STATE OF VERMONT
DEPARTMENT OF FINANCIAL REGULATION

In The Matter Of:	)	
	)	
Application by the Proposed Vermont Health CO-OP	)	
For a Certificate of Public Good and Certificate of	)	**Docket No. 12-041-I**
Authority to Commence Business as a Domestic	)	
Mutual Insurance Company		

LICENSING DECISION AND ORDER

I. SUMMARY OF THE DECISION

The application is denied. The applicant has failed to meet legal and financial standards to support the issuance of a Certificate of Public Good. Further, the applicant has failed to meet the necessary criteria to receive authorization to conduct the business of insurance under a Certificate of Authority.

As part of the Patient Protection and Affordable Care Act ("ACA"), a loan and grant program designed to assist establishment and operation of nonprofit, member-run health insurance issuers in the states was implemented (the "Federal Loan Program"). Under the Federal Loan Program, the U.S. Centers for Medicare and Medicaid Services ("CMS") awarded start-up and solvency loans to the applicant. Based on this, the applicant (the "CO-OP") applied to Commissioner Susan L. Donegan of the Vermont Department of Financial Regulation ("Commissioner") for a Certificate of Public Good and a Certificate of Authority, which together operate as a license to conduct the business of insurance as a new Vermont domestic mutual nonprofit insurance company. This order is the result of an extensive review and regulatory analysis as to whether the CO-OP demonstrated the ability to meet all elements necessary to obtain a license, including the elements of solvency and corporate governance, which are critical

to the viability and sustainability of a successful insurance company. It is the decision of the Commissioner that the CO-OP has failed to meet these elements due to estimated rates that are unaffordable, financial projections that show cumulative losses during the first three years of operations and reliance on unrealistically high enrollment assumptions. These failures point to an extremely high risk of insolvency. Further, the Commissioner has identified significant corporate governance flaws, including serious conflicts of interest and a lack of adequate oversight at the board level that would prove detrimental to the viability of the organization. As a result, the Commissioner has concluded that the general good of the state will not be promoted by the establishment and maintenance of this corporation and a Certificate of Public Good will not be granted.

The proposed corporation has also failed to satisfactorily show it will be able to procure an adequate amount of subscriptions for insurance, which is a necessary requirement before being authorized to commence business. The corporation has proposed premium rates that are materially higher than those of the existing carriers. As noted above, the CO-OP's target enrollment is unlikely to materialize. It is probable that enrollment would be well below the target, exacerbating operating losses. The CO-OP fails to differentiate itself from other carriers with respect to payment systems or make good on its goal to provide innovative care. Multiple assumptions underlying the CO-OP's targeted enrollment projection have changed negatively, yet the corporation's targeted enrollment number has not changed at all, further eroding its credibility. As a result, the Commissioner has concluded that a Certificate of Authority will not be granted.

II. INTRODUCTION

a. Background

Insurance is a promise between a company and a policyholder. The policyholder promises to pay a certain amount of premium in exchange for the company's promise to pay benefits at some later date in response to a particular event. With certain exceptions, insurance regulation is state-based. In Vermont, the Insurance Division at the Department of Financial Regulation ("DFR") is the primary regulatory agency. DFR is responsible for ensuring that companies deliver on their promises to policyholders. This is done by both monitoring existing insurance companies and by only allowing new entrants into the Vermont insurance market that demonstrate the ability to operate properly and be financially viable.

DFR has used time-honored processes and principles to regulate the creation of a solvent and viable insurance carrier. These principles can be summarized by the Declaration of Policy contained in 8 V.S.A. § 10, which states in relevant part that, "the business of organizations that offer financial services and products shall be supervised by the commissioner in a manner to assure the solvency, liquidity, stability and efficiency of all such organizations, to assure reasonable and orderly competition." The statute also states, "all such organizations shall be supervised in such a way as to protect consumers against unfair and unconscionable practices." The process guiding the creation of solvent, viable insurance companies consists of robust analysis into areas of solvency, operations, corporate governance, personnel, and other relevant aspects of a potential insurer. This comprehensive scrutiny ensures that DFR upholds its policy obligations and that every applicant meets all statutory requirements.

According to 8 V.S.A. § 3305, before a company can receive a license "the commissioner must find and adjudge that the establishment and maintenance of the proposed corporation will

promote the general good of the state." Under 8 V.S.A. § 3309, a mutual insurer "shall not receive authorization to commence business until it complies with such preliminary requirements for the procurement of an adequate amount of subscriptions and possesses and thereafter maintains unimpaired basic surplus..." An application must be scrutinized with all of these elements in mind so that a company, if granted a license, promotes the public good and is not found to be hazardous to the public or its future policyholders.

b. Summary of the Proposed CO-OP

The CO-OP proposes to form a domestic mutual health insurance company under Chapter 101 of Title 8 V.S.A and the Federal Loan Program. Loan recipients under the Federal Loan Program must meet specific federal requirements and must further comply with all applicable state laws and regulations with respect to establishing and maintaining a health insurance issuer. 42 U.S.C. § 18042(c)(5). The CO-OP proposes to offer health insurance to individuals and small groups through Vermont's new health benefit exchange, Vermont Health Connect, beginning in 2014, and to large groups outside of Vermont Health Connect.[1] The federal loans received include a start-up loan in the amount of $6,289,400 and a solvency loan in the amount of $27,548,400. Individuals insured by the CO-OP would be members of the organization. Members would be permitted to vote for the board of directors. The CO-OP would be a nonprofit corporation, and any excess funds (after developing adequate surplus reserves and providing for the repayment of federal loans) would be returned to members in the form of improved quality or reduced costs of health care.

[1] Vermont Health Connect is run by the Agency of Health and Human Services' Department of Vermont Health Access.

c. Procedural History

On December 12, 2011, representatives from the Consumer Health Coalition of Vermont, Inc. ("CHCVT") had a preliminary meeting with former Commissioner Stephen W. Kimbell to discuss the possibility of CHCVT applying to be a new health insurance issuer in Vermont pursuant to the Federal Loan Program. According to records, a few weeks later CHCVT filed an application with CMS to receive loans under the Federal Loan Program.

CHCVT was the first iteration of the CO-OP. From December 2011 through September 2012, all of DFR's interactions were with CHCVT. As part of the application review by CMS, DFR sent a letter to a representative from CMS confirming that the draft loan agreement reviewed by DFR could qualify as a surplus note. Shortly after that letter, on June 19, 2012, CMS awarded CHCVT $33,837,800 under the Federal Loan Program. Then, between June 2012 and September 2012, DFR fielded questions on an informal basis from counsel for CHCVT regarding general licensure process and requirements. On September 7, 2012, DFR met with representatives of CHCVT regarding the formation of a new insurance company in Vermont pursuant to the Federal Loan Program. After that meeting, DFR received a letter from counsel for CHCVT outlining its response to DFR's questions regarding the Vermont regulatory authority that allows for the licensure of CHCVT as a Vermont domestic nonprofit mutual insurer.

On October 12, 2012, DFR received a Uniform Certificate of Authority application (a standardized licensing application published by the National Association of Insurance Commissioners ("NAIC")) from counsel for CHCVT seeking licensure for CHCVT as a domestic mutual insurer (Exhibit 1).[2] The application included a request for a hearing under 8

[2] The NAIC is comprised of 50 state insurance commissioners, as well as those from Washington D.C. and the U.S. territories. It is the standard-setting body for state insurance regulation. Vermont is an accredited member.

V.S.A. § 3305. The application was fatally flawed for a number of reasons, including that the petition for the hearing was not made by at least 15 incorporators, nor was the petition made prior to CHCVT incorporating, both of which are required by Vermont's licensure statutes. On October 22, 2012, DFR met with representatives of CHCVT to inform them that the application would not be considered. At the meeting the groups discussed how to overcome the obstacle of CHCVT already having been incorporated and awarded loans under the Federal Loan Program.

On November 9, 2012, DFR received a petition on behalf of 19 incorporators for a hearing under 8 V.S.A. § 3305 to determine whether the formation of a proposed domestic mutual health insurance issuer would promote the general good of the state (Ex. 2)[3]. This group of incorporators represented the CO-OP as it is contemplated throughout the rest of this order. The CO-OP assumed that it would merge with CHCVT once it received a Certificate of Public Good and incorporated. On November 14, 2012, DFR sent a letter to the CO-OP opening docket number 12-041-I but refusing to immediately schedule a hearing because the petition did not include any information on which a hearing could be based (Ex. 3). Over the ensuing months, DFR and the CO-OP held numerous meetings, often on a weekly basis, regarding the status of the application and next steps in the review process. One of those steps was that DFR called an examination of the CO-OP on November 20, 2012, to investigate and examine the application, activities, and transactions related to the application (Ex. 4). DFR and the CO-OP had even more frequent interactions through the examination process as DFR made many requests for records and information, and discussed and asked questions about the CO-OP's responses.

[3] Many of the exhibits referenced in this Decision and Order were created or obtained under an examination conducted pursuant to Title 8 V.S.A. Chapter 101, §§ 3551-3579. Under 8 V.S.A. § 3574, "all working papers, recorded information, documents and copies thereof produced, obtained by or disclosed to the commissioner or any other person in the course of an examination made under this section are confidential and are not subject to subpoena and may not be made public by the commissioner or any other person..." Certain exceptions to this requirement exist, but are not applicable here. Thus, every exhibit referenced herein is part of the Decision and Order, but only those that are not confidential are attached hereto. None of the exhibits are confidential with respect to the CO-OP itself, and it has been provided with copies of all exhibits.

At the same time the CO-OP's application was being reviewed by DFR, the CO-OP was preparing to respond to a request for proposals by the Department of Vermont Health Access ("DVHA") to offer health insurance products on Vermont Health Connect when it opens in 2014. Selling plans through Vermont Health Connect in 2014 was a central part of the CO-OP's business plan. At the time, DVHA was only accepting responses from licensed insurers. DFR granted the CO-OP's request to expedite the hearing process in order to come to a licensing decision by January 8, 2013, by scheduling a public hearing for January 2, 2013.

On December 17, 2012, DFR met with representatives of the CO-OP to let them know that DFR and its actuaries had not received enough information by that time and would not be in a position to complete a review and analysis regarding whether the CO-OP should receive a certificate of public good and authorization to commence business by the hearing date. The CO-OP then requested to postpone the January 2, 2013, hearing. DVHA had also amended its request for proposals to permit unlicensed loan recipients under the Federal Loan Program to respond. During this time DFR continued to meet regularly with the CO-OP and interact through the examination process.

Vermont laws prohibit both conducting the business of insurance without a license and engaging in practices that could deceive or mislead Vermonters. *See* 8 V.S.A. §§ 3368, 4724. On January 9, 2013, DFR sent a letter to the CO-OP demanding that the CO-OP stop all promotion and advertising that could be misleading to Vermonters, including use of the Vermont Health Connect logo (Ex. 5). Again on February 26, 2013, DFR sent a letter to the CO-OP in response to a telephone conference and presentation materials submitted by the CO-OP demanding the CO-OP stop all public presentations that could be construed as soliciting insurance applications (Ex. 6).

On January 31, 2013, the Commissioner ordered that notice be published pursuant to 8 V.S.A. § 3305 for a public hearing regarding whether the formation of a CO-OP would be in the public good of Vermont (Ex. 7). The order was followed by required publication of the hearing in the Burlington Free Press on February 3, 10, and 17, 2013 (See Ex. 8). The hearing was scheduled for March 1, 2013. The hearing was held on March 1 as scheduled. The CO-OP made a presentation to the Commissioner and eight members of the public commented (Ex. 9).[4] Those who commented raised many points, including the potential for increased competition and increased accountability for policyholders and the insurance company, as well as the CO-OP's intended focus on wellness programs and mental health integration. DFR also received six letters from members of the public commenting on the proposed CO-OP between February 15 and March 7, 2013 (See Ex. 10). The letters provided comments regarding, among other things, the potential for lower premiums through competition, more choice for Vermonters, and the potential hazards of a new insurance company if it does not have an adequate network of providers or if its management is not sufficiently experienced.

On April 1, 2013, the Department's Chief Examiner submitted an examination report and management letter to the Commissioner and to the CO-OP pursuant to the examination order and statute identifying significant risks (See, Ex. 11; 12). The CO-OP responded to the examination report and management letter on April 5, 2013, and waived any additional time permitted to

[4] Generally, the statutes contemplate that the Commissioner would make a decision regarding a Certificate of Public Good under 8 V.S.A. § 3305 after the hearing, and then move on to an analysis regarding a Certificate of Authority under 8 V.S.A. § 3309. DFR and the CO-OP agreed to combine these steps. The decision to merge these aspects of the licensure process was driven mainly by the CO-OP's concern for having a final decision on licensure be made as quickly as possible, allowing it to focus on meeting separate obligations to be considered to sell products through Vermont Health Connect beginning January 1, 2014. Approaching §§ 3305 and 3309 at the same time does not compromise the rigor or integrity of the licensing process contemplated by the statutes. Section 3305 permits the Commissioner to consider aspects of the proposed insurer or financing as she may deem advisable to determine whether establishment and maintenance of the proposed corporation will promote the public good of the state. These discretionary considerations, especially for a start-up company, necessarily overlap with and encompass the additional requirements promulgated in § 3309.

make written submission or rebuttal (See Ex. 13; 14). The CO-OP's responses highlighted information from its submissions to DVHA that, according to the CO-OP, would mitigate many concerns raised in the examination report. As a result, on April 10, 2013, the Commissioner sent a letter notifying the CO-OP that additional information would be sought under the examination including updated pro-forma financial statements and rate projections using information from its submissions to DVHA (Ex. 15). On May 3, 2013, the Chief Examiner submitted to the Commissioner and to the CO-OP an addendum to the examination report showing that the new information did not mitigate the risks raised in the initial report, but rather exacerbated them (Ex. 16). The CO-OP responded to the addendum on May 6, 2013, again waiving any additional time permitted to make written submission or rebuttal (Ex. 17). The Commissioner adopted the examination report and addendum on May 22, 2013 (Ex. 18).

III. ANALYSIS AND CONCLUSIONS

a. Overview of Insurance Company Licensing Statutes

The CO-OP proposes to operate as a Consumer Operated and Oriented Plan under the Federal Loan Program created by the ACA. The ACA and accompanying regulations make clear that independent of the requirements of the Federal Loan Program, any loan recipient must meet all applicable state insurance company licensing requirements.[5]

8 V.S.A. §§ 3302, 3303, 3305 and 3309 govern licensure of a Vermont domestic mutual insurance company. Section 3302 requires that a new insurer have not less than 15

[5] Section 1322(c)(5) of the ACA states "An organization shall not be treated as a qualified nonprofit health insurance issuer unless the organization meets all the requirements that other issuers of qualified health plans are required to meet in any State where the issuer offers a qualified health plan, *including solvency and licensure requirements*, rules on payments to providers, and compliance with network adequacy rules, rate and form filing rules, any applicable State premium assessments and any other State law described in section 1324(b)." (Emphasis added.)

incorporators, of whom not less than two-thirds are citizens of Vermont. Section 3303 requires the articles of association or bylaws of a mutual insurer to set forth the manner in which its board of directors or other governing body shall be elected, and in which meetings of policyholders shall be called, held and conducted. The CO-OP has satisfied each of these criteria.

8 V.S.A. §§ 3305 and 3309 promulgate more complex licensing criteria, which require significant review and analysis. Section 3305 states that "[b]efore the articles of association are transmitted to the secretary of state, the incorporators shall petition the commissioner to hold a public hearing...to determine whether the establishment and maintenance of the proposed corporation will promote the general good of the state." Should the incorporators meet this burden, the Commissioner would issue a Certificate of Public Good. In determining whether a corporation will be in the public good, section 3305 requires that the Commissioner consider three criteria:

> (1) the character, reputation, financial standing and purposes of the organizers, incorporators, and subscribers organizing the proposed insurer or organization;
>
> (2) the character, reputation, financial responsibility, insurance experience, and business qualifications of its proposed officers and directors; and
>
> (3) such other aspects of the proposed insurer or financing as he or she may deem advisable.

Here, the Commissioner has deemed it advisable to consider three additional aspects: the CO-OP's risk of insolvency, its corporate governance, and the legal landscape.

Section 3309 provides for additional requirements that must be met before a corporation can receive authorization to commence business as a mutual insurer. These requirements are only considered if the Commissioner determines that a Certificate of Public Good should be granted. If an applicant both meets the burden for a Certificate of Public Good and complies with the requirements under § 3309, an authorization to commence business in the form of a

Certificate of Authority would be issued. The additional requirements under § 3309 are that the corporation:

> (1) comply with such preliminary requirements for the procurement of an adequate amount of subscriptions for insurance; and
>
> (2) possesses and thereafter maintains unimpaired basic surplus of not less than $2,000,000.00 and, when first so authorized, shall possess free surplus of not less than $3,000,000.00...The commissioner may prescribe additional surplus based on upon the type, volume, and nature of insurance business transacted.

A public hearing was held pursuant to 8 V.S.A. § 3305. This decision discusses the Commissioner's conclusions with respect to each criterion considered in denying the application for a Certificate of Public Good. It further discusses the failure of the proposed CO-OP to demonstrate that it has met the criteria for a Certificate of Authority.[6]

b. Licensing Considerations under 8 V.S.A. § 3305

To determine whether the CO-OP will promote the general good of the state, the Commissioner must give consideration to each statutory factor, as well any additional factors the Commissioner deems advisable to consider. The decision under 8 V.S.A. § 3305 is made based on a totality of the considerations. No one consideration is dispositive, and not all considerations are given equal weight. Risks of insolvency and the corporate governance of the CO-OP are the most critical factors in this application and are discussed first.

i. Risks of Insolvency

A crucial consideration in determining whether the CO-OP will promote the general good of Vermont is the question of whether it will be a viable and stable insurance company and

[6] In addition to the licensing criteria, the applicant must also satisfy other requirements before selling health insurance in Vermont. Additional requirements include successful procurement of a mental health review agent license pursuant to DFR Rule H-2011-01, satisfactory completion of a baseline review for managed care organizations under DFR Rule H-2009-03, approval of forms by DFR, approval of rates by the Green Mountain Care Board, and to sell plans through Vermont Health Connect, certification as a Qualified Health Plan by the Department of Vermont Health Access. Analysis of these additional requirements is subsequent to receiving a license and is beyond the scope of this order.

remain financially solvent by maintaining sufficient assets in excess of its liabilities. The most important areas in determining the probability of continued solvency are whether, using justifiable assumptions, the rates to be charged are both sufficient to cover obligations at specified enrollment target numbers and competitive enough to achieve those. Analysis by DFR demonstrates that the CO-OP's significant liabilities and high proposed rates will make it extremely difficult for the CO-OP to remain solvent.

As part of the examination associated with the review of the CO-OP's license application, DFR and its actuaries analyzed information from the CO-OP's proposed rates that were submitted to DVHA. The analysis showed that a weighted average of the CO-OP's proposed rates for "standard" plans are more than 15% higher than the proposed rates of comparable standard plans from competitors (Ex. 16, p.4). Standard plans are those that will offer nearly identical levels of benefits, meaning that price is one of the only factors on which consumers can base their choice. The CO-OP projects that the largest portion of enrollees in its standard plans (42%) will enroll in a "silver" plan option (Ex. 16, p.4). However, the proposed rates for the silver plan options are approximately 17% more than comparable silver plan options from the CO-OP's competitors (approximately $73 per month for a single person). Rates for the CO-OP's silver plans are comparable to rates for its competitors' gold plans. The plans are divided by the level of benefits in each and named for the metals bronze, silver, gold and platinum, with platinum being the highest.[7] CO-OP plans would consistently offer consumers fewer benefits than competitors for a similar price.

[7] These comparisons are limited to the standard plan options that would have been offered through Vermont Health Connect. The CO-OP additionally contemplated offering "choice" plans through Vermont Health Connect. Prices for choice plans are not compared here because the benefit levels in choice plans can differ, making price comparison less meaningful. However, to the extent that the CO-OP's choice plan pricing is based on similar cost trends as standard plan pricing, it is reasonable to assume that its choice plan prices will be similarly higher than comparable plans of its competitors. Finally, the CO-OP contemplated offering plans to large groups outside of

It is likely that enrollment in CO-OP plans will be significantly lower than the CO-OP forecasts because its proposed rates are significantly higher than those of its competitors. The CO-OP developed a target enrollment number of 19,645 members. This number was developed based partially on the assumption advanced by the CO-OP that its rates would be 4% lower than market average in 2014 (Ex. 20, p.6). Subsequent rate development by the CO-OP has shown that rates are in fact likely to be an average of 15% higher than the CO-OP's competition in the market (Ex. 16, p.4). Though the assumed price difference from the market changed unfavorably by nearly 20% during the license review process, its projected enrollment did not change at all. This undermines any credibility in the CO-OP's forecast. It is unreasonable for the CO-OP to continue to expect to enroll 19,645 members with significantly less competitive rates than initially calculated.

Even using its unjustifiably high target enrollment assumptions and proposed rates, the CO-OP forecasts that it will lose approximately $0.8 million cumulatively from 2014-2016. Beginning in 2017 it projects to be consistently profitable. However, the CO-OP also forecasts more than $6 million in loan spending through 2016, which begins to be repaid in 2017 (start-up loan) and 2021 (solvency loan) (Ex. 16, p.4). If the CO-OP achieves 50% of its target enrollment (which appears more realistic given its proposed rates), its projected losses would be approximately $3 million per year in 2014, 2015, and 2016, for a cumulative loss of $9 million by 2017, in addition to the more than $6 million in loan obligations (Ex. 16, pp.4-5). Within three years of beginning operations, there is a high risk that the CO-OP would be insolvent.

The CO-OP points out that it is possible its rates would decrease if subjected to a full rate review process rather than a pro-forma analysis using information from proposed rates (Ex. 17,

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Vermont Health Connect. Those plans were projected to account for approximately 5% of total enrollment and rate information for those plans was not analyzed (Ex. 19, p.2).

p.2). This possibility fails to mitigate the likelihood that the CO-OP becomes insolvent. First, the formal rate review process is reserved for licensed carriers and the CO-OP falls short of the standards for licensing in many areas in addition to rates and solvency, so a potential rate decrease through a formal rate review is purely speculative. Further, as noted above the CO-OP's targeted enrollment number was developed partially based on rates that would be approximately 4% lower than competitors. The CO-OP's own projections show it losing money from 2014 – 2016, and those projections are based on rates that are at least 15% higher than competitors. If rates were lowered to be 4% lower than competitors in order to better justify the enrollment assumption, the CO-OP would suffer unsustainable operating losses. That is, the amount of revenue the CO-OP would receive from each covered life would decrease when even the amount of revenue at the higher rate would not have been sufficient to cover costs in the first place.

Consequently, either the CO-OP's rates would be higher than competitors and enrollment would suffer as a result, or the CO-OP's rates would be competitive in the market and insufficient to cover obligations. In either scenario, it is unlikely the CO-OP would remain solvent.

Another consideration in the solvency discussion as critical as rates is the CO-OP's debt, which is very high. If licensed, the CO-OP would begin operations with up to $6 million in liabilities as a result of start-up loan funds expended from the Federal Loan Program (Ex. 16, p.5). While this amount does not begin to be repaid until 2017, it represents a significant burden requiring the CO-OP to be more profitable than it would otherwise need to be without these loan repayment obligations. In addition to the start-up loan liability, all of the CO-OP's surplus would be in the form of a note which must be repaid (the solvency loan), leaving the CO-OP

with negative unassigned surplus. By way of contrast, each of the other issuers in the market have more than $100 million in positive unassigned surplus (See, Ex. 21).

Additionally, the CO-OP's proposed rates for its first year of operations defer 25% of fixed administrative costs in an apparent effort to lower prices and gain subscriptions (Ex. 22). These costs would have to be paid in later years, unnecessarily exacerbating the burden already in place during those years due to the loans.[8] Beginning its operations with such a financial disadvantage leaves the CO-OP with very little room for error in developing and charging rates that cover obligations while achieving sufficient enrollment. The CO-OP's loans and its decision to defer costs from its rates will create a higher burden of profitability in the long term than its potential competitors. The CO-OP's outsized debt as it begins operations, coupled with its rate and enrollment issues create a high likelihood that the CO-OP will become insolvent.

The Commissioner has considered this criterion under 8 V.S.A. § 3305 and concludes that this aspect of the proposed CO-OP weighs strongly against the promotion of the general good of the state.

ii. Corporate Governance

The Commissioner has deemed it vital to consider the CO-OP's corporate governance in determining whether the CO-OP will promote the general good of Vermont. The term "corporate governance" describes the "framework of systems, policies, and procedures through which an insurer effectively and efficiently: provides for sound and prudent management and

[8] DFR described to the CO-OP on several occasions the risks associated with these burdens and the pressure they create to make higher profits more quickly, especially compared to competitors that do not face any similar burdens. In response, the CO-OP maintained that while competitors allocate excess premiums to reserves, the CO-OP will return any excess premiums to members after maintaining adequate reserves (Ex. 17, p.3). This position ignores the statutory and contractual obligation to repay loans to CMS, as well as the reality that artificially depressed rates in early years will necessarily result in artificially inflated rates in later years.

oversight of the insurer's business, creates security and long-term value for policy-holders, beneficiaries, and other stakeholders; exercises its corporate authority; and holds its Board members, senior management and key persons in control functions accountable." National Association of Insurance Commissioners, White Paper on High Level Corporate Governance Principles for Use in U.S. Insurance Regulation at 1.1 (2011), *available at* http://naic.org/documents/committees_ex_isftf_corp_governance_white_paper_high_level_corp_gov_principles.pdf [hereinafter CG Principles] (not adopted). The importance of adequate corporate governance cannot be overstated particularly in the wake of the 2007-09 financial crisis. The NAIC has expanded its focus on corporate governance as a key area for scrutiny, and this focus has helped inform the Commissioner's review.

U.S. insurance regulators review the corporate governance of prospective insurers before granting a certificate of authority to engage in the business of insurance. National Association of Insurance Commissioners, The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative at section 5.30 (2013), *available at* http://naic.org/documents/index_smi_exposures_smi_white_paper.pdf (not adopted). This includes review of such things as bylaws, proposed articles of incorporation, ethics and conflicts of interest policies, accountability, responsibility, compliance and oversight. *CG Principles,* at 1.2. In Vermont, the board of directors and senior management are individually evaluated pursuant to statutory criteria and NAIC risk-based examination principles of corporate governance. 8 V.S.A. § 3573(a) (incorporating by reference the NAIC Examiners Handbook (2013)). They are interviewed to demonstrate their understanding of and ability to articulate the risk-profile and mitigation strategy of the insurer. DFR tests to see if board members are engaged and whether management brings adequate expertise to the job. This level of scrutiny

ensures that any weaknesses in corporate governance are timely identified. This is the process that DFR followed in evaluating whether the CO-OP demonstrated sufficient standards of corporate governance.

The ultimate responsibility for effective governance of an insurer rests with its board. The board is responsible for ensuring that appropriate corporate governance systems, policies and procedures are implemented and applied in a sound and prudent manner and for overseeing the implementation of an insurer's business objectives and strategies. Delegation of authority by the board to its committees, senior management, key persons in control of functions or to external parties does not absolve the board from these responsibilities. *CG Principles,* at 2.1. Individual members of the board have a statutory fiduciary duty to perform these responsibilities in good faith, in the best interests of the corporation, and with the care an ordinarily prudent person in a similar position would exercise. 11B V.S.A. § 8.30(a). Board members are placed in a position of trust and confidence and should not use their positions to further private interests. *CG Principles,* at 4.1. They are responsible for establishing the "tone at the top" and should be actively involved in specific oversight responsibilities including code of ethics/conflicts of interest, risk management, control functions and senior management supervision. *CG Principles*, at 5.

The CO-OP's current formation board of directors was formally elected on January 1, 2012 (Ex. 23). Prior to the January 1, 2012, board meeting, the application for an award under the Federal Loan Program was completed and filed (Ex. 24). The next board meeting occurred 10 months later, on October 23, 2012. During that time period only one other board action was taken, in the form of unanimous written consent by each board member. This action generally consisted of appointing officers and directors to specific positions and of authorizing the

submission of an application to DFR for a license (Ex. 23). Between the January and October board meetings, a thorough review and vetting process was undertaken by CMS, $33,837,800 in loan money was awarded, and the application for a license to conduct business as an insurance company in Vermont was prepared. There is no evidence of any discussion, input or oversight by board members of any of these significant events.

DFR conducted interviews with board members based on NAIC guidelines for risk-focused examinations. Questions were asked regarding members' understanding of risks facing the CO-OP, the level of involvement of the board in making decisions regarding contracts, strategy and direction of the CO-OP, and individual board members' views on their roles and responsibilities. The responses given during these interviews raised significant concerns that the board had not competently executed its responsibilities. When asked about a key contractual arrangement that implicated conflicts of interest and fiduciary duties, one board member stated that he knew such a relationship existed, but was not aware of any contract. When asked about the direction of the company and the risks it faces once operational, multiple board members noted that they had not discussed issues beyond the licensing phase. Finally, multiple board members described a very passive role for themselves, noting that CMS is providing oversight and that the CEO and president of the board were in control of matters. These interviews and meeting minutes demonstrate the failure of board members to understand the role and statutory duties required in effectively overseeing an insurance company.

All current board members were asked to serve on the board by Mr. Mitchell Fleischer. Mr. Fleischer is the current president of the board and has been a driving force behind the CO-OP's formation and application to DFR. As president of the board, Mr. Fleischer is paid a salary of $10,500 per month, and is expected to work with the CEO to oversee all departments of the

CO-OP and to provide leadership, direction, planning and participation in business operations and strategic development (Ex. 25, p.1). Other board members are compensated at the rate of $250 per board meeting attended (Ex. 26). The Vermont Legislature has expressed concern with excessive remuneration to board members of health insurance companies, passing a law in 2012 requiring a supplemental filing disclosing salaries of board members and senior officers. 18 V.S.A. § 9414a. To further put this into perspective, Mr. Fleischer's $126,000 annual salary eclipses the salary of the chair of the board of Blue Cross Blue Shield of Vermont, a much larger nonprofit health insurance company, who is paid $28,900 per year (Ex. 27). It is also significantly more than the $48,750 annual salary paid to the chair of the board of MVP Health Plan, a multi-billion dollar health insurance company operating in several states (Ex. 28). The board is responsible for determining reasonable compensation, if any, for directors (Ex. 29, p.7). There is no evidence of discussion by the board of Mr. Fleischer's surprisingly high salary. Nor is there evidence of any discussions of salaries for any officers of the CO-OP. The CO-OP's compensation practices exhibit a lack of oversight by the board of directors and an outsized influence by the president of the board. There are tremendous risks associated with licensing a company given these characteristics.

The board has allowed the CO-OP to enter into a contractual arrangement with Fleischer Jacobs & Associates, Inc. ("Fleischer Jacobs") that is illegal and creates a conflict of interest for Mr. Fleischer. Mr. Fleischer is both the president of the CO-OP board of directors and the president of Fleischer Jacobs. On December 4, 2012, Fleischer Jacobs entered into a contract with the CO-OP to be the exclusive agent for the CO-OP in soliciting applications for CO-OP products (Ex. 30). Though formalized in December 2012, this arrangement was contemplated at least a full year earlier when the CO-OP was applying to CMS for loans under the Federal Loan

Program (Ex. 31, pp.4-5, 7). Under this agreement, the CO-OP is paying Fleischer Jacobs at least $26,786 per month through 2013, with the possibility of an additional $250,000 through 2013 for marketing and distribution, for a potential total of more than $500,000 before even beginning insurance operations (Ex. 30, p.9).[9] The CO-OP has maintained that this arrangement with Fleischer Jacobs is a key component to the success of the CO-OP, even after being advised that the agency and commission structure under the contract is illegal under Vermont law for plans offered through Vermont Health Connect. 8 V.S.A. § 4085. Notwithstanding this admonition, the CO-OP has not submitted to DFR an amended contract changing the payment structure to Fleischer Jacobs.

There were multiple conflicting accounts of the amount of oversight the board had at the time this contract was contemplated and signed, but it is clear that there was no competitive bidding process before the contract was awarded. Board minutes from October 23, 2012, reflect a discussion and vote on the terms, payment structure, and whether to proceed with the contract (though there is no discussion of procuring these services from other vendors) (Ex. 23). However, when interviewed during the application process, the board member who, according to the minutes, moved to approve the contract could not recall or describe any relationship between Fleischer Jacobs and the CO-OP. When asked specifically about board discussions of the contract, the general counsel for the CO-OP noted that the board did not have any in-depth conversations about the relationship between Fleischer Jacobs and the CO-OP, but that the relationship and the contract were reviewed and scrutinized by CMS. The general counsel provided a memo outlining the CO-OP's responses to concerns from CMS dated November 28, 2012, more than a month after the board minutes reflect a discussion of the contract (Ex. 32).

[9] As previously noted, Vermont law prohibits solicitation of customers without a license, so the marketing efforts of Fleischer Jacobs must be either very limited or illegal.

These conflicting accounts are troubling and show a failure by the board to fulfill its fiduciary duties and a lack of competence by management in handling a contract with illegal terms.

In addition to demonstrating the failure of the board as a whole, the contract with Fleischer Jacobs creates a stark, ever-present conflict of interest for Mr. Fleischer as president of the board. Every discussion the board has and every decision it makes could implicate the interests of Fleischer Jacobs. Each time the interests of the CO-OP and Fleischer Jacobs are not in perfect alignment, Mr. Fleischer's conflict of interest will require him to act in the interest of one entity and to the detriment of the other. Or, he could recuse himself from discussions and voting, consistently leaving the board shorthanded to make decisions without its most involved and influential member. Mr. Fleischer is receiving significant monetary compensation from the CO-OP, both directly through his salary as board president and indirectly through the CO-OP's contract with Fleischer Jacobs. The genesis and the existence of the relationship between Fleischer Jacobs and the CO-OP, as well as the ongoing conflict of interest for Mr. Fleischer, create insurmountable risks for the CO-OP.

Both the board of directors and management of the CO-OP have made poor attempts to justify the board's lack of oversight. The board follows a model of "policy governance," which is described as the board setting the "ends" for the company but allowing management to be nimble and figure out how to accomplish those ends (Ex. 23). This model of governance does not account for the lack of meetings or the gaps in oversight prior to its adoption. During interviews with board members, multiple board members were unaware of specific contracts or salaries of executives, but expressed confidence in these areas due in part to the rigorous oversight exercised by CMS. However, the oversight by CMS does not extend to matters of state law or state-specific insurance regulatory issues and markets and is not a substitute for oversight

by the board. Further, there is no evidence of board discussion of the scope or extent of the review process undertaken by CMS, nor is there evidence of whether and for what reasons the board would rely on the expertise of individuals at CMS.

Management for the CO-OP has responded to this lack of oversight by noting that the formation board is intended to be "small and manageable," and that every board member will be replaced by policy holders within two years (Ex. 17, p.4). A small board may be helpful for a start-up company. But a board that is "manageable" and does not thoroughly oversee and scrutinize the most important contracts, business models, and transactions that will form the foundation of the CO-OP in its operational phase creates an enormous risk.

The Commissioner has considered this criterion under 8 V.S.A. § 3305 and concludes that this aspect of the proposed CO-OP weighs strongly against the promotion of the general good of the state.

iii. The Character, Reputation, Financial Responsibility, Insurance Experience, and Business Qualifications of the Proposed Corporation's Proposed Officers and Directors

The officers and directors of the proposed CO-OP provided to DFR detailed biographical affidavits. These individuals were also scrutinized by an outside insurance regulatory consulting firm as part of DFR's examination of the CO-OP. Finally, individuals at DFR noted and discussed the behavior and interactions of the officers and directors with DFR throughout the license application process. The character and reputation of the CO-OP's officers and directors are not in question. All officers and directors are contributing members of their respective Vermont communities. However, the officers and directors have weaknesses related to financial responsibility, insurance experience, and business qualifications.

Certain key officers of the CO-OP lack the insurance experience and business qualifications commensurate with similar positions in similar entities, including a lack of specific experience operating a health insurance company. The Chief Executive Officer has experience as a health care regulator, and the Chief Operating Officer has experience as the director of a small business association that facilitated health insurance for its members. Neither of these individuals have any reported experience in operating a health insurance company. They are less qualified than officers in similar positions at similar entities (Ex. 11, p.13).

The lack of specific experience is mitigated somewhat by the hiring of staff with health insurance-related experience and the qualifications of other members of the management team, but still raises significant risks. A recent health policy brief stated "CO-OPs will need to recruit and retain employees who have a broad range of talents—from conducting insurance operations to, in at least some cases, delivering care. Not only will these people need expertise in managing risk and administering claims, but they will also need experience operating nonprofit, member-run organizations." James, Julia, "The CO-OP Health Insurance Program" Health Affairs (February 28, 2013), *available at* http://www.healthaffairs.org/healthpolicybriefs/brief.php?brief_id=87. Additionally, the national actuarial firm Milliman noted that "mismanagement was cited as a common feature of all insolvencies" when discussing how CO-OPs can avoid common causes of failure for health plans. Troy J. Pritchett & Shelley Moss, "CO-OPs: Learning from History," Milliman (March 2012). Vermont has a unique and highly concentrated health insurance market, leaving very little margin for error in handling challenges that are certain to arise.

The importance of highly experienced management is even more acute for the CO-OP, which by law is required to elect its board from amongst its members. It is likely that few, if

any, members would have experience or understanding of the insurance industry. Such an inexperienced board implies an even greater need for the top levels of management to have significant experience running an insurance company. The lack of a management team with comprehensive understanding of insurance operations, especially at the top, results in a risk that the CO-OP will not be adequately prepared to identify, understand and respond to critical issues as they arise. Mishandling of such critical issues could lead to additional compliance, reputational and financial risks.

The CO-OP's officers exhibited additional weaknesses related to insurance experience and business qualifications through their behavior during the application process. Early in the process the officers of the CO-OP were given instructions by DFR with respect to the CO-OP's marketing and advertising practices, specifically as they relate to misleading Vermonters. Though apparently not maliciously, some of these instructions were not followed, and others were followed so narrowly as to continue to mislead Vermonters. Multiple reproaches by DFR were necessary before the officers fully heeded instructions and affirmatively ensured the CO-OP's contractors would do the same. This lack of control and ability to abide by applicable laws and instructions casts doubt on the ability or willingness of the officers and directors to timely comply with all laws and regulations to which the CO-OP would be subject if it was granted the authority to transact the business of insurance in Vermont.

In addition to the officers, the financial responsibility, insurance experience, and business qualifications of the board of directors were also considered. Some board members have tangential experience with the health insurance industry as doctors, business owners responsible for providing health insurance, or as members of boards for companies in the insurance industry. None have firsthand experience with running an insurance company. Generally, experience in

the particular industry is not necessary for members of the board of directors of a company, and here the board members bring varied and useful experiences and perspectives to the company. However, because there is a general lack of insurance operational experience and business qualifications at the management level, there is a risk that a board without any directly relevant experience will not be in a position to competently oversee management and guard against the dangers represented by inexperienced officers.

The Commissioner has considered this criterion under 8 V.S.A. § 3305 and concludes that this aspect of the proposed CO-OP weighs strongly against the promotion of the general good of the state.

iv. Legal Landscape

In 2011, Vermont passed *An Act Relating To a Universal and Unified Health System* ("Act 48"). Act 48 makes clear that the state intends to implement Green Mountain Care, a system of publicly financed health care coverage for all Vermont residents as early as 2017. More than stating an intention, Act 48 put into motion important changes, deadlines and milestones designed to facilitate the state's transition to Green Mountain Care. Unless and until new legislation changes the existing legal framework, whether formation and maintenance of the CO-OP would promote the general good of Vermont must be judged with the assumption that the CO-OP would cease to exist in its proposed form within a very limited number of years from its inception.[10]

[10] It is possible that the CO-OP, if licensed, could continue to exist in a different form with a very different function after the institution of Green Mountain Care. For example, it is possible that the state partners with an existing health insurance carrier to provide administrative services to the Green Mountain Care program. However, the stated purpose of the Federal Loan Program is to foster the creation of qualified nonprofit health insurance issuers to offer qualified health plans in the individual and small group markets. Under Green Mountain Care, no function the CO-OP could serve would meet this purpose.

Any attempt by a start-up company to enter a highly concentrated industry that will cease to exist as early as three years after entry may not serve the public interest. Here, that issue is exacerbated by a number of factors. First, the CO-OP is projected to lose money in almost every realistic financial and enrollment scenario during the years leading up to the anticipated roll-out of Green Mountain Care, including the CO-OP's own target enrollment scenario. Additionally, the CO-OP projects that it will have spent approximately $6 million in loans that begin to come due approximately the same time as the anticipated roll-out of Green Mountain Care. According to the loan agreement between the CO-OP and CMS, if the CO-OP ceases to offer health insurance, all outstanding amounts become immediately due and payable.[11]

The CO-OP continues to maintain that it anticipates reaching financial viability quickly enough to repay loans should Vermont adopt and implement Green Mountain Care in 2017 (Ex. 17, p.3). The CO-OP's own financial projections show the opposite outcome. Though these financial projections are especially troublesome in light of the implementation of Green Mountain Care, the CO-OP has not demonstrated it will become a viable entity within any realistic timeframe even if Green Mountain Care was not implemented in 2017, or at all.

The Commissioner has considered this criterion under 8 V.S.A. § 3305 and concludes that the existing legal landscape in Vermont weighs against the promotion of the general good of the state, but this criterion carries minimal weight.

[11] Ceasing to offer health insurance would likely trigger multiple events of default as described in the loan agreement between CMS and the CO-OP. These could include having its state license to offer health insurance revoked or terminated, the CO-OP failing to be in compliance with any provision of the agreement or the Federal Loan Program, the CO-OP ceasing to be solvent, or the CO-OP defaulting on the performance of any covenant or breaching any representation or warranty in the loan agreement, among others (Ex. 35, pp.36-37).

v. The Character, Reputation, Financial Standing and Purposes of the Organizers Organizing the Proposed Insurer.

There are 19 individuals petitioning the Commissioner for a hearing under 8 V.S.A. § 3305 to determine whether the proposed CO-OP will promote the general good of the state. Under the applicable incorporation statutes and throughout Vermont law, incorporators are not required to play a major role in corporate formation. Here, the incorporators will play only a minor role in the corporation once formed. Because of the minor role of the incorporators, DFR conducted a very brief review of the character, reputation, financial standing and purposes of the incorporators. DFR did not find any cause for concern in its review.

The Commissioner has considered this criterion under 8 V.S.A. § 3305 and concludes that this aspect of the proposed CO-OP weighs in favor of the promotion of the general good of the state, but this criterion carries minimal weight.

c. Licensing Criteria Under 8 V.S.A. § 3309

To determine whether the CO-OP will receive authorization to commence business in the form of a certificate of authority, it must meet two statutory requirements. Failure to satisfy either criterion will result in the denial of a certificate of authority.

i. The Proposed Corporation Complies With Such Preliminary Requirements for the Procurement of an Adequate Amount of Subscriptions for Insurance.[12]

The CO-OP projects that it will enroll 19,645 members in 2014 (Ex. 1, section 6). In determining that number, the CO-OP assumed that the price for its products would generally be

[12] Neither 8 V.S.A. § 3309 nor any other section in Title 8 describes "such preliminary requirements" referenced in this criterion. Consistent with the statutory mission of DFR under 8 V.S.A. § 10, DFR has sought from the CO-OP its best attempts at quantifying and justifying its assumptions regarding enrollment and has analyzed the justifications with an emphasis on the enrollment necessary to assure the solvency, liquidity, stability, and efficiency of the CO-OP if it were to be licensed.

4% lower than market average (Ex. 20, p.6). It further noted its plan to be the only carrier offering products through Vermont Health Connect that would pay commissions to agents to sign consumers up for CO-OP plans (Ex. 1, section 6; Ex. 31, p.7). The CO-OP correctly notes that in 2014 many individuals and small groups will be directed to a single health insurance marketplace (Vermont Health Connect) and required to purchase a new health insurance policy. This requirement creates more potential CO-OP subscribers at one time than would have existed in any previous circumstances. As a result, the CO-OP believes it is well-positioned to achieve significant enrollment. It also points out that its officers and directors have existing relationships with small businesses that will make those businesses more likely to subscribe to CO-OP plans (Ex. 14, p.3). Finally, the CO-OP notes its unique structure as a member owned, local nonprofit which will provide excellent customer service, integrated care, and provide products such as employee assistance programs that appeal to Vermonters. These factors are all relevant, and the CO-OP has failed to demonstrate that it will achieve an adequate amount of subscriptions.

The CO-OP has not provided a revised target enrollment number since it first provided the figure of 19,645 members to DFR with its original application. Since that time, two of the assumptions underlying that number changed considerably. First, the assumed price differential relative to the market has increased nearly 20%. However, the CO-OP did not project an accompanying decrease in anticipated enrollment.

The second assumption in the CO-OP's enrollment calculus was its plan to utilize brokers through its arrangement with Fleischer Jacobs and to be the only carrier that paid those brokers a competitive commission. Directly or indirectly paying commissions to sign consumers up to plans through Vermont Health Connect is illegal. 8 V.S.A. § 4085. The CO-OP has not provided an amended contract with Fleischer Jacobs, but has indicated it is aware that it must

change its compensation for brokers with respect to the approximately 95% of lives it expects to sign up for CO-OP plans through Vermont Health Connect. Though its plans for sales and compensation of brokers must change considerably, the CO-OP has not made any accompanying change to its target enrollment number. Because these two significant components underlying the CO-OP's target enrollment have changed dramatically, the CO-OP's unchanged target for enrollment is not credible.

With respect to the changes to the health insurance market in 2014, the CO-OP is correct that many individuals and small groups that would otherwise not be seeking insurance will be required to purchase new plans. Even so, the plan options that will be available on Vermont Health Connect will, in many cases, not differ much from the existing plans that individuals and small groups currently have with existing market competitors. The CO-OP has not attempted to quantify the effects of Vermont's shift to Vermont Health Connect on consumer choice, so the CO-OP's explanation is but one possible outcome of several, and is not persuasive. In fact, there is research that shows that individuals receiving health insurance through their employer often choose to remain with existing health insurance plan options, even when offered a lower rate elsewhere. Su Liu & Deborah Chollet, Price and Income Elasticity of the Demand for Health Insurance and Health Care Services: A Critical Review of Literature, p.20 (2006). This research supports the opposite conclusion that the CO-OP draws, indicating that people will choose plan options similar to their current plans rather than new options with a new, unproven carrier.

The CO-OP also notes that relationships between certain officers and directors of the CO-OP and small businesses in Vermont increase the probability that those businesses will purchase CO-OP plans. The relationship the CO-OP notes is through an association that provides its small business members with employee benefits, payroll services, and other business services. The

employee benefits offered to members include dental, life, and accidental death and dismemberment insurance. However, the association does not offer health insurance to its members. As a result, these small businesses all currently receive health insurance through one of the CO-OP's direct competitors that will be offering products through Vermont Health Connect. While it is possible that professional relationships through the association will steer businesses to the CO-OP, it is also possible that existing relationships with competing health insurance carriers will steer those same businesses to the CO-OP's competitors.

The CO-OP claims that member ownership, local appeal and a new health insurance option in a highly concentrated market will appeal to Vermonters and increase enrollment (Ex. 33, pp.3-4). This is one possible outcome. However, the CO-OP will not be offering an innovative way to deliver or pay for services as was originally contemplated in the CO-OP's application for Federal Loan Program funds and to DFR for licensure. Rather, the CO-OP will use a standard fee-for-service model after being unable to secure an innovative partnership in which costs were shared with a provider network (Ex. 34, p.3). The CO-OP will outsource many of its core insurance functions to third party vendors, including claim administration, billing, coordination of benefits, and provider network management. Many of these vendors are not Vermont companies and the CO-OP's competition provides many of these services in-house, lessening the CO-OP's "local" appeal. Member ownership and increased accountability could indeed be attractive to Vermonters, but this again is not a quantified factor. Vermonters may be as attracted to familiarity and track record as they are to a fresh new player. The CO-OP has not provided any quantifiable or persuasive reason why the unique nature of the CO-OP will cause it to procure adequate subscriptions.

Finally, and most tangibly, the CO-OP notes that its rates will be competitive with other carriers on Vermont Health Connect. As discussed above, proposed rates submitted to DVHA for offerings on Vermont Health Connect indicate that all but one of its standard plan options will be more expensive than similar options from competing carriers. These options are an average of 15% more expensive, and the plan option the CO-OP assumes will be its most popular is approximately 17% more expensive than similar options offered by other competitors (Ex. 16, p.4). There is no guarantee that consumers will always choose less expensive plans, but plan rates are the most tangible indication of whether the CO-OP will be able to procure adequate subscriptions. Based on information currently available, the CO-OP's rates will not help its enrollment and could be a hindrance.

The CO-OP has pointed out aspirational goals, fortunate outcomes in unpredictable situations, and hypothetical consumer behaviors. It has also retained its enrollment target despite major changes to the assumptions underlying that target. Cost, which is the only concrete factor relevant to enrollment, weighs against the CO-OP. While analysis of future enrollment is inherently subjective, the CO-OP has not presented convincing arguments that it will be able to procure adequate subscriptions for insurance.

The applicant has not satisfied this criterion under 8 V.S.A. § 3309.

ii. The Proposed Corporation Possesses and Thereafter Maintains Unimpaired Basic Surplus of Not Less than $2,000,000.00 and, When First so Authorized, Shall Possess Free Surplus of Not Less Than $3,000,000.00…The Commissioner May Prescribe Additional Surplus Based Upon the Type, Volume, and Nature of Insurance Business Transacted.

The CO-OP has been awarded a start-up loan from CMS in the amount of $6,289,400 and a solvency loan in the amount of $27,548,400 under the Federal Loan Program. Each of the

loans is disbursed in installments, dependent on the CO-OP meeting specified milestones set by CMS in a loan agreement with the CO-OP. The loan agreement permits an initial disbursement from the solvency loan of an amount sufficient to meet reserve capital and solvency requirements as determined by a state insurance regulator for the purpose of becoming licensed (Ex. 35, p.20). DFR has worked with CMS and agreed that the loan agreement between CMS and the CO-OP, including the terms governing disbursement of the solvency loan, is acceptable as regulatory capital for purposes of compliance with 8 V.S.A. § 3309.

There is little concern that the CO-OP will be able to maintain a satisfactory level of unimpaired surplus in the short term. The loan agreement between CMS and the CO-OP provides that amounts from the solvency loan will be disbursed to the CO-OP at its request for certain specified reasons, and upon a certification by the CO-OP that it is meeting all obligations promulgated by CMS. There is a possibility that the CO-OP will not be able to access additional amounts from the solvency loan if it does not meet certain enrollment and premium milestones, or if its operations or structure deviates from that of a CO-OP as contemplated by statute. The loan agreement makes clear that any funds from the solvency loan will go to paying claims and maintaining required reserve funds under state insurance laws before CMS can make any claim on the funds for repayment (Ex. 35, p.62). Even in the event of default on the loan agreement, solvency loan funds will be available to pay claims and maintain required reserves. Further, 8 V.S.A. § 3309 permits the Commissioner to require surplus amounts higher than those listed in the statute. Section 3309 also permits the Commissioner to require a portion of the surplus funds to be held on deposit with the state Treasurer, putting these funds in the direct possession of Vermont.

While there is little concern for the maintenance of unimpaired basic surplus in the short term, concern could increase in the medium term if the CO-OP were licensed and was not immediately profitable. CMS has confirmed that, while it was not the intention of the Federal Loan Program, the CO-OP's start-up loan could be repaid using funds disbursed from its solvency loan (Ex. 36). Repayment of the start-up loans generally occurs five years from each disbursement. The first repayments would begin in 2017. If the CO-OP were to be licensed and lose money over its first years of operation, as it projects, there is a high likelihood that money from its solvency loan would be required to repay the start-up loan in 2017. These repayments could cause the CO-OP to draw down more solvency loan funds, which would then have to be repaid in due time, as well. Beginning in 2019, interest payments on solvency loan disbursements begins. In 2021, principal payments begin (Ex. 35, p.65). Because the CO-OP is applying to be a mutual insurer, it will not have the ability sell equity as a way to access additional capital, and would be limited to traditional borrowing and charitable contributions. If the CO-OP does not receive enough premium to pay claims, fund operations, and pay back loans, there is a risk that its surplus could fall below required levels.

The applicant has satisfied this criterion under 8 V.S.A . § 3309.

IV. LICENSING DECISION

a. Overview

The CO-OP applied for more than $30 million in loans under the Federal Loan Program at the end of 2011. That application told a story of a new entrant into Vermont's insurance market that would have a high likelihood of success and would create competition and

innovation that would benefit Vermonters. The application that was reviewed by DFR tells a very different story than was told to CMS.

The CMS application included a risk-sharing partnership with Vermont Managed Care, Inc. This partnership would provide the CO-OP with a network of providers who would share risk with the CO-OP, helping to align incentives and provide cost certainty to the CO-OP. Vermont Managed Care did not agree to work with the CO-OP, and the CO-OP now proposes a standard fee-for-service model predominantly through outsourced contractors. The CO-OP promoted to CMS a unique and competitive commission structure for its brokers in the small group market, giving the CO-OP an edge over competition. Providing commissions in the small group market is illegal in Vermont, eliminating the CO-OP's potential "edge." The CO-OP touted its selective outsourcing model, allowing it to use competitive processes to find the "best-in-breed" vendors for many services the CO-OP will provide. In reality, the marketing and sales arrangement with Fleischer Jacobs has been contemplated since before the CMS application was submitted and was never put to a competitive bid. The CO-OP assumed its premium rates would be approximately 4% lower than market average when it began operations. The CO-OP has revised that assumption since, most recently showing its rates to be approximately 15% higher than the competition. These are only a few examples of where the CO-OP's story differs from reality.

The CO-OP presented a story to CMS and to the public that is very different from what would be reality if the CO-OP were to be licensed. A new domestic mutual nonprofit health insurer may have been very beneficial to Vermont's health insurance industry, especially one

that promoted lower costs and innovation.[13] Unfortunately, DFR must make a determination on the application based on the reality that is presented to it using the statutory licensing criteria. The CO-OP has failed to meet those criteria.

b. Certificate of Public Good

Pursuant to 8 V.S.A. § 3305, a certificate of public good is awarded to an applicant if the Commissioner determines that establishment and maintenance of the proposed corporation will promote the general good of the state. In making this determination, the Commissioner must consider the incorporators, the proposed officers and directors, and any other aspects of the proposed insurer or financing as she deems advisable. With respect to the CO-OP's application, the Commissioner has deemed it advisable to consider the CO-OP's risk of insolvency and its corporate governance, as well as the existing legal landscape in Vermont. The Commissioner has considered all applicable criteria and finds that for the reasons discussed above, establishment and maintenance of the CO-OP will not promote the general good of the state and a Certificate of Public Good will not be awarded.

c. Certificate of Authority

Pursuant to 8 V.S.A. § 3309, a mutual corporation cannot receive authorization to commence business until it complies with such preliminary requirements for the procurement of an adequate amount of subscriptions for insurance, and possesses and maintains sufficient unimpaired basic surplus. The Commissioner has considered the application and finds that the CO-OP has not satisfied the requirement for the procurement of an adequate amount of

[13] It is not unrealistic for a start-up company under the Federal Loan Program to deliver on lofty goals such as innovation and cost containment. Evergreen Health Cooperative in Maryland, which has received a state license, will set up its own clinics "where doctors will be salaried instead of getting paid for every procedure they perform." The goal for this innovative structure of care delivery is to undercut competitors' rates by as much as much as 30%. Alex Wayne, "Maryland's Health-Care Experiment: An Insurance Co-op" Bloomberg Businessweek (February 7, 2013), *available at* http://www.businessweek.com/articles/2013-02-07/marylands-health-care-experiment-an-insurance-co-op.

subscriptions. Because the CO-OP has not complied with one of the necessary criteria, it will not receive authorization to commence business and a Certificate of Authority will not be awarded.

V. ORDER

It is hereby ordered, adjudged, and decreed by the Commissioner of the Department of Financial Regulation of the State of Vermont that the establishment and maintenance of the Vermont Health CO-OP will not promote the general good of the state. A Certificate of Public Good, pursuant to 8 V.S.A. § 3305, is not issued in this matter.

Further, it is hereby ordered, adjudged, and decreed by the Commissioner of the Department of Financial Regulation of the State of Vermont that the Vermont Health CO-OP is not authorized to commence business as a mutual insurer. A Certificate of Authority, pursuant to 8 V.S.A. § 3309 is not issued in this matter.

This Order can be appealed under 8 V.S.A. § 16 to the Supreme Court of Vermont by any person aggrieved and directly affected by the Order.

Order Entered May 22, 2013

Susan L. Donegan

Susan L. Donegan, Commissioner