

**EXAMINATION REPORT**  
**of**  
**PIEDMONT COMMUNITY HEALTHCARE, INC.**  
**Lynchburg, Virginia**  
**as of**  
**December 31, 2012**

**COMMONWEALTH OF VIRGINIA**  
**STATE CORPORATION COMMISSION**  
**BUREAU OF INSURANCE**

# COMMONWEALTH OF VIRGINIA

JACQUELINE K. CUNNINGHAM  
COMMISSIONER OF INSURANCE  
STATE CORPORATION COMMISSION  
BUREAU OF INSURANCE



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I, Jacqueline K. Cunningham, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Piedmont Community Healthcare, Inc. as of December 31, 2012, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand  
and affixed to the original the seal of the Bureau at the City  
of Richmond, Virginia this 28<sup>th</sup> day of February, 2014

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Jacqueline K. Cunningham  
Commissioner of Insurance

(SEAL)

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Richmond, Virginia  
November 15, 2013

Honorable Jacqueline K. Cunningham  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Dear Madam:

Pursuant to your instructions and by the authority of Section 38.2-1317 of the Code of Virginia, an examination of the records and affairs of

**PIEDMONT COMMUNITY HEALTHCARE, INC.**

Lynchburg, Virginia

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

**DESCRIPTION**

The Corporation is a stock accident and sickness insurance company licensed under and subject to the general insurance laws contained in Title 38.2 of the Code of Virginia. Prior to December 19, 2007, the Corporation operated as a health maintenance organization ("HMO") in the Commonwealth of Virginia. The Corporation was last examined by representatives of the State Corporation Commission's ("Commission") Bureau of Insurance ("Bureau") as of December 31, 2009. This examination covers the period from January 1, 2010 through December 31, 2012.

**HISTORY**

The Corporation was issued a certificate of incorporation by the Commission on September 26, 1997 and began operating as a HMO effective June 29, 1998. The Corporation operated as a HMO until December 19, 2007. On December 19, 2007, the Corporation received approval from the Bureau to convert from a HMO to an accident and sickness insurer pursuant to Section 38.2-1016.1 of the Code of Virginia.

## MANAGEMENT AND CONTROL

The bylaws of the Corporation provide that the affairs of the Corporation shall be managed by a Board of Directors (the "Board") consisting of twelve individuals. The Board shall be comprised of the same individuals who serve as the directors of Piedmont Community Health Plan, Inc. ("PCHP"). A majority of the Board shall constitute a quorum for the transaction of business.

The bylaws also provide that the Board may designate one or more of its members to constitute an executive committee or any other committee. If the Board appoints an executive committee, it shall have and may exercise all of the authority of the Board except to fill vacancies on the Board or any of its committees, amend the articles of incorporation, adopt, amend or repeal the bylaws, approve a plan of merger, authorize or approve a distribution, or authorize or approve the issuance or sale of shares of the Corporation's stock.

The Board shall annually elect officers of the Corporation. The officers shall consist of a Chairman of the Board, a Vice-Chairman, a President, a Secretary and a Treasurer who shall be the same individuals who serve in these capacities for PCHP. Such other officers and assistant officers may be elected or appointed by the Board as deemed necessary. At December 31, 2012, the Board and Officers of the Corporation were as follows:

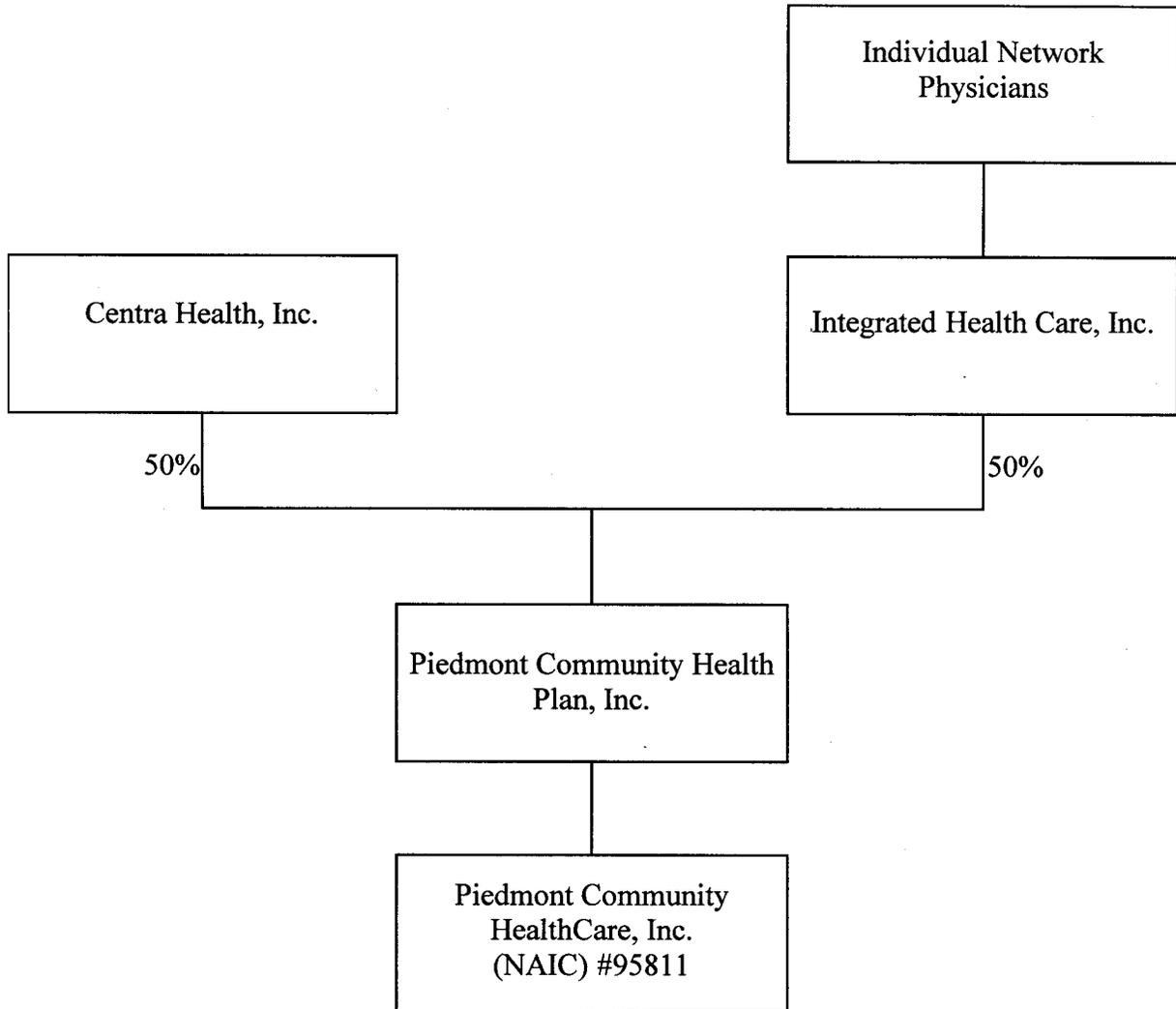
<u>Directors</u>	<u>Principal Occupation</u>
David D. Adams	Senior Vice President Centra Health, Inc. Lynchburg, Virginia
Lewis C. Addison	Senior Vice President and Chief Financial Officer Centra Health, Inc. Lynchburg, Virginia
William M. Bryant	President and Chief Executive Officer Centra Health, Inc. Lynchburg, Virginia
Michael V. Bradford	Vice President of Institutional Advancement Central Virginia Community College Lynchburg, Virginia

<u>Directors</u>	<u>Principal Occupation</u>
David R. Cannon, M.D.	Physician Lynchburg, Virginia
Robert D. Clower, M.D.	Physician Lynchburg, Virginia
Lewis P. Dabney, M.D.	Physician Lynchburg, Virginia
Rodger W. Fauber	Retired Lynchburg, Virginia
Leah H. Hinkle, M.D.	Physician Lynchburg, Virginia
Morris E. McCrary, III, M.D.	Physician Lynchburg, Virginia
Richard C. Morris, M.D.	Physician Lynchburg, Virginia
Marc A. Schewel	Business Owner Lynchburg, Virginia

### Officers

Lewis P. Dabney, M.D.	Chairman of the Board
William M. Bryant	Vice-Chairman
Alan J. Wood	President and Chief Executive Officer
David D. Adams	Treasurer
Richard C. Morris, M.D.	Secretary

The Corporation is a wholly owned subsidiary of PCHP. PCHP is owned equally by Integrated Healthcare, Inc. ("Integrated"), a stock corporation of physicians providing care to residents in the Lynchburg area, and Centra Health, Inc. ("Centra Health"), a not-for-profit corporation consisting primarily of three acute care hospitals, three nursing homes and a residential adolescent psychiatric facility. By virtue of this ownership, the Corporation is a member of an insurance company holding system as defined in Section 38.2-1322 of the Code of Virginia. The chart on the following page illustrates the organizational structure of the Corporation and its affiliated entities at December 31, 2012.



## TRANSACTIONS WITH AFFILIATES

### Management Services Agreement

Effective January 1, 2011, the Corporation entered into an amended Management Services Agreement with PCHP. The new agreement maintains the same services as mentioned in the previous agreement but also reflects reimbursement to PCHP for services at a different rate for the new Medicare Advantage business. Additional changes were made so the amended agreement complies with the Centers for Medicare and Medicaid Services (CMS) standards. According to the agreement, PCHP shall provide or arrange for all administrative and management services including, but not limited to, the following:

- a. Development of provider network agreements and implementation of a medical delivery system. Providing an annual report to the board of the results under the Credentialing Program.
- b. Development and implementation of utilization review and quality assurance programs.
- c. Development and filing of all forms, benefit plans, rates, contracts and other documents necessary to sell the Corporation's products.
- d. Management of the Corporation's assets and liabilities including cash disbursement authority and accounting and reporting of financial results.
- e. Providing data processing services and claims administration services including customer service, claims processing, member eligibility, reporting and related services.
- f. Marketing of the Corporation's products.
- g. Providing underwriting and actuarial services.
- h. Arranging for legal services as necessary.
- i. Communicating with CMS as required.
- j. Reporting to the board on administrative and management activities.

As compensation for administrative and management services, the Corporation shall pay PCHP 10% of premiums received, net of commissions, for commercial customers and 8% of premiums received, net of commissions, for Medicare Advantage customers, no later than 30 days after the end of each calendar quarter. The Corporation incurred management fees equaling \$4,474,907 and \$4,266,862 in 2012 and 2011, respectively.

### Network Services Agreement

Effective January 1, 2007, the Corporation entered into an amended and restated Network Services Agreement with PCHP whereby PCHP will provide the Corporation access to its provider network in exchange for including these providers in the Corporation's network of participating providers. The network provided by PCHP includes participating physicians, hospitals and other health professionals and facilities. Participating providers are compensated on a fee-for-service basis based on the lesser of billed charges or established fee schedules minus any applicable copayments. Twenty percent of the payment to Integrated and Centra Health providers designated by the Corporation is retained by the Corporation in a withhold account. One hundred twenty days after the end of the calendar year, the Corporation will compare actual medical expenses to budgeted medical expenses for the year. Each year, the budgeted medical expenses is set at 90% of total earned premiums, net of agent commissions. If the actual medical expenses are less than the budgeted medical expenses, the Corporation shall pay PCHP the difference within 20 days of such determination. If the actual medical expenses are greater than the budgeted medical expenses, PCHP shall contribute, or arrange for Integrated and Centra Health to contribute, the difference to the Corporation within 30 days of receipt of request for payment from the Corporation. Such contributions by PCHP or Integrated and Centra Health, in total, shall not exceed 15% of the budgeted medical expenses for the year. Contributions made by Integrated and Centra Health shall be based on a percentage of medical payments received by Integrated and Centra Health providers during the year. All of the 20% withholds from Integrated and Centra Health providers are paid to PCHP or directly to Integrated and Centra Health providers within 120 days after the end of the calendar year. Upon PCHP's request, the Corporation shall pay the 20% withholds in advance of 120 days after the end of the calendar year or on a regular distribution schedule.

### Tax Sharing Agreement

Effective December 1, 2006, the Corporation entered into a Tax Sharing Agreement with PCHP. Pursuant to the agreement, the Corporation is included in the consolidated federal income tax return filed by PCHP. The Corporation's federal income tax liability or refund is determined as if it was filing its own separate federal income tax return. If the Corporation's tax liabilities are used to increase the consolidated federal tax liability, the Corporation will pay PCHP the amount equal to the increase in the consolidated federal income tax liability. If the Corporation's tax benefits (i.e. losses or credits) are used to reduce the consolidated federal tax liability, PCHP shall retain the amount equal to the reduction in the consolidated federal income tax liability. In the instance where PCHP retains the reduction in the consolidated federal income tax liability caused by the Corporation's losses or credits, PCHP will have funded the Corporation's losses through the Network Services Agreement described above and, in turn, would receive the benefit derived by such losses in the consolidated federal income tax return.

## **TERRITORY AND PLAN OF OPERATION**

At December 31, 2012, the Corporation was authorized to transact the business of accident and sickness insurance in the Commonwealth of Virginia.

The Corporation markets a point-of-service ("POS") product and a preferred provider organization ("PPO") product. Under the POS product, a member is required to select a primary care physician ("PCP") from a directory of the Corporation's primary providers. A member can receive covered services from either participating or non-participating providers without a referral from a PCP; however, these services are subject to a reduced level of benefits. Under the PPO product, members receive covered services from either participating or non-participating providers and are not required to select a PCP. A member who receives covered services from non-participating providers is subject to a reduced level of benefits.

Marketing of these products is directed toward employer groups that qualify for either small or large group insurance coverage. The Corporation's marketing effort is primarily accomplished through the use of independent agents.

The amended January 1, 2011 Management Service Agreement allows the Corporation to sell a Medicare Advantage product. For 2012, the total revenue for this product was \$7,303,131, total underwriting expenses was \$7,516,268 and the net underwriting loss was (\$213,137). The number of enrollees as of year-end was 963.

## **CONFLICT OF INTEREST**

The Corporation has adopted a conflict of interest policy applicable to its officers and directors. The conflict of interest policy states that officers and directors should govern the Corporation's affairs honestly and economically, exercising best care, skill and judgment for the benefit of the Corporation. To avoid any potential conflicts the Corporation's officers and directors should disclose any situation where a conflicting interest or duality of interest could cause the officer or director to act in any matter other than in the best interest of the Corporation. To ensure compliance with the Corporation's conflict of interest policy, officers and directors must complete conflict of interest disclosure forms on an annual basis.

## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2012, the Corporation was listed as a named insured on a commercial crime policy with a \$900,000 limit of liability, subject to a \$100,000 deductible, to insure against losses arising from dishonest acts from employee theft.

Additionally, the Corporation was listed as a named insured on a directors and officers liability policy and a managed care errors and omissions liability policy.

### GROWTH OF THE CORPORATION

The following data represents the growth of the Corporation for the ten-year period ending December 31, 2012. The data is compiled from the Corporation's filed Annual Statements, previous examination reports, and the current examination report.

<u>Year</u>	Total Admitted <u>Assets</u>	Total <u>Liabilities</u>	Total Capital and <u>Surplus</u>
2003	\$13,370,629	\$9,682,330	\$3,688,299
2004	11,977,378	7,850,451	4,126,927
2005	13,304,922	8,510,800	4,794,122
2006	15,825,372	10,240,188	5,585,184
2007	14,344,603	8,408,369	5,936,234
2008	15,025,865	8,995,504	6,030,361
2009	17,187,686	11,155,020	6,032,666
2010	13,881,038	7,634,060	6,246,978
2011	14,054,510	7,785,049	6,269,461
2012	15,422,871	9,065,970	6,356,901

<u>Year</u>	Total <u>Revenue</u>	Net Investment <u>Gains</u>	Medical & Hospital <u>Expenses *</u>	Administrative <u>Expenses</u>	Pre-Tax Income <u>(Loss)</u>
2003	\$34,024,380	\$77,362	\$30,111,356	\$3,297,006	\$693,380
2004	33,767,274	108,888	29,012,350	4,213,148	650,664
2005	32,664,617	324,455	28,162,320	3,935,416	891,336
2006	37,806,094	643,520	32,663,902	4,485,763	1,299,949
2007	38,529,856	587,496	34,069,908	4,497,793	549,651
2008	41,804,749	179,558	36,726,607	5,117,773	139,927
2009	46,621,403	29,751	40,321,197	6,327,052	2,905
2010	46,320,484	14,489	40,000,025	6,346,962	(12,014)
2011	44,779,458	8,607	38,787,678	5,976,864	23,523
2012	47,886,778	5,768	41,588,728	6,186,232	117,586

\* Increase/(decrease) in reserves were included in this category

The Corporation's enrollment data at year-end is illustrated as follows:

<u>Year</u>	<u>Number of Members</u>
2003	13,613
2004	11,704
2005	11,942
2006	12,615
2007	11,732
2008	12,800
2009	13,161
2010	11,502
2011	10,536
2012	10,270

### **EXCESS LOSS INSURANCE**

Effective September 1, 2012, the Corporation entered into an Excess Risk Insurance Agreement with HCC Life Insurance Company ("HCC Life"). For eligible services, the deductible is \$330,000 per member for each policy year. Once the deductible has been reached in a policy year, HCC Life will reimburse the Corporation 90% of all eligible expenses.

The maximum lifetime excess insurance payable under this agreement for any one member shall not exceed \$2,000,000. The agreement includes a continuation of coverage endorsement in the event of the Corporation's insolvency.

**SCOPE**

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2010 through December 31, 2012. Assets were verified and liabilities established at December 31, 2012.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook. The Handbook requires that the Bureau plan and perform the examination to evaluate the financial condition and identify prospective risks of the Corporation, assess corporate governance, identify and assess inherent risks within the Corporation, and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Corporation were considered in accordance with the risk-focused examination process.

**FINANCIAL STATEMENTS**

There follows a statement of financial condition as of December 31, 2012; a statement of revenue and expenses for the year ending December 31, 2012; a reconciliation of capital and surplus for the period under review; and a statement of cash flows for the year ending December 31, 2012. The financial statements are presented in accordance with Statutory Accounting Principles.

**ASSETS**

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Cash and short-term investments	<u>\$11,856,164</u>	<u>                    </u>	<u>\$11,856,164</u>
Subtotals, cash and invested assets	\$11,856,164	\$0	\$11,856,164
Investment income due and accrued	1,661		1,661
Uncollected premiums and agents' balances in the course of collection	231,052		231,052
Accrued retrospective premiums	48,443		48,443
Amounts recoverable from reinsurers	130,028		130,028
Net deferred tax asset	79,756		79,756
Health care and other amounts receivable	<u>3,075,767</u>	<u>                    </u>	<u>3,075,767</u>
Total assets	<u><u>\$15,422,871</u></u>	<u><u>\$0</u></u>	<u><u>\$15,422,871</u></u>

**LIABILITIES, CAPITAL AND SURPLUS**

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims unpaid	\$5,908,201	\$483,889	\$6,392,090
Aggregate health policy reserves	727,500		727,500
Premiums received in advance	895,011		895,011
General expenses due or accrued		290,598	290,598
Current federal income tax payable		7,421	7,421
Amounts due to parent, subsidiaries and affiliates	728,866		728,866
Liability for amounts held under uninsured plans	<u>24,484</u>		<u>24,484</u>
 Total liabilities	 <u>\$8,284,062</u>	 <u>\$781,908</u>	 <u>\$9,065,970</u>
 Common capital stock			\$1,000,000
Gross paid in and contributed surplus			5,029,191
Unassigned funds (surplus)			<u>327,710</u>
 Total capital and surplus			 <u>\$6,356,901</u>
 Total liabilities, capital and surplus			 <u><u>\$15,422,871</u></u>

**STATEMENT OF REVENUE AND EXPENSES**

	<u>Uncovered</u>	<u>Total</u>
Net premium income	<u>XXX</u>	<u>\$47,886,778</u>
Total revenues	<u>XXX</u>	<u>\$47,886,778</u>
<b>Hospital and Medical</b>		
Hospital/medical benefits	\$627,093	\$14,925,599
Other professional services	1,842,576	18,609,683
Emergency room and out-of-area	175,750	1,410,268
Prescription drugs		9,043,694
Aggregate write-ins for other hospital and medical		<u>(2,462,842)</u>
Subtotal	<u>\$2,645,419</u>	<u>\$41,526,402</u>
<b>Less:</b>		
Net reinsurance recoveries		<u>337,674</u>
Total hospital and medical	<u>\$2,645,419</u>	<u>\$41,188,728</u>
General administrative expenses	6,186,232	6,186,232
Increase in reserves for life and accident and health contracts		<u>400,000</u>
Total underwriting deductions	<u>\$8,831,651</u>	<u>\$47,774,960</u>
Net underwriting gain	<u>XXX</u>	<u>\$111,818</u>
Net investment income earned		<u>\$5,768</u>
Net investment gains		<u>\$5,768</u>
Net income before federal income taxes	<u>XXX</u>	<u>\$117,586</u>
Federal income taxes incurred	<u>XXX</u>	<u>7,420</u>
Net income	<u>XXX</u>	<u>\$110,166</u>

**RECONCILIATION OF CAPITAL AND SURPLUS**

	<u>2010</u>	<u>2011</u>	<u>2012</u>
Capital and surplus prior reporting year	<u>\$6,032,666</u>	<u>\$6,246,978</u>	<u>\$6,269,461</u>
<b>GAINS AND LOSSES TO CAPITAL AND SURPLUS</b>			
Net income	(\$12,014)	(\$415)	\$110,166
Change in net deferred income tax	(32,666)	22,898	(22,725)
Surplus adjustments:			
Paid in	250,000		
Aggregate write-ins for gains or (losses) in surplus	<u>8,992</u>		<u>(1)</u>
Net change in capital and surplus	<u>\$214,312</u>	<u>\$22,483</u>	<u>\$87,440</u>
Capital and surplus end of reporting year	<u><u>\$6,246,978</u></u>	<u><u>\$6,269,461</u></u>	<u><u>\$6,356,901</u></u>

**CASH FLOW****CASH FROM OPERATIONS**

Premiums collected net of reinsurance	\$47,744,514
Net investment income	4,336
Total	<u>\$47,748,850</u>
Benefit and loss related payments	\$42,382,916
Commissions, expenses paid and aggregate write-ins for deductions	5,910,683
Federal income taxes paid	23,938
Total	<u>\$48,317,537</u>
Net cash from operations	<u>(\$568,687)</u>

**CASH FROM FINANCING AND MISCELLANEOUS SOURCES**

Cash provided (applied):	
Other cash provided	<u>\$130,788</u>
Net cash from financing and miscellaneous sources	<u>\$130,788</u>

**RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS**

Net change in cash and short-term investments	(\$437,899)
Cash and short-term investments:	
Beginning of the year	<u>12,294,063</u>
End of the year	<u><u>\$11,856,164</u></u>

**CONCLUSION**

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Chris Collins, CFE, and Kevin Knight, CFE, of the Bureau participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "John P. Drear". The signature is written in a cursive style with a large initial "J" and "P".

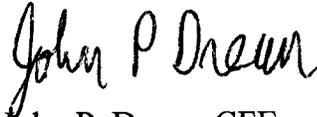
John P. Drear, CFE  
Senior Insurance Examiner  
Commonwealth of Virginia  
Representing the Southeastern Zone, NAIC

## CONCLUSION

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Chris Collins, CFE, and Kevin Knight, CFE, of the Bureau participated in the work of the examination.

Respectfully submitted,



John P. Dreaun, CFE  
Senior Insurance Examiner  
Commonwealth of Virginia  
Representing the Southeastern Zone, NAIC



**PIEDMONT COMMUNITY HEALTHCARE**

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STATE CORP. COMMISSION

2014 FEB 14 AM 8:36

BUREAU OF INSURANCE

February 10, 2014

David H. Smith, CFE, CPA, CPCU  
Chief Examiner  
State Corporation Commission  
Bureau of Insurance  
P.O. Box 1157  
Richmond, Virginia 23218

Re: Examination Report as of December 31, 2012

Dear Mr. Smith:

Thank you for your letter dated January 15, 2014, with which you provided a copy of the Piedmont Community HealthCare ("Piedmont") Examination Report as of December 31, 2012. Piedmont requests 15 copies of the Examination Report for distribution to members of its Board of Directors and its owners.

On behalf of Piedmont's management and staff, please express our thanks to Mr. Chris Collins, Mr. Jack Drean, and Mr. Kevin Knight for their courtesy and professionalism during this examination.

Regards,

Alan J. Wood  
President & Chief Executive Officer