

NCHE Workers' Compensation Fund, Inc.

Cary, North Carolina

Report on Examination

As of December 31, 2018

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May 12, 2020

Honorable Mike Causey
Commissioner of Insurance
State of North Carolina
Raleigh, North Carolina

Sir:

Pursuant to your instructions and in accordance with Section (“§”) 58-2-131 of the General Statutes of North Carolina (“GS”), the North Carolina Department of Insurance (“Department”) conducted an examination of the records, business affairs and financial condition of

NCHE Workers’ Compensation Fund, Inc.

(hereinafter referred to as the “Fund”), at its Managing General Agent’s main administrative office located at 4250 Congress Street, Suite 200, Charlotte, North Carolina 28209. The Fund’s statutory home office is located at 2400 Weston Parkway, Cary, North Carolina 27513. The following report on examination is respectfully submitted.

SCOPE OF THE EXAMINATION

We performed a full-scope statutory examination of the Fund. This examination covers the period from January 1, 2014 to December 31, 2018, including any material transactions and events occurring subsequent to the examination date and noted during the course of this examination. The Department’s most recent prior examination of the Fund was as of December 31, 2013.

The purpose of this examination is to review and evaluate the Fund’s business processes and controls to assist in accessing and monitoring its current financial condition and prospective solvency. Pursuant to GS § 58-2-132, this Report on Examination comprises only facts appearing in the books, records, or other documents of the Fund (together with citations of pertinent laws, regulations, and rules) with regard to any material adverse findings disclosed by the examination.

We conducted our examination in accordance with auditing standards established by the Department and the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook. The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Fund, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer’s surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Fund were considered in accordance with the risk-focused examination process and the following key functional activities were identified:

Investments
Premiums and Underwriting
Reserves and Claims Handling
Reinsurance - Ceding

This may include assessing significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with GS Chapter 58 and evaluating management's compliance with Statutory Accounting Principles. This examination does not attest to the fair presentation of the financial statements included herein. If during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately from the Fund's financial statements.

This examination report includes significant findings of fact and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to the Fund.

The Fund's Annual Statements, work papers, and the independent audit work papers were reviewed and relied upon whenever possible. A trial balance reconciliation of the Annual Statement was performed, as were a verification of ownership and valuation of assets, determination of liabilities and reserves, and an analysis and review of such accounts and records as deemed necessary by the examination team. A management representation letter attesting to the Fund's ownership of assets, the nonexistence of unrecorded liabilities and contingent liabilities was received from Fund management.

The books and records of the Fund are audited annually by independent certified public accountants in accordance with GS § 58-10-185(a). Dixon Hughes Goodman LLP of High Point, NC, the designated independent public accountant of the Fund, issued an unmodified opinion for each year subsequent to the Department's prior examination through, and including, the year ended December 31, 2018.

REPORT ABBREVIATIONS

General Statutes of North Carolina	“GS”
North Carolina Department of Insurance	“Department”
NCHE Workers’ Compensation Fund, Inc.	“Fund”
National Association of Insurance Commissioners	“NAIC”
Board of Directors	“Board”
North Carolina Healthcare Enterprises, Inc.,	“NCHA”
North Carolina Association Strategic Partners	“Strategic Partners”
Arthur J. Gallagher Risk Management Services, Inc.	“AJG”
Managing General Agent	“MGA”
Allied Claims Administration, Inc.	“Allied”

SUMMARY OF SIGNIFICANT FINDINGS

COMMENTS, RECOMMENDATIONS AND DIRECTIVES

1. The Fund did not maintain any fidelity bond coverage for all years under examination. The NAIC Financial Condition Examiners Handbook’s recommended minimum range for the Company’s fidelity bond coverage is \$150,000 to \$175,000. We recommend that the Fund maintain fidelity bond coverage for no less than the minimum recommended by the NAIC.

FUND HISTORY

The Fund was incorporated on September 9, 1993 and commenced business on October 1, 1993. The Fund is licensed as a self-insured group fund to provide workers’ compensation insurance coverage for its member hospitals and healthcare networks in the State of North Carolina (“NC”).

The Fund is sponsored by the North Carolina Healthcare Enterprises, Inc., a wholly owned subsidiary of NCHA Inc. (“NCHA”), also known as North Carolina Hospital Association. NCHA is a statewide trade association representing over 100 hospitals and healthcare networks. Pursuant to GS § 58-47-65(c), all the Fund’s participants are members of NCHA. North Carolina Healthcare Enterprises, Inc. operates under the trade name of North Carolina Hospital Association Strategic Partners (“Strategic Partners”).

The Fund is managed by Arthur J. Gallagher Risk Management Services (“AJG”), a Managing General Agent (“MGA”), which provides administrative services including, marketing, underwriting, loss control services, management, accounting and placement of excess insurance coverage. Allied Claims Administration, Inc. (“Allied”), a service company owned equally by AJG and Healthcare Insurance Resources, Inc., a wholly owned subsidiary of Georgia Hospital Association, provides claims administration services to the Fund. The Fund changed its MGA from McNeary, Inc. in May 2016 when AJG purchased McNeary and Allied.

DIVIDENDS TO POLICYHOLDERS

Dividends are paid as declared by the Fund’s Board of Directors (“Board”). Under the insurance regulations of North Carolina, the maximum amount of dividends which the Fund may pay to shareholders is limited to the greatest of 10% of the most recent year-end member's surplus or net income (excluding realized capital gains) earned for that same year-end. The Fund declared dividends totaling \$1,822,017 and \$2,181,680 in 2018 and 2017, respectively.

MANAGEMENT AND CONTROL

CORPORATE GOVERNANCE

Board of Directors

The business of the Fund is conducted by its officers and MGA and subject to review by the Board. The bylaws specify that the number of Directors shall be not less than 7 and no more than 12. Directors are elected annually, at the annual meeting of members or by the written consent of the members, and each director elected shall hold office until a successor is elected and qualified.

The following individuals served as directors at December 31, 2018:

Name	Location	Principal Occupation
Gregory Wood	Laurinburg, NC	Chief Executive Officer, Scotland Health Care System, and Chairman of the Board
Linwood Jones	Cary, NC	Attorney, North Carolina Healthcare Association, and Secretary/Treasurer of the Board
Richard Brvenick	Morehead City, NC	President and Chief Executive Officer, Carteret General Hospital
Lawrence Chewning	Rocky Mount, NC	Independent Health Consultant
John Green	Statesville, NC	Hospital Administrator, Iredell Memorial Hospital
Laura Lambeth	Jefferson, NC	Chief Executive Officer, Novant Health
Stephen Lawler	Cary, NC	President & Chief Executive Officer, North Carolina Healthcare Association

The Board established an Audit Committee and an Underwriting Committee to act on behalf of the Fund. The following individuals served on committees at December 31, 2018:

Audit Committee

Linwood Jones, Chair
Lawrence Chewning

Underwriting Committee

John Green, Chair
Linwood Jones
Gregory Wood

Officers

The bylaws provide that the officers of the Fund shall consist of a Chairman, a Secretary and a Treasurer. Other officers, including a President, Vice Presidents and subordinate officers may from time to time be elected by the Board. Any two or more officers may be held by the same person, but no officer may act in more than one capacity where action of two or more officers is required, and neither the Chairman nor President may hold the office of Secretary.

The following individuals served as officers of the Fund at December 31, 2018:

Name	Title
Gregory Wood	Chairman
Linwood Jones	Secretary/Treasurer

CODE OF CONDUCT AND CONFLICT OF INTEREST

The Fund has an established policy and procedure to identify existing or potential conflicts of interest and to report the same to the Board. Annually, the Fund requires a signed statement from each director and officer disclosing any conflict of interest. A review of the signed conflict of interest statements for the examination period revealed that the Fund acted in accordance with its policy and procedure for disclosure of conflicts of interest.

CORPORATE RECORDS

We reviewed the minutes of the meetings of the Board and its committees for the period under examination. Based on our review, it appears that the minutes documented the Fund's significant transactions and events, and that the directors approved these transactions and events.

The Fund's Articles of Incorporation and Bylaws were reviewed for any changes during the period under examination. No changes were noted regarding the articles of incorporation and bylaws for the Fund.

STATUTORY DEPOSITS

Statutory deposits are maintained as required by insurance regulatory agencies for doing business in such jurisdictions. The Fund only maintains a North Carolina statutory deposit.

FIDELITY BONDS AND OTHER INSURANCE

The Fund did not have any fidelity bond coverage for the period under examination. (Refer to the Summary of Significant Findings)

In addition, the Fund is a named insured on a directors and officers liability policy and a cyber-security policy, which appears to be adequate to cover risks in the normal course of business.

TERRITORY AND PLAN OF OPERATION

The Fund provides workers compensation coverage to members of the North Carolina Hospital Association (“NCHA”). The Fund is sponsored by NCHA Strategic Partners, a for-profit subsidiary of the NCHA. There are 25 healthcare institutions, including NCHA, which purchase workers’ compensation coverage from the Fund.

TRENDS OF THE FUND

The following data, obtained from annual statements filed with the Department, illustrates the trends of the Fund for the five-year period ended 2018:

Year	Total Net Admitted Assets	Surplus	Gross Premiums Written	Net Earned Premiums	Net Income(loss)
2018	\$12,375,092	\$4,566,559	\$6,806,718	\$6,309,168	\$121,063
2017	\$13,568,235	\$5,062,642	\$6,188,132	\$5,747,107	\$250,741
2016	\$14,143,528	\$4,600,442	\$5,717,011	\$5,615,837	\$294,968
2015	\$14,495,751	\$4,408,698	\$5,281,275	\$4,838,203	\$118,007
2014	\$17,141,325	\$5,475,488	\$7,335,464	\$6,535,290	(\$143,681)

ACTUARIAL OPINION

Every property and casualty insurance Fund doing business in this State, unless otherwise exempted by the Commissioner, shall annually submit the opinion of an appointed actuary and an actuarial opinion summary in accordance with GS § 58-10-150 and GS § 58-10-155

The statutory reserves and related items for 2018 were reviewed and certified by the Fund’s Appointed Actuary, J. Edward Costner, ACAS, MAAA, President of Casualty Actuarial Consultants, Inc. Actuarial opinions regarding the Fund’s reserves for loss and loss adjustment expenses were issued by an appointed actuary for all years in the examination period. The appointed actuary evaluated the data provided by the Fund for reasonableness and consistency of the loss and loss adjustment expense reserve. According to the actuarial opinions, the Fund’s reserve on the loss and loss adjustment expense met the requirements of the insurance laws of North Carolina; were consistent with reserves computed in accordance with accepted actuarial standards and principles; and made a reasonable provision for all unpaid loss and loss expense obligations of the Fund under the terms or its policies and agreements.

REINSURANCE PROGRAM OVERVIEW

REINSURANCE CEDED

The Fund has an excess workers' compensation and employer liability reinsurance contract with State National Insurance Company ("Reinsurer") effective January 1, 2018, whereby the Fund cedes excess worker's compensation and employer's liability to the Reinsurer. A summary of the coverage provided under this contract is as follows:

Specific Excess Insurance

The Fund retains the first \$500,000 of loss each and every occurrence during the policy period. The Fund is also responsible for an additional \$200,000 of total loss per policy period in excess of the self-insured retention of \$500,000 per occurrence. Such additional one-time deductible of \$200,000 for each annual period may be satisfied by losses stemming from one or several occurrences. The Reinsurer is liable for the losses in excess of the Fund's retention up to the statutory limit for workers compensation coverage and \$1,000,000 for each occurrence for employer liability written.

The Fund ceded premiums totaling \$497,550 and \$498,988 in 2018 and 2017, respectively, under the reinsurance Contract.

Aggregate Excess Insurance

The Fund was granted an exemption, from the Department for all years under examination, to purchase aggregate excess insurance for workers' compensation and employer liability due to its prohibitive cost.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Fund with the Department and present the financial condition of the Fund for the period ending December 31, 2018. The supporting exhibits present the information required to be included, in conformity with reporting practices prescribed by the Department. The financial statements and supporting schedules as of December 31, 2017, are unexamined and are presented for comparative purposes only.

NCHE Workers' Compensation Fund, Inc.
Statutory Statement of Admitted Assets
December 31, 2018

	2018	2017 <i>(unexamined)</i>
Bonds	\$7,753,200	\$7,912,405
Common stocks	2,860,111	3,198,777
Cash and short-term investments	1,117,730	1,290,051
Total cash and invested assets	11,731,041	12,401,233
Investment income due and accrued	53,991	53,022
Premiums and agents' balances in course of collection	(1,465)	59,753
Premiums and agents' balances booked but deferred and not yet due	20,000	(140,000)
Reinsurance recoverable	(16,522)	791,718
Federal income tax recoverable	484,678	278,615
Claim deductible billing receivable	103,369	123,894
Total admitted assets	\$12,375,092	\$13,568,235

NCHE Workers' Compensation Fund, Inc.
Statutory Statement of Liabilities and Surplus
December 31, 2018

	2018	2017 <i>(unexamined)</i>
Losses	\$5,299,060	\$5,334,555
Loss adjustment expenses	692,102	769,266
Other expenses	16,461	33,690
Taxes, licenses and fees	16,832	12,560
Advance premium	-	204,758
Dividends declared and unpaid: Policyholders	1,822,017	2,181,680
Ceded reinsurance premiums payable	(37,939)	(30,916)
Total Liabilities	7,808,533	8,505,593
Unassigned funds	4,566,559	5,062,642
Total surplus	4,566,559	5,062,642
Total Liabilities and Surplus	\$12,375,092	\$13,568,235

NCHE Workers' Compensation Fund, Inc.
Statutory Statement of Operations
December 31, 2018

	2018	2017 <i>(unexamined)</i>
Underwriting Income		
Premiums Earned	\$6,309,168	\$5,747,107
Deductions		
Losses incurred	2,361,583	1,715,360
Loss adjustment expenses incurred	1,324,968	1,462,352
Other underwriting expenses incurred	1,098,071	1,027,340
Total underwriting deductions	4,784,622	4,205,052
Net underwriting gain	1,524,546	1,542,055
Investment Income		
Net investment income earned	313,977	333,673
Net realized capital gains	(13,040)	120,977
Net investment gain	300,937	454,650
Other Income		
Dividends to Policyholders	1,822,017	2,059,026
Federal income taxes incurred	(117,597)	(313,062)
Net Income	\$121,063	\$250,741

NCHE Workers' Compensation Fund, Inc.
Statutory Statement of Surplus
December 31, 2018

	2018	2017 <i>(unexamined)</i>
Surplus, beginning of year	\$5,062,642	\$4,600,442
Net Income	121,063	250,741
Change in net unrealized capital (losses) or gains	(341,490)	192,500
Change in net deferred income tax	2,823	2,639
Change in non-admitted assets	(278,479)	16,320
Change in surplus as regards policyholders for the year	(496,083)	462,200
Surplus, end of year	\$4,566,559	\$5,062,642

NCHE Workers' Compensation Fund, Inc.
Statutory Statement of Cash Flow
December 31, 2018

	2018	2017 <i>(unexamined)</i>
Cash (Used By) Operations		
Premiums collected net of reinsurance	\$5,720,126	\$5,681,977
Net investment income	548,246	602,598
Total	6,268,372	6,284,575
Benefit and loss related payments	1,588,838	2,465,851
Commissions, expenses paid and aggregate write-ins	2,513,160	2,408,916
Dividends paid to policyholders	2,181,680	2,821,277
Federal income taxes paid	85,000	391,413
Total	6,368,678	8,087,457
Net cash (used by) operations	(100,306)	(1,802,882)
Cash (Used By) From Investments		
Proceeds from investments sold, matured, or repaid	2,249,095	4,341,965
Cost of investments acquired	2,341,635	2,532,508
Net cash (used by) from investments	(92,540)	1,809,457
Cash From Financing and Miscellaneous Sources		
Other cash provided	20,525	1,719
Net cash from financing and miscellaneous sources	20,525	1,719
Reconciliation of Cash and Short-Term Investment		
Net change in cash and short-term investments	(172,321)	8,294
Cash and short-term investments, beginning of year	1,290,051	1,281,757
Cash and short-term investments, end of year	\$1,117,730	\$1,290,051

COMMENTS ON FINANCIAL STATEMENTS

There were no changes to the Fund's financial statements, and there were no proposed adjustments to surplus as a result of this examination.

Basis of Presentation and Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the basis of the accounting practices prescribed or permitted by the Department.

The more significant accounting policies followed by the Fund are as follows:

Bonds: Bonds not backed by other loans are stated at amortized cost using the interest method. The Fund has no non-investment grade bonds.

Common Stocks: Common stocks are stated at fair value.

Cash and Cash-Equivalents: Carried at amortized cost (which approximates fair value) and includes money market instruments.

Premiums: Insurance premiums, net of premiums ceded to reinsurers, are earned over the terms of the policies. The portion of direct premiums written applicable to the unexpired terms of the policies is recorded as unearned premium. Premiums are earned on a pro rata basis.

Reinsurance: Premiums, commissions, expense reimbursements, and reserves are reported for on a basis consistent with the original policies issued and the terms of the reinsurance agreements. Premiums ceded are reported as a reduction of premium income. Losses and loss adjustment expenses are reported as reductions of those items.

Non-admitted assets: Certain assets, such as uncollected premiums, are "non-admitted" and are charged against surplus.

Loan-backed securities: Stated at amortized cost. The retrospective adjustment method is used to value all loan-backed securities. The Fund has no non-investment grade loan-backed securities.

Unpaid loss & loss adjustment expense: Includes amounts determined from individual case estimates and loss reports and amounts, based on experience, for losses incurred but not reported.

Analysis of Assets:

The Fund reported uncollected premiums and agent's balances totaling \$278,479 as non-admitted at December 31, 2018.

Reinsurance Activity:

The Fund has an excess of loss contract to minimize its exposure to losses. Reinsurance contracts do not relieve the Fund of its primary obligation to policyholders. Failure of the reinsurers to discharge their obligations could result in losses to the Fund. The Fund utilizes AJG as a reinsurance intermediary to negotiate and obtain reinsurance contracts on its behalf for specifically identified risks.

Direct and ceded premiums written and earned are as follows:

	2018	2017
Direct written	\$ 6,806,718	\$6,188,132
Ceded written	497,550	498,988
Net written	6,309,168	5,689,144
Direct earned	6,806,718	6,246,095
Ceded earned	497,550	498,988
Net earned	\$6,309,168	\$5,747,107

The types of contract and retention limits are described under the Reinsurance Program Overview.

Summary of Reserves:

The following provides a reconciliation of the Fund's reserves for losses and loss adjustment expenses:

	2018	2017
Reserve for losses and loss adjustment expenses, beginning of year	\$ 6,103,821	\$6,113,953
Add:		
Provision for losses and loss adjustment expenses, current year	3,779,871	4,443,421
Change in estimated losses and loss adjustment expenses, prior years	(93,320)	(1,265,709)
Total incurred	3,686,551	3,177,712
Deduct:		
Losses and loss adjustment expenses paid, current year	1,328,504	1,588,434
Losses and loss adjustment expenses paid, prior year	2,470,706	1,599,410
Total paid	3,799,210	3,187,844
Reserve for losses and loss adjustment expenses, end of year	5,991,162	6,103,821
Increase in reserve for losses and loss adjustment expenses	\$112,659	\$10,132

The Fund did not reduce reserves by anticipated salvage and subrogation in 2018 and 2017.

Reserves for losses and loss adjustment expenses are reported net of the amounts that are recoverable under the Fund's reinsurance contracts. At December 31, 2018 and 2017, the liability for losses and loss adjustment expenses was reduced by \$1.3 million and \$1.7 million, respectively, for amounts to be recovered from reinsurers.

Policyholders' Surplus:

The following, in conjunction with the Statutory Statement of Capital and Surplus, represents the changes in the Fund's surplus since the Department's last examination as of December 31, 2013:

	2016	2015	2014
Surplus, beginning of year	\$4,408,698	\$5,475,488	\$5,893,937
Surplus increases (decreases):			
Net income (loss)	294,968	118,007	(143,681)
Change in net unrealized capital gain (loss)	(57,359)	(252,214)	(547,766)
Change in net deferred income tax	(29,545)	(932,583)	57,763
Change in non-admitted assets	(16,320)	-	215,235
Change in surplus as regards policyholders for the year	191,744	(1,066,790)	(418,449)
Surplus, end of year	\$4,600,442	\$4,408,698	\$5,475,488

Contingencies and Commitments:

The Fund is subject to assessments by the North Carolina Self Insurance Security Association to pay claims on behalf of insolvent members of the association. The Fund incurred \$25,978 in assessments during 2018. There is no liability for assessments as of December 31, 2018.

SUBSEQUENT EVENTS

The Fund's Board appointed Chris Lumsden as a new member of the Board in February 2019, to replace Laura Lambeth who resigned from the Board in 2018. Chris Lumsden serves on the Audit Committee.

The Fund purchased specific excess and aggregate excess insurance coverage for workers compensation and employers' liability from Safety National Casualty Corporation effective January 1, 2019. This policy replaces the specific excess workers compensation policy with State National Insurance Company described in the Reinsurance Program Overview section. The specific excess coverage under the contract with Safety National Casualty Corporation remains the same.

Under aggregate excess coverage, the reinsurer will indemnify the Fund for losses of all occurrences, except for any loss that is covered under the specific excess layer described above, once the Fund has reached the amount of \$8,065,503. The reinsurer's maximum limit of indemnity is \$2,000,000 per policy year.

NCHE Workers' Compensation Fund, Inc.
DISTRIBUTION OF REPORT ON EXAMINATION
December 31, 2018

Jannette Mullis, Financial Analyst
Arthur J. Gallagher Risk Management Services
4250 Congress Street, Suite 200
Charlotte, North Carolina 28209

Linwood Jones, Secretary and Treasurer
NCHE Workers' Compensation Fund, Inc.
2400 Weston Parkway
Cary, North Carolina 27513

CONCLUSION

The examination procedures, described, herein, revealed no material adverse findings or adjustments to surplus.

We conclude that the Fund complies with the minimum capital and surplus requirements of GS § 58-47-85 for the kinds of insurance that the Fund has been authorized to write, which is \$352,461.

The courteous cooperation and assistance extended by the officers and employees of the Fund during the examination is hereby acknowledged.

Respectfully submitted,



Ke Xu, CPA, CFE
Chief Financial Examiner
North Carolina Department of Insurance

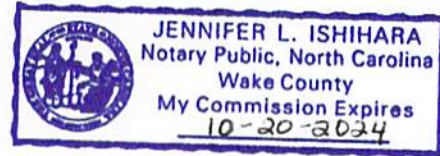
May 12, 2020

STATE OF NORTH CAROLINA

COUNTY OF WAKE

Bill Keely, Examination Supervisor North Carolina Department of Insurance, being first, duly sworn, deposes and says that this report on examination, subscribed by him, is true and correct to the best of his knowledge and belief.

Signature: Bill Keely Date: 5/12/20
Bill Keely



Sworn and subscribed before me this 12th day of May, 2020.

Notary Public Signature: Jennifer L. Ishihara Notary Public Seal: