined "gross written contributions" as amounts actually collected from Participants who are covered under a standard Coverage Certificate, plus the amount equal to the Contribution Maximum as defined under the Retention Plan Endorsement for those covered under an Incurred or Paid Loss Retention Plan (or, in the case of Members whose contribution payments are financed by or through the Trust, on such Members' accounts) as contributions required to be made to the Trust in accordance with the provisions of such Members' Coverage Certificates issued by the Trust; but shall not mean any payments received from Members (or on Members' accounts) of amounts that represent the New York State Assessment, Retention Plan Contribution Adjustments or amounts assessed by the Trust pursuant to applicable provisions of the Trust's By-laws.

[111] The HCPSIT's 2001-2008 audited financial statements reveal that contributions written revenue were in excess of $10 million each year, and at one point exceeded $20 million. It therefore appears that PRM had a strong financial incentive to find new members to join the Trust.

Concerning the duties performed by the Program Administrator, Wang said that PRM had responsibility for insurance-type issues, and she handled administrative issues. She noted that the Trust provided marketing materials and PRM had sales people to perform marketing and referral functions.[112]

Arney recalled that his fee was 10% of gross contribution[113] and that Resources received 3% for the first 3-5 years of the Trust. He said 10% was a normal fee and comparable to what he received for the other trusts he managed. Arney noted that he received monthly premium payments, deducted his fee, and sent the net amount to the HCPSIT account. Concerning Phyllis Wang's role with respect to the Program Administrator, Arney said "She was the boss." He said he was clearly working for her. Arney characterized Wang as "fair" but "hard to move on some things." He noted that she would complain that he was "making too much money."[114]

Conroy told BST that he became PRM's President in 2003 when he and three others - Edward Sorenson, Gail Farrell, and Colleen Bardascini, purchased the firm from Arney upon Arney's retirement. Conroy noted HCPSIT was PRM's largest trust. Conroy said he was Vice President under Arney and handled the firm's day-to-day operations and underwriting. Since Arney retired, he served as both HCPSIT's Program Administrator and Program Manager. Conroy noted Arney formed all trusts serviced by PRM except the Team Trust which they took over from another administrator. He said Arney formed the CRISP and ESTRA trusts while at Naples in 1995.

Conroy indicated that PRM's management fee was consistently 7% of contributions and later went to a sliding scale of between 6% and 8%. Conroy noted that PRM has no accounting or bookkeeping responsibilities for the Trust other than invoicing members, collecting premium down payments, and processing premium financing agreement payments. He noted that the Association does the bookkeeping, deposits funds into the appropriate accounts, and transfers funds back to the claims account.[115]

As noted above and to be discussed later in this report, on June 27, 1997 Arney and Conroy formed PRM Claim Services (PRMCS), which assumed duties as the Trust's Claims Administrator by written agreement dated November 1, 1998.[116] By serving as HCPSIT's Program Administrator and Claims Administrator, Arney and Conroy were in a position to manipulate individual case reserves to portray the Trust in the most favorable financial light,

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[112] As discussed later in this report, PRM and the Association had a separate Marketing Agreement relating to efforts to promote a broader range of insurance products to Association members.
[113] As noted previously, fees ranged from 6%-8%.
[114] This statement is interesting in light of the fact that Wang negotiated the contracts directly with Arney and could determine the fee structure.
[115] BST was advised by the WCB that the Trust's auditor prepared the Trust's trial balances and financial statements, which would impair the auditor's independence since he was responsible for auditing the financial statements. As noted elsewhere in this report, BST was advised that the Association/Resources prepared the financial statements later audited by the Trust's auditor.
[116] As noted previously, BST identified a signed Agreement between the Trust and PRMCS dated November1, 1997.

thereby preserving their own financial interests as Program Administrator for HCPSIT and for the other trusts it administered. This dual role has been viewed by many in the industry as inherently conflicted, and some jurisdictions, such as the State of California, prohibit program administrators from having a financial interest in a claims administrator. The potential conflict is further exacerbated by the fact that as Program Administrator, PRM had responsibility "to coordinate actuarial services relating to prospective and present Members of the Trust" thereby having influence in establishing the Trust's reserve liabilities. This will be discussed in more detail in the Actuarial and Claims Handling sections of this report.

Overall, interviews and documents reveal that the members felt Arney, Conroy, and their staff consistently provided good service to the Trust in their role as Program Administrator. Written procedures were in place for major operating areas, and transactions were generally well-documented. BST found PRM to be performing at a higher administrative level than other program administrators reviewed by BST on behalf of the WCB.[117] Fees paid to PRM appear to have been fair and reasonable and within the range of fees normally paid to program administrators, although additional fees were paid by HCPSIT to Resources CPR for services typically performed by program administrators.

In addition to fees received from HCPSIT for program administration, claims management, and loss control, as a licensed insurance agency, PRM derived commissions for the brokering of various insurance policies on behalf of the Trust including excess insurance, Trustees' Errors and Omissions (E&O), and crime (fidelity) policies. Concerning these insurance placements, Wang told BST that Arney and Conroy received proposals from various carriers and made recommendations to the Chair who would give his approval. She stated that all parties were aware that PRM would earn commissions from the carriers for placing this insurance coverage.

Arney and Conroy both confirmed they received commissions for placement of the various necessary Trust policies. With respect to excess insurance specifically, Arney noted that he tried to find the best market after September 11. He said he marketed excess insurance himself previously and had a lengthy personal relationship with an underwriter with Safety National which he felt was important. Arney said he received a 10% commission for the excess insurance, which he believed, later dropped to either 5% or 7%. Conroy stated that PRM received a 10% commission for placing the Trust's Directors' and Officers' insurance with National Union which has an annual premium of $18,000. BST found these commissions to be fair and reasonable, and properly disclosed to the Trust.

As noted above, the Trust offered a premium financing program to participants whereby they would make an initial 10% down payment on their annual premium (contribution) and finance the balance over nine additional monthly payments. A sample of financing documents reviewed showed that interest rates ranged from approximately 1% in the earlier years of the Trust to 9% in the later years. The program assisted often cash-strapped health care employers' cash flow by spreading their payments over ten months.

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[117] Prior to this engagement, BST reviewed 9 other group self-insurance trusts on behalf of the WCB involving 3 different program administrators.

Arney stated to BST that 99% of the Trust members participated in the premium financing program. He noted that he had check drafting authority from the premium financing company and received a 1%-2% commission on transactions. Conroy also acknowledged that PRM received a commission from the premium financing company for processing financing applications. He said that originally the application process was performed manually with carbon copies and the fee covered PRM's administrative costs. The commission initially was 1% of the amount financed and diminished to .75% and .50% as the process became automated. Conroy said the commission was discontinued in 2007. Conroy said Wang was aware of the commission, but he was not sure if HCPSIT Trustees knew. He said PRM issued an RFP for premium financing vendors every 2-3 years.[118] Conroy explained that PRM received the premium check from the finance company and then forwarded the funds on to the Trust minus their fee.

When asked about PRM's premium financing commission, former Trust Counsel Hodes said he had no knowledge of the commission. Wang said she could not recall if she knew about the commission, but appeared surprised when BST informed her of it. Wang said that PRM solicited premium financing firms and let the Board Chair know who was selected after the fact based on best rates. None of the Trustees interviewed was aware of the commission. BST did not locate any Trust documents in which premium financing commission paid to PRM were discussed or disclosed to the Trustees.

BST does not question the legitimacy of PRM receiving commissions from the premium financing company. However, the apparent lack of disclosure by PRM to the Trustees of commissions is troubling, particularly in light of the fact that PRM selected the premium financing company on behalf of the Trust. As such, PRM was in the position to make a selection to maximize its commission opportunity[119] rather than to minimize financing costs to participants.

In summary, the documents reviewed and the interviews conducted show that:

- Thomas Arney played a prominent role in the formation of HCPSIT in 1992, and firms with which he was associated served continuously as the Trust's Program Administrator until the Trust's termination in 2009;
- There was no periodic, competitive process undertaken by the Trust to determine or help ensure that fees paid to the Program Administrator were competitive;

[118] Trust documents indicate that at least two companies, Cananwil and A.I. Credit Corp. (a.k.a. AICCO, Inc.) provided premium financing services to the Trust.

[119] For example, total Trust written contributions for 2005 were approximately $17.1 million. The financed amount, assuming all participants were enrolled in the financing program, would have approximated $15.4 million ($17.1M x .90). Using a 1% fee on the amount financed, PRM could have earned approximately $154,000 ($15.4M x .01) in commissions for that year alone, a rather substantial amount. BST was unable to determine actual commissions received by PRM for premium financing services.

- Functions typically performed exclusively by a program administrator were shared by the Trust's Program Administrator and Resources, a for-profit affiliate of the Association, and the Trust paid fees to both entities;
- The Trust's Program Administration contracts with Arney's firms and successor firm were negotiated directly by Phyllis Wang on behalf of HCPSIT and Thomas Arney and Arney's successor, John Conroy, subject to Trustee approval;
- PRM Claim Services, Inc., a firm formed, owned, and controlled by PRM's principals, served as the Trust's claims administrator creating a possible conflict of interest situation whereby claims reserves could be established for the financial benefit of PRM and not the Trust; and
- The payment of commissions to PRM by the firm selected by PRM to provide premium financing to Trust participants was not disclosed by PRM to the Trustees.

D. SGRisk, Inc.

12NYCRR Section 317.19 requires, in part, all Trusts to submit on an annual basis an actuarial report certified by a qualified actuary verifying claims as defined in 12NYCRR Section 317.2c and the method of calculating such claims be based upon accepted actuarial standards of practice.[120]

The actuarial reports provided an estimate of HCPSIT's reserve liabilities and expenses, which then allowed PRM and the HCPSIT Trustees to evaluate the reasonableness of the premiums (and discounts) it charged its members. The cost of the member premiums directly influences which Association members join HCPSIT as employers seeking coverage tended to select the carrier offering the lowest premium.[121] Furthermore, the cost of the member premiums also had a direct impact on PRM's revenues, as lower premiums resulted in more members, generating additional revenues for PRM (and Resources).

There exists a financial incentive for both PRM and the Association's affiliate, Resources, to solicit more employers to join HCPSIT, as PRM's and Resources' administrative fees were based on the total number of employers to join the Trust and the employer members' gross written contributions. Therefore, an increase in the Trust membership allowed PRM and the Association (via Resources) to better cover its fixed overhead costs and increase its profits, regardless of the members' contribution to the Trust.

Pursuant to WCB policy, so long as a trust is at least 90% funded, the WCB does not implement remediation procedures for that trust. These remediation procedures include limitation or elimination of the amount of allowable discounts provided to existing members and/or the restriction or elimination of the number of new members allowed to participate in the trust. These procedures are designed to restore the trust to a funded position and/or limit the exposure of additional members to an under-funded trust. This fact was known to both PRM and the Association and is important for several reasons.

[120] The rules became effective January 31, 2001.
[121] This was confirmed through interviews with certain members and insurance brokers.

First, in the event that the WCB implemented these procedures for a PRM administered trust, such as HCPSIT, the procedures would have had the effect of substantially reducing the fees earned by PRM and Resources. This is because PRM and Resources earned their administrative fees based upon the number and size of participants in the trust, and if the trust was precluded from accepting new members, or was effectively priced as unattractive to current members by virtue of the reduction or elimination of discounts, PRM's and Resources' fee base would dramatically decrease.

Second, PRM and Resources earned fees based upon the "gross written contributions" for a particular member, which is exclusive of whatever discount may have provided to that member, including participation in the Retention Plan. As PRM and Resources would receive the exact same fee regardless of whether or not a particular member received a large discount or no discount whatsoever, there existed no economic disincentive to provide the greatest possible discounts to members regardless of whether or not the ensuing premiums collected were sufficient to meet the actuarially determined necessary reserves. Thus, there was a financial incentive for PRM and Resources to have HCPSIT appear to be at least 90% funded and for reserves to be set as low as possible.

As detailed in SECTION M of this report, an independent claims consultant retained by BST found "reserving deficiencies." The under-stating of the Trust's reserve liabilities by PRMCS (as noted by the claims consultant) and the under-reporting of these liabilities on the Trust's financial statements by the Association would have painted a false and misleading picture of the Trust's true financial position.

PRM, pursuant to its Service Agreement with HCPSIT, was responsible for coordinating actuarial services relating to prospective and present Members of the Trust. PRM (and its predecessor program administrators - Jardine and Naples) selected SGRisk, Inc. (SGRisk), a New Jersey-based actuarial firm, which performed these services from the Trust's inception to October 2008.[122] The President of this firm is Charles Gruber. According to a PRM official, SGRisk also performed, and continues to perform, actuarial services for other group self-insured trusts administered by PRM. As detailed below, SGRisk officials declined to meet with us and/or be interviewed as we were unable to agree on the specific conditions set forth by SGRisk through their attorney. Therefore, we had to rely on the documents provided.

SGRisk prepared independent actuarial reports on behalf of HCPSIT for the fiscal years ended October 31, 1994 through October 31, 2008.[123] Concerning the quality of work performed by SGRisk, Arney told BST that he was satisfied with SGRisk's work but added that after later

[122] SGRisk previously went by the name of Stergiou & Gruber Risk Consultants, Inc. (S&G). The other principal of S&G and SGRisk is E. James Stergiou. Interviews indicate that Gruber was the primary contact with HCPSIT with another SGRisk actuary, David Royce, taking more of lead role in the later years of the Trust.

[123] BST was unable to obtain actuarial reports prepared by SGRisk for the period October 1994 through October 31, 1996.

seeing some other actuaries' work; he thought that the Trust should have looked at other actuaries. Arney believed that SGRisk was consistent in their actuarial approach.

Arney noted that claims are reserved on an individual claim-by-claim basis and that the incurred but not reported (IBNR) would be established and recommended to the Trustees for approval. He did not recall the Trustees setting reserves 10% below the low range estimate (as told to BST by Conroy, see below). He said Gruber would provide five different methodologies, and the Trustees would go with Gruber's recommendation.

With respect to the actuarially determined estimated year end claims related liabilities, Conroy advised BST that the Trustees picked an amount at 10% below the actuary's low estimate.[124] He recalled this being discussed by the Trustees each year. He was not sure how the 10% was arrived at as it was set before he became involved with the Trust. He said the WCB allowed it to be set 5% below. Conroy said most trusts use a higher discount factor as it relates to the actuary's discount. Conroy was satisfied with SGRisk's work though he did look at other actuaries periodically.[125] SGRisk made a slide presentation to the Trustees each year.

Wang stated that Arney selected SGRisk as the Trust's actuary. As stated by Conroy, Wang noted that the Trust looked at other actuaries periodically but stayed with SGRisk. She noted that the Trustees also got second opinions about SGRisk's work. She recalled Arney telling her that it was best to stay with the same actuary because of the learning curve and the need for the actuary to better know the client. Wang said that Milliman and Robertson (M&R) also performed an independent actuarial review of the Trust.

Hodes confirmed to BST that Gruber and later David Royce came to the annual Trustees meeting each October for a two-hour presentation."[126] He felt it helped the Trustees understand things better. Wang said HCPSIT stayed with SGRisk as qualification issues raised by the WCB regarding SGRisk could not be substantiated.

Concerning the setting of reserves, Wang said options came to the Trustees from PRM and SGRisk, but the Trustees would make the final decision. Wang and Hodes had no recollection of the Board selecting reserves below the recommended low range, and as previously noted, the financial statements reveal the actuarial reserves on the financial statements approximated the low estimate noted by SGRisk.

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[124] A review of the financial statements and the SGRisk reports reveals that the amounts on the financial statements were approximately 10% below the actuarial midrange estimate. The actuary provided the midrange estimate, and a low and high estimate, which were 10% above/below the midrange estimate noted. So, it appears the estimate selected by the Trustees was within the range noted by SGRisk, and was not 10% below the low estimate.

[125] BST found no evidence that PRM or the Trustees actively solicited or considered other actuarial firms for the Trust.

[126] BST's review of Trustee and Investment/Finance Committee minutes shows that SGRisk/S&G's representatives attended Trustee meetings a total of eight times from 1993-2009. No representatives attended from 1998-2004 while they were in attendance annually from 2005-2008. Gruber attended each time as SGRisk/S&G's representatives with the exception of one event in 2008 (held in Montreal. Canada) attended only by Royce. Royce and Gruber attended together in 2005. Investment/Finance Committee minutes do not reflect any attendance by a SGRisk/S&G representative but do reflect Gruber's participation in a conference call with the Committee in 2002.

Wang indicated to BST that the preparation of the monthly HCPSIT financial statements was a management responsibility of Resources under the terms of the Resources Agreement. As Resources did not employ its own accounting staff for the purpose, that task was subcontracted to the Association, whose accounting department prepared the statements in the first instance. The draft statements were then reviewed by the Finance Committee of the HCPSIT Board of Trustees, revised if and as necessary, and reviewed and formally approved by the full HCPSIT Board it its next meeting.

As noted by Wang, Arney retained M&R in 1994 to "review certain actuarial analysis" performed by SGRisk for HCPSIT. In its report, dated November 28, 1994, M&R found that the contribution rate used by the Trust is "likely to be inadequate." (See Exhibit 14)[127]

Trustee minutes for December 7, 1994 show that Arney presented this report to the Trustees. The minutes state that one Trustee commented that M&R and SGRisk have very different approaches to rate setting and characterized M&R's as the more conservative approach. Arney told the Trustees that he was satisfied with SGRisk's methodology. Arney also recommended that the Trust continue to retain SGRisk as its actuary, with periodic reviews of their work by outside auditors.

In 1997, Arney who had since formed PRM, again retained M&R to "perform an independent actuarial analysis" of HCPSIT's loss and allocated loss adjustment expense ("ALAE") reserves as of April 30, 1997. In its detailed report, dated September 10, 1997, M&R stated that their "selected ultimate losses were $0.9 million or 3.8% below the ultimate losses estimated by SGRisk in their report to PRM." Trustee meeting minutes show the results of the M&R study were shared with the Trustees on September 23, 1997. M&R's estimate was not materially different than SGRisk's and, therefore, suggests that SGRisk's actuarial estimates appear to have been reasonable.

In 2002, HCPSIT retained TTP to perform an actuarial analysis of the Trust's reserves. BST asked Wang about the genesis of the TTP report, to which she responded in writing as follows:

> The TTP report was a second opinion. It was the Board's perception based on discussion with PRM at the time that HCPSIT was not being given credit by Stergiou and Gruber in S&G's actuarial report for the improvements in "claim experience" that the Trust was having by this time (2001). PRM recommended and the Board voted to have HCPSIT invest in a second opinion to see if the results of another actuary would be markedly different. After reviewing the draft TTP report, the Board felt that S&G and TTP were not markedly different in their opinions and that the reports reflected such, though the process was slightly different. TTP said there was improvement in pure premium, loss development was not being postponed and there was improvement in claims handling which was having a measureable impact on losses. Since there was no significant

[127] This may partially explain the Trust's audited member deficit from 1994 through 1996.

differences we decided to go with (submit) the S&G report, since otherwise we had no particular reason to change actuaries.[128]

Interestingly, as discussed later in this report, PwC provided to the WCB an independent analysis of the SGRisk and TTP actuarial estimates as of October 31, 2001, and noted that SGRisk's estimate was approximately $9.9 million lower than the amount estimated by TTP, thereby suggesting there were significant differences between SGRisk and TTP estimates.

BST interviewed David Mohrman, the principal author of TTP's report on HCPSIT's claims related liabilities as of October 31, 2001. The draft report is dated January 29, 2002 (see Exhibit 15) and addressed to Wang as HCPSIT President. Mohrman stated he was contacted by Debbie Turner[129] from TTP and told that HCPSIT was requesting some assistance with regard to actuarial loss reserve estimates. He was not sure why TTP was contacted, but he noted that he was not surprised when he learned SGRisk prepared the initial loss reserve - as "SGRisk was notorious for not being the best actuary."[130]

Mohrman stated that he had many conversations with Wang about the services he provided. Page 8 of the January 15, 2002, SGRisk report notes that Gruber made several actuarial calculations using various discount rates, including an 8% and 10% discount rate suggested by the Trust's auditor. As detailed below in Section E, the Trust's auditor relied on the actuaries experience, credentials, and prior work when auditing the claims reserve liability appearing on the Trust's financial statements. However, in doing so, it appears the Trust's auditor audited the liability amount which was partially based on his input, which on appearance seems to be a violation of Generally Accepted Auditing Standards. Certainly, the CPA would have seen that the actuary relied on his discount recommendation, as the actuary quoted the auditor on page 8 of his report, which the auditor subsequently obtained and reviewed.[131]

When asked by BST about the 8% discount rate used and noted in a November 15, 2001, memo (prepared by HCPSIT's auditor), Mohrman stated that TTP usually defers to the client with regard to the discount rate they want to use. However, he stated he personally would have used a lower rate if he was the client, as the 8% may have been too high given the restrictions placed

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[128] TTP revealed to WCB that the reserves were understated and that the report was never finalized.

[129] Turner had performed a number of claims management reviews of HCPSIT for TTP.

[130] Mohrman told BST that SGRisk/S&G may have been banned from providing services in Canada and/or had some issues with the Professional Actuarial Standards Board. BST found that SGRisk/S&G principal, E. James Stergiou, was "Publicly Reprimanded" by the American Academy of Actuaries in November 1998 at the request of the Canadian Institute of Actuaries for "failure to comply fully with applicable standards of professionalism when providing professional services in Canada."

[131] The language quoted by the actuary in his report was actually taken from a November 15, 2001, memorandum from the Trust's auditor to Arney. It is unclear why the auditor was telling the Trust's Program Administrator what discount factor should be considered for claims reserves, especially since the Trust's auditor had the responsibility to audit the assumptions used by the actuary, including the discount rate. Auditors are required to review the reasonableness and consistent application of actuarial assumptions; however, since auditors are not qualified to make actuarial judgments, they rely on the actuary's expertise. Because the Arney used the auditor's estimate of the discount factor, the auditor, in essence impaired his independence by auditing his own professional opinion with respect too the Trust's claims liability.

on Trust investments. He also stated that TTP did not rely on Johnson's work papers, or the audited financial statements when they prepared their independent analysis.

Mohrman stated that he thought the trust retention issues (as discussed later in this report) were significant, as Conroy and the Association did not see the need to report incurred but not reported claims. He believes SGRisk relied on what management and/or PRM told them.

Mohrman stated that he did not recall meeting with the Trust's auditor or speaking with him with regard to TTP's actuarial report and that he never met with the HCPSIT's Trustees. A November 5, 2002, email from Conroy suggests that TTP prepared another report during 2002; however, we have so far been unable to obtain a copy of this report from Conroy, the Association, or TTP.

An internal WCB email dated November 11, 2002 reveals concerns relating to TTP's reported findings that the Trust's reserves should have been $29 million on a discounted basis while showing only $15 million on its financial statements. The WCB addresses the possibility of freezing new membership. The email also indicated that TTP was the consultant preferred by the Trust to perform this actuarial review.[132]

In early 2003, the WCB retained PwC to review the loss, ALAE, and assessment reserves of the Trust. PwC was not requested to perform an independent evaluation of the Trust's reserves. PwC's analysis encompassed reviewing for reasonableness the assumptions, methodologies, and conclusions of the October 31, 2001, report prepared by SGRisk, Inc.[133] The PwC report issued on May 9, 2003 (see Exhibit 16) found that the Trust reserves should be nominally adjusted as of October 31, 2002. Meeting minutes reflect discussion of the PwC report by PRM and the Trustees.

The WCB issued a Level I Review Report, dated July 26, 2004 indicating that as of October 31, 2003, HCPSIT had a regulatory deficit of $20,776,674, and the Trust was deemed underfunded. Pursuant to 12NYRCC 317.6, Group Self-Insurers are required to establish and maintain Trust Assets in an amount which exceeds Trust Liabilities. It is important to note, however, that only assets and liabilities as defined in Section 317.2 of the Rules and Regulations are considered when determining a Group's regulatory funding position. As the definition of Trust Assets and Liabilities provided in the Rules and Regulations differs from that provided for in Generally Accepted Accounting Principles (GAAP), a Group's regulatory funding position may differ, in some cases significantly, from the financial statements prepared in accordance with GAAP.

In a Level I Review Report dated May 10, 2005, the WCB indicated that as of October 31, 2004, HCPSIT had a regulatory deficit of $21,337,669 and was deemed underfunded.

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[132] BST identified an email dated November 5, 2002, from Conroy to TTP confirming a meeting with TTP and the WCB on November 12 to discuss concerns relating to TTP's report.

[133] The PwC report indicates that they were engaged to review the reserves as of October 31, 2002; however, the body of the report suggests they were actually analyzing the reserves as of October 31, 2001. Indeed their reference to SGRisk's report dated December 4, 2001, relates to the SGRisk cover letter and schedules submitted during January 2002

As a result of PwC's findings and Level I reviews performed by the WCB for the periods ended October 31, 2003 and October 31, 2004, the HCPSIT Trustees entered into a Consent Agreement with the WCB in August 2005 agreeing to a number of administrative procedures being implemented. Among these requirements were the following:

- That the Trust will provide all current members with written notice of the determination by the WCB of the regulatory funding position of the Trust, and the terms and conditions contained in this Consent Agreement. Such notice must be pre-approved by the Workers' Compensation Board before being issued.
- That the Trust agrees to pay all assessments upon receipt of any bills received from the Board.
- That there shall be no greater than twenty (20) new members (including affiliates) added to the Trust during the twelve-month period from the date the Consent Order is issued, or an alternate date granted by the Board in writing, whichever comes first.
- That the Trust acknowledges that the receivable associated with the Retention Program is not recognized as an acceptable asset as defined in 12 NYCRR Part 317. The Trust agrees to reduce the current year cash flow by at least five percent (5%) per year.
- That the Trust acknowledges, for the period of this Consent Agreement, a Retention Program may only be offered to new members with contributions exceeding $150,000. No cash flow will be allowed.
- That the maximum discount off manual rates to new and existing members shall be no greater than twenty percent (20%).
- The Trust shall also charge the NYS assessment as published by NYCIRB to new and existing members.
- That the reinvestment plan must be submitted to the WCB.

A Level I Review Report dated May 22, 2006 reports that as of October 31, 2005, HCPSIT had a regulatory deficit of $22,992,244 and again was deemed underfunded.

In 2007, the WCB again engaged the services of PwC to perform an independent review of the Trust's actuarial reports for the years 2003-2006. PwC issued a report to the WCB, dated June 13, 2007 (see Exhibit 17). BST interviewed the primary author of this report to the WCB, Alan Hines, concerning some very specific elements of his report. As noted in his report, Hines stated that it did not seem appropriate that the Trust was accounting for the excess recoveries appropriately, i.e., by grossing up the net reserves and establishing a receivable for the anticipated recoveries. He also thought there should have been some explanation as to why the claims reserves on the audited financial statements were less than the actuary's best estimate.

Hines stated that the claims reserves would have been higher if the actuary used industry benchmarks, although he said there was no reason to believe that the internal benchmarks were inappropriate. He stated that part of the problem with the low reserve amounts may have also been due to the discount factors used. He said the Trust's asset base was declining after 2001, although it appears the discount rate was somewhat aggressive.

The WCB issued a Level I Review Report, dated June 18, 2007 indicating that as of October 31, 2006, HCPSIT had a regulatory deficit of $22,730,659 and was deemed underfunded. The WCB performed Level I reviews for the years ended October 31, 2007 and October 31, 2008[134] and reported regulatory deficits of $23,078,871 and $27,414,648, respectively.

As part of our analysis, BST retained By the Numbers Actuarial Consultants (BYNAC), to review the Trust's actuarial reports and the other aforementioned actuarial reports and analyses and to provide input with regard to these documents.

The BYNAC report to BST, dated March 31, 2010 (see Exhibit 18) noted the following:

With respect to PwC's analysis of HCPSIT's actuarial reports as of October 31, 2001 through October 31, 2006, BYNAC concurs with PwC's conclusions that SGRisk's reports were complete and well documented and that the methods relied on by the SGRisk were reasonable and consistent. However, she indicated that the following main concerns expressed by PwC are still valid through the 2008 financial statements:

- The recorded reserves (per the financial statements) are significantly below the actuarial indications.
- The Trust does not seem to be accounting for excess recoveries appropriately.
- The collectibility of the anticipated premiums from loss sensitive programs is a concern due to the large size of the anticipated additional premium.
- Since the Trust is not holding invested assets to support the recorded loss reserves, the appropriateness of the discounting is questionable.

Concerning the SGRisk actuarial reports as of October 31, 2007 and October 31, 2008, and SGRisk's analysis of rates effective November 1, 2008, BYNAC offered the following opinions:

1. The methods used by the actuary in all of the reports were reasonable and provided an adequate review of HCPSIT. Selected estimates were consistent with those of a prudent actuary. The actuarial review could have been more complete in the areas described below.
    a. Certain diagnostics are not included in the reports that we believe a prudent actuary would include.
    b. It is clear that anticipated recoveries were not handled consistently between the actuarial reports and financial statements.
    c. The estimated ultimate incurred losses selected by SGRisk in the October 31, 2001 through October 31, 2008, actuarial reports have increased about $10,200,000 over the eight-year period.

[134] The report as of October 31, 2008, was draft.

BYNAC offered the following opinion of WCB's Level I reports:

> The Level I reviews rely heavily on the estimates in the actuarial reports. To the extent that the actuarial estimate is inadequate or inaccurate, the funding level calculation shown in these reports is also inaccurate. The Level I reviews express concern about the large loss sensitive premium receivable and the difference between actuarial indications and carried reserves. In 2005, the Trust entered into a Consent Agreement to address the issue with the retention program receivable asset. The "Profitability Predictor" shown in the 10/31/06 review indicated that the 11/1/06-07 period would break even. This is consistent with BYNAC's determination that the actuarial reports provided gave reasonable projections of ultimate losses.

In summary, the documents reviewed and the interviews conducted by BST suggest that:

- For approximately two years, the loss estimates provided by SGRisk were significantly different than the estimates provided by other independent actuaries, and
- The Association/Resources apparently reported loss reserves on the financial statements that were less than the actuary's best estimate. There is no documentation or basis to support the use of these amounts, and these amounts may have created a misleading impression about the financial well being of the Trust.

E. DeChants, Fuglein & Johnson, LLP

12 NYCRR Section 317.19 requires, in part, all Trusts to submit audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) and certified by an independent certified public accountant.[135] The largest liability and expense appearing on HCPSIT's financial statements relate to the members' claims (loss reserves); accordingly, these account balances at any point in time are material to the overall fairness of the financial statements.[136]

Individual claim loss reserves were initially established by PRM as Program Administrator upon notification and examination of the injury claims filed by its members. The loss reserve amounts established by PRM were, in turn, relied upon by HCPSIT's actuary when estimating loss reserves that were used as the basis for reporting the claim liability and expense on the financial statements prepared by the Association/Resources. HCPSIT engaged DeChants, Fuglein & Johnson, LLP (DF&J) to conduct an audit of HCPSIT's financial statements.[137] HCPSIT also engaged SGRisk, Inc. to annually provide an estimate of the annual claim liabilities and expenses.

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[135] The rules became effective January 31, 2001.

[136] The loss reserves represent the amount that PRM believes HCPSIT will have to pay out as a result of injury claims.

[137] The Trust's financial statements were prepared by DF&J's predecessor firm, Roth and DeChants, from 1993-1996.

Inherent within GAAP is the principle of conservatism, which requires the preparers of financial statements to make evaluations and estimates, to deliver opinions, and to select procedures, and to do so in a way that neither overstates nor understates the affairs of the business or the results of operation.

While the Association/Resources had the responsibility to apply the concept of conservatism, it was DF&J's responsibility to determine whether the claims liability/expense amounts reported by the Association/Resources were not materially misstated, and opining on the overall fairness of HCPSIT's financial statements. During the periods ended October 31, 1993 through October 31, 2008, DF&J (and its predecessor firm) concluded that HCPSIT's financial statements were presented fairly, in all material respects.

In conducting its audit, DF&J was obliged to follow Generally Accepted Auditing Standards (GAAS) used in the United States. Statements on Auditing Standards (SAS) provide guidance to auditors on GAAS in regard to auditing an entity and preparing a report.

SAS 73, *Using the Work of a Specialist*, requires the auditor to evaluate whether the specialist's findings support the assertions in the financial statements. SAS 73 applies to various specialists, including actuaries such as SGRisk. Accordingly, if DF&J believed SGRisk's findings (claims reserves) were unreasonable[138]; DF&J should apply additional audit procedures, which may include obtaining the opinion of another actuary.

DF&J's representative noted that the claims related liabilities/expenses represented the vast majority of the Trust's liabilities and expenses. DF&J's audit work papers reveal DF&J had access to HCPSIT's Board of Trustees meeting minutes and other relevant documents during its audits of HCPSIT.

As detailed earlier in this report, beginning in 1994, another independent actuary (M&R) prepared reports addressing the actuarial methods used by and reserves reported by SGRisk. These reports do indicate that the estimates provided by SGRisk were relatively consistent with Milliman's estimates.

Also discussed previously was that another actuarial firm (TTP) was engaged by HCPSIT to conduct an actuarial analysis of the Trust as of October 31, 2001. TTP's draft report revealed that their actuarial determined reserve estimate as of October 31, 2001, was approximately $27,000,000, significantly more than the $16,636,173 reserve figure reported by SGRisk, and almost more than twice the amount ($13,477,461)[139] reported by the Association/Resources on the Trust's October 31, 2001, financial statements - which were audited by DF&J.

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[138] The Trustees and the Trust's representatives relied on the amounts reported by the actuary, and then reported a similar amount, albeit usually lower, on the financial statements.
[139] This amount is net of the estimated recoveries of $534,789 as noted in the footnotes to the audited financial statements.

Not only was the amount reported by the Association/Resources significantly less than the best estimate provided by SGRisk, but the amount reported on the financial statements was materially less than the estimate provided by TTP. The TTP report was received by Wang at least one week before the audited financial statements were issued to the HCPSIT Board of Trustees. However, it is unclear whether this information was ever provided to DF&J.

The difference in estimates would appear to have a material impact on the Trust's financial statements. Regardless, the material difference in estimates should have been of future concern to the Trust's auditor (assuming they saw the reports), as the reports seem to suggest that SGRisk's estimates (and the amounts reported in the respective financial statement) were inadequate and could be misleading.

As noted above, SAS 73 requires the auditor to evaluate whether a specialist's (including actuaries') findings support the assertions in the financial statements. Accordingly, if DF&J believed SGRisk's findings (claims reserves) were unreasonable, DF&J should have applied additional audit procedures, which may include obtaining the opinion of another actuary.

It is possible that HCPSIT did not advise DF&J about the January 2002 TTP report, however, an examination of DF&J's audit work papers relating to the Trust revealed that Trust representatives signed representation letters (to DF&J), a document in which HCPSIT affirmed that they provided DF&J with all financial records and related data.[140] Interestingly, unlike other representation letters relating to other trusts reviewed by BST, the HCPSIT completed representation letter did not contain any affirmation that HCPSIT provided DF&J with "all actuarial reports prepared for the trust during the year."

HCPSIT also affirmed in the representation letter that there are no estimates that may be subject to material change in the near future that have not been properly disclosed in the financial statements. Therefore, and according to the signed representation letters, it was incumbent upon Trust representatives to provide the TTP report to DF&J, HCPSIT's auditor, as it did have in its possession actuarial reports that reported reserves that were significantly, if not materially, different than reserve amounts provided by SGRisk.[141]

Any failure to provide DF&J with other actuarial reports may have resulted in DF&J rendering an inappropriate financial statement audit opinion. BST did not identify any information which lead us to believe that DF&J received the draft January 2002 TTP report.

As previously noted, DF&J's work papers indicate that they reviewed and tested certain aspects of the actuary's report and evaluated the credentials of the actuary. We were unable to determine whether DF&J's prior professional relationship with the Association and its affiliates may have influenced DF&J's planned audit approach, however, if DF&J failed to inquire about and/or

[140] BST noted that Wang signed the representation letter relating to the 2007-2008 audits.

[141] The most likely Trust representative would have been Wang who served in multiple capacities overseeing the activities of the Trust, Resources and the Association.

obtain the other actuary reports, its failure to do so may have constituted a breach of its audit responsibilities to obtain sufficient, competent evidential matter.

A concern which does not appear to have been addressed by the Board of Trustees is whether or not there might have been some lack of economic independence on the part of DF&J because of the significant amount of business that DF&J received from the Association and its affiliates, including Resources, CHC, HCPDBT, and the HCP PAC.[142]

As noted in Section D above, DF&J recommended a discount rate that was eventually used as an assumption by the actuary when conducting their actuarial analysis and estimating the Trust's claims reserve - the largest liability on the audited financial statements. Accordingly, DF&J while conducting its financial statement audit of HCPSIT, audited its own assumptions. It is not clear how DF&J was able to objectively audit its recommendation that was partially used as the basis for the actuaries claims reserve opinion.

An analysis of the Trust's 2006-2008 audited financial statements reveal that the Association/Resources and/or DF&J reported the claims related liabilities at an amount less than the actuary's best estimate. For example, the financial statements audited by Johnson noted that the discounted claims liabilities as of October 31, 2008, were $32,605,013 before recoveries, or $27,919,476 net of expected recoveries of $4,685,537. Furthermore, Footnote 5 to the 2008 audited financial statements indicates that these amounts were provided by the actuary retained by the Trust. However, the related actuarial report obtained by BST reveals that the actuary's best estimate claims related liability (net of recoveries) was $37,359,223, approximately $10 million more than what was reported by Association/Resources officials and audited by DF&J. This $10 million dollar appears to be material and could have influenced the individuals relying on the financial statements, as it had the impact of reducing the overall members' deficit by approximately $10 million.

There does not appear to be any justification for the reporting of an amount less than the actuary's best estimate amount by the Association/Resources, and it is unclear how DF&J could have concluded that the amount reported by the Association/Resources was appropriate, given the fact that the expert retained to provide an opinion concluded that the amount should be approximately $10 million more, or about 36% higher. As noted in prior audited Trust financial statements, Note 5 of the 2008 audited financial statements states that "sufficient long-term historical claims experience does not exist to support its entire estimate of ultimate payable for future claims incurred." This appears to be misleading, for as of October 31, 2008, the Trust had been in existence for approximately fifteen years, and appears to have demonstrated enough claims experience to rely on the actuarial best estimate

Interestingly, in a January 29, 2010 letter (see Exhibit 22) to the WCB with regard to another Trust, Johnson of DF&J states "Although, personally, I may not necessarily agree with everything, as an auditor I have to accept the finding of the actuary." From our standpoint, it appears as if the Association/Resources and/or DF&J reduced the actuary's best claim estimate

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[142] DF&J also conducted the audit of PRM and another trust managed by PRM.

not once, but twice for the $4,685,573 of expected reinsurance recoveries. The net claims amount reported on the related financial statements was $27,919,476, or $9,439,747 less than what was reported by the actuary. This latter amount closely corresponds to the double recording of the expected recoveries ($4,685,537) estimated by the actuary. For example, $4,685,537 multiplied by 2 equals $9,371,074.

The possible double booking of the reinsurance recoveries was also noted by an actuary employed by one of the largest CPA firms in the world relating to another PRM trust (using both DF&J and SGRisk), who disagreed with the claims amounts audited by DF&J. This actuary concluded that the expected recovery amount reported on the financial statements should have been excluded, as the actuary already factored this amount into their claim reserve estimate.

Another issue questioned by the WCB involved Johnson's reluctance to suggest that the Association/Resources report/record the unallocated loss adjustment expenses (ULAE) on the HCPSIT financial statements. Johnson ostensibly didn't believe ULAE expenses should have been recorded 1) if there had not been a change in claims processing firms, 2) since the ULAE costs were unknown, and 3) because the costs related to the life of the claims processing contract. However, the WCB obtained second opinions from a large international accounting firm and another New York State firm, and both concluded that the ULAE should be accounted for and reported. BST did note that HCPSIT was audited the following year by another firm after the WCB assumed control of HCPSIT's assets and payment of liabilities, and BST noted that the new auditor recorded ULAE expenses of approximately $9.5 million for the year ended October 31, 2009.

Also as noted in Section D, the WCB retained PwC to perform some agreed-upon procedures, during 2003, including a review of DF&J's work papers relating to the audit of HCPSIT. With the exception of a few comments relating to some numerical adjustments, PwC had no comments regarding the adequacy of DF&J's work papers relating to the financial statement audit for the period ended October 31, 2002.[143]

In summary, the documents examined and the interviews conducted reveal that:

- DF&J should have been provided with a copy of the January 2002 TTP report;
- HCPSIT, contrary to their representation letter to DF&J, may not have provided DF&J with all documents and/or information relating to DF&J's financial statement audit of HCPSIT;
- DF&J may have violated Generally Accepted Auditing Standards by auditing their recommendation that was one of the assumptions used by the Trust's actuary to estimate the Trust's claims reserve liability;
- DF&J may have mislead the users of the Trust's financial statements by opining that the Trust's reported claims reserves were not materially misstated, and

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[143] The report was very favorable with regard to other facets regarding the administration of the Trust, including its control environment, the internal control structure, and reinsurance.

- DF&J did not agree that the ULAE should be reported on the Trust's financial statements.

F. Marketing

The success of any group self-insurance plan relies, in part, on its ability to attract and differentiate itself from its competitors and to offer favorable rates to members with good loss histories. Unlike most other group self-insured trusts, HCPSIT is not "broker-driven" in that the primary source of marketing was not through licensed insurance brokers. Rather, participation in HCPSIT was open only to Association members in good standing. Therefore, marketing efforts were limited to the Association's existing membership base, or health care providers eligible for membership in the Association and interested in joining HCPSIT for their workers' compensation insurance coverage.

Wang told BST that Association members liked joining the Trust because it gave them cost predictability which was more important than the lower premiums, in her opinion. She said about 65%-70% of the Association's provider members joined the Trust and that some providers joined the Association in order to join the Trust.

Wang identified to BST the Trust's Retention Plan[144] as a major marketing tool to attract larger health care providers to the Trust. Wang recalled that, initially, the average home care agency joining the Trust was in the $1-$4 million annual gross revenue range. As the Trust evolved, larger agencies in the $25-$50 million gross range began to inquire about joining and were looking for a "loss sensitive" plan[145], similar to those offered by the large insurance carriers.

Wang said Arney told her that something needed to be done to attract these members and suggested a "loss sensitive" plan. Wang noted there was much discussion among the Trustees about why some members should get better rates under such a plan, but the Trustees finally decided it was a good way to expand and market the Trust and make the Trust stronger.[146] Wang agreed that the addition of larger members, through the Retention Plan, made the Trust stronger because HCPSIT could acquire bigger, more prominent members, and the Trust would look

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[144] The International Risk Management Institute, Inc. (IRMI) defines a retention plan as: A type of dividend plan most often used only in connection with workers' compensation insurance. This plan provides that the net cost to the insured is equal to a retention factor (insurance company expenses) plus actual incurred losses, subject to a maximum equal to standard premium less premium discount. This can also be used for other lines of insurance.

[145] IRMI defines a loss sensitive plan as: An insurance rating plan for which the final premium is dependent on the actual losses during the period the plan is in effect. This risk financing technique places upper limits on the insured's costs if its losses are high but also requires the payment of a minimum premium in the event it experiences low losses or is loss-free. Thus, the risk financing costs tend to vary based on actual loss experience. This type of plan provides an incentive for insureds to emphasize safety and loss control activities. Deductible plans, retrospective rating plans, dividend plans, and retention plans are all examples of loss sensitive plans.

[146] It is still unclear why both Arney and then Wang felt the necessity to implement a loss sensitive plan to attract new members that ostensibly were able to enroll in loss sensitive plans offered by large insurance companies. The Trust was ostensibly designed to offer a cheaper option, albeit, for the good of the Trust members as a whole, not necessarily an isolated group of larger members.

better if it had more members.[147] Also, the Trust could more easily attract new, non- Association members into the Association who wanted to join the Trust. The latter statement appears to be extremely self-serving to the Association and not necessarily HCPSIT, and therefore, should not have been the impetus to implementing a loss sensitive plan.

BST spoke to Arney concerning the genesis of the Retention Plan. Arney indicated that the Trust was losing members to workers' compensation carriers who had "cash flow" plans.[148] Arney said he tried to duplicate the Kemper insurance "cash flow" plan model. Arney noted that the Retention Plan was limited to members with more than $150,000 in annual premium, and the Retention Plan members remained jointly and severally liable along with the other Trust members. Arney stated the Trust was initially pleased with the Trust's Retention Plan, but as time went on, the Retention Plan was no longer needed to maintain the competitive advantage over the large insurance carriers. He said he recommended that the Trust discontinue the Retention Plan, but the Trustees wanted to keep it, as most of them were Retention Plan participants. He said this all happened about the time he left PRM (2003) and retired. In the long run, he felt the Retention Plan was not helpful as the individual members, and not the Trust, had the "float."[149]

Concerning the origins of the Retention Plan, Conroy stated that the Trust "had to do it." He recalled that Allen Health Plan was the first Retention Plan member in January 1996. The concept was introduced to the Trustees as an option and is also referred to as "Retro Plans" and "Dividend Plans" in other insurance settings. He said that PRM thought other low cost options could sweep away the good members, as competing insurance agents were recruiting Association members for their workers' compensation coverage.

Conroy added that there was concern that potential members would be lost to other trusts, and the Plan was offered to only those who had also received another quote, such as Allen had.[150] The Retention Plan was not made generally known to all members early on, but other members eventually found out about the Retention Plan and wished to participate. Conroy confirmed that the threshold for Retention Plan membership was set by the Trustees at $150,000 annual premium. He said the Trust was looking for good performers but noted that bad performers had to pay to their retention cap anyway.[151] Conroy stated that Retention Plan members represented 70% of total Trust participants' payroll.

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[147] What Wang didn't state was that the Association and Resources would make more money of larger members joined the Trust.

[148] IRMI defines a cash flow program as: Any insurance rating scheme that allows the insured to hold and benefit from loss reserves until paid as claims, e.g., deferred premium plans, self-insurance, and paid loss retros.

[149] Wang and former HCPSIT Counsel Hodes both had no recollection of Arney ever recommending to or discussing with them or the Trustees that the Retention Plan be discontinued as the plan was no longer required for the Trust to remain competitive. Wang said she would have remembered if Arney had told her that.

[150] There was no explanation provided from Conroy, Wang, or Arney why moving to another Trust was a bad option for the member, especially if that member was able to procure their insurance at a cheaper cost.

[151] The retention cap is the maximum contribution that a Retention member would pay and is equal to the amount any other non-retention member would pay.

It is clear that the Retention Plan played a prominent role in expanding the Trust and recruiting new, larger payroll employers to the Trust. The Retention Plan had a major impact on the Trust's overall financial growth and eventual deterioration, which will be discussed in more detail later in this report. It is interesting that the Trust's leadership wanted HCPSIT to be "competitive" but was very concerned about losing members, regardless of the fact that Association members apparently could obtain less expensive coverage elsewhere.

Of course, growing the Trust was in the best financial interest of both the Association and PRM, as larger gross contributions meant larger management fees to both Resources and PRM. If Wang and the Trustees participating in the Retention Plan indeed rejected Arney's purported suggestion to discontinue the Retention Plan, then it would appear that continuance of the Retention Plan may have been motivated by narrow financial self-interests and not for the benefit of all Trust participants. Whether or not Arney did convey his concerns to Wang and the Trustees, as the Trust's insurance professional, Arney's opinion that the Retention Plan had outlived its usefulness as a sound insurance practice is significant.

The Trust was very successful in attracting new members and grew quite rapidly. During its sixteen years of operation, the Trust serviced over 330 participants and typically serviced approximately 180-200 active participants at any one time. Minutes for April 24, 1994 report that as of March 31, 2004, the Trust had grown to 50 participants. Minutes for April 28, 1996, reflect a report to the Trustees from the Association's Marketing Director that approximately one-half of eligible Association members were participants in the Trust and that 20% of new Association members are joining to participate in the Trust.

Wang noted that HCPSIT (through Resources)[152] produced and provided the marketing materials to PRM which had sales people for marketing and referral follow-up. Wang was asked about a note to the Trust's October 31, 1994, financial statements indicating that, in addition to the management fee paid by the Trust to Resources, an extra 1/3% of gross commissions were to be paid to Resources for marketing expenses. Wang had no recollection of this, or any other separate marketing fees paid by the Trust,[153] but added that Resources did provide some marketing services to the Trust under its Management Agreement.[154] Wang did indicate, however, that PRM and Resources have a marketing contract for the Association to market the

[152] The Resources Agreement makes no specific reference to marketing-related duties. A letter from HCPSIT's Counsel to PRM's Counsel dated November 1, 2001 states, inter alia, "In the absence of a formal agreement for the provision of marketing services by HCP Resources, Inc. ("HCPR") to PRM for the period July 1, 2000 through October 31, 2001, PRM and HCPR have agreed that the total fee to be paid to HCPR by PRM for marketing services rendered during that period is $14,315.90. PRM has heretofore paid to HCPR a total of $14,000 for those services. Accordingly, there is now due HCPR from PRM the sum of $315.90."

[153] Subsequent financial statements make no reference to this fee, but General and Administration Expenses show that the Trust incurred $193,206 in Marketing and Promotion expenses from 1995-2008.

[154] As noted previously, the Association through Resources prepared the financial statements and the notes to the financial statements and as President of the Trust and of the Association; Wang would have been one of the people involved in reviewing and approving these statements. Moreover, Wang signed the management representation letter to the CPA indicating that HCPSIT has provided all relevant material for the audit, some of which is included in the notes to the financial statements.

full range of Association insurance services offered by PRM that was separate and apart from HCPSIT.[155]

Arney told BST that Resources had responsibility for marketing but that PRM actually performed this function. He confirmed that Resources printed up materials, and PRM did the distribution. Arney said he made marketing presentations at HCPSIT Board meetings and recruited members. He said recruiting members was the "biggest" part of his duties early on. Conroy indicated that PRM was responsible for marketing the Trust to Association members in conjunction with the Association, and was a "dual" effort. They jointly put together materials and brochures and made presentations at the annual conference. He noted that PRM has a marketing person, as does the Association.[156]

Former HCPSIT Board Chair Todd Brason, when asked to identify the party responsible for marketing the Trust indicated that Resources marketed the Trust to Association members and that there was a separate marketing agreement with Resources for $1,500 per month. The latter statement appears to contradict Wang's assertion that the PRM/Resources Agreement was separate and apart from HCPSIT.

Trustee meeting minutes, particularly in the Trust's earlier years, reflect discussion of marketing issues by the Program Administrator and marketing personnel from the Association and the Association's non-profit affiliate, Community Health Care Services Foundation, Inc. (CHC). Marketing strategies were discussed with the Trustees and proposed marketing materials such as a Trust newsletter and Trust logo were reviewed. Minutes reflect little discussion of marketing issues or strategies in the Trust's later years. The Trust produced and distributed an Annual Report, a newsletter and other informational brochures.

It would seem that an Association member would logically expect the Association to be marketing its range of member services, including workers' compensation insurance, as a function supported by annual association membership dues. As such, a question arises concerning why the Trust was using Trust revenue to pay for an association expenses.

In summary, the documents examined and the interviews reveal the following:

1. The marketing strategy employed by the Association and PRM resulted in a dramatic growth in HCPSIT membership, which clearly financially benefited both the Association and PRM. The use of the Retention Plan to attract new and larger payroll participants greatly facilitated this growth.

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[155] BST obtained a copy of the PRM/Resources Agreement for the period November 1, 2007 through October 31, 2012. Under this Agreement, PRM agreed to pay Resources $2,000 per month, and beginning February 1, 2008, an additional $6,000 per quarter, for marketing-related services and recognizing PRM as the Association's "select agent or broker for sponsored insurance programs available to HCP members", including but not limited to programs for professional and general liability and third-party fidelity insurance and disability benefits coverage.
[156] It would seem that a member's Association dues would have already covered this.

2. The Trust's continuation of the Retention Plan beyond its usefulness as a necessary marketing tool must be questioned and may have been predicated on the self-interest of the Association and Retention Plan participants and not the totality of the Trust's participants.

3. It remains unclear the extent to which Resources may have received separate fees for marketing services performed on behalf of the Trust.

G. Underwriting

Prudent business practices dictate that underwriting criteria be established, documented, and re-evaluated over time. We examined materials provided by PRM and HCPSIT and numerous other documents provided by other parties, and determined that the underwriting guidelines were developed and applied over the course of the life of the Trust.

Article VI, Section 2 of the Trust Agreement states the following concerning the consideration of new members into the Trust:

> The trustees, after the inception date of the Fund, shall receive applications for membership from prospective new members to the Fund and shall consider such application for membership in accordance with the Rules for Self-Insurance, the terms of the Indemnity Agreement, and the rules and regulations established and promulgated by the trustees for the admission of new members to the Fund. The Board of Trustees may delegate the ministerial authority for membership approval to the administrator or such other person as they select, provided that such administrator or person designated is not an owner, officer, or employee of a third party administrator. All members of the fund shall specifically acknowledge that they are jointly and severally liable for all claims made against the Fund.

Article III, Section 2 of the Trust's By-Laws states:

> Additional members may be added to the Trust by vote of the Trustees of the Trust, in accordance with these by-laws and any applicable regulations governing the group self-insurance trust as adopted from time to time by the Workers' Compensation Board of the State of New York. To qualify for membership, an applicant must be a member of the New York State Association of Health Care Providers, Inc.[157] and satisfy the following underwriting criteria:
>
> [i] A prospective member must be financially solvent, and must meet such other criteria as to financial qualification as may be established by the Trustees;
> [ii] a prospective Member's expected loss rate must be within the parameters as determined from time to time by the Trustees;

[157] The By-Laws were amended in June 1999 to expand membership in the Trust to "other approved sponsoring" organizations.

[iii] a prospective Member must satisfy all other requirements of the Fund's excess carrier or carriers, the Workers' Compensation Board of the State of New York; and
[iv] a prospective Member must adhere to the safety policies and practices as outlined in the policies adopted by the Trustees from time to time.

Article III, Section 5 of the By-laws gives the Trustees sole authority to approve or reject new members as follows:

> The approval or rejection of any application for admission by a prospective additional Member shall be subject to the sole and unfettered discretion of the Trustees, notwithstanding the qualification of the applicant and the satisfaction of the requirements of these By-laws and applicable rules and regulations, and the Trustees may approve or reject any such application for any reason, and no- applicant shall be deemed to have any legal or equitable entitlement, or right to membership in the Trust.

Based on these governing provisions, the Trustees had the authority to select new members from among the Association's membership and to establish their own selection criteria within the parameters established by their excess insurance carrier and applicable laws and regulations. Ministerial authority for such approval could be delegated to the administrator or another third party "provided that such administrator or person designated is not an owner, officer, or employee of a third party administrator."

Interviews and documents reviewed indicated that the Trustees had ultimate sign-off on the admission of new members based upon the recommendation of the program administrator (PRM and its predecessor administrators).

Selection criteria were discussed by the Trustees and the Program Administrator beginning in the early years of the Trust. For example, Trustee meeting minutes for July 14, 1993 state the following:

> Tom Arney reviewed Underwriting Standards for the Trust. Current applicants are being recommended for acceptance with experience ratings of less than 1.35, are being surveyed at their expense with ratings between 1.35 and 1.50. Applicants above 1.50 are not being recommended for acceptance. He reviewed an issue that involves the 8828 Homemaking Rate. Tom Arney proposed that app1icants in classification 8828 be enrolled as a separate category up to a maximum experience mod of 1.25. He has worked with our actuaries and proposes a $1.00 surcharge on these applicants that will decline and disappear after three years of participation… Upon a motion by Joel Schwartz and seconded by Edna Lauterbach, this proposal was unanimously approved.

Interviews and documents reviewed indicate that Trustees approved all new Trust members; however, the Trustees interviewed could not recall any specific benchmarks and criteria used to evaluate new members. Evidence indicates that PRM pre-screened applicants and sent a summary approval sheet to the Trustees containing the applicant's name, payroll information, claims history, and a recommendation to the Trustees.[158] The Trustees would review the information and either approve or reject an applicant. Approval of a majority of Trustees was required.

Concerning the underwriting process for new Trust members, PRM President Conroy told BST that PRM obtained payroll, loss information, and financial statistics from interested Association members. PRM evaluated loss ratios, experience modifications, and three years of operating history. Conroy confirmed that PRM provided summary information to the Trustees via fax, and a majority of Trustees needed to approve the applicant for Trust membership. He said PRM essentially pre-screened applicants and sent to the Trustees only those who it felt would be good candidates. He noted that Trustees sometimes knew something about a potential candidate from a certain geographic area and shared this information with PRM. Conroy referred BST to the Trustee Manual for specific information regarding underwriting procedures and criteria.[159]

Section E of the Trustee Manual indicates that the minimum general underwriting criteria that applicants must meet the following requirements the minimum general underwriting criteria: (1) in business at least three years; (2) an acceptable loss record, and (3) sound financial statements.

The Manual notes that that applicant rejection rate is "about 33%." As described by the Trustees and Conroy, the Manual states that once it is established "there is a reasonable chance the applicant will qualify" a Trustee Worksheet is completed and faxed to the Trustees for their approval.

The Manual indicates that the standard maximum experience modification (mod) is "1.35% without explanation" and from "1.35% to 1.50% an explanation is requested of the mod level and what actions or situations will cause their loss record to improve." (These criteria essentially are the same as the criteria approved by the Trustees in July 1993.) An inspection/loss control report may also be performed to verify the data. The Manual states that a "sensitivity analysis" (a computer program that projects loss trends) is then performed. Applicants with experience modifications above 1.50% require the approval of the reinsurer to even be considered.[160] The Manual notes that the "goal of the Trust program is to have a balance which produces as close to an overall aggregate 1.00 (experience modification) as possible."

The Manual further points out that most recent loss experience is used as a "further qualifier" because the experience modification data is based on data more than one year old and may not be a good indicator of an applicant's current situation. Calculation of current losses includes the last three years' numbers divided by the premium/contribution paid for that period. If the loss ratio is "marginal," the Manual states that the Trust looks at what its projected contribution

[158] BST was advised that providing applicants' financial statements to the Trustees was discontinued as applicants were concerned about the sharing of this information with competitors serving on the Board of Trustees.

[159] BST spoke to Arney briefly about new member underwriting. He stated that "underwriting got more lax as we went along" and that that the original Trustees were "tougher" in signing up new members.

[160] The Manual states that renewals have coverage from the re-insurer up to experience modifications of 1.75%, without further underwriting approval. On renewal, the program administrator will review the loss experience and the financial data on the same basis as a "new" applicant, using the same criteria for continuation.

would be to determine if any further analysis needs to be considered. It is at this point in the analysis that applicants often are rejected.

Concerning the use of financial statements in the underwriting process, the Manual states that PRM reviews the statements to determine an applicant's "financial soundness" and consults with the Trust's auditor when there is a question.[161]

As reflected above, it appears that the underwriting process was well documented, consistent, and structured; and provided the Trustees with sufficient information to determine the appropriateness of applicants to join the Trust. While the Trustees retained final authority over new member selection, they clearly relied upon the information, analysis, and recommendation of PRM which was granted the "ministerial authority" provided for by Article VI, Section 2 of the Trust Agreement.

As reflected above, Article VI, Section 2 of the Trust Agreement also prohibits the administrator with this "ministerial authority" from being an owner, officer, or employee of a third-party administrator. Therefore, based on the role delegated by the Trustees to PRM in the underwriting process and the concurrent role played by PRMCS, a claims administration firm also controlled by PRM's principal, it would appear that the Trustees violated Article VI, Section 2 of the Trust Agreement. BST found no evidence that PRM, PRMCS, or its principals used these concurrent roles to the detriment of the Trust or its members; however, the potential did exist for a conflict of interest to evolve, as was apparently envisioned by the authors of the Trust Agreement.

BST determined that 16 members had experience modification rates greater than 1.35 in their initial year of membership, including 6 who had experience modification rates greater than 1.50. Trustee Brason's firm, Willcare, Inc., entered the Trust with an experience modification rate of 1.84 and had an average rate of 1.365 during its 15 years of membership. Willcare, Inc.'s net negative contribution (cost to the Trust) was approximately $7 million for the period 1998-2008.

Industry experts interviewed (including an actuary) stated that it is not an industry practice to keep the same experience modification rate for several years. However, our analysis of the member files, member experience modifications rates, and loss runs during this period revealed the following underwriting observations:

- At least thirty eight (38) members had experience modification rates that remained the same for at least three consecutive years. These members incurred losses of approximately $22 million.
- Three (3) members had experience modification rates of at least 1.06 for three consecutive years with one member having an experience modification rate of 1.16 for a three year period.

[161] PRM's Systems and Procedures Manual indicates that financial documents obtained from applicants include such information as certified auditor's reports, tax returns, internal financial reports, and Dun & Bradstreet or similar reporting organization reports.

- Nineteen members had experience modification rates that were 1.5 or greater for at least two consecutive years;
- Six members had experience modification rates of 1.75 or greater for two consecutive years;
- Five members had experience modification rates of 1.8 or greater for two consecutive years;
- One member's experience modification rate ranged from 1.15 to 1.36 during he past seven years the member was in the Trust;
- One member had an average had experience modification rate of 1.32 during the 8 year period they were in the Trust;
- One member had an average had experience modification rate of 1.49 during the eleven years the member was in the Trust;
- One member had an average had experience modification rate of 1.75 during the first eight years the member was in the Trust;
- One member had an average had experience modification rate of 1.31 during the sixteen year period the member was in the Trust, and
- Twelve members had average experience modification rates in excess of 1.35 during the years they were in the Trust.

In summary, the documents reviewed and the interview results show that:

- The Trust had underwriting policies and members were approved by the Board of Trustees;
- Members with high experience modification rates were admitted to the Trust and were allowed to stay in the Trust despite continuing losses and high experience modification rates, and
- One Trustee member firm was allowed to stay in the Trust for 15 years despite having an average experience modification rate of 1.365 and a net negative contribution of $7 million during a ten year period.

H. Discounts

Premium discounts are typically one of the methods used to lure potential members into a group self-insured trust. Given the highly competitive market for workers' compensation insurance, it was imperative that HCPSIT offer competitive discounts to prospective members and current members, especially those members with low loss rates. The success of any group self-insured trust is, in part, due to the ability to attract and retain members with low loss rates with the hope that the discounts will be offset with efficiencies realized over the long-run, provided the members' cumulative loss rates do not materially increase.

Theoretically, larger discounts should be offered to employers with low experience modification rates and/or loss runs, and smaller discounts should be offered to marginal employers.

Section 317.7 of the NYCRR (effective January 31, 2001) states the following:

"The contribution rates utilized by a group self-insurer shall not be inadequate or detrimental to the solvency of the group."

Premium discounts are typically given to trust members based on their individual loss histories with higher discounts going to those members with fewer claims and lower aggregate losses, and serve as an incentive for members to emphasize safety and loss control efforts.

Both Arney and Conroy advised BST that across-the-board discounts were applied to the New York State Compensation Insurance Rating Board (NYSCIRB)[162] rates for all members. Arney indicted that all members were given a standard across-the-board discount of 10%-15% off of the NYSCIRB rates and that the standard discount went down over the years.

BST's review of member files found that the members and Trustees generally received the same standard discount (with minor exceptions).

In addition to the standard discount, and as discussed in the Marketing Section of this report, the Trust, at Arney's suggestion[163], implemented a "loss sensitive" or "Retention Plan" to attract larger health care providers in the $25-$50 million gross revenue range in an effort to make the Trust more "competitive." The Retention Plan reportedly was targeted to members with more than $150,000 in annual premium, and according to Conroy, Retention Plan members represented 70% of total Trust participants' payroll. The Retention Plan offered select members beginning in 1996[164] the ability to earn cash credit if actual losses were less than estimated losses. Records show that over the course of the Trust, forty-eight (48) employers participated in the Retention Plan.

A document prepared by HCPSIT entitled *Overview of HCPSIT Retention Plans* describes the Retention Plan as follows:

> Under these plans, at inception of coverage the participant will pay a fixed amount (known as the retention amount) plus an estimate of their losses.
>
> > For example: Assuming a standard contribution of $100,000 the participant pays a $30,000 retention amount and a $70,000 loss estimate or a total of $100,000 at inception of coverage. Six months after expiration of the coverage the actual

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[162] The New York Compensation Insurance Rating Board (NYCIRB) is a non-profit, unincorporated association of insurance carriers, including the State Insurance Fund. In conjunction with the New York Workers' Compensation Law, the Insurance Law provides for the Superintendent of Insurance to designate a rate service organization to collect the loss, premium, and payroll data from each carrier, summarize this information, and develop an adequate rate structure.

[163] As noted previously, Arney told BST that he recommended that the Trust discontinue the Retention Plan, but the Trustees wanted to keep it, as most of them were Retention Plan participants. In the long run, he felt the Retention Plan was not helpful as the individual members, and not the Trust, had the "float." Wang and HCPSIT Counsel had no recollection of Arney's recommendation.

[164] The Trustees approved a "large deductible program" on January 30, 1996.

losses are calculated and the contribution is adjusted. If the losses were $60,000 during the twelve-month coverage term and $70,000 was estimated, a credit of $10,000 was earned. If a credit was earned, the Trust only returns cash for 50% of that amount and the other 50% remains on the Trust's books as a reserve toward future adjustments.[165] Every twelve months adjustments are made until all claims are closed or until the member has reached their maximum contribution. Under the Trust's retention plans, the maximum contribution is equal to the standard contribution.[166]

The *Overview* goes on to explain that consistent with standard insurance accounting, reserves for future losses (Incurred But Not Reported, or IBNR) are held as a liability by the Trust on its balance sheet, and the Trust bills the retention member for actual losses - not including the IBNR portion. The estimate of future losses will trigger additional contributions only if those estimates are accurate. A retention accrual is recorded as an asset prior to future losses becoming actual losses. To help ensure that this asset does not become uncollectable, the Retention Plan required the following:

1) A note is signed by each member to secure the amount due.
2) If a retention member leaves the Trust, the Retention Plan terms are null and void.
3) If a retention member leaves the Trust, the member is required to escrow an amount equal to the anticipated receivable.

The Trust's audited financial statements as of October 31, 2002, showed that the Trust's retention receivable was $6,319,578, and the audited financial statements as of October 31, 2003, reported that this receivable had grown to $11,991,554.[167] The dramatic growth of the retention receivable became of increasing concern to the WCB because, on a regulatory basis, trusts must maintain acceptable assets which meet or exceed their total liabilities. Acceptable assets may not include receivables, particularly those that have not yet been billed, or do not expect to be collected within 60-90 days; total liabilities includes claims incurred but not reported.

It appears that in the WCB's view, the substantial receivable resulting from the Trust's Retention Plan would contribute to the Trust to be consistently underfunded by regulatory standards and

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165 Although the example provided suggests that Retention Plan members would initially pay the full standard contribution and later receive credits against it if losses developed lower than the estimated losses, this was not, in fact, how the Retention members were billed. Loss estimates employed in the calculation of required contributions resulted in payments substantially less than the standard contribution amounts, that is, the plan did create a cash flow benefit to the participants.

166 Notes to the Trust's audited financial statements define a Retention Plan as follows: A loss sensitive plan that provides the insured (participant) with an opportunity to realize significant cost savings if losses are kept to a minimum. At inception of coverage, an estimate of losses is used to establish a deposit contribution. After the policy period has expired, a comparison of actual losses is made. If actual losses were less than estimated losses, a return contribution would result. If actual losses were greater than estimated losses, an additional contribution would result.

167 An internal WCB document dated October 29, 2004, reports that the receivable balance was $15 million as of December 31, 2003. The document also expresses concerns that the overall funding of the Trust was "very tenuous" and that "accounts receivable has become a larger portion of their total asset base."

expose the Trust's participants to potentially substantial joint and several liability in the event the receivable, or a portion thereof, became uncollectable from one or more Retention Plan member (which consisted of many of the Trust's largest health care providers).

In a Level I Review Report prepared by the WCB as of October 31, 2003, the WCB disallowed, inter alia, the retention receivable as a Trust asset. This resulted in a change in the Trust's equity from an equity surplus under GAAP[168] of $235,137 as reported in the Trust's audited financial statement, to a total regulatory deficit of $20,776,674 and the Trust being deemed underfunded.[169]

With the WCB's underfunding determination, the WCB, PRM, and HCPSIT embarked on an ongoing and sometimes contentious debate over the Retention Plan and how the retention receivable should be reflected on the Trust's balance sheet.

In brief, PRM and HCPSIT (and HCPSIT's auditor)[170] argued that under GAAP, the retention receivable was appropriately classified as an asset and that Retention Plan participants sign a promissory note (Retention Plan Endorsement) agreeing to pay to the Trust what is owed. The WCB opined that current assets as defined by GAAP are resources expected to be realized during the next year. As such, the WCB took the position that given the long-term nature of workers' compensation claims and that this receivable will not be billed until the claim is actually realized, at a future date yet to be determined, the classification of the receivable as a current asset is inappropriate.

Trustee meeting minutes reflect general discussions relating to the WCB's concerns regarding the Retention Program and the status of continuing discussions between the WCB and HCPSIT. As noted previously in this report, the HCPSIT Trustees entered into a Consent Agreement with the WCB on August 4, 2005, in response to the WCB's concerns about HCPSIT's underfunded status. The Consent Agreement addressed, inter alia, the Retention Plan and participant discounts.[171]

With respect to discounts, the Consent Agreement limited the maximum discount off manual rates to new and existing members to no greater than twenty percent (20%). Concerning the Retention Plan, HCPSIT officially acknowledged that the retention receivable is not recognized as an acceptable asset pursuant to 12NYCRR Part 317. Further, the Trust agreed to reduce the current year's cash flow[172] by at least five percent (5%) per year and to continue the positive

[168] Current assets are defined by GAAP as resources that are expected to realized in cash during the next year.
[169] The WCB deemed the Trust to be underfunded until dissolved on June 30, 2009.
[170] Notes to the Trust's audited financial statements for 2003-2008 state: "The Trust's "Accounts Receivable Retention Plan" is an acceptable asset for both GAAP and Statutory Insurance Accounting. Under Workers' Compensation regulations, it is not an allowable asset."
[171] Trustee meeting minutes indicate that WCB representatives met with the Trustees on July 29, 2005, to discuss the terms of the Consent Agreement and obtain the signatures of the Trustees on the document.
[172] The cash flow is defined as the difference between the contribution maximum and the contribution deposit, by member.

trend when comparing the cumulative retention contribution to the total retention receivable.[173] During the term of the Consent Agreement, HCPSIT also agreed to offer a retention program only to new members with contributions exceeding $150,000 and that no cash flow would be allowed.

Despite efforts to reduce the large retention receivable, HCPSIT's audited financial statements as of October 31, 2006, report that the receivable had increased to $17,678,361 from $14,975,957 the previous year.[174] A Level I Review as of October 31, 2006, by the WCB found that HCPSIT was only 36.90% funded and had a regulatory deficit of $24 million. On this basis, HCPSIT Trustees and the WCB on February 25, 2008, entered into a second Consent Agreement to address the Trust's continuing underfunded condition.

With respect to Retention Plans, the 2008 Consent Agreement required HCPSIT to bill retention plan claims to its members, active and inactive, for the program years, inception to date to help reduce the IBNR retention receivable on the balance sheet over time. Billings of estimated amounts owed were mailed during October 2009, however, most of the monies owed apparently have not been remitted by the members.

On June 6, 2008, the WCB issued to HCPSIT a Final Determination Letter regarding the Trust's funding status based on a WCB Level I Review Report dated May 7, 2008. that concluded that as of October 31, 2007, HCPSIT had a regulatory deficit of $26,588,134 and was deemed underfunded.[175]

On February 5, 2009, HCPSIT's auditor, DF&J, issued its report on the financial statements for the period ended October 31, 2008, and showed that the retention receivable had increased from $14,624,658 in 2007 to $16,198,867. Shortly thereafter, on March 24, 2009, the WCB issued a Preliminary Level I Review Report that concluded that as of October 31, 2008, HCPSIT had a regulatory deficit of $27,414,548 and was deemed underfunded.

As a result of the Trust's continuing regulatory deficit that included a growing retention receivable, on March 26, 2009, the WCB Chair sent a letter to the Trustees revoking the Trust's self-insurance status effective June 30, 2009. On April 24, 2009, Wang and HCPSIT Chair Brason sent a letter to Trust participants concerning developments with the WCB. The letter referred to the Trust's opposition to close the Trust and the seeking of legislative intervention to keep the Trust open. The letter states that the "HCPSIT Board of Trustees vigorously rejects the WCB's assertion that the Trust is underfunded.[176] As explained in the letter to HCPSIT

[173] Evidence suggests that this did not occur as the Retention Plan factor remained at 30% and the "loss pick" did not increase in all instances.

[174] The audited financial statements also reported that the Trust's assets of $39.96 million exceeded its liabilities of $34.68 million on a GAAP basis.

[175] The Trustee met with WCB representatives on September 12, 2008, to review the October 31, 2007 Level I Report.

[176] Contrary to Wang and Brason's assertion, the Trust's audited financial statements for the period ending October 31, 2009, reveal that the Trust is severely underfunded with Trust liabilities exceeding the Trust's assets by approximately $114,000,000.

participants last week, the Trust has always been fully funded according to Generally Accepted Accounting Principles (GAAP); however, the WCB uses an accounting method not based on GAAP or any other generally accepted insurance standards. According to this method, HCPSIT does not meet the funding requirements of the WCB because of some of its plan offerings - loss sensitive plans that were established for large HCPSIT participants and long accepted by the traditional insurance market." The letter characterized the relationship between the WCB and HCPSIT as "increasingly hostile over the past decade" and having "intensified in the last two years." The letter further noted that the Trustees were exploring a captive self-insurance option for Trust participants.

On April 27, 2009, a meeting was held between the WCB and HCPSIT representatives concerning the transition process to be followed when the Trust closed on June 30, 2009. In an attempt to preserve the Trust, HCPSIT was able to arrange a meeting with the Governor's Office, WCB Chair, and NYS Senate majority's Counsel concerning the Trust's status. At the April 30, 2009 meeting, Trust representatives proposed a new remediation plan that included collection of $16 million from employer members. The WCB agreed to consider such a plan.

On May 11, 2009, the HCPSIT Trustees met to develop a remediation proposal to be presented to the WCB. The Trustees voted to submit a proposal to the WCB to collect $16 million[177] through a capital contribution from current and past Retention Plan participants,[178] sell investments disallowed by the WCB, and communicate to the WCB that the Trust commits to evaluate reducing expenses overall by 10%.

HCPSIT's remediation plan was subsequently submitted to and conditionally approved by the WCB in an August 6, 2009, letter to Chair Brason. The conditional approval was based on the HCPSIT's assurances that it would raise $16 million by September 2009 and that the "money will be unrestricted and available to either HCP or the Board to pay the claims" and that "under no circumstances will money be returned to the members of HCP, or third parties, regardless of whether it is HCP or the Board who will ultimately be administering the claims." Also, in the event the cash was raised, HCPSIT must have a detailed plan on how it would continue to maintain a year's worth of cash.

Documents reviewed by BST indicate that Retention Plan participants were sent invoices by PRM in relation to the $16 million capital contribution. BST was unable to determine the total value of payments received and the final disposition of all these funds. However, the current claims administrator retained by the WCB determined that some members made capital contributions, although the exact amount could not be determined because the funds were deposited by PRM with funds from other Trusts, and PRM would not grant the current claims administrator access to the records of this bank account.

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177 The $16 million approximated the retention receivable as of October 31, 2008. John Conroy stated that by the end of the Trust, he felt that there was a cumulative credit accrued of $32 million and felt they could collect $16 million of this total accrued credit.

178 The Trust had previously recommended to post a $16 million letter of credit. The Trust was unable to secure a letter of credit or other type of security.

I. Payroll Audits

Standard industry practices require audits of the Trust members' payroll to reconcile the members' premiums that were previously based on an estimate of the members' payroll. The performance of these audits is imperative because of the direct correlation between the member premiums billed and the payroll reported. As such, there exists a financial incentive for the members to misclassify the payroll for the riskier job positions in order to reduce their annual premiums.

Pursuant to Article VI, Section 5 of the Trust Agreement, the Trustees had the responsibility to ensure periodic payrolls were performed for each of the members. The Trust's By-laws and Service Agreement with PRM are silent with respect to payroll audits. However, our analysis of the member files and other documents revealed that payroll audits were regularly performed by a third-party payroll auditor and that the corresponding adjustments were made to the members' annual premium, and that litigated adjustments were pursued.

J. Safety Programs

The implementation of a robust safety program is generally recognized as an insurance industry best practice and an effective method in which group self-insured trusts, and any insured organization, can potentially reduce their exposure to losses due to employee accident or injury.

Program administrators typically have primary responsibility for delivering loss control and safety programs to a trust's membership. Consistent with this, loss control services were embodied in all HCPSIT program administration agreements with Jardine, Naples, and PRM. From 1992 to 1995, the Program Administrator had direct responsibility for developing these programs under the Program Administration Agreement. In June 1995, Wang and Arney, who while still at Naples Risk Management, agreed that the Trust would pay a separate fee of $6,000 per month for loss control services.[179]

After forming PRM, Arney sent a memorandum to Wang on November 29, 1995, stating there was a "need to arrive at a 'new' arrangement for Loss Control Services" and recommended a $5,000 per month fee. This request was made despite the fact that Arney and Wang had executed a Program Administration Agreement on August 1, 1995, which, inter alia, required PRM to design and develop safety programs and training for Trust members within the overall fee structure of the Agreement. Records suggest that this separate fee arrangement continued from that point forward. The Program Administration Agreements beginning in 1998 required the Administrator to "manage the activities of the loss control consultant retained by the Trust."

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[179] Minutes for June 28, 1995 state: "Phyllis Wang reviewed correspondence between herself and Tom Arney in reference to Loss Control Services for the Trust. Wang and Arney agreed that the Trust will pay $6000 a month for services performed by Hank Mumme of Naples until October 31 and during that time evaluate the cost and level of service requirements. A decision will then be made as to whether the Trust should contract or hire for loss control services."

We were not able to obtain a copy of any formal loss control agreements, if they existed, between the Trust and PRM through the end of 2001.[180] Wang and Arney executed Loss Control Agreements for the periods November 1, 2001-October 31, 2004 and November 1, 2004-October 31, 2007. Wang and Conroy signed an Agreement for the period November 1, 2007-October 31, 2012.

Under the terms of these Agreements, PRM's loss control consultant was to "design and implement an individual loss control program specifically tailored to the Workers' Compensation loss experience and operational needs of each of the Trust's Participants." Among the specific services to be provided were

- Collecting and analyzing loss control and claims data;
- Reporting annually to each participant compensable losses;
- Preparing reports to the Trust regarding participants' loss history and efficacy of participants' loss control programs;
- Consulting with and conduct annual site visits annually with each participant;
- Preparing written site visit reports;
- Conducting training and in-service programs to participants;
- Developing jointly with the Trust and revise educational and training materials; and
- Advising and consulting with the Trust on loss control issues.

The fee for these services was $7,500 per month, plus reimbursement for reasonable and necessary incidental expenses.

Evidence indicates that the Trust embraced the importance of loss control and safety in an attempt to minimize claims. The Trustees interviewed were generally satisfied with PRM's loss control services. They confirmed annual site visits were performed and reports written.[181] They noted that training was provided in such areas as lifting, use of back belts, and needle stick technique. One Trustee did comment that services were "up and down" and that the Trustees had to get PRM more focused on problem members, rather than members with good histories.

Loss control issues and loss information were discussed periodically at Trustee meetings, and claims information was regularly furnished to the Trustees. The Trustees established a separate Loss Control/Safety Committee on March 2, 1995, but minutes provided to BST by the Association only document six meetings of this committee.

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[180] We were unable to determine from available HCPSIT accounting records and audited financial statements the Trust's actual total expenses incurred and paid to PRM for loss control services during this time period.

[181] PRM furnished to BST a listing of site visits preformed for the years 2005-2009 which reflects that most participants received at least one annual site visit. BST also received from a Trustee a sample loss control site visit report that included a completed inspection check list, recommendations for improvement, program loss control analysis, and claims summary.

All three Program Administrators - Jardine, Naples, and PRM prepared a Safety Manual for Trust participants that addressed such topics as how to establish a safety program and training, patient lifting, accident prevention, accident investigation, safety inspections, vehicle safety, and infection control procedures. Each participant was required to have a written safety and loss control program.

Wang told BST that PRM had a very good loss control program that the members liked. She confirmed that the loss control program was originally under the Program Administrator's main agreement but was later separated out. She said that Arney told her that PRM had to start charging for loss control services separately. In response, she told him that to do so the Trust wanted standards set which were put into the Loss Control Agreement. The standards provided for more services and coverage.

Conroy confirmed with BST that there was a separate loss control contract because the Trustees wanted something specifically binding with respect to annual loss control visits to members. Conroy said each member was visited at least once a year by his loss control staff. He said they targeted their loss control program to managers, supervisors, and field staff. Conroy said loss control reports were not kept in hard-copy form and are maintained electronically in each member's electronic file. He also noted that the Association non-profit affiliate, CHC, conducted safety training sessions and prepared training materials for the Trust.[182]

In summary, available evidence indicates that the Trust did implement a substantive safety and loss control program to mitigate member losses.

K. Renewal Process

Prudent business practices dictate that a trust member's loss runs and loss history should be reviewed and evaluated prior to accepting and/or renewing the member. In addition, a thorough and complete analysis of the trust's cumulative member deficit, if any, should be considered before member discounts are offered to the member.

The Trust Agreement does not specifically address the renewal process; however, Article VI Section 6(i) of the Trust Agreement authorizes the Trustees to "adopt and promulgate rules and regulations for the proper administration of the Fund, the admission of members to the Fund, the suspension of members, and the expulsion of members."

Article III, Section 7 of the Trust's By-Laws, as amended through September 29, 1995, gives the Trustees the authority to terminate Members from the Trust as follows:

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[182] Trustee meeting minutes for March 15, 1996, show the Trustees approved engaging CHC to organize one day Supervisor Safety Management Seminar sessions. On July 21, 2004, the Trustees approved providing a $7,500 grant to CHC to prepare a Back Injury Prevention Guide. The completed Guide was presented to the Trustees at their meeting of September 27, 2005.

Membership shall be continued for qualified Members, except that the Trustees may exclude or suspend any Member from continued membership or decline to renew the membership of any member whose membership would otherwise expire for failure to comply with these Bylaws, failure to comply with the underwriting criteria enumerated in Section 2 of this Article, failure to comply with applicable laws relating to Workers' Compensation, failure to submit for review by the Trustees upon request and upon application for renewal of membership acceptable current financial and any other information deemed by the Trustees to be necessary to confirm such compliance or failure to pay contributions due.

Evidence indicates that the Trustees delegated this authority to PRM which had primary responsibility for managing the member renewal process with limited involvement of the Trustees.[183] While PRM's Service Agreement does not specifically address the Program Administrator's role in the renewal process, Section 2e (i) of the Service Agreement authorizes the Program Administrator to "perform such other and further duties as are or may be reasonably related to the administration of a New York Workers' Compensation group self-insurance trust, whether or not such duties are or have been specifically or expressly delegated to the Program Administrator by the Trustees…"

BST found that PRM developed and implemented a structured member renewal process. The renewal process was detailed in the *PRM Quality Systems and Procedures Manual - Tab Six Procedures for Renewal Processing, Experience Modification Calculations and Audi*ts (as of 2/25/05) and summarized in the *Trustee Manual*. PRM used a Renewal Checklist to track collection and review of financial and loss information for each member renewal. Records show that members had to supply their latest financial statements, details of significant operational changes, and estimated payrolls for the following year. PRM would review this information in conjunction with loss experience information and applicable rates and then calculate a renewal contribution. A Renewal Review form was then prepared summarizing such information as loss history, payroll history, contributions, worker classification, assessments/charges, discounts, and renewal contribution along with a renewal approval/ disapproval recommendation.

The *Trustee Manual* indicates that renewals have coverage from the re-insurer up to experience modifications of 1.75, without further underwriting approval from the re-insurer. The *Manual* further states that PRM will "review the loss experience and the financial data on the same basis as a new applicant, using the same criteria for continuation."[184]

We selected a judgmental sample of 15 of the 141 members leaving the Trust prior to Trust's dissolution on June 30, 2009. We reviewed the *Notice of Termination of Employer's*

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[183] One Trustee advised BST that the Trustee approved member renewals, but other evidence, including member file documents, meeting minutes, and interviews show that PRM did not seek nor obtain Trustee approval on member renewals.

[184] The Manual indicates that the standard maximum experience modification (mod) for new members is "1.35% without explanation" and from "1.35% to 1.50% an explanation is requested of the mod level and what actions or situations will cause their loss record to improve."

Participation in Group Self-insurance Plan Form GSI-3.1 for each of these members and found the following with respect to the reason for membership termination as stated on the form:

Reason for Terminating	Number	%
Out of Business	9	60
Obtained Coverage Elsewhere	3	20
Failure to Furnish Renewal Info	2	13
Non-payment of Premium	1	7
Total	15	100

Based on this sample, it appears that members were terminated for failing to provide required information to PRM and that a majority of members left the Trust due to ceasing operations.

AS detailed in the underwriting section, many members were renewed despite having extraordinary large experience modification rates, including members who rates increased in successive years. For example, at least 13 members had experience modification rates of at least 1.2, and their experience modification rate increased in three consecutive years.

In summary, the documents reviewed and the interviews conducted show that:

- Despite having an apparent structured renewal process, members with high experience modification rates were allowed to stay in the Trust, and
- Despite poor loss histories, few members appear to have been refused coverage by the Trust.

L. Member Deficit

Each of the HCPSIT members is jointly and severally liable for the expenses and obligations of the Trust during the period the member was in the Trust. The members' obligations are expressly noted in the Joinder and Indemnity Agreements as well as the Trust Agreement.

Section 317.9 (b) (7) of the NYCRR (effective January 31, 2001) stipulates that a group self-insurer may be required to levy an assessment upon a group or its members (if the group is under-funded) to make up the deficiency, i.e., if the assets of the Trust are actuarially determined to be insufficient to enable the Trust to discharge its legal liabilities.

Based on 2002 Year End Statements, and as noted in Section H above, the WCB began conducting Level I reviews. While the financial statements did not reveal a member deficit, the WCB Level I reviews from 2003 through 2008 determined that HCPSIT had a regulatory deficit ranging from approximately $20,000,000 to approximately $26,000,000.

Throughout this period, the WCB had ongoing discussions and meetings with the HCPSIT Trustees and PRM regarding the regulatory deficit, which was primarily due to the incurred but nor reported receivable relating to the retention members and some disallowed investments.

Despite the statutory requirements to levy an assessment and verbal commitment to the WCB, we determined that the Trustees and PRM did not bill the retention members until October 2009, and then only at the direction of the WCB. As previously noted, we were unable to determine how much of the assessment billings were eventually collected.

M. Claims Handling Procedures/Practices

The handling and processing of claims is an integral part of the administration process. Article VI, Powers and Duties of the Trustees, Section 6c of the Trust Agreement[185] provides that the Trustees "take all necessary precautions to safeguard the assets of the Fund" including but not limited to the "(d)esignation of a third party administrator" to resolve and pay claims pursuant to the Workers' Compensation Law. Section 2(a) of the Service Agreement authorizes the Program Administrator to, inter alia, "manage the activities of the third party administrator retained by the Trust."

As discussed above, the Trust initially engaged Gallagher Bassett as claims administrator upon Thomas Arney's suggestion. On June 27, 1997, PRM Claim Services, Inc. (PRMCS) was formed by Arney (see Exhibit 19), and on November 1, 1998, Arney and Wang signed an Agreement appointing PRMCS as HCPSIT's new third-party claims administrator (see Exhibit 20).[186]

As previously noted, the roles of program administrator and claims administrator should remain separate to help ensure that claims are administered independently of any financial incentives the program administrator might realize from the deliberate under-reserving of claims. This principle was essentially disregarded when two entities with common ownership, PRM and PRMCS, served concurrently as the Trust's Program Administrator and third-party Claims Administrator. Also as noted above, the Trustees apparently had concerns about this relationship and engaged a consultant, Tillinghast-Towers Perrin (TTP), to conduct an independent review of PRMCS's claims handling procedures.

Conroy informed BST that the Trustees hired TTP to perform an independent review of PRMCS's work every three years. He noted that TTP also performs independent reviews of other PRM trusts for their respective trustees and is presently conducting a claims review now. He said PRMCS failed the first review for HCPSIT. He noted that Safety National, the excess carrier performed a reserve audit as did PwC in 2003. Conroy said that Travelers also performed two audits. Conroy said he was not intimately involved in the claims process himself.

BST obtained copies of TTP's reports and interviewed the reports' primary author, Deborah Turner. Turner told BST that the first report prepared by TTP was during 1999. Turner stated that she usually met with Wang to provide an oral report concerning TTP's preliminary findings,

[185] The Trust Agreement contains two Articles entitled "Article VI."
[186] As noted previously, BST identified a signed Agreement between the Trust and PRMCS effective November 1, 2007.

and that she had presented her findings to the HCPSIT Board of Trustees on approximately two occasions.[187]

Turner stated she did not recall being contacted by PRM with regard to the reports, and that she initially met with Tom Arney and later Gail Farrell while on-site at PRM's offices. She stated that Wang was initially disappointed with Arney as a result of TTP's first report, primarily because Arney had been affiliated with the Trust and had broken away. Turner thought Arney was employed by the Trust. Turner stated that the biggest problem with PRM's claims handling procedures revolved around the promotion of a claims handling staff person to another position. As a result, the claims handling suffered for a while. She could not recall why TTP was not hired after 2006.

The first TTP report, dated August 25, 1999, found that the "quality of claim handling provided is not at a meets/exceeds performance level and, based on our experience, is below average performance for similar third-party administrators handling workers compensation claims." The report cited deficiencies relating to PRM not following its best practices manual, inadequate claims staffing, and a poorly planned transition from Gallagher-Bassett to PRM. TTP made a number of recommendations.[188]

The next report, dated February 2000, found that "(a)lthough the quality of claim handling has improved, it has not improved to a Best Practices performance level and, based on our experience, is still below average performance for similar third-party administrators handling workers compensation claims." A July 2000 report found that "PRM's claim handling performance is moving closer to a reasonable quality level" and PRM has made significant progress in the last six months." A report issued in July 2001 found that PRM's claim handling performance is at a best practices quality level as compared to similar TPA's handling workers compensation claims." TTP reports of August 2003 and September 2006 reported similar overall findings.[189]

Trustee meeting minutes indicate that claims issues were discussed routinely at the meetings with PRMCS providing the Trustees a summary of claims received and pending, settlements, recoveries, payments, and reserves.

BST hired KBM Management, Inc. (KBM), a third-party claims vendor, to independently review the HCPSIT claim files and determine whether claims were handled in accordance with written

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[187] Trustee meeting minutes show that Turner attended Trustee meetings on August 31, 1999, March 3, 2000 (via conference call), and July 26, 2000.
[188] The report, in part, addressed case strategy and planning.
[189] In early 2003, the WCB engaged PwC to review the reasonableness of loss reserves of another PRM's ESTRA Self-Insurance Workers' Compensation Trust. PwC's discussion draft dated March 11, 2003, states the following: "We find that PRM's claim practices are reasonable and consistent with leading practices for managing worker's compensation claims in general and, specifically, in accordance with the requirements of New York law.... Of the three trust administrators whose claims controls and practices we have reviewed to date, we find that PRM appears to demonstrate the greatest consistency in the reasonableness of' its performance in both categories."

policy and industry standards, whether benefits were paid in a timely manner, and whether claims were appropriately reserved and adjusted as the cases matured.

KBM, in its report dated April 29, 2010, noted that they audited claims processed on behalf of HCPSIT by PRMCS, and that the claims dated back to the origin of the Trust (see Exhibit 21). Their audit, which included the examination of a sample of files, focused on the larger dollar claims. KBM's observations/findings are as follows:

- The stop-loss insurer denied certain payments to the Trust based on untimely notification by PRM, potentially exposing the Trust to unlimited risk.[190]
- The Trust did not receive all eligible reimbursements due to the untimely filing of form C-250 by PRM or other filing deficiencies.
- Of thirty-two (32) files examined, KBM found that twenty-nine (29) were under-reserved and two (2) files were over-reserved. Only one (1) file had proper reserves. There were several instances where forms were not timely filed or CRM did not obtain medical records to substantiate potential claims for reimbursement from second injury funds.

In concluding, KBM noted that PRM:

> failed to show they had a grasp on proper reserving techniques and failed to provide a satisfactory level of claims processing service on behalf of the Health Care Providers Self-Insured Trust. The deficiencies described in this report were found in reserving deficiencies and filing timeliness, not filing forms when appropriate, insufficient or incorrect information on forms, overall claim management, and poor transfer of information.

KBM further noted:

> Please note that the main focus of the initial audit was a review of the reserves to determine if they were set properly. There were several other issues noted when they "jumped off the page" at the auditor while reviewing the reserves such as; penalties for non-payment of medical bills and late payment of awards, improper filing of C-250's, poor excess carrier reporting and poor follow up on issues identified by attorney's, investigator's and doctors. A thorough review of six files found those deficiencies noted above as well as late payment of medical bills, overpayment of medical bills and duplicate medical bill payments.

In summary, BST's independent consultant determined that claims were being under-reserved by PRMCS, thereby contributing to the member deficit. Therefore, the failure of the Trustees to ensure the independence of the program administrator and claims handling functions may have had a material impact on the extent of the ultimate member deficit.

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[190] Failure to notify the insurer could potentially result in denial of the claim.

SCHEDULE OF EXHIBITS

EXHIBIT #	DESCRIPTION
1	Trust Agreement, September 17, 1992
2	Trust Indemnity Agreement, September 17, 1992
3	HCP Resources, Inc. Incorporation, September 22, 1992
4	Trust By-Laws, September 23, 1992
5	Trust Group Application Package, September 24, 1992
6	Trust Agreement with HCP Resources, Inc., August 25, 1993
7	Trustee Manual Table of Contents
8	Trust Agreement with HCP Resources, Inc., November 1, 2007
9	Disability Trust Application Package, August 1995
10	Jardine Service Agreement, September 14, 1992
11	Naples Risk Management Service Agreement, April 1, 1994
12	Program Risk Management, Inc. Incorporation, July 25, 1995
13	Program Risk Management Service Agreement, August 1, 1995
14	Milliman & Robertson Report, November 28, 1994
15	TTP Draft Report, January 29, 2002
16	PwC Report to WCB, May 9, 2003
17	PwC Report to WCB, June 13, 2007
18	By the Numbers Actuarial Consulting Report to BST, March 31, 2010
19	PRM Claim Services, Inc. Incorporation, June 27, 1997
20	Trust Agreement with PRM Claim Services, Inc., November 1, 1998.
21	KBM Management, Inc. Quality Assurance Claim Audit Report to BST, April 29, 2010
22	January 29, 2010 letter to the WCB from Dave Johnson, CPA