Report on Examination

of the

Tennessee Health Care Association Selective Workers' Compensation Group

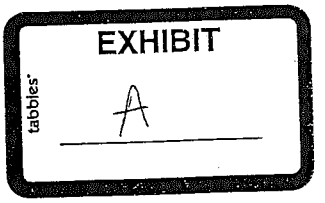
Nashville, TN

as of

December 31, 2003

Department of Commerce and Insurance

State of Tennessee



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Nashville, TN

July 8, 2005

Honorable Paula A. Flowers
Commissioner of Commerce & Insurance
State of Tennessee
Nashville, TN

Commissioner:

Under authority delegated by you and in compliance with your instructions, a financial examination and market conduct review has been made of the condition and affairs of the

Tennessee Health Care Association Selective Workers' Compensation Group
Nashville, Tennessee

(hereinafter generally referred to as the "Group") as of December 31, 2003, and a report thereon is respectfully submitted as follows:

Introduction

This examination was arranged by the Commissioner of the Department of Commerce and Insurance, State of Tennessee, in accordance with Tenn. Code Ann. § 50-6-405 and Tenn. Comp. R. & Regs., 0780-1-54-.06. It was commenced on June 28, 2004, by examiners employed with the Department of Commerce and Insurance. This is the second examination of the Group.

Scope of Examination

The period covered hereunder is from December 31, 1998, the date of the last examination of the Group, to the close of business on December 31, 2003, the date of this examination. The examination was conducted at the office of the Group's administrator, TIS Insurance Services, Inc. ("TIS"), located at 1900 Winston Road, Suite 100, Knoxville, Tennessee 37919 and at the office of the Group's claims service provider, Brentwood Services Administrators, Inc. ("BSA"), located at 104 Continental Place, Suite 200, Brentwood, Tennessee 37027. The Group keeps its Trust Agreement and Declaration of Trust and Bylaws, Indemnity Agreement and Power of Attorney, third-party agreements, trustee and member meeting minutes, member files, correspondence files, bank statements, investment records, excess insurance contract, underwriting, policy issuance, accounting records and audited financial statements at the office of TIS. Records for workers' compensation claims are maintained at the office of BSA.

During the course of the examination, the assets of the Group were verified, and liabilities were determined or estimated as of December 31, 2003, in accordance with procedures as prescribed by Tenn. Code Ann. and Tenn. Comp. R. & Regs., of the State of Tennessee, the National Association of Insurance Commissioners (NAIC), the National Council on Compensation Insurance (NCCI) and Generally Accepted Accounting Principles (GAAP) where applicable. The Group's financial solvency and degree thereof was thus established. Test checks covering selected periods were made of income and disbursement items, and a general review was made of the Group's operations, practices and compliance with Tenn. Code Ann. and Tenn. Comp. R. & Regs., to the extent hereinafter set forth. In order to reduce duplication of examination procedures and to contribute to the efficiency of this examination, the examiners relied upon the work papers of the Group's independent Certified Public Accountant ("CPA") firm, to the extent deemed necessary.

An examination of all asset and liability items contained in the financial statement of this report was made and individual items were verified with relative emphasis according to their amount and significance. An examination was also made into the following matters:

Status of Prior Examination Findings
History and Organization
Trust Agreement and Declaration of Trust and Bylaws
Indemnity Agreement and Power of Attorney
Management and Control
Corporate Records
Management Agreements
Fidelity Bonds
Statutory Deposit
Market Conduct Activities
Excess Insurance Coverage
Loss Experience
Accounts and Records
Litigation, Contingent Liabilities and Subsequent Events
Notes Receivable from Members
Dividends and Refunds
Subsequent Events
Financial Statement

They are discussed in detail as follows:

Status of Prior Examination Findings

The exception conditions and recommendations made in the preceding Report on Examination dated March 4, 2000, which covered the period from April 1, 1992 through December 31, 1998 and the corrective actions taken by the Group are as follows:

(1) The current Indemnity Agreement and Power of Attorney contract between the Group and its members does not reflect the change from Robert M. Sims Company to the TIS Insurance Services, Inc. (TIS) as the Group's administrator. It was recommended that the Indemnity Agreement and Power of Attorney contract be changed to reflect that TIS is now the Group's administrator.

Corrective Action: For the current period under review, the Group complied with the recommendation and revised the Indemnity Agreement and Power of Attorney to reflect TIS as the Group's administrator. However, the revised Indemnity Agreement and Power of Attorney have only been signed by Group Members that joined after the revisions were made.

(2) The Group changed its fiscal year end from March 31 to December 31 effective December 31, 1995. This change did not appear in the Indemnity and Power of Attorney contract. It was recommended that the contract be changed to read that the Group's fiscal year ends on December 31.

Corrective Action: For the current period under review, the Group complied with the recommendation and revised the Indemnity Agreement and Power of Attorney to reflect December 31st as the Group's fiscal year end.

(3) Tenn. Comp. R. & Regs. 0780-1-54-.09(2) reads that, "unless the Commissioner of Commerce and Insurance otherwise permits, the service contract shall state that the service company shall handle to their conclusion all claims and other obligations incurred during the contract period." It was recommended that the claims service contract be amended to comply with Tenn. Comp. R. & Regs.

Corrective Action: For the current period under review, the Group complied with the recommendation and amended the claims service contract with Brentwood Services Administrators, Inc. (BSA) in order to comply with Tenn. Comp. R. & Regs. 0780-1-54-.09(2).

(4) Since the Group's inception, no formal contract has been executed between Tennessee Health Care Association and the Group for royalty payments. It was recommended that a contract be drawn up and executed between both parties.

Corrective Action: During the current period under review, the Group did not comply with the recommendation that a formal contract be executed between Tennessee Health Care Association and the Group for royalty payments. However, on June 17, 2004, a Royalty Agreement was executed between the Tennessee Health Care Association and the Group.

(5) The Group has not obtained regulatory approval for the 1997 and 1998 policy year dividend declarations from the Department of Commerce and Insurance. The Group's Indemnity Agreement and Power of Attorney states that any excess funds distributed to Members or former Members are to be approved by the Department of Commerce and Insurance. It was recommended that all future dividends declared by the Board of Trustees be approved by the Department before any distributions are made to members or former members of the Group.

Corrective Action: The Group did not declare and distribute any new dividends during the current period under review. Although the Group did not declare any new distributions, the Group during the years 1999 through 2002 continued to distribute dividends previously declared for the 1997 and 1998 policy years without the approval of the Department of Commerce and Insurance. Therefore, the Group during the period of review continued to be in violation of Section 10(f) of its Indemnity Agreement and Power of Attorney.

History and Organization

The Tennessee Health Care Association ("THCA") is a Tennessee non profit trade association of licensed nursing homes which was organized in 1947. THCA has been a viable, continuing entity since its inception, and currently includes over 300 nursing homes in Tennessee with more than 32,000 beds. The Group is an unincorporated association that was created by THCA to act as a self-insured workers' compensation group. The operation of the Group is confined to Tennessee where it is licensed to transact the business of workers' compensation and employers' liability insurance. Membership in the Group is composed of qualifying members of THCA that have pooled their liabilities in accordance with the Tennessee Workers' Compensation Act. The Group at year-end 2003 included 27 Members with approximately 2,000 beds. A Member of the Group may have more than one (1) facility covered by the Group.

The Group was created on April 1, 1992, with contributions from the initial members equal to 25% of their first year estimated annual net premium for workers' compensation

coverage (in accordance with Tenn. Comp. R & Regs., 0780-1-54-.04). The Group's primary objectives are to provide sound and economical workers' compensation insurance for its members and to minimize the cost of insurance through specialized claim processing services and loss prevention programs.

The following table reflects the growth and financial history of the Group, since its organization, as shown by its financial statements filed with the Department of Commerce and Insurance:

*Year	Members	Premium Revenue	Total Expenses	Assets	Equity
March 31, 1993	28	$2,213,818	$2,195,181	$1,274,957	$23,251
March 31, 1994	37	3,615,402	3,498,685	2,808,847	133,817
March 31, 1995	33	4,396,109	3,760,034	4,780,546	607,819
December 31, 1995	33	3,235,130	1,438,551	5,532,089	1,934,827
December 31, 1996	41	4,554,362	5,147,304	6,148,562	1,756,683
December 31, 1997	38	3,934,881	2,181,245	8,068,236	1,389,510
December 31, 1998	31	2,468,344	2,268,284	6,426,964	1,099,267
December 31, 1999	28	1,532,302	2,091,574	3,851,743	656,820
December 31, 2000	30	1,748,182	1,920,116	3,347,121	647,623
December 31, 2001	33	1,990,990	2,523,030	3,355,447	326,209
December 31, 2002	30	2,309,555	2,388,233	3,377,295	394,902
December 31, 2003	27	2,787,529	2,567,747	3,967,506	741,766

* The Group changed their fiscal ending from March 31 to December 31 in 1995.

Trust Agreement and Declaration of Trust and Bylaws

The Group was created through the adoption of the Declaration of Trust and Bylaws which was executed on April 2, 1992. The Group was formed to act as a workers' compensation self-insurance group as defined by Tenn. Comp. R & Regs., 0780-1-54-.02 and as authorized by Tenn. Code Ann. § 50-6-405. The Trust Agreement and Bylaws state the purpose of the Group as follows:

> "For the purpose of holding and administering the Fund through which its Members can meet and fulfill their obligations and liabilities under the Tennessee Workers' Compensation Act; to form a workers' compensation self-insurance group pursuant to the Act to provide for workers' compensation coverage and for benefits to employees of its Members; to provide the maximum allowable advance discounts or dividends on premium payments made by Members for workers' compensation

coverage; and to minimize the cost of providing workers' compensation coverage by developing and refining specialized claim services and a loss prevention program within THCA."

The Group is an association which is owned by its Members. Membership in the Group consists of individuals, corporations and partnerships or other legal entities which are members in good standing with THCA and which contribute to the Group as a participating member. The term "Members" includes those individuals, corporations and partnerships executing, or otherwise being bound by, the Indemnity Agreement and Power of Attorney.

Bylaw Amendments During the Period of Examination:

Article IV, Section 4: Election of Trustees; Term of Office (New Language)

> "The Trustees shall be elected by Members of the Trust (Group) with one (1) Trustee elected from each of THCA's geographic districts, with the district having the Board of Director's chairman, having two (2) Trustees. In the event there is no Member from a district, the Board may appoint an interim Trustee from another district. Each trustee shall serve, subject to the provisions of the Article regarding resignation, death, incapacity or refusal to act, for a term of five (5) years."

Article V, Section 2: Meetings of the Members (New Language)

> "The Members shall meet annually at the offices of the Trust (Group) or at such other place and time as may be determined by the Board of Trustees. Special meetings of the Members may be called at any time by the Board of Trustees and shall be called upon the written request of not less than twenty percent of the Members. Written notice of all meetings of the Members shall be delivered not less than ten (10) days or more than thirty (30) days prior to the meeting, either in person or by mail. Members may vote either in person or by written proxy. A quorum at any meeting of the members shall be attended by the representative of not less than ten percent of the Members of the Trust (Group)."

Article V, Section 8: Cancellation Penalty (New Language)

> "In the event that a Member of the program elects to exit the Trust (Group), that Member will be allowed re-entry into the Trust (Group). If a Member exits the Trust (Group), re-enters, and then exits for a second time, re-entry after the second exit will not be allowed until a twenty four (24) month waiting period has elapsed. Any Member exiting the Trust (Group) prior to the expiration of an annual term shall incur a short-rate penalty for cancellation."

The Bylaws previously did not allow re-entry into the Group to an exiting Member until after

a twenty four (24) month waiting period.

Article V, Section 8: Cancellation Penalty (New Language)

> "In the event of cancellation of a Member that is initiated by the Trust (Group), a pro-rata penalty for cancellation shall be applied."

The Group did not notify the Department of Commerce and Insurance of this 2003 By-Law Amendment. This was a violation of Tenn. Comp. R & Regs., 0780-1-54-.04(3). This issue is further addressed in "Recommendations" section of this report.

Article V, Section 9: Aged Receivables Offset by Dividends

> "Aged receivables for Members of the Trust (Group) may be offset by any dividend proceeds after such Members have been notified in writing."

Article VII, Section 1: Miscellaneous

> "This Agreement may be amended in writing at any time by the concurrence of a 2/3rd vote of the Trustees and ratified by a majority of the Members, except that this Agreement may not be amended so as to change its purpose as set forth in Article III above or to permit the diversion or application of any of the funds of the Trust (Group) for any purpose other than those set specified herein. A copy of the approved amendment shall be sent to all Members of the Trust (Group)."

This change provided an opportunity for more involvement by specifying a role for the Members in the process by which the Group's Bylaws are amended.

Indemnity Agreement and Power of Attorney

In accordance with Tenn. Comp. R & Regs., 0780-1-54-.04(2)(e), each Member is required to execute and be bound by an "Indemnity Agreement and Power of Attorney" as a condition of membership in the Group. Significant terms that each member agrees to include the following:

- To assume, pay and discharge any liability of the self-insurance programs of the Group of any and all members, and each member agrees to pay contributions and such assessments as may be required. Without limiting any other rights of the Group, the Department of Commerce and Insurance shall have the right to enforce, on behalf of the Group, of the joint and severally liability of the members under this

agreement and liability in the event of the Group's failure to enforce such obligations made by its members. Provided, the Group's Board of Trustees shall use best efforts, in the event assessments require the performance of the members' joint and several obligations hereunder, to impose such assessments in an equitable manner against all members.

- The members intend for this agreement to establish a mutual covenant of assumption of joint and several liability, provided, however, the relationship of the members with each other and the Group shall not be deemed to form or operate as a partnership for any other purpose except that for which the Group is organized and operated.

- The Board of Trustees may admit as members of the Group only acceptable and financially sound entities, except as otherwise provided by the Regulations. The Board of Trustees will be the sole judge of whether an applying entity shall be admitted to membership and the eligibility of an entity to remain a member.

- The Board of Trustees will promulgate the Rules and Regulations for administering the Group, the expulsion of or suspension of members and, subject to the Regulations, the admission of members. Each member of the Group agrees to abide by such Rules and Regulations.

The revised Indemnity Agreement and Power of Attorney currently in use, as of the date of this examination contains two (2) revisions made as a result of recommendations in the prior Examination Report. The revised agreement designates TIS as the Administrator of the fund, and the Group's fiscal year ending date was changed from March 31 to December 31.

A revised Indemnity Agreement and Power of Attorney with the aforementioned changes was implemented in 2001. Only new Members entering the Group after implementation signed the revised Indemnity Agreement and Power of Attorney. See the "Comments" Section of this Examination Report.

Management and Control

The operation and administration of the Group is the joint responsibility of a Board of Trustees ("Board") consisting of not more than fifteen nor less than five individuals. All

Trustees are required to be residents of the State of Tennessee or officers of corporations authorized to do business in the State of Tennessee which is in accordance with Tenn. Comp. R & Regs., 0780-1-54-.07. At least two-thirds of the Trustees are required to be employees, officers or directors of Members of the Group. No affiliate of the administrator or the service agent shall serve as a Trustee. The Board shall elect officers from among its members to serve for terms of five (5) years.

As of December 31, 2003, the following persons were serving as members of the Board :

Trustee	Occupation
Craig Laman, Chairman	Bells Nursing Home, Bells, TN
Marietta Hardy, Vice Chairman	Obion County Nursing Home, Union City, TN
Russell Caughron, Secretary/Treasurer	Peach Tree Ctr Nursing & Rehab, Smyrna, TN
Don Moneyhun	Bristol Nursing Home, Bristol , TN.
Linda Austin	Knollwood Manor, Lafayette, TN

The initial Board was empowered by the Declaration of Trust and Bylaws and served until the first meeting of the Group. Thereafter, the Board shall be elected by the members of the Group with one (1) Trustee elected from each of THCA's geographic districts and the district having the Board of Director's chairman, having two (2) Trustees. In the event there is no Member from a district, the Board may appoint an interim Trustee from another district. Each Trustee shall serve, subject to the provisions of the Article regarding resignation, death, incapacity or refusal to act, for a term of five (5) years.

A Trustee may resign and be fully discharged from all further duties or responsibilities by giving at least thirty (30) days prior written notice to the Chairman. A Trustee may be removed, with or without cause, by a majority vote of all Trustees. If a Trustee dies, becomes incapacitated, refuses to act, resigns or is removed, his successor shall be appointed by the remaining Trustees to fill the unexpired term of office.

On December 4, 2001 the Board approved, for the first time, Member Cancellation Procedures for the Group effective January 1, 2002.

Responsibilities of the Board as stated in the Bylaws include the following:

- The Trustees shall be responsible for all monies collected or disbursed by the Group and for the segregation of all monies into the claims fund account and the administrative fund account.

- The Trustees shall receive applications for membership from prospective new members of the Group and shall approve or disapprove such applications in accordance with rules promulgated by the Trustees.

- The Trustees shall be responsible for establishing such trusts, loss funds, or other funds as may be required from time to time by the Rules or as may be established by the Trustees from time to time.

- The Trustees shall be responsible for and shall undertake the posting of such security deposits and/or security bonds as may be required to be posted with the Department of Commerce and Insurance.

- The Trustees shall be responsible for and shall cause to be filed with the Department of Commerce and Insurance and elsewhere such annual or other periodic audits, reports and disclosures as may be required from time to time by applicable federal or state statutes or governmental regulations.

- The Trustees shall take all necessary precautions to safeguard the Trust and the other assets of the Group including designating the administrator and the service agent of the Group.

Corporate Records

The Board shall meet quarterly or as often as required, at the principal office of the Group or at such other location as may be acceptable to the Board. Special meetings of the Board may be called at any time and may be by telephone conference calls or other methods of communication by which all Board members participating may simultaneously hear each other, or written consent in lieu of meetings may be executed by mail. The Members of the Group shall meet annually at the offices of the Group or at such other place and time as may be determined by the Board. During the period under examination there were eight (8) regular meetings and one (1) informal meeting (by mail ballot) of the

Board and five (5) meetings of the Members of the Group. The minutes of the meetings were reviewed and appear to reflect properly the acts of the respective bodies. Membership requirements, powers and duties of Board members and Group Members were verified to be in accordance with Tenn. Comp. R. and Regs., 0780-1-54-.07. The "Subsequent Events" section of this report on page 35 contains comments about outside control and influence on the Group by their sponsoring association.

Conflict of Interest Policy:

The Group does not have a Conflict of Interest Policy for its Board of Trustees.

Pecuniary Interest:

Due to the waiver provided by Tenn. Comp. R. and Regs., 0780-1-54-.01, the Group was not subject to Tenn. Code Ann. § 56-3-103.

Management Agreements and Policies

Administration Agreement:

On June 28, 1995, an "Administration Agreement" was reached between TIS (the Administrator) and the Group. Prior to this date the Group had an "Administration Agreement" with the Robert M. Sims Company beginning April 1, 1992. The Board of Trustees of the Group has engaged the Administrator (TIS) to act as the administrator of the Group within the meaning of Tenn. Comp. R. and Regs., 0780-1-54-.02(1), to carry out the policies established by the Board of Trustees and provide daily management of the Group, to the extent such functions are not performed by the service company. TIS shall provide the following services for the Group under the "Administration Agreement":

- Maintaining in effect the certificate of approval issued to the Group by the Department of Commerce and Insurance
- Maintaining the accounting books and records and arranging for an annual audit of the Group by independent certified public accountants
- Soliciting applications for membership in the Group and screening prospective members in accordance with standards adopted by the Board.

- Preparing all reports furnished to the Members
- Providing all clerical, secretarial and administrative support
- Receiving the premiums paid by the Members
- Depositing the premiums in the claims fund account
- Administering and investing the claims fund and the administrative fund in accordance with criteria established by the Board
- Preparing an annual budget and paying for reasonable expenses
- Negotiating on behalf of the Group with the service company
- Directing the daily operations in cooperation with the Service Company to insure that the operations are conducted in a sound business like manner

TIS shall be paid annually by the Group. As of the examination date, the fee for this service was 0.36 per $100 of payroll, adjusted year-end, and based on audited payrolls. The amount charged by TIS shall be approved by the Group's Board.

TIS shall furnish to the Group's Board audited financial statements on or before 120 days after the end of the fiscal year and unaudited financial statements for each quarter on or before 45 days after the end of each fiscal quarter. These reports shall include known claims and expenses, claims incurred but not reported, unearned premiums, and bad debts.

The Group may terminate the Agreement with TIS without cause upon 90 days written notice or with cause immediately upon written notice to TIS. TIS may terminate the Agreement without cause upon 90 days written notice to the Group or with cause upon written notice to the Group.

The "Administrative Agreement" under heading # 5, "Agents", empowers TIS to execute agreements on behalf of the Group with accountants, attorneys, brokers, investment advisors and agents, subject to the approval of the Board. However, it was not apparent during the examination period which TIS employees had the authority to execute agreements on behalf of the Group. This issue is further addressed in the "Comments" section of this report.

Claims Service Agreement:

On April 1, 1992, the Group entered into a claims service contract with "BSA". This agreement was in effect until a revised contract went unto effect June 28, 1995. Attachment C of the contract was amended January 7, 1998, to update the fees for services provided. The major services stated in the contract that BSA is to provide is as follows:

- Provides claims handling and loss prevention services that are outlined in Attachment A to the contract.
- Maintains adequate General Liability, Automobile Liability, Workers' Compensation, Fidelity Bond and Errors and Omissions Insurance Coverage.
- Agrees to indemnify, defend and hold harmless the Group with respect to any claims asserted as a result of any errors, omissions, torts, intentional torts or other negligence on the part of BSA and/or its employees and subcontractors; the Group also agrees to indemnify, defend and hold harmless BSA with respect to the aforementioned and any violations of state laws, or negligence on the part of Group and/or its employees.
- Furnish the Group a claims activity loss run quarterly.
- Funds will be available for BSA to draw from at any time and from time to time for claim and/or loss payments and for associated allocated expense; BSA will also make a reasonable and timely accounting to the Board according to normal and customary business practices at the request of the Board (Allocated expenses are outlined in attachment B).
- BSA and the Group mutually agreed that upon contract termination, the Group shall have one of the following options:

  A. Require BSA to return all open files and BSA will be entitled to payment for all services rendered up to that time or,

  B. Require BSA to adjust and handle to a conclusion all open claims on a time and expense basis at its then prevailing time and expense rate

- Both parties agree that this contract shall be interpreted and construed in accordance with the laws of the State of Tennessee.

- This contract represents the entire understanding of BSA and the Group, supersedes all prior oral and written communications between the parties as to the subject matter; and neither this contract nor any provisions of it may be amended, modified or waived except in writing signed by a duly authorized representative of BSA and the Group.

As of January 7, 1998 and thereafter, the Group will pay BSA an annual fee for claims administration and loss prevention. The fee schedule is as follows: 1998 and year-to-year thereafter unless renegotiated, 0.45 per $100 of payroll, adjusted year-end; and based on audited payrolls.

The "Claims Service Contract" between the Group and BSA is effective for the remainder of calendar year 1995, calendar year 1996 and year to year thereafter unless terminated as hereafter provided. The contract may be terminated by the Group without cause upon ninety (90) days written notice to BSA, or immediately with cause upon written notice to BSA. BSA may terminate the contract without cause upon ninety (90) days written notice to the Group or with cause upon written notice to the Group.

In March 2001 TIS and BSA signed an addendum to section seven (7) of the Claims Service Contract in response to a recommendation from the prior Examination Report (Item 3 in the "Status of Prior Examination Findings" section of this report). This addendum noted, subject to the approval of the Commissioner, upon termination of the Claims Service Contract the option was given A) of requiring BSA to return all open files and compensating BSA for all services rendered up to that time or B) requiring BSA to adjust to conclusion all open claims at its then prevailing time and expense rate.

Furthermore, BSA performs certain claims cost reviews and medical case management functions for the Group. Additionally BSA contracts with other vendors who provide similar services for the Group.

Royalty Agreement:

Beginning April 1, 1992 through 1997, the Group paid royalty fees to the THCA Association equal to 2% of earned premiums. This fee obligation was addressed in the minutes of the June 28, 1995, Board's meeting. At the January 7, 1998, Board of

Trustees meeting, a motion was passed that beginning January 1, 1998, the royalty fee was to be based on 0.12% of Members' payroll. These fees are paid to THCA for its sponsorship of the Group.

For the period under review, there was no formal contract entered into between the Group and the THCA per the current royalty agreement. It was recommended in the prior Examination Report as of December 31, 1998 that such a contract be drawn up and executed between the THCA and the Group. Subsequent to the examination period, on June 17, 2004, the Group executed a Royalty agreement with the THCA.. See the "Subsequent Events" section of this report for compliance by the Group.

Investment Policy:

The Board adopted an investment policy for the Group during their June 28, 1995 meeting. The policy states that TIS will exercise ordinary care and judgment, taking into consideration existing economic conditions in the management of the Group's cash assets. It further states that TIS will make investment decisions after careful consideration is given to investment return versus safety of the investment instrument and in consultation with the Executive Director of THCA and the Group's Chairman of the Board. The policy outlines the types of investments that are approved by the Board. The investments outlined in the policy are in direct agreement with the limitations established by Tenn. Comp. R. & Regs., 0780-1-54-.14. The Group's investment practices, as performed by their investment manager Highland Capital Management Corp, appear to follow the guidelines as established by the investment policy.

Investment Advisory Agreement:

The Group was a party to an investment advisory agreement with Highland Capital Management Corp. (Investment Advisor) that was in effect during the period of examination. The agreement that was executed and signed by TIS on September 2, 1996 gives the Investment Advisor discretion to supervise and direct, on a continuing basis, as agent and attorney-in-fact on behalf of the Group without prior consultation, the investment

and reinvestment of all assets, subject to the limitations, needs and objectives imposed by the Group. The agreement includes a schedule of compensation which was reviewed as part of the examination and was determined to be reasonable. The agreement appears to be valid; however there is a question as to what guidance was given by the Group as to investment limits, needs and objectives. This issue is further addressed in the "Comments" section of this report.

Custodial Agreement:

The Group was party to a custodial agreement with First Tennessee Bank National Association (First Tennessee) that was in effect during the period of examination. The agreement appointed First Tennessee as the custodian of property deposited by the Group, the investment and reinvestment of which is managed by their Investment Advisor. The custodial agreement was executed and signed by TIS on September 2, 1996 in the name of the THCA. Although this agreement met Tenn. Comp. R. & Regs. in effect during the period of examination for Self-Insured Workers' Compensation Pools, there were several issues to include the proper listing of the Group's name as the "Tennessee Health Care Association – Selective Workers' Compensation Group" on the custodial agreement and the non-admittance of the Group's custodian held assets that are further addressed in the "Subsequent Events", "Comments" and "Addendum" section of this report.

Fidelity Bonds

TIS and BSA are required to maintain, at all times, a fidelity bond in a form and amount prescribed by the Commissioner as listed in Tenn. Comp. R. & Regs., 0780-1-54-.04(2)(f) and (2)(g). Tenn. Comp. R. & Regs. require fidelity bonds be written by a bonding company licensed to do business in the State of Tennessee and provide coverage in an amount satisfactory to the Commissioner. As of the examination date, TIS maintained fidelity bonding coverage with Federal Insurance Company for Directors and Officers Liability ($1,000,000 aggregate limit), Fiduciary Liability ($1,000,000 aggregate limit),

Internet Liability ($1,000,000 aggregate limit), Employee Dishonesty ($500,000 limit) and Forgery or Alteration ($250,000 limit). BSA maintained fidelity bonding coverage with Illinois Union Insurance Company that provides coverage for Directors and Officers Liability ($2,000,000 aggregate limit). Illinois Union Insurance Company was an approved foreign surplus lines company in Tennessee. BSA, also, maintained Employee Theft ($5,000,000 aggregate limit) with Fidelity Deposit Company of Maryland and Fiduciary Liability ($2,000,000 aggregate limit) with Executive Risk Indemnity, Inc.

The Group had coverage for Trustees Errors and Omissions Insurance for Self-Insurance Funds through Landmark American Insurance Co. from January 1, 2003 through January 1, 2004. The Liability Limit was $2,000,000 per occurrence, subject to $2,000,000 policy aggregate. There was a $10,000 deductible for any one act and a $20,000 aggregate deductible. The 2003 and 2004 policies were retroactive to occurrences that took place on or after April 1, 1992. All companies providing fidelity coverage are licensed to do business in the State of Tennessee or are an approved foreign surplus lines company in Tennessee.

Statutory Deposit

Pursuant to Tenn. Comp. R. & Regs., 0780-1-54-.04(2)(b), workers' compensation groups are required to maintain either a security deposit, a surety bond, or a financial security endorsement on file with Department of Commerce and Insurance in an amount approved by the Commissioner in order to obtain and maintain self-insured status. The Group has satisfied this requirement by obtaining a surety bond with Safety National Casualty Corporation, a corporate surety company authorized to transact business in the State of Tennessee. The amount of the bond is prescribed by the Commissioner and is based on factors such as size, years in existence, and types of employment. The surety bond with Safety National Casualty Corporation provides $250,000 in coverage which shall be used by the State for the sole purpose of paying workers' compensation claims and associated expenses, if the Group fails to pay the benefits in which it is legally obligated to pay.

Market Conduct Activities

Underwriting:

The Group utilizes the services of TIS (formerly Tennessee Insurance Services, Inc.) to assist with premium underwriting guidelines of its members. Casualty Actuarial Consultants, Inc., Brentwood, TN, assists with the rating and actuarial projections used by the Group. The Group used the following underwriting guidelines for its Members:

- Five year loss ratio less than 70% (Exceptions may be made for a large loss that is not expected to reoccur)
- Experience Modification Factor of 1.30 or less
- Minimum premium of $25,000
- Loss runs for the last five (5) years must be provided
- All Members must submit to a formal loss prevention program
- Members or potential members must have acceptable financial statements
- Potential members must have been in business at least three (3) years
- Excess insurance company must approve a potential member before it can join the Group
- Potential member must be submitted to State of Tennessee for approval before it can join the Group
- Potential member of the Group must be a member of the THCA
- Final approval of membership is the responsibility of the Board.

During the period of examination, the Group's Board made questionable decisions in its underwriting of three (3) Members: Community Eldercare Services, LLC, Continuum Care Corporation and Home Quality Management. This issue is addressed in the "Comments" section of this report.

Rating:

Examination procedures included verification of the Group's use of approved rating procedures and manuals during the period of examination. The method and setting of rates during the period of examination were in accordance with the rating procedures published by NCCI, with two (2) exceptions:

1) The Group applied a "loss credit" when calculating its Members' premiums. All Members in the Group received a 5% "loss credit". Some Members received an additional 5% to 15% "loss credit" based upon their loss history for the preceding three (3) years. The NCCI premium formula does not include a "loss credit" as a factor in order to determine workers' compensation premium. Therefore, the Group did not calculate individual Members' premiums in accordance with Tenn. Comp. R. & Regs., 0780-1-54-.15(1) and NCCI guidelines. (See the "Recommendations" section of this Report.)

2) Three (3) officers from three (3) Group Members were improperly excluded from the calculation of 2003 premiums. The Group did not properly account for Officer's Payroll for three (3) Members while calculating the estimated and actual 2003 policy year premium amounts. During the Member File Review the examiners discovered that these three (3) Members did not file I-6 Forms with the Tennessee Department of Labor in order to receive an officer's exclusion in accordance with Tenn. Code Ann. § 50-6-104(c). (See the "Recommendations" section of this Report.)

The Group's Loss Cost Multiplier (LCM) was set at 2.143 in 2003 and 2.374 in 2004 based upon actuarial estimates using historical results of the Group's losses since inception. These LCM amounts in 2003 and 2004 were higher than the weighted average LCM of the voluntary market in Tennessee and the LCM for the State of Tennessee's Assigned Risk Plan due to the unique nature of Workers' Compensation coverage in Tennessee for nursing homes and the characteristics of the Group's Members.

Before the beginning of the policy year the Group's Members submit estimated

payroll amounts. The Group then applies experience modification adjustments, premium volume discounts and loss ratio credit discounts to amounts derived from applying premium factors for specific class codes to estimated payroll dollars to calculate a Member's annual premium. After the end of the policy year the Group uses the same premium formula but inserts actual audited Member payroll into the formula instead of estimated payroll to determine a final premium amount. Differences in estimated and actual audited premium are settled after all audit disputes are resolved. *(NOTE: The Group uses Table 7, Type A, Carriers Premium Discount Table which is specifically designated for "assigned risk plan" participants in Tennessee.)*

On July 15, 2003 the Group's Board approved new premium payment terms effective January 1, 2004. The Member will be required to pay a 10% deposit due at the beginning of the policy year, with nine (9) equal installments due the first of every month thereafter, ending in October.

Forms:

A signed completed application, Board approval letter and Indemnity Agreement and Power of Attorney are provided to the Department of Commerce and Insurance for approval before entry into the Group and for evidence of membership and coverage. Examination procedures included verification of the Group's use and proper execution of approved forms for each of its members.

Upon approved entry into the Group, "New Members" received a certificate of insurance, premium rating calculation form, premium invoice, claim filing information, forwarded by BSA. However, Members were not provided an operation manual that outlined all benefits provided; the calculation, billing, audit and dispute of premiums; and the Group's dividend policy. These benefits and procedures are normally listed on a standard workers' compensation policy form. Failure to provide a Member a dividend refund plan upon application for membership is a violation of Tenn. Comp. R. & Regs., 0780-1-54-.16(2). See the "Recommendations" section of this report for further discussion.

Claims:

The Group's practices pertaining to the handling of loss settlements were reviewed by sampling both open and closed claim files. The sample consisted of claims paid, unpaid claims and those in litigation. The review disclosed that the Group settled its claims promptly after receipt of the necessary documents and in accordance with policy provisions and the Tenn. Code Ann.

Policyholder Complaints:

The Group does not have any formal written complaint procedures or maintain a formal complaint register. Inquiries made to the Consumer Insurance Services section of the Department of Commerce and Insurance indicated no regulatory concerns with the Group during the period under examination.

Disputed claims or questions concerning workers' compensation benefits can be addressed to a Workers' Compensation Specialist with the Tennessee Department of Labor and Workforce Development.

Privacy:

The Group is not subject to Tenn. Comp. R. & Regs., 0780-1-72 due to the waiver provided by Tenn. Comp. R. & Regs., 0780-1-54-.01.

Anti-Fraud Plan:

As of December 31, 2003 the Group has in place an Anti-Fraud Plan that complied with the Tennessee Workers' Compensation Reform Act of 1996.

Excess of Loss Insurance

In accordance with Tenn. Comp. R. & Regs., 0780-1-54-.04(2)(c), an excess of loss agreement with Safety National Casualty Corporation was entered into effective April 1,

1992, to limit the liability of the Group for workers compensation and employers liability claims. The agreement limits the Group's obligation for losses and claim expenses. There have been several policies in effect for the period under review all with the same carrier with some differences in retention and levels of loss share. The policy that was in effect on the date of the examination limits the Group's specific liability to a statutory maximum limit of indemnity per occurrence with the employer's liability maximum limit of indemnity per occurrence set at $1,000,000 and a self-insured retention of $350,000 per occurrence. As of December 31, 2003, aggregate excess insurance attaches at 103% of the loss fund or $2,812,811.00 with the maximum limit of indemnity of the carrier for policy period set at $5,000,000.

The increase in the specific retention amount from $300,000 to $350,000 and the reduction in the aggregate maximum limit of indemnity to $5,000,000 from statutory during the period of examination has increased the Group's risk of paying more for workers' compensation claims for a given policy year. As of December 31, 2003, the Group's reported surplus was $741,766. Therefore, there is an increased risk of a reduction in surplus or a potential surplus deficit.

The policies provide coverage for losses sustained by the Group as a result of injury by accident occurring during the policy period or by disease caused or aggravated by exposure to conditions causing the disease occurring during the policy period. The policies have a modified aircraft exclusion endorsement and provisions for the continuation of coverage in the event the Group becomes insolvent. In addition, the policies contain an endorsement for coverage of any voluntary non-compensated employees of the Members of the Group. The policies were underwritten by a company authorized to do business in Tennessee and the policy forms in use were verified to have been filed with and approved by the Department of Commerce and Insurance.

Since their April 1, 1992 inception date, the Group experienced no accident years or specific claims for which the actual ultimate incurred losses exceeded the aggregate or specific retention levels, respectively under the terms of their Workers' Compensation Excess Insurance Policy with Safety National Casualty Corporation.

Loss Experience

The following table depicts the ratio of incurred losses valued as of June 30, 2004, to earned premium revenue for the periods indicated below:

Incurred Losses and Underwriting Ratio Table

Fiscal Year Ending	Premiums Earned	Incurred Losses as of 4/30/2004	Underwriting Ratio
MARCH 31,1993	2,202,246	1,439,208	65%
MARCH 31, 1994	3,615,271	1,354,415	37%
MARCH 31, 1995	4,378,913	1,620,204	37%
DECEMBER 31, 1995	3,200,600	1,343,877	42%
DECEMBER 31, 1996	4,481,230	1,405,002	31%
DECEMBER 31, 1997	4,045,996	1,612,536	40%
DECEMBER 31, 1998	2,469,767	1,396,349	57%
DECEMBER 31, 1999	1,553,788	1,001,516	64%
DECEMBER 31, 2000	1,741,784	1,354,263	78%
DECEMBER 31, 2001	1,960,445	1,350,205	69%
DECEMBER 31, 2002	2,307,635	1,364,383	59%
DECEMBER 31, 2003	2,828,929	2,057,077	73%

Note: The Group changed its fiscal year from ending March 31 to December 31 during the calendar year 1995

Accounts and Records

Financial Records:

Financial records and reports are maintained and produced by TIS with input provided on claims account management from BSA. The Group's principal accounting records are maintained primarily by a computerized accounting program. Accounting records are produced from various source documents including cash receipts, cash disbursements, journal entries and other specific entry documents. The Group contracts with an independent actuarial firm to periodically perform an evaluation of loss and loss expense reserves. The Group retains an independent accounting firm to compile the financial statements and to prepare the federal income tax return.

During the course of this examination, such test and audit procedures were

performed as were deemed necessary to verify the accuracy of the Group's accounts and records for the period under examination. General ledger trial balances were reconciled with the financial statements and all were reviewed for completeness of disclosure and conformity to GAAP as currently permitted by the Department of Commerce and Insurance.

The accounts and records examined conform to the above requirements and in general appear to reflect properly the operations of the period under examination and the status of the Group as of the date of examination, except as otherwise commented upon in this report. Minor discrepancies were noted during reconciliation of the 2002 financial statement with the 2002 general ledger and trial balance. This issue is further addressed in the "Recommendations" section of the report.

Member Files:

All sixty-two (62) of the former and current Group Member files, which included ninety-five (95) Member owned facilities were reviewed for accurate disclosure of addition and cancellation information to the Department of Commerce and Insurance. The following problems were noted:

- The Department of Commerce and Insurance was not notified of the cancellation of five (5) former Members.
- The Department of Commerce and Insurance was not notified of the addition of two (2) former Members.
- The Group did not have any Member file information for a former Member based upon Department of Commerce and Insurance records.
- The effective dates of four (4) of the Group's former Members did not match Department of Commerce and Insurance records.
- The effective date of one (1) of the Group's current Members did not match Department of Commerce and Insurance records.
- The cancellation dates of two (2) of the Group's former Members did not match Department of Commerce and Insurance records.
- The Federal Employee Identification Numbers (FEIN #) of six (6) of the Group's former Members did not match Department of Commerce and Insurance

records.

- The FEIN # of one (1) of the Group's current Members did not match Department of Commerce and Insurance records.

Group Member Files including Fourteen (14) current and fourteen (14) former Members were reviewed for complete execution of all documents and disclosure of all required information to the Department of Commerce and Insurance. The following problems were noted:

- Applications for two (2) of the Group's former Members were not signed..
- The Board letters granting approval for membership in the Group were not signed in five (5) instances.
- The Indemnity Agreement and Power of Attorney documents in six (6) instances were unsigned by either the Member or the Board of Trustees.
- There were five (5) past Members and one (1) current Member that did not have a copy of their financial statements required to be submitted at the time of application to the Group in their Member File.

These issues are further addressed in the "Recommendations" section of the report.

Litigation, Contingent Liabilities and Subsequent Events

The Group is named as defendant in various legal actions arising from workers' compensation claims. The Group upon estimating the reserves for losses and loss adjustment expenses considers these legal actions. From the data made available during the course of this examination, it would appear that the Group had no matters of pending litigation which would adversely affect its financial condition at December 31, 2003. The Group reported that it had no other agreements or pending matters of contingent nature that would materially affect its financial position or operating results at December 31, 2003.

Dividends and Refunds

Pursuant to Tenn. Comp. R. & Regs., 0780-1-54-.16, self-insured workers'

compensation pools are allowed to provide refunds to the members of the pool when there is an excess amount of premium above what is necessary to fund all obligations for that fund year. The Board must declare the refund not less than 12 months after the end of the fund year; and if the refund is declared, 10% of the refundable amount must be retained by the pool for an additional one year period in order to cover any claims obligations that may not yet have been reported or developed. The following table is a summary of the dividend refunds declared since the inception of the Group:

Year of Declaration	Amount of Dividend Declared
1996	$2,262,758
1997	2,695,019
1998	750,000
Total Policy Holder Dividends Declared (all years)	$5,707,777

Section 10(f) of the Group's Indemnity Agreement and Power of Attorney state as follows:

> "After payment of claims and claim expenses and after provision has been made for open claims, including reported but unpaid claims and incurred but not reported claims, any contingency reserve required by the Regulations and the costs and expenses described in the proceeding subparagraphs, the Board may set aside such portion of any excess funds arising in any fiscal year as they, by resolution, find appropriate for the purpose of establishing and managing an additional reserve fund used for the benefit of this Group. *Any remaining amounts of such excess funds shall be distributed to Members or former Members in such manner as the Board may deem equitable, subject, however, to approval of any such distribution by the Department of Commerce and Insurance.* (Emphasis added)"

According to the records on file with the Department of Commerce and Insurance, approval for the 1997 and the 1998 dividend distributions were not obtained by the Group.

During the current period under review, the Group did not declare and distribute any new dividends since the 1998 policy year dividend declaration. Therefore, the Group is in compliance with the previous Report on Examination recommendation. However, the Group during the years 1999 through 2002 distributed dividends previously declared in 1997 and 1998 without the approval of the Department of Commerce and Insurance. Therefore, the Group during the period of review continued to be in violation of Section

10(f) of its Indemnity Agreement and Power of Attorney. This issue is further addressed in the "Status of Prior Examination Findings" section and also the "Comments" section of this report.

Notes Receivable from Members for Premiums

During 2002, the Group requested and received promissory notes totaling $472,364 from three (3) Members with large past due premium receivable balances. Accordingly, the premium balances due from these Members, including certain accrued finance charges, were reclassified and recognized as notes receivable balances. Of these notes, two (2) accrues interest based upon the prevailing prime rate plus 2% and the third note specifies a fixed rate of 7.75%. Interest accrues daily and finance charges accrue as applicable. Original repayment periods for these notes were estimated to range from approximately 24 to 48 months, based on scheduled payments of $5,000 per month.

When circumstances indicate that a premium or note receivable balance from a Member is potentially uncollectible, and the balance is not otherwise collateralized, management recognizes a bad debt expense by recording a provision for uncollectible receivables. This provision may be increased or decreased as the payment history of the Member develops. Amounts deemed totally worthless are written off.

As of December 31, 2003 the Group had outstanding Notes Receivable from Members for Premiums balances of $307,800 as noted on the 2003 Audited Financial Statement. The Group recognized a bad debt expense by recording a provision for uncollectible receivables in the amount of $240,000 on the 2003 Audited Financial Statement. However, as a result of this examination, an adjustment to this amount has been made. See the "Assets" section of the "Financial Statement" and the "Recommendation" section of this report for justification.

Furthermore, the Group did not receive approval from the Commissioner for two (2) out of the three (3) aforementioned promissory notes in accordance with Tenn. Comp. R. & Regs., 0780-1-54-.07(2)(a). Reference the "Recommendations" section of this report for further discussion of this issue.

Subsequent Events

1. The Group's Custodial Agreement in effect as of year-end 2003 specifically stated that First Tennessee Bank National Association held investments on behalf of THCA rather than the Group. Subsequent to the December 31, 2003 date of examination the Group executed a new custodial agreement with First Tennessee Bank that properly reflects the Group as the account holder. This new custodial agreement was signed and executed with a November 9, 2004 effective date by and between the Group, First Tennessee Bank and the Group's Investment Advisors.

2. Since the Group's inception, no formal contract had been executed between THCA and the Group for royalty payments. It was recommended in the prior examination report as of December 31, 1998 that a contract be drawn up and executed between both parties. During the current period under review, the Group did not comply with the recommendation that a formal contract be executed between THCA and the Group for royalty payments. However, subsequent to the December 31, 2003 examination date, a Royalty Agreement was executed on June 17, 2004 between the THCA and the Group.

3. Effective July 1, 2004 Tenn. Code Ann. § 50-6-405(c)(1) was amended by deleting the first sentence in its entirety and substituting instead the following language: "With the permission of a trade or professional association board of directors, ten (10) or more employers of the same group may enter into agreements to pool their liabilities under this chapter for the purpose of qualifying as self-insurers. Such pool and agreement shall only continue as long as the sponsoring association's board of directors deems that such pool is operating in compliance with the sponsoring association's constitution, bylaws, and procedures and applicable state statutes and regulations". It appears that the sponsoring association as a result of the law change may be able to exert more control over the operation of the Group.

4. The Group in 2004 applied a "loss credit" when calculating its Members' premiums in violation of Tenn. Comp. R. & Regs., 0780-1-54.15(1) and NCCI guidelines. As a result,

the Group collected approximately $274,442 less premium in 2004 from its Members based upon 2004 Member payroll estimates. This issue is further addressed in the "Recommendations" section of this report.

5. The Department of Commerce and Insurance considered a request via an October 11, 2004 and a January 6, 2005 letter from the Group to allow it to continue to apply a "loss credit" to each member's premium calculation formula and continue to deviate from NCCI guidelines for the 2005 policy year. A March 3, 2005 letter from the Assistant Commissioner for Insurance granted approval to apply a "loss credit" to each member's premium calculation formula and deviate from NCCI guidelines only for the 2005 policy year. The March 3, 2005 letter also stated future requests for deviation from NCCI rules must be submitted 30 days in advance of any offering of coverage for the 2006 plan year or beyond and must be authorized by the Commissioner.

6. In July of 2004 one of the Group's Members, Community Eldercare Services, LLC filed for Federal Bankruptcy protection under Chapter 11 of the Federal Bankruptcy Code. As of December 31, 2003 Community Eldercare Services, LLC had an outstanding balance on a Promissory Note payable to the Group. This balance was still outstanding at the time Community Eldercare Services, LLC filed for bankruptcy

7. Three (3) of the Group's Members had not made their regularly scheduled dues payments to THCA in 2004. Two (2) of these Members of the Group lost their membership with the THCA in 2004 due to non-payment of dues. Article I of the Group's "Trust Agreement and Declaration of Trust and By-laws" requires that a Member "be in good standing of THCA". Also, the Group's underwriting guidelines require membership in the THCA. Furthermore, this appears to be a violation of Tenn. Comp. R. & Reg., 0780-1-54.02(8)(b).

8. The Group did not abide by its cancellation policy in the case of two (2) Members in 2004. Community Eldercare Services, LLC and Community Living Centers, LLC as of December 23, 2004 both had premium balances over 90 days past due. The

Group's cancellation policy specified that if premium payments were not received during the first 30 days of the month that payment was due the Member would be cancelled effective on the 30th of the month. Notification of Group membership cancellation was to be delivered via certified letter sent on the 20th day of the month that the premium was due.

Financial Statement

There follows a balance sheet and a statement of operations as of December 31, 2003, together with a reconciliation of members' equity, as established by this examination.

Balance Sheet

Assets:	
Investments: Available-for-sale debt securities, at fair value	$ 3,663,477
Cash and cash equivalents	36,259
Accrued investment income	35,448
Premiums receivable from members	149,457
Notes receivable from Members for premiums, net of allowances for uncollectible amounts in 2003 -$260,064 and 2002 - $185,000	47,736
Prepaid expenses	6,738
Refundable federal income taxes	695
Special Code Section 847 federal income tax deposits	7,632
Total assets	$ 3,947,442
Liabilities:	
Reserves for losses and loss adjustment expenses	$ 2,885,073
Premiums refundable to members	105,868
Accounts payable	25,569
Administration fees payable	40,701
Association royalty fees payable	14,739
Premium taxes payable	1,375
Dividends to policyholders	152,415
Total liabilities	$ 3,225,740
Members' Equity:	
Retained earnings (deficit)	$ 683,415
Accumulated other comprehensive income:	
Net unrealized appreciation of available-for-sale debt securities, less deferred federal income taxes of $25,694 and $8,650 at 1998 and 1997, respectively	38,287
Total members' equity	721,702
Total liabilities and members' equity	$ 3,947,442

Statements of Operations, Comprehensive Income and Members' Equity

Revenues:	
Premiums earned	$ 2,787,529
Net investment income	86,264
Interest and finance charges on notes receivable	32,573
Interest on refunds from Internal Revenue Service	4,130
Total revenues	2,910,496
Expenses:	
Losses and loss adjustment expenses	1,587,704
Excess insurance and surety bond premiums	194,125
Administration and claims service fees	509,623
Association royalty fees	75,500
Premium taxes	66,901
Professional fees	56,551
Provision for uncollectible notes receivable	75,064
Other expenses	22,343
Total expenses	2,587,811
Income before income taxes	322,685
Income Tax Benefit	
Current	0
Deferred	1,399
Total Income Tax Benefit	1,399
Net Income	324,084
Other comprehensive income (loss):	
Unrealized appreciation of debt securities	4,115
Reclassification adjustment for net realized gain from sales of debt securities, included in Revenues above	0
Increase in deferred federal income tax liability on net unrealized appreciation for the year	(1,399)
Other comprehensive income, net of tax	2,716
Total Comprehensive Income	326,800
Members' equity at beginning of year	394,902
Members' Equity At End Of Year	$ 721,702

Reconciliation of Members' Equity

(Fund Balance)

Item	Year Ending Dec 31, 1999	Year Ending Dec 31, 2000	Year Ending Dec 31, 2001	Year Ending Dec 31, 2002	Year Ending Dec 31, 2003
Members' Equity at Beginning of Year	$1,099,267	$656,820	$647,623	$326,209	$394,902
Net Income (Loss) after taxes, but before dividends to Policyholders	(368,251)	(31,425)	(342,588)	52,205	324,084
Distributions (to)/from members during the year (dividends declared)	0	0	0	0	0
Other Comprehensive Income (Net of Income Taxes	(74,196)	22,228	21,174	16,488	2,716
Total members equity (deficit) at year end	$656,820	$647,623	$326,209	$394,902	$721,702

Analysis of Changes in Financial Statement and Comments Resulting From Examination

Notes Receivable From Members For Premiums, Net of Allowances For Uncollectible Amounts in 2003 **$47,736**

The above amount is $20,064 less than the amount reported by the Group in its 2003 Audited Financial Statement. Upon review of 2004 and 2005 payment information by the three (3) Members that have uncollateralized promissory note balances the Examiners estimated an allowance of $260,064 for an uncollectible amount which is $20,064 more than the amount reported by the Group in its 2003 Audited Financial Statement. Further comments are found in this Examination Report under the "Recommendations" section.

Summary Schedule for "Analysis Of Changes In Financial Statement"

The following depicts the change in surplus as outlined in the previous section of this report:

Item	Surplus Increase	Surplus Decrease
Notes Receivable From Members for Premiums, Net of Allowances for Uncollectible Amounts		20,064
Totals	$0	$20,064
Net change in surplus		$20,064

Comments

1. Indemnity Agreement and Power of Attorney:

As previously stated in this report, a revised Indemnity Agreement and Power of Attorney was implemented in 2001. All new Members entering the Group after implementation signed the revised agreement. However, the Group's Members that joined the Group before that time signed the original agreement that does not contain the aforementioned revisions. All Members of the Group should sign and execute the current Indemnity Agreement and Power of Attorney that contains the two (2) revisions made as a result of recommendations from the prior Examination Report.

2. Accounting Procedures:

At the time of the examination TIS did not have an in-house accounting procedures manual. The Group should develop written procedures for all accounting and administrative functions of the Group performed by TIS.

3. Custodial Agreement:

In applying the standards for custodial agreements as required by Tenn. Code Ann. § 56-6-405(c), Tenn. Comp. R. & Reg., 0780-1-46 and the 2004 NAIC Examiners Handbook it was determined that the Group's Custodial Agreement with First Tennessee is inadequate in that a number of the key provisions for the safeguard of securities are not included in the agreement. Although it has been determined by the Department of Commerce and Insurance that at the present time the Group's Custodial Agreement with First Tennessee is not subject to established Department of Commerce and Insurance nor NAIC requirements for insurance companies, these requirements have been determined by the NAIC and the State of Tennessee to be critical to the safekeeping of securities placed in the control of an external custodian (agent or clearing corporation). Without incorporation of these additional safeguards in the Group's Custodial Agreement, the

Group's securities could be subject to undue risk of loss.

Although the Group's custodial agreement appears to be exempt from Tenn. Code Ann. § 56-6-405(c), Tenn. Comp. R. & Reg., 0780-1-46 and the 2004 NAIC Examiners Handbook guidelines, based upon Tenn. Comp. R. & Reg., 0780-1-54-.01 "Purpose and Scope", the agreement must accurately identify the parties involved to be a valid agreement. The current custodial agreement with First Tennessee identifies the Group as the "Tennessee Health Care Association" instead of the "Tennessee Health Care Association - Selective Workers Compensation Group" – two separate organizations. As a result, all investment transactions and records appear to be in the name of the "Tennessee Health Care Association" and not the "Tennessee Health Care Association Selective Workers Compensation Group". However, the current custodial agreement did reflect the Group's federal tax identification number. This mistake could possibly put the Groups investments at additional risk of loss.

During the examination it was recommended that the Group take immediate action to execute a revised custodial agreement in the Group's correct name and that the name on all securities belonging to the Group is changed to reflect the Group's correct name. (See the "Subsequent Events" section of this report for corrective actions taken by the Group). It should be noted that failure to maintain the assets of the Group in the name proper name of the Group may result in the non-admission of said assets in the future.

4. Investment Policy:

Minutes from the Group's Board of Trustee and Membership Meetings, were reviewed in conjunction with the Group's Investment Policy that was approved by the Board on June 28, 1995, and the Group's Investment Advisory Agreement with the Group's Investment Advisor that was executed on September 6, 1996. In comparing these documents and their related provisions, it is not apparent that the Group or TIS as their representative has established a definite set of limitations, needs and objectives for the investment advisor to follow. Although from examination it appears that the investment adviser is investing in accordance with the Group's desires, key points as to the length of maturity and quality of bonds need to be clarified and addressed. It is recommended that

TIS clarify and confirm in writing with the Investment Advisor of the Group's investment strategy (i.e. limitations, needs and objectives).

5. Bank Signature Cards:

The Group's signature cards with First Tennessee were examined and it was confirmed that officers at TIS and BSA who are authorized to conduct business and sign checks are listed as signatories to the required accounts. However, the signature cards also listed several officers as having signature authority that are either deceased or no longer working with either TIS or BSA. It is recommended all signature cards with First Tennessee be updated, to list only those officers currently authorized to sign checks and conduct business on behalf of the Group.

6. Dividends to Policyholders:

The Group during the years 1999 through 2002 continued to distribute dividends previously declared for 1997 and 1998 policy years in the amounts of $2,695,019 and $750,000, respectively, without the approval of the Department of Commerce and Insurance. Therefore, the Group during the period of review continued to be in violation of Section 10(f) of its Indemnity Agreement and Power of Attorney. (See the "Status of Prior Examination Findings", Point # 5, noted earlier in this Report.)

The Group declared and issued but did not release dividend checks to three (3) former Members in 1996, 1997, 2000 and 2001. The Group held the dividend checks of Cambridge, Reliance and Henry County Nursing Home in order to determine the proper payee. As of the date of this report these dividend payments have yet to be made. The Group should pay these aged "Dividends to Policyholders" balances to former Members or turn these dividend checks over to the State of Tennessee as unclaimed property.

7. Royalty Fees Payable:

The Group had outstanding Royalty Fee balances payable to THCA, for policy years 2000 through 2003 that totaled $14,738.57. This outstanding balance resulted from

differences in estimated payroll and actual audited payroll of the Group's Members for 2000 through 2003 policy years used in the calculation of this liability.

The Royalty Agreement between the Group and THCA, dated June 17, 2004, (Item 6 – Waiver) states, "Failure to remit or failure to demand remittance, of the Royalty Payment shall not relieve either party from its obligations hereunder." The Royalty Agreement does not specify any penalties or fines for late payment of Royalty Fees. The Group should pay their aged outstanding balances to bring their account current. TIS should pay all future Royalty Fee liabilities in a timely manner directly to THCA using the Group's Administration Bank Account.

8. Payment of Royalty Fee Obligations:

The Group issues checks to TIS for payment of its Royalty Fee obligations due the THCA. This is a violation of Part 1: Duties of the Administrator, Section H of the Administration Agreement which states, " paying the reasonable expenses of the Trust" (Group) "from the Administration Fund Account in accordance with such budget as approved by the Board of Trustees". Royalty Fees are a liability of the Group and not TIS. Therefore, the Group should issue payment directly to THCA for Royalty Fees.

9. Administration Fees Payable:

The Group had outstanding Administration Fee balances payable to TIS for policy years 2000 through 2003 that totaled $26,215.75. This $26,215.75 amount was included in the Group's $40,701 "Administration Fees Payable" liability shown on the 2003 Audited Financial Statement. This outstanding balance resulted from differences in estimated payroll and actual audited payroll of the Group's Members for 2000 through 2003 policy years used in the calculation of this liability.

The Administration Agreement between the Group and TIS does not specify any penalties or fines for late payment of Administration Fees. The Group should pay their aged outstanding balances to bring their account current. TIS should remit all future Administration Fee liabilities in a timely manner.

10. Claim Service Fees Payable:

The Group had outstanding Claim Service Fee balances payable to BSA, for policy years 1993 through 2003 that totaled $14,484.96. This $14,484.96 amount was included in the Group's $40,701 "Administration Fees Payable" liability shown on the 2003 Audited Financial Statement. This outstanding balance resulted from differences in estimated payroll and actual audited payroll of the Group's Members for 1993 through 2003 policy years used in the calculation of this liability.

The Claims Service Agreement between the Group and BSA does not specify any penalties or fines for late payment of Claim Service Fees. The Group should pay their aged outstanding balances to bring their account current. TIS should pay all future Claim Service Fee liabilities in a timely manner.

11. Premium Taxes Payable:

State Premium Taxes are calculated based on prior year actual and current estimated total premiums collected. The Group's 2003 financial statement listed premium taxes payable of $1,375.00. A review of actual and estimated premiums reported to the Department of Commerce and Insurance and examination recalculation of state premium taxes indicated that the balance in this account should be $2,359.13. The $984 difference in the above amounts is a result of the Group making additional adjustments to the audited 2002 total premium collected. The Department of Commerce and Insurance records show that on June 5, 2003 the Group reported actual 2002 total premium collected of $2,349,035. On November 5, 2003 the Group arrived at an adjusted final 2002 total premium collected of $2,307,634. There is no record of a follow-up report being submitted to the Department of Commerce and Insurance reporting any change in the 2002 total premium collected. In order for the Group to obtain an adjustment in premium taxes it must report to the Department changes in estimated and actual written premiums as they occur. As of the date of this examination report the Group has not reported this change, therefore the Group's 2003 financial statement should list premium taxes payable in the amount of $2,359.13. However, because the total error of $984 was significantly less than

the $4,000 tolerable error set for this examination, this error is considered immaterial and no recommended changes are made to the financial statement. It is however recommended that action be taken by the Group to report this and others changes in total actual premiums collected as soon as they are verified by independent sources. In the future the Group will be charged penalties and interest for failing to make timely payment of premium taxes based upon the final actual amount of premiums collected for a specific policy year.

12. Premiums Refundable to Members:

The examiners calculated an $88,518 balance per examination amount or $17,350 less than the $105,868 amount reported by the Group in its 2003 Audited Financial Statement. Final 2003 Member payroll audits completed after the release of the 2003 Audited Financial Statement and improper exclusion of officers from three (3) Group Members from the calculation of 2003 premiums yielded an overall reduction in the amount of premiums to be refunded to Members.

The immaterial $17,350 examination difference based on actual Member premium is less than 1% of 2003 Earned Premium and should be trued up by the Group's CPA firm sometime before the July 1, 2005 release of the 2004 GAAP audited financial statements.

The Group as of year-end 2003 only had 27 Members and should have had all Member payroll audits completed before the spring 2004 CPA audit fieldwork was completed. The Group's CPA firm noted as a 2001 Audit Reportable Condition: Timely Completion of Payroll Audits. The Group's CPA firm suggested TIS should require that all payroll audits should be completed within 120 days after policy year-end. Detailed payroll records should be available to the payroll auditors soon after Members file their annual federal payroll tax returns, which are due February 1, each year. Payroll Audits finished in a timely manner will aid in the completion of a more accurate annual audited financial statement and quicker billing, collection and audit dispute resolution.

13. Aged Premiums Refundable to Members:

The Group has two (2) aged outstanding premium refundable items included in the "Premiums Refundable to Members" 2003 liability balance sheet account that originated in 1997 and 1998. The Group is liable for premium refunds due to former Members, McKendree Village, Inc. in the amount of $3,354 and Reliance Healthcare of Eastland, Inc. for $18,692, for a total of $22,316. These specific liabilities have aged more than five (5) years. The Group should pay these premium refunds or turn them over to the State of Tennessee as unclaimed property.

14. Authority of the Administrator:

Heading # 5, "Agents", in the Administration Agreement empowers TIS to execute agreements on behalf of the Group, subject to the approval of the Board of Trustees. However, as of the date of this Examination, TIS had not designated specific TIS employees that were approved and authorized to execute agreements on behalf of the Group. TIS should designate specific employees that are authorized to execute agreements on behalf of the Group.

15. Underwriting:

The Group's Board made questionable decisions in its underwriting of three (3) Members: Community Eldercare Services, LLC (CES), Continuum Care Corporation (CCC) and Home Quality Management (HQM).

CES exited the Group in March 2001 after being cancelled by the Group in February 2001. CES reentered the Group effective July 1, 2002 and currently remains a member of the Group. However, it appears that CES was allowed to reenter the Group on July 1, 2002, even though they had an outstanding balance on a Promissory Note Dated March 1, 2002 pledged to the Group and a history of untimely premium payments. The Board on July 3, 2002 by mail ballot voted to change the By-Laws to allow CES to reenter the Group. As of December 31, 2003 CES had six (6) open claims for policy year 2003.

CCC and HQM were allowed to remain in the Group up until February 2002 even

though they had past due premium balances due the Group dating back to 1998. As of December 31, 2003 CCC had open claims for policy years 1997, 1999, 2000, 2001 and 2002. See the "Recommendations Section" of this report for further discussion of CCC and HQM.

16. Information Requests:

During the course of the examination ten (10) written requests for information were submitted to TIS in the areas of Claims, Notes Receivable from Members for Premiums, Dividends to Policyholders, Premium Testing, and Member File Review. Complete written responses for each item in these requests regarding the aforementioned subject matter were not received in a timely manner. Out of the ten (10) requests dated from August 5, 2004 through December 7, 2004 the Examiners waited an average of 94.6 days for receipt of the requested information. This slowed the Examiners' progress in completing this examination.

Recommendations

1. Member Premium "Loss Credit":

The Group should cease applying a "loss credit" when calculating its Members' premiums. As stated earlier in this report, this is a violation of Tenn. Comp. R. & Regs., 0780-1-54-.15(1) and NCCI guidelines. **In the future the Group should seek approval from the Commissioner for deviations from NCCI guidelines as to the calculation of Member premiums for each policy year.**

2. Extension of Credit to Members for Payment of Premium:

The Group did not seek or receive approval by the Commissioner for two (2) promissory notes dated November 1, 2002 in lieu of past due premiums from two (2) former Members, Continuum Care Corporation (CCC) and Home Quality Management, Inc. (HQM). This was a violation of Tenn. Comp. R. & Regs., 0780-1-54-.07(2)(a). In the

future the Group should seek approval from the Commissioner for the extension of credit to Members for payment of premium.

On April 1, 2001, HQM acquired Group Member CCC and its Group insured facilities. CCC and HQM left the Group in February 2002. Promissory Notes dated November 1, 2002, were executed for outstanding premium balances due the Group for policy years 1998 through 2002. CCC and HQM were allowed to remain in the Group up until February 2002, even though they had past due premium balances due the Group dating back to 1998.

3. Fiduciary Responsibility of the Board of Trustees:

In the case of CCC and HQM, the Group's Board failed to enforce their premium obligations as required by the Trust Agreement and Declaration of Trust and Bylaws and the Indemnity Agreement and Power of Attorney. As stated previously CCC and HQM had past due premium balances due the Group for policy years 1998 through 2002. From August 25, 1999 through January 10, 2002 Mr. Doug Hornsby was an officer of a CCC owned facility (Mountain City Care Center) and a member of the Group's Board.

Section 9 (c) of the Group's "Indemnity Agreement and Power of Attorney" states "Each Member shall make prompt payment of all contributions and assessments as required by the Board". Section 8 and Section 8 (e) – "Administration of the Trust", in the "Trust Agreement and Declaration of Trust and Bylaws" states "The Trustees shall take all necessary precautions to safeguard the Fund and the other assets of the Trust" (Group), "including, but not limited to, the following: (e) Activating efforts to collect delinquent accounts resulting from any unpaid premiums by Members, which shall include any costs incurred in the collection thereof".

"Lack of Timely Premium Payments by Significant Member" by CCC was cited in a June 14, 2000 Management Letter to the Group's Board of Trustees as a "Reportable Condition: 1999 Audit" from the Group's CPA firm.

Collection of Promissory Note Balances in Default:

On March 8, 2002 the Group filed a complaint in Knox County Court against HQM and CCC for breach of contract in the amounts of $222,912 and $149,139, respectively. The complaint also requested an undisclosed amount against HQM and CCC for "unjust enrichment of insurance benefits". As of October 21, 2002, HQM and CCC had not filed an answer to the complaint. Also, as of October 21, 2002, TIS instructed their legal counsel not to file a Motion for Default and / or Summary Judgment. In July 2004, TIS made the decision to voluntarily dismiss the complaint against HQM and CCC.

During the time the Group filed and dismissed the Group's complaint in Chancery Court of Knox County TIS was negotiating with HQM and CCC for the payment of the outstanding Promissory Note balances due the Group. In a letter dated November 25, 2002, HQM and CCC requested the Group forgive 50% of the interest on the Notes and offered "a consent judgment" upon default on the Notes as an additional level of security. The Chairman of the Board, Craig Laman agreed to forgive 50% of the interest on the Notes but the examiners had no record of Board approval to accept the consent judgment offer.

In 2003, HQM made 9 of 12 scheduled payments on their Promissory Note and CCC made 8 of 12 scheduled payments on their Promissory Note. In 2004, HQM and CCC each made 2 of 12 scheduled payments on their Promissory Notes. None of the information provided to the Examiners suggested that either HQM or CCC was unable to pay due to financial constraints.

On page 2 of the HQM and the CCC Promissory Note under the heading "Default and Acceleration" it states "nonpayment of any payment when due on this Note" would cause the entire principal sum and accrued interest to become due and payable immediately at the Lender's option. Therefore, based upon the terms of the Promissory Notes, HQM and CCC were in default as of year-end 2003. However, information provided during the examination showed that the Group's Board never demanded the payment of all outstanding principal and interest by HQM and CCC upon default.

The Group's Board through TIS, failed to aggressively pursue collection of

Promissory Note balances for past due premiums through negotiation and the court system. Promissory Note balances, under certain circumstances, are considered Assets under GAAP accounting standards. This was a violation of Tenn. Comp. R. & Regs., 0780-1-54-.07 "Board of Trustees: Membership, Powers, Duties and Prohibitions". Tenn. Comp. R. & Regs., 0780-1-54-.07 states, "The board of trustees of each group shall ensure that all claims are paid promptly and take all necessary precautions to safeguard the assets of the group". In the future the Group should "take all necessary precautions to safeguard the assets of the group" in accordance with Tenn. Comp. R. & Regs., 0780-1-54-.07.

Promissory Notes Due to the Administrator and the Group:

A November 21, 2002 letter from HQM representative Laura Bradley revealed HQM and CCC had Promissory Notes due the Group's administrator TIS at the same time Promissory Notes were due the Group. The letter noted a Promissory Note balance due TIS in the amount of $348,639 from HQM, a Promissory Note balance due TIS in the amount of $203,695 from CCC, a Promissory Note balance due the Group in the amount of $125,000.00 plus $58,484 interest from HQM and a Promissory Note balance due the Group in the amount of $180,000.00 plus $42,912 interest from CCC. This letter further revealed a request to TIS to forgive 50% of the interest owed to TIS and the Group associated with each Promissory Note. Therefore, HQM and CCC were indebted to a greater degree to TIS, than to the Group as of November 21, 2002.

4. Total Members' Equity:

Total Members' Equity as stated in the Group's 2003 Audited Financial Statement was $741,766 for all fund years combined since inception. However, the surplus balance for the years 1993 to 2003 as determined by the Group's independent CPA firm show the Group with deficits during the following fund years:

Fund Year	Surplus (Deficit)
03 – 94	(3,307.67)
12 – 99	(6,894.44)
12 – 03	(129,286.59)

Tenn. Comp. R. & Regs., 0780-1-54-.18(2) of the rules governing Self-Insured Worker's Compensation Pools requires that deficiencies in any fund year be made up immediately and provides several options to remedy the situation, including the transfer of funds from a surplus year to deficit year. Tenn. Comp. R. & Regs. also states that the Commissioner shall be notified prior to the transfer of any surplus funds from one fund year another. The Group has in the past chosen to remedy similar fund deficit situations by transferring funds from years with a surplus, to years with a deficit. The Group must again take action to comply with rule requirements. **It is recommend the Group take immediate action in accordance with Tenn. Rule 0780-1-54-.18(2) to make up the deficiencies recorded as of 12/31/03 in fund years 03-94, 12 – 99, and 12 – 03.**

5. Officers' Exclusion from Member Payroll:

Three (3) officers from three (3) Group Members were improperly excluded from the calculation of 2003 premiums. **These three (3) Members should file I-6 Forms with the Tennessee Department of Labor in order to receive an officer's exclusion as allowed by Tenn. Code Ann. § 50-6-104(c).**

6. Member Files:

The Examiners found some current and former Member file documents were not properly executed and disclosure of all required Member information was not provided to the Department of Commerce and Insurance. Failure to notify the Department of Commerce and Insurance of the date Members entered and exited the Group was a violation of Tenn. Comp. R. & Regs., 0780-1-54-.04(3) and Tenn. Comp. R. & Regs., 0780-1-54-.08(2). Also, failure to submit a properly executed application to the Group's Board was a violation of Tenn. Comp. R. & Regs., 0780-1-54-.08(1). Finally, failure to submit a properly executed indemnity agreement to the Department of Commerce and Insurance was a violation of Tenn. Comp. R. & Regs., 0780-1-54-.04(2)(e). **In the future the Group and its Members should fulfill its obligations as specified by Tenn. Comp. R. & Regs., 0780-1-54-.04(3), Tenn. Comp. R. & Regs., 0780-1-54-.08(2), Tenn. Comp. R. &**

Regs., 0780-1-54-.08(1) and Tenn. Comp. R. & Regs., 0780-1-54-.04(2)(e).

7. Notification of By-Law Changes:

The Group did not notify the Department of Commerce and Insurance of all 2003 By-Law Amendments. The Examiners only received from the Group a record of Member premium payment schedule changes approved by the Department in 2003. This was a violation of Tenn. Comp. R. & Regs., 0780-1-54.04(3). **In the future it is recommended that the Group notify the Department of Commerce and Insurance of any changes to documents that are required to be filed under subsection (1) or (2) of Tenn. Comp. R. & Regs., 0780-1-54.04.**

8. Dividend Plan:

Based upon information provided to the Examiners the Group did not provide each Member "a written description of the refund plan at the time of application for membership" in accordance with Tenn. Comp. R. & Regs., 0780-1-54-.16(2). It is recommended that the Group comply with Tenn. Comp. R. & Regs., 0780-1-54-.16(2).

Conclusion

The work papers and audited financial statements used in connection with the examination of the Group were prepared using generally accepted accounting principles (GAAP) and National Association of Insurance Commissioners (NAIC) procedures, where applicable. These work papers were used to verify and value the assets and determine the liabilities of Tennessee Health Care Association Selective Workers' Compensation Group as of December 31, 2003. In addition, Tennessee Code Annotated and Tennessee Comprehensive Rules and Regulations of the Department of Commerce and Insurance were utilized to determine compliance of the issues addressed in this report on examination

In such manner, it was found that as of December 31, 2003, the Group had assets of $3,947,442 and liabilities, exclusive of capital and surplus, of $3,225,740. Thus, there existed for the additional protection of the policyholders, the amount of $721,702 in the form of premiums refundable to members (Members' Equity).

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Examiner-in-Charge
Insurance Examiner III
State of Tennessee

Gregory Bronson
Insurance Examiner II
State of Tennessee

Kurt Polasko
Insurance Examiner II
State of Tennessee

Examination Affidavit

The undersigned deposes and says that he has duly executed the attached examination report of Tennessee Health Care Association Selective Workers' Compensation Group dated July 14, 2005, and made as of December 31, 2003, on behalf of the Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce, Jr.
Examiner-in-Charge
Insurance Examiner III
Department of Commerce and Insurance
State of Tennessee

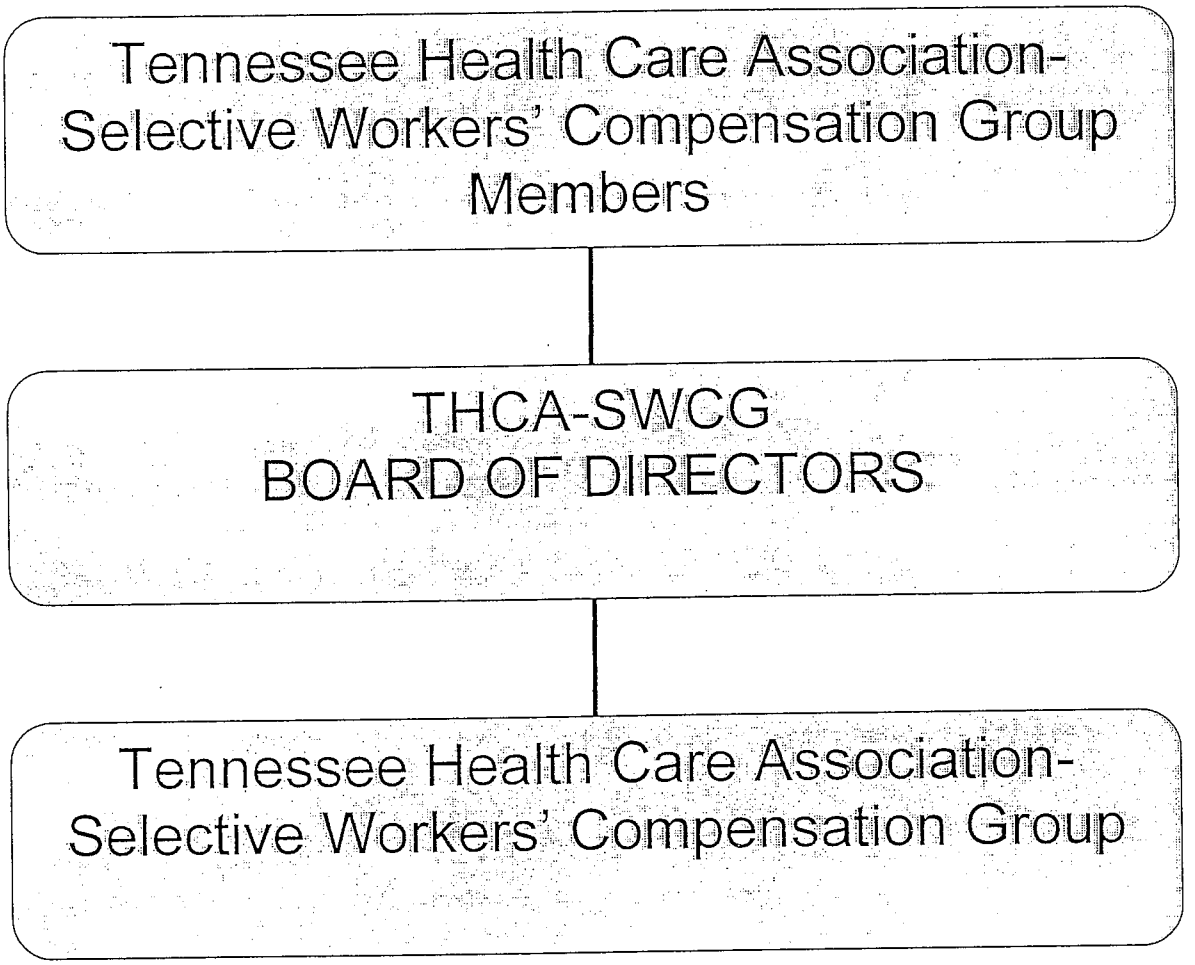
County Davidson
State Tennessee

Subscribed and sworn to before me
this 14th day of
July, 2005.

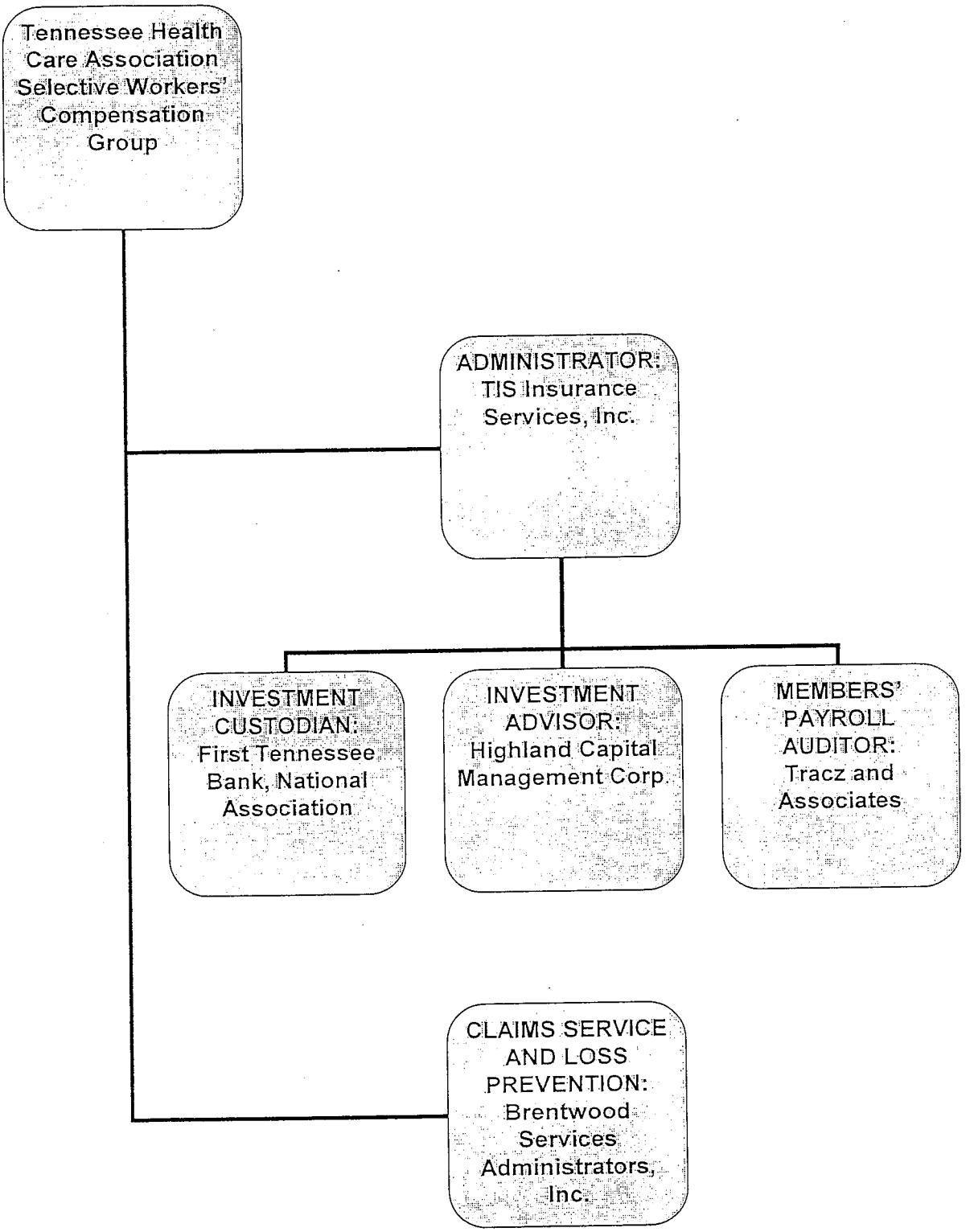
Helen M. Dersey
(Notary)

My Commission Expires:
03/25/2006

ORGANIZATIONAL CHART # 1



ORGANIZATIONAL CHART # 2



INNOVATORS IN RISK
MANAGEMENT SINCE 1945

July 27, 2005

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Mr. Don Spann, CFE
Insurance Examination Director
State of Tennessee
Department of Commerce & Insurance
500 James Robertson Parkway
Nashville, TN 37243

RE: Financial Condition Examination of Tennessee Health Care Association
Selective Workers' Compensation Group
Made as of December 31, 2003

Dear Mr. Spann:

I am pleased to respond to the aforementioned Report on Examination of the Tennessee Health Care Association Selective Workers' Compensation Group ("Report").

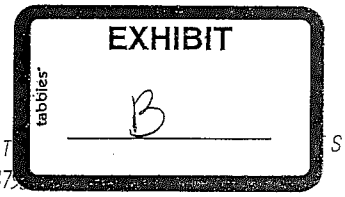
The report, in many instances, does address certain issues multiple times. When responding to a specific item, I will attempt to incorporate each particular area of the report that deals with that item.

(1) On page 7, Status of Prior Examination Findings, item (1) The corrective action says . . . "The revised Indemnity Agreement and Power of Attorney have only been signed by group members that joined after the revisions were made". We assume from this wording and the wording in the initial draft of this same report, that there is no recommendation to go back and amend prior agreements to reflect the TIS name instead of Robert M. Sims Company, the administrator name prior to TIS.

(2) Page 42, item 7. Royalty Fees Payable says that "The group should pay their aged outstanding balances to bring their account current. TIS should pay all future royalty fee liabilities in a timely manner . . . ". The only delays occurring in payment of royalty fee liabilities in a timely manner to the THCA were as a result of the difference between estimated and audited (actual) payrolls. Obviously, any additional royalty fees resulting from additional premium which resulted from additional audited payroll, cannot be paid until the additional premium is calculated, after a policy period is concluded.

We believe the report is inaccurate in reflecting these payments have been made late and/or need to be paid in a timely manner in the future.

(3) The issue of dividend declaration and distribution is addressed on page 9, item (5), page 30 and page 42, item 6. Dividends to Policyholders.



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It is the Fund's belief that they were not required to obtain Insurance Department approval for dividend/refund distributions so long as those distributions were in compliance with rule 0780-1-54-.16, which they were. Our understanding is the proposed rules will specifically require prior approval, but the current rules do not. The Group certainly recognizes the interest the Department has in ensuring that dividends paid by a group do not jeopardize the solvency of a group, and THCASWCG intends to notify the Department of any dividend declarations and seek its blessing prior to any future dividend declaration.

Further, since the previous examination report said that "further dividend declarations should be approved" and the Fund has made no new dividend declarations since the last examination, then it would seem there is no need for comments in this report on this matter.

The examiner continues to refer to "violations" of the indemnity agreement and the royalty agreement, as opposed to "breaches" of those agreements. The remedy for a breach of contract is an action by the non-breaching party on the contract. However, in the case of the refund payment, the member employees are not harmed by the breach, and in the case of the administration agreement on royalty fees, the group is not harmed by the breach (as the royalty payments are paid to the sponsoring association). Consequently, the examiners comments appear irrelevant. We would respectfully ask that these comments either be removed or amended.

We continue to maintain that we are in no violation of any Department of Commerce & Insurance statute relative to declaration and distribution of dividends heretofore. Therefore, we would respectfully ask that the language relating to dividends and refunds be deleted.

(4) Page 16, Conflict of Interest Policy states that the Group does not have a Conflict of Interest Policy for its Board of Trustees. We would request this provision be deleted from the report, as we are unaware of any statute or law that says this is required or that it is a bad practice not to have this Conflict of Interest Policy. We will, however, continue to monitor the practices and procedures of the Group in order to ensure the smooth and efficient operation of the Group.

(5) Page 17 and page 46, item 14. Authority of the Administrator both relate to the issue that TIS, as administrator, is empowered to execute agreements on behalf of the Group with accountants, attorneys, brokers, investment advisors and agents, subject to the approval of the Board of Trustees. The report states that TIS should designate specific employees that are authorized to execute agreements on behalf of the Group.

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It is our position that the administrator is defined as TIS, not a specific person, and that wording suggesting that specific employees be designated, be removed from the report. If this designation is required, we ask that the examiners provide us with the citation in Tennessee Law that imposes, what we believe to be an extraordinary requirement.

We will, however, continue to monitor the practices and procedures of the Group in order to ensure the smooth and efficient operation of the Group.

(6) Page 20, Investment Advisory Agreement and page 41, item 4. Investment Policy deal with the Investment Advisory Agreement and the Investment Policy of the Fund.

The recommendation of the report is that the Group Administrator clarify and confirm in writing with Highland Capital Management Corporation the Group's investment strategy (i.e. limitations, needs and objectives). The Fund will certainly comply with this recommendation, although it is stated on page 41 that "Although from examination it appears that the investment advisor is investing in accordance with the Group's desires . . .".

(7) The matter of the Custodial Agreement is dealt with on page 21, Custodial Agreement page 33, item 1., page 40, 41 3. Custodial Agreement.

The Fund corrected the name on the actual agreement itself, as suggested by the examiners during their examination and referred to in these three different parts of the examination report. This was a minor oversight that has since been corrected.

(8) Page 23 Underwriting and page 46 item 15. Underwriting, deal with underwriting decisions of the Fund. The report states that the Group's Board of Trustees "made questionable decisions in its underwriting of three members . . .".

Underwriting, plain and simple, is the major tool leading to the success or failure of a group, and insurance companies and groups must often make tough decisions for what they perceive will permit the insurance company or group to be successful. The Fund made conscious underwriting decisions to improve its position.

We believe that the Fund made conscious underwriting decisions in each specific case mentioned relative to the inclusion of these respective members. The Fund's position was improved dramatically by allowing each of these three members to continue in the Group.

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In order for groups to have the ability to distinguish themselves and provide a true benefit for the member employers being served, the group must have the freedom to make underwriting decisions. Certainly, the potential for conflicts exist, and each group must ensure that the group isn't used to unfairly benefit one member employer over another, either in underwriting or in the application of rating components. But the ability of a group to determine which member employers are permitted in the group must remain unfettered to ensure that the group is given the chance to succeed, and so as to provide all employers in the association an additional option in the procurement of Workers' Compensation.

Thus, it seems that some of the comments made by the examiners are somewhat harsh and unrealistic, given the decisions made by the Fund which turned out to be good decisions.

(9) Page 24, 1), page 33 and 34 4. and page 47, item 1. Member Premium "Loss Credit" all deal with the issue of the Fund using a "loss ratio credit" or "schedule rating matrix" as referred to by the Department of Commerce & Insurance.

The Fund did request and receive from the Department of Commerce & Insurance, approval to use said "schedule rating matrix" or ".15 Plan" as referred to by Mr. Larry Knight in his letter of March 3, 2005, for the 2005 plan year. Mr. Knight indicated that if the Fund wished to deviate from NCCI rules beyond 2005, it would need to request this from the Department of Commerce & Insurance.

Further, we have not been made aware of any State rule or regulation, prior to Commissioner Flower's bulletin of October 21, 2003, Self Insurance Funds, which imposed a requirement on Self Insurance groups to follow the NCCI guidelines without discretionary modifications.

Therefore, we respectfully request any wording in the examination report such as that on page 24, item (1), which indicates the Group did not calculate premiums in accordance with Tennessee statute, or NCCI guidelines, be removed from the report.

(10) Page 26 and 27 deal with Excess of Loss Insurance. Basically, the report states that increasing the specific retention and/or reducing the aggregate limit of liability increased the Group's risk of a reduction of a potential surplus deficit. This is true as it is also true that making the same changes result in a savings in premium to the Fund, thereby having the opposite affect which is to reduce the risk of a reduction in surplus or potential surplus deficit.

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We believe that much of this wording in this item of the report relates to basic insurance risk versus reward concepts and is unnecessary.

(11) Page 28 and 29, Accounts and Records, Financial Records and page 50, 51, 4. Total Member's Equity. Page 50, 51 item 4. Total Members Equity says that "the group take immediate action in accordance with Tennessee Rule 0780-1-54-.18(2) to make up the deficiencies recorded as of December 31, 2003 in Fund years 03-94, 12-99 and 12-03". As previously stated by the Fund, we ask that the Department of Commerce & Insurance re-review correspondence of November 17, 2003 sent to Mark Brothers regarding the notification of surplus transfers between policy years. This indicates we routinely monitor any surplus deficiencies by Fund year and take corrective action as necessary.

(12) Page 29, Members Files, relates to various discrepancies or variances in the Fund's member files. We would respectfully request that the examiners provide specific details and comparative data in order for the Fund to assess whether the differences described actually exist, and are material or even relevant.

(13) Page 32, Notes Receivable From Members for Premiums and page 47, 2. Extension of Credit to Members for Payment of Premium relate to Promissory Notes processed by the Fund. As I stated previously, this matter was discussed with the examiners on multiple occasions. It seems the examiners felt the Fund was accepting notes or note receivables in lieu of premium payments when, in fact, the execution of the notes occurred after the members were already in default on payment of premiums, resulting in the Fund moving to a more advantageous legal position for purposes of trying to collect old balances due.

The recommendation to seek approval from the Commissioner for the extension of credit to the members for payment of premium is a practice that the Group already practices but certainly will continue to comply with.

(14) Page 33, item 3. appears to be commentary regarding oversight that exists by a change in Tennessee Law. We believe this is irrelevant to the examination results and request that this item be deleted from the report to avoid any potential confusion to a subsequent reader.

(15) Page 34, item 7. talks about three of the Fund's members and their membership in the Tennessee Health Care Association. Each of these three members, as of the date of this initial report, are paid up and in good standing with the Tennessee Health Care Association. This can be confirmed with the THCA directly. Consequently, we would ask that this item be removed from the examiner's report, as there is no violation of Tennessee statute.

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(16) Page 34, item 8. relates to old premium balances due by several members of the Fund. We would ask that the examination report reflect that the administrator has received from these insureds, payment of all old premiums due.

(17) Page 39 is titled Analysis of Changes in Financial Statement. The examiners have come up with a different (higher) amount of allowance than reported in the financial statements. However, they do not explain the basis for their position. I am requesting that the examiners provide the underlying details and the support for their conclusion.

Based on the approach taken by the Fund and Faulkner, Mackie and Cochran ("FMC"), the outstanding balances of members for the past due premiums were evaluated as of each year end. Outstanding balances were admitted as a receivable generally to the extent of amounts collected in the period subsequent to year end but prior to issuance of the financial statements plus any marginal amount expected based on the recent payment trend. At December 31, 2003, the admitted receivable balance for past due members included $10,000 of subsequent collections from CCC and HQM, plus three more payments each at $5,000 per payment from these two members, plus the entire balance from CLC, which was current with is payments at the time. The remaining receivables balance of $240,000 was reported in the allowance account.

It is possible that the examiners have used the additional 12-18 months of hindsight to more precisely calculate actual subsequent collections, thus resulting in the adjustment. This type of adjustment is not generally proposed in the "real world", because the reporting entity's estimate should be evaluated based on the facts available for consideration at the time the financial statements were prepared. Instead, this type of adjustment would be recorded as a component of a future reporting period after additional information becomes available.

(18) Page 40, item 2. Accounting Procedures states that "The Group should develop written procedures for all accounting and administrative functions of the Group performed by TIS". As the Fund is unaware of any TCA citation or authoritative statute that supports this recommendation, we would respectfully ask that this provision of the examination report be removed.

We will, however, continue to monitor the practices and procedures of the Group in order to ensure the smooth and efficient operation of the Group.

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(19) Page 43, item 9. Administration Fees Payable and page 44, item 10. Claim Service Fees Payable state that TIS, as the Group's administrator, should pay all future administration fees and claim service fee liabilities in a timely manner. It is stated within the examination report that discrepancies are "trued up" at the time of payroll audits performed after each year and are reflected in the audited financial statements.

Therefore, I would submit that TIS is remitting administration fee liabilities and claim service fee liabilities in a timely manner at present and that the comments in the report relating to this issue be reviewed and possibly removed.

We will, however, continue to monitor the practices and procedures of the Group in order to ensure the smooth and efficient operation of the Group.

(20) Page 48, recommendation 3. Fiduciary Responsibility of the Board of Trustees. We would like to make the point that the Group's Board of Trustees acted to collect past due premium balances from CCC and HQM via the execution of Promissory Notes, and it further should be noted that the Board of Trustees certainly acted in what it believed was in the best interest of the Fund in this regard.

Mr. Spann, we will appreciate the Department of Commerce & Insurance reviewing carefully the points we have chosen to discuss, and we hope the report is changed accordingly. Certainly if the report on examination has made recommendations, the THCA Selective Workers' Compensation Group will comply.

We further wish to state that, with all due respect to the examiners who conducted the examination, we believe that the length of time spent on this examination by the Department of Commerce & Insurance and the cost of the examination, in our opinion, are unreasonable. This is a relatively small Workers' Compensation Self Insurance Fund which was previously examined by the Department of Insurance through December 31, 1998. It was stated on more than one occasion by the examiners that the use of NAIC examination criteria and the fact that this was the first Tennessee Workers' Compensation Fund to be examined, caused there to be a significant "learning curve" by the examiners and that much time was spent deciding which NAIC examination procedures should be applied in this examination. I appreciate your understanding of our comments in this regard.

Mr. Spann, if we can be of any further service to you in regard to this effort, please advise.

Sincerely,

Edward B. Sims

Edward B. Sims

EBS/dl