



**THE COMMONWEALTH OF MASSACHUSETTS**

**OFFICE OF CONSUMER AFFAIRS AND BUSINESS  
REGULATION**

**Division of Insurance**

*Report on the Statutory Examination of*

*Health New England, Inc.*

*Springfield, Massachusetts*

*As of December 31, 2005*

**NAIC COMPANY CODE: 95673**

**EMPLOYERS ID NUMBER: 04-2864973**

*For Informational Purposes Only*

**Commonwealth of Massachusetts Division of Insurance  
REPORT ON THE STATUTORY EXAMINATION OF  
HEALTH NEW ENGLAND, INC.**

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**COMMONWEALTH OF MASSACHUSETTS**  
**Office of Consumer Affairs and Business Regulation**  
**DIVISION OF INSURANCE**

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May 30, 2007

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Division of Insurance  
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Honorable Commissioners:

Pursuant to your instructions and in accordance with Massachusetts General Laws, Chapter 176G, Section 10, an examination has been made of the financial condition and affairs of

**HEALTH NEW ENGLAND, INC.**

at its home office located at:

One Monarch Place, Springfield, MA 01144

The following report thereon is respectfully submitted.

## **SCOPE OF EXAMINATION**

This statutory examination of Health New England, Inc., hereinafter referred to as "the Company," "HNE," or "the Corporation," is as of December 31, 2005, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

The current examination was conducted at the direction of, and under the overall management and control of the examination staff of the Massachusetts Division of Insurance (the Division). The statutory examination was performed at the Company's home office in Springfield, Massachusetts. KPMG was engaged to perform certain agreed-upon procedures, which are in compliance with the *NAIC Financial Condition Examiners' Handbook*. KPMG's actuaries were involved in the performance of those procedures to the extent that such procedures related to the Company's reserves for unpaid claims and loss adjustment expenses and provider risk sharing settlements as of December 31, 2005. KPMG's Information Technology Advisory Services (ITAS) personnel were engaged to perform an evaluation of the "Controls in Information Systems Questionnaire" in a form substantially similar to the one established in the *NAIC Financial Condition Examiners' Handbook*. KPMG Tax Specialists were engaged to perform procedures related to both tax assets and tax liabilities. The ITAS Specialists performed examination procedures pertaining to the examination of the IT System as outlined in the *NAIC Financial Condition Examiners' Handbook*. All procedures were reviewed, approved, and performed under the management and control and general supervision of the Division.

The examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners (NAIC) Financial Condition (E) Committee and prescribed by the current *NAIC Financial Condition Examiners' Handbook*.

In addition to a review of the financial condition of the Company, the examination included a review of the Company's business policies and practices, corporate records, provider contracts, reinsurance treaties, conflict of interest disclosure statements, fidelity bonds and other insurance, employees' pension and benefits plans, disaster recovery plan, and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk and examination efforts were directed accordingly.

In determining the scope of the statutory examination, after review and evaluation, the examination team placed reliance on certain workpapers provided by the Company's external auditors, Ernst & Young LLP (E&Y). Wherever possible and wherever deemed appropriate and effective, their independent work product was used to define, support, document and expedite the overall examination process.

## **DESCRIPTION OF COMPANY**

### **History**

Health New England, Inc. is a for-profit health maintenance organization (HMO) domiciled in Massachusetts. HNE was incorporated as a Massachusetts corporation on May 17, 1985. The Company was licensed as an HMO by the Massachusetts Commissioner of Insurance (the Commissioner) on November 27, 1985 and commenced business on January 1, 1986. The Company was granted Federal Qualification as an HMO by the U.S. Department of Health and Human Services on June 1, 1987.

The Company was formed by capital contributions from three hospitals including Baystate Health, Inc. (BHS), the parent corporation of Baystate Medical Center, and a group of BHS-affiliated private care physicians. In March 1997, the Company underwent a corporate reorganization, issuing approximately \$1.5 million in notes payable to former physicians and hospital shareholders; BHS' ownership increased to an approximate 95% interest. In July 1998, the Company and Harvard Pilgrim Health Care, Inc. (HPHC) executed a stock purchase agreement, whereby the Company

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issued additional common stock in exchange for HPHC's business in Western Massachusetts. BHS subsequently entered into an agreement with HPHC, whereby HPHC purchased a portion of BHS' interest in HNE.

During 1989, the Company established a wholly-owned subsidiary, HNE Advisory Services, Inc., (HAS) through which self-funded managed health care products are offered. The Company acts as a third party administrator of managed care programs for the subsidiary. During 1992, the Company established Health New England Insurance Services, Inc. (HIS), a wholly-owned subsidiary. HIS is an insurance agency through which the Company's sales executives broker ancillary insurance lines to employer accounts.

HPHC entered receivership in January 2000 and the Commissioner assumed direct supervision and control of HPHC's assets and operations. In February 2000, BHS submitted a proposal to purchase HPHC's ownership interest in HNE. BHS completed this purchase in October 2000, gaining 95.8% of the Company's shares with affiliated physicians controlling the remaining 4.2%. The Company subsequently reached a settlement agreement with the physician and hospital shareholders in connection with notes issued to them in March 1997. The majority of those noteholders have executed settlement of the notes under the terms of the agreement.

As of December 31, 2005, BHS owned a 96.52% interest in the Company, with individual physicians controlling the remaining 3.48% interest.

**Organization**

The Company is owned 96.52% by BHS, a Massachusetts corporation, and the remaining 3.48% outstanding shares are owned by individual physicians. The Company controls three wholly owned subsidiaries, HAS, HIS, and Health New England of Connecticut, Inc. (HNECT). HAS provides administration and claims processing services on behalf of self insured employer sponsored health care benefit plans. Each month, the Company bills HAS for administrative duties performed on behalf of HAS. HIS collects commissions for placement of stop-loss coverage for ASO groups. HNECT is not licensed in Connecticut and has insignificant activity.

**Capital and Surplus**

Capital and Surplus represents the capitalization of the Company as well as the excess of revenues over expenses since inception. The total admitted assets, total liabilities and capital and surplus of the Company from 2003 to 2005 is shown in the following schedule.

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Net Worth</u>
2003	\$50,441,291	\$38,273,132	\$12,168,159
2004	60,476,260	43,400,030	17,076,230
2005	67,472,790	42,777,841	24,694,949

As a form of background, HNE issued surplus notes totaling \$4 million on April 9, 1999. The notes are currently held by BHS. The notes were issued to meet HNE's working capital needs and statutory capital and surplus requirements as determined by the Division. The notes are uncollateralized and subordinate to all present and future indebtedness of HNE, as well as policy claims and prior claims against HNE. The Division approved the issuance of these surplus notes.

## MANAGEMENT AND CORPORATE RECORDS

### Articles of Incorporation and By-Laws

The Corporate By-Laws may be amended by a vote of more than fifty percent (50%) of the issued and outstanding capital stock entitled to vote at any annual or special meeting of the Stockholders, if notice of the substance of the proposed amendment is stated in the notice of such meeting. If authorized by the Articles of Organization, the Directors, by a majority of their number then in office may also make, amend or repeal the Corporate By-Laws by vote in accordance with the section of the By-Laws governing Director voting. Notwithstanding the preceding sentence, the Directors may not make, amend or repeal the Corporate By-Laws with respect to any provisions governing: the composition of the Board of Directors or Executive Committee; the election or removal of Directors; shareholder voting; indemnification of Directors; procedures for amending the Corporate By-Laws; or any other provision of the By-Laws which by law, the Articles of Organization or the By-Laws requires action by the Stockholders. Any By-Law adopted by the Directors may be amended or repealed by the Stockholders entitled to vote on amending the By-Laws.

### Stockholders and Capital Stock

The Company's By-Laws indicate the following regarding its stockholders:

- Stockholder Meetings: The annual meeting of stockholders shall be held at a time and place to be decided by the Directors, provided however, that such meeting shall be held within six (6) months after the end of the fiscal year of the Corporation, as provided by law. The purposes for which the annual meeting is to be held, in addition to those prescribed by law, by the Articles of Incorporation or by the Corporate By-Laws may be specified by the Board of Directors or the President/Chief Executive Officer. If no annual meeting is held in accordance with these provisions, a special meeting may be held in lieu of the annual meeting, and any action taken at that special meeting shall have the same effect as if it had been taken at the annual meeting. Special meetings of stockholders may be called by the Board of Directors. Upon written application of one or more stockholders who are entitled to vote at the meeting, special meetings shall be called by the Clerk or Assistant Clerk, or in the case of the death, absence, incapacity or refusal of the Clerk or Assistant Clerk, by any other Officer.
- Quorum: The holders of more than fifty percent (50%) of the issued and outstanding capital stock entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business, except as otherwise provided by statute, the Articles of Organization or the Corporate By-Laws. Shares owned directly or indirectly by the Corporation shall not be counted in determining the total number of shares outstanding for this purpose.
- Voting and Proxies: Each stockholder shall have one vote for each share of stock entitled to vote held of record by such stockholder and a proportionate vote for each fractional share so held, unless otherwise provided by the Articles of Organization. The Corporate By-Laws indicate that there are no provisions or requirements for classification of stockholders or class voting. Stockholders may vote either in person or by written proxy dated not more than six (6) days before the meeting named in the proxy. Except as otherwise required by law or by the Corporate By-Laws, and provided that a quorum is present, the affirmative vote of more than fifty percent (50%) of the issued and outstanding capital stock entitled to vote shall decide any matter to be voted on by the stockholders, except when a larger vote is required by law, the Articles of Organization or the Corporate By-Laws. The Corporation shall not directly or indirectly vote any share of its own stock. Any action required or permitted to be taken at any meeting of the stockholders may be taken without a meeting if all stockholders entitled to vote on the matter consent to the action in writing and the written consents are filed with the records of the meetings of the stockholders. Each such consent shall be treated for all purposes as a vote at a meeting.

The Company's By-Laws indicate the following regarding its stockholders:

- Issuance of Capital Stock: Unless otherwise voted by the stockholders, the whole or any part of any unissued balance of the authorized capital stock of the Corporation or the whole or any part of the capital stock of the Corporation held in its treasury may be issued or disposed of by vote of the Board of Directors, in such manner, for such consideration and on such terms as the Directors may determine. Each stockholder shall be entitled to a certificate of the capital stock of the Corporation in such form as may be prescribed from time to time by the Directors. Every certificate for shares of stock which are subject to any restriction on transfer pursuant to the Articles of Organization, the Corporate By-Laws, applicable securities laws or any agreement to which the Corporation is a party, shall have conspicuously noted on the face or back of the certificate either the full text of the restriction or a statement of the existence of such restrictions and a statement that the Corporation will furnish a copy of the restrictions to the holder of such certificate upon written request and without charge.
- Transfers of Capital Stock: Subject to the restrictions, if any, stated or noted on the stock certificates, the restrictions noted in Article VI of the Corporate By-Laws (effective February 17, 2005), and the restrictions noted in any stockholder's agreement to which the Corporation is a party, shares of stock may be transferred on the books of the Corporation by the surrender to the Corporation or its transfer agent of the certificate representing such shares properly endorsed or accompanied by a written assignment or power of attorney properly executed.
- Restrictions on the Transfer of Shares: Article VI of the Corporate By-Laws, covering Restrictions on the Transfer of Shares, is applicable to all stockholders owning less than ten percent (10%) of the outstanding shares of the Corporation's stock. Covered stockholders shall not transfer all or part of the shares, except as provided in the Corporate By-Laws' subsections covering the Right of First Refusal and the Corporation's Option to Purchase.
- Right of First Refusal: The Corporate By-Laws indicate that the first right to purchase is granted to the Corporation or its designee if the stockholder desires to sell his shares for cash pursuant to a bona fide written offer from a Qualified Individual (i.e., an officer of the Corporation or its subsidiaries, such as CEO, President, COO, Chief Medical Officer, or Vice President) or a Physician Stockholder (i.e., a physician licensed to practice in Massachusetts who owns capital stock of the Corporation). In such a situation, the stockholder shall give the Corporation written notice of such sale, which shall state the cash price offered and the name of the Qualified Individual or Physician Stockholder. The Corporation or its designee shall have ninety (90) days after receipt of such notice in which to exercise its right to purchase. The purchase price shall be the cash price offered by the Qualified Individual or Physician Stockholder as stated in the notice, and written notice of the exercise of the right shall be communicated to the stockholder within the ninety (90) day period. If the Corporation or its designee does not exercise the right to purchase, then the stockholder shall have the right to sell the shares to the Qualified Individual or Physician Stockholder provided such sale shall be only for a cash price not less than the price stated in the original notice provided to the Corporation. Transfer of title shall occur within ninety (90) days after the stockholder initially provided notice to the Corporation. If the sale is not consummated during this timeframe, the shares shall again be subject to compliance with the right of first refusal procedures.
- Corporation's Option to Purchase: Upon the occurrence of any one of the Triggering Events detailed in the Corporate By-Laws, the Corporation or its designee shall have the option to purchase the shares of the stockholder within ninety (90) days of receiving written notification of such Triggering Event from the stockholder or upon written notice by any means of such Triggering Event. Upon exercise of such option, the stockholder, his agent(s) and personal representative(s) shall be bound to sell such shares to the Corporation. Triggering events are defined as: (a) the Stockholder's insolvency, bankruptcy, liquidation or receivership; (b) failure by a Physician Stockholder to maintain compliance with the requirements for being a Participating

Physician (i.e., a physician licensed to practice medicine in Massachusetts and who has an agreement to participate in at least one managed care product offered by the Corporation or its subsidiaries); (c) a Physician Stockholder being convicted of a felony or a misdemeanor involving moral turpitude; (d) the failure of a Qualified Individual to maintain compliance with the requirements of such status (i.e., no longer an officer of the Corporation or its subsidiaries). The stockholder shall notify the Corporation in writing immediately upon the occurrence of a Triggering Event.

- **Mandatory Repurchase by Corporation:** Notwithstanding the provisions governing the Corporation's option to purchase, if a Physician Stockholder fails to maintain compliance with the requirements for being a Participating Physician, each by reason of the Physician Stockholder's relocation out of the area, ceasing to engage in activities requiring status as a licensee of the Board of Registration in Medicine, retirement or death, the Corporation shall repurchase and the stockholder or the stockholder's estate shall sell all of the stockholder's shares at a price to be established pursuant to rules set forth in the Corporate By-Laws. These rules provide that if the shares were issued on or before December 31, 1997, valuation is set at the greater of the original purchase price per share or the current market value, as periodically determined by the Board of Directors; if the shares were issued after December 31, 1997, current market value is used. Notwithstanding the provisions governing the Corporation's option to purchase, if a Qualified Individual fails to maintain compliance with the requirements for being a Qualified Individual, by reason of retirement, death or termination of employment for grounds other than for cause, the Corporation shall repurchase and the stockholder or stockholder's estate shall sell all of the stockholder's shares at the current market value of the shares, as periodically determined by the Board of Directors. Transfer of share ownership shall occur immediately and in full upon the Corporation's exercise of repurchase, although the Corporation shall have the right to make the payment for such shares in installments of equal amount over a period not to exceed three (3) years; however, payment by installation shall not be construed as creating an installment share sale.
- **Valuation:** Pursuant to the provisions for the Corporation's right to Mandatory Repurchase, management of the Corporation shall, on a periodic basis, retain an independent advisor to prepare a valuation analysis of the Corporation's common stock. This valuation analysis shall be prepared based on a market comparable approach using as a guideline publicly traded companies in the same or similar line of business as the Corporation. The valuation analysis shall take into account the restricted nature of the stock and the minority interest nature of the stock, if so provided in the offering memorandum, subscription agreement or other disclosure document or agreement pursuant to which the shares were originally issued.

### **BOARD OF DIRECTORS**

The Company's By-Laws indicate the following regarding its Board of Directors (the "Board"):

- The business of the Corporation shall be managed by a Board of Directors, who may exercise all the powers of the Corporation except as otherwise provided by law, by the Articles of Organization or by the Corporate By-Laws. In the event of a vacancy in the Board, the remaining Directors, except as otherwise provided by law, may exercise the powers of the full Board until the vacancy is filled.
- The Board shall consist of up to sixteen (16) Directors, consisting of two (2) Directors serving ex officio and up to fourteen (14) Directors elected by the shareholders. The ex officio Directors shall be the Chief Executive Officer of Baystate Health, Inc. and the President/Chief Executive Officer of the Corporation. The remaining Directors shall consist of not less than five (5) and not more than seven (7) Directors who are current employees of, or current or former trustees, Directors or committee members of Baystate Health, Inc. its affiliates or subsidiaries (hereinafter the "BHS Directors") and a number of Directors equal to the number of BHS Directors who are Participating Physicians and meet the alignment criteria periodically established by the stockholders (hereinafter the "Physician Directors"). Each Director other than the ex officio Directors shall hold office until the next Annual Meeting of the Corporation or until his or her successor shall have been duly



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elected and qualified, unless he or she sooner dies, resigns, is removed, or becomes disqualified. There shall be no limit to the number of consecutive terms an individual may serve as a Director.

- The stockholders, at a properly convened meeting thereof, shall elect Directors (other than the Directors serving ex officio). Prior to the election, a nominating committee appointed from and by the Board shall select a slate of nominees to be presented to the shareholders. The BHS Director nominees must be chosen by members of the nominating committee who are BHS Directors, and the Physician Director nominees must be chosen by members of the nominating committee who are shareholders in the Corporation and who are also Participating Physicians.
- Subject to any relevant provisions of the Articles of Organization or the Corporate By-Laws, unless and until filled by the stockholders, any vacancy in the Board, however occurring, including a vacancy resulting from an enlargement of the Board, but not including a vacancy in the office of the Chairman of the Board, may be filled by vote of the Directors present at any meeting of Directors at which a quorum is present. However, if the vacancy occurs because of the resignation, death, removal or disqualification of a BHS Director, such vacancy must be filled, by the remaining BHS Directors, by a person qualified as a BHS Director; the same procedures apply with respect to filling vacancies by Physician Directors. Each such successor shall hold office for the unexpired term of his predecessor and until his successor is chosen and qualified or until his earlier death, resignation, removal or disqualification. Vacancies in the office of the Chairman of the Board shall be filled either by succession in the office of Chief Executive Officer of Baystate Health, Inc., or by action of the shareholders at the Annual Meeting or a special meeting of shareholders.
- Any Director may resign by delivering his written resignation to the Corporation at its principal office or to the President/Chief Executive Officer or Clerk. Such resignation shall be effective upon receipt unless otherwise specified. Stockholders may remove any Director, with or without cause, by a vote of more than fifty percent (50%) of the issued and outstanding capital stock entitled to vote. A Director other than an ex officio Director may also be removed, with or without cause, by the vote of more than two thirds (66.67%) of the total number of Directors; the Director being removed shall not be entitled to vote on such action. Notwithstanding the foregoing, for so long as may be required by Massachusetts law, a Director may be removed for cause only after a reasonable notice and opportunity to be heard before the body proposing to remove such Director. Any BHS Director or Physician Director who ceases to satisfy the criteria for such position shall be deemed to have been immediately removed as a Director.
- Regular meetings of the Board may be held without call or notice at such times as the Directors may from time to time determine, provided that any Director who is absent when such determination is made shall be given notice of the determination. A regular meeting of the Directors may be held without a call or notice immediately after and at the same place as the annual meeting of stockholders. Special meetings of the Directors may be held at any time and place designated in a call by the Chairman of the Board, the President/Chief Executive Officer, two or more Directors or by one Director if there is only a single Director in office. Notice of any special meeting of the Directors shall be given to each Director by the Clerk, or by the Officer or one of the Directors calling the meeting at least 48 hours (for hand delivery, telegram, fax) or 72 hours (by mail) in advance.
- At any meeting of the Board, a majority of the members of the Board eligible to vote shall constitute a quorum, subject to the following provisions. The Chairman of the Board is included for calculating the quorum, but not the President/Chief Executive Officer. During such time as Baystate Health, Inc. and its subsidiaries collectively hold no less than fifty percent (50%) of the issued and outstanding capital stock entitled to vote, a quorum must include at least one BHS Director. If the opportunity to participate in a particular meeting via conference call is not available, then the quorum must include at least one Physician Director. The Chairman of the Board may decide that a matter is of sufficient significance or importance that the quorum requirement

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will only be satisfied if the number of BHS Directors present and voting on the issue is at least equal to the number of Physician Directors present and voting on the issue.

- Unless otherwise specified by law, the Articles of Organization or the Corporate By-Laws, at any meeting of the Board at which a quorum is present, the vote of a majority of those present shall be sufficient to decide matters considered by the Board, so long as the affirmative vote includes a majority of the BHS Directors present, during such times as Baystate Health, Inc. and its subsidiaries collectively hold no less than fifty percent (50%) of the issued and outstanding capital stock entitled to vote. The Chairman of the Board shall be a voting member of the Board, and the President/Chief Executive Officer shall be a non-voting member of the Board. If the Chairman of the Board or his designee is not present, an action may only be approved if a majority of the Directors in attendance and voting on the action are BHS Directors. Any action required or permitted to be taken at any meeting of the Board may be taken without a meeting if all the Directors consent to the action in writing and the written consents are filed with the records of the Directors' meetings; each such consent shall be treated for all purposes as a vote at a meeting.
- During such time as Baystate Health, Inc. or its successor owns fifty percent (50%) or more of the outstanding capital stock of the Corporation, the favorable vote of a majority of the BHS Directors is required for approval of any matter that may present, in the sole discretion of the Chairman of the Board, a material threat to the tax-exempt or charitable status of Baystate Health, Inc. or any of its subsidiaries holding such status.

At December 31, 2005, the Board was comprised of ten (10) directors, which is in compliance with the Corporate By-Laws. Directors elected and serving at December 31, 2005, with addresses and business affiliations, are as follows:

<u>Director</u>	<u>Principal Occupation</u>	<u>Term Expires</u> <u>June</u>
Bruce Brown Conway, MA	Retired President of Monarch Life Insurance Co.	2007
Michael J. Daly Longmeadow, MA	Vice Chairman, Baystate Health, Inc.	2007
John Egelhofer, M.D. Holyoke, MA	Chestnut Medical Associates, Inc. Private Practicing Physician	2007
Benjamin Liptzin, M.D. Longmeadow, MA	Chairman, Dept. of Psychiatry/BMERF, Baystate Health System, Inc.; Private Practicing Physician	2007
Keith C. McLean-Shinaman Tariffville, CT	Treasurer and Senior Vice President, Finance, Baystate Health, Inc.	2007
Richard Segool, M.D. Suffield, CT	Pioneer Valley Pediatrics Private Practicing Pediatrician	2007
Peter F. Straley Amherst, MA	President & Chief Executive Officer, Health New England, Inc.	Ex officio (non-voting)
Stephen Sweet, M.D. Amherst, MA	President & Chief Executive Officer, Baycare Health Partners; Private Practicing Nephrologist	2007
Mark R. Tolosky Longmeadow, MA	President & Chief Executive Officer, Baystate Health, Inc.	Ex officio Chairman
Steven Wenner, M.D. Longmeadow, MA	New England Orthopedic Surgeons Private Practicing Orthopedic Surgeon	2007

***Committees of the Board***

Subject to any relevant provision of the Articles of Organization of the Corporate By-Laws, the Board may, by vote (in accordance with Section 3.13 (“Directors – Voting”) of the Corporate By-Laws) elect from their number an Executive Committee or other appropriate committees and may, by like vote, delegate to committees, so elected, some or all of their powers to the extent permitted by law. Except as the Board or the Corporate By-Laws may otherwise determine, any such committee may make rules for the conduct of its business, but unless otherwise provided by the Directors or in such rules, its business shall be conducted as nearly as possible in the same manner as is provided by the Corporate By-Laws for the Directors. The Board shall have the power at any time to fill vacancies in any such committee, to change its membership or to discharge the committee. If a quorum shall not be present at any meeting of a committee, the committee members present may adjourn the meeting from time to time, with notice to all committee members, until a quorum shall be present. No action taken by any committee, other than the Executive Committee, shall be final unless the action is ratified by the Board or the Executive Committee; the action is reported at a meeting of the Board or Executive Committee and no objection is raised by any Director present; or a majority of the members of the Committee in attendance and voting on the action are BHS Directors.

The Board may, in its discretion, also elect advisory or administrative committees that include non-members of the Board.

The Board shall appoint an Executive Committee, which will consist of the Chairman of the Board plus equal numbers of BHS Directors and Physician Directors. The President/Chief Executive Officer shall also serve, ex officio, as a non-voting member of the Executive Committee. A quorum for the Executive Committee shall consist of a majority of its members, except that during such time that Baystate Health, Inc. and its subsidiaries collectively hold no less than fifty percent (50%) of the issued and outstanding capital stock entitled to vote, a quorum must include at least one BHS Director, and if the opportunity to participate in the meeting through a conference call is unavailable, a quorum must include at least one Physician Director. Unless otherwise specified by law, the Articles of Organization or the Corporate By-Laws, the act of the majority of the Executive Committee members present at a meeting at which a quorum is present shall be the act of the Executive Committee. However, during such time that Baystate Health, Inc. and its subsidiaries collectively hold no less than fifty percent (50%) of the issued and outstanding capital stock entitled to vote, the affirmative vote must include a majority of the BHS Directors members present. The Chairman of the Board shall be entitled to cast a tiebreaking vote.

The current standing committees of the Board are as follows:

Executive Committee  
Finance Committee

**NOTE:** To comply with the governance issues raised by the Division, the BHS Audit and Compliance Committee now has full audit oversight duties and responsibilities for HNE.

**OFFICERS**

The Company’s officers shall consist of a Chairman of the Board, President/Chief Executive Officer, a Treasurer, a Clerk, and such other Officers with such other titles as the Board may determine from time to time, including but not limited to a Vice Chairman of the Board, one or more Vice Presidents, Assistant Treasurers and Assistant Clerks. With the exception of the Chairman of the Board and the President/Chief Executive Officer, who shall serve as members of the Board ex officio, no Officer need be a Director or stockholder. Any two or more offices may be held by the same person. The Clerk shall be a resident of the Commonwealth of Massachusetts unless the Corporation has a resident agent appointed for the purpose of service of process.

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The Chairman of the Board shall be the Chief Executive Officer of Baystate Health, Inc., or an individual designated by him or her in writing to serve as Chairman for one or more meetings of the Board. The President/Chief Executive Officer, Treasurer and Clerk shall be elected annually by the Board at its first meeting following the annual meeting of the stockholders. Consistent with the requirements of the Corporate By-Laws, Officers may be chosen or appointed by the Board at any such meeting or at any other meeting. Except as otherwise provided by law, the Articles of Organization or the Corporate By-Laws, the President/Chief Executive Officer, Treasurer and Clerk shall hold office until the first meeting of the Directors following the next annual meeting of stockholders and until their respective successors are chosen and qualified; all other Officers shall hold office until the first meeting of the Directors following the annual meeting of stockholders, unless a different term is specified in the vote choosing or appointing them.

Any Officer may resign by delivering his or her written resignation to the Corporation at its principal office or to the President/Chief Executive Officer or Clerk. Such resignation shall be effective upon receipt unless otherwise specified. Any Officer may be removed at any time, with or without cause, by a vote taken consistent with the Corporate By-Laws. An Officer may be removed for cause only after reasonable notice and opportunity to be heard by the Board prior to action thereon.

The elected officers and their respective titles at December 31, 2005 were as follows:

<b><u>Officer</u></b>	<b><u>Principal Occupation</u></b>
Mark R. Tolosky	Chairman of the Board
Richard Segool, M.D.	Vice Chairman of the Board
Keith McLean-Shinaman	Treasurer
Peter F. Straley	President and Chief Executive Officer
Thomas Ebert, M.D.	Vice President and Medical Director
James Kessler	Vice President and General Counsel
Robert Kosior	Vice President, Finance and Chief Financial Officer
Philip LaCombe	Vice President, Information Technology
Maura McCaffrey	Vice President of Pharmacy and Service Operations
Bruce Ruder	Vice President, Sales and Marketing
Amy Trombley	Vice President, Human Resources
Ellen Simanski	Secretary of the Corporation and Clerk
Noel Blagg, M.D.	Associate Medical Director
David Boss, M.D.	Associate Medical Director
Donna O'Shea, M.D.	Associate Medical Director
David Methe	Security Officer
Renee Wroth	Compliance Officer and Privacy Officer

**CONFLICT OF INTEREST PROCEDURES**

The Company has adopted a conflict of interest policy statement. The Company has an established procedure for the disclosure to the Board of any material interest or affiliation on the part of any officer or Director which is in or is likely to conflict with his/her official duties.

The Company's conflict of interest policy also governs its affiliates, HAS and HIS. Covered Persons are defined as members of the Board of Directors, corporate officers as named by the Corporate By-Laws or by the Board, and any employees designated as Covered Persons by the Board or the President/Chief Executive Officer.

A Covered Person must disclose the existence of any potential conflict of interest (e.g., a financial or competitive interest or other obligation to another entity) and all material facts to the Company's Board of Directors, or to any committee or individual designated by the Board to receive such disclosures. Each Covered Person shall annually

**Commonwealth of Massachusetts Division of Insurance  
REPORT ON THE STATUTORY EXAMINATION OF  
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receive a copy of the Company's conflict of interest policy, and shall be asked to report any Potential Conflicts to the Board or its designee at least annually on a form prescribed by the Board. Each Covered Person shall be required to report any material changes to the information in the report to the Board or its designee as soon as such changes occur.

The completed Conflict Statements were reviewed, and no discrepancies were noted in the response to the General Interrogatories regarding conflicts of interest as reflected in the Company's 2005 Annual Statement.

**CORPORATE RECORDS**

*Articles of Incorporation and By-Laws*

Our review of the By-Laws and Articles of Incorporation indicated that the By-Laws were last amended effective February 17, 2005. This amendment reflects the transfer of the audit committee function to BHS.

*Board of Directors Minutes*

The minutes of the Board and committee meetings for the period under statutory examination were read and indicated that all meetings were held in accordance with the Company By-Laws and the laws of the Commonwealth of Massachusetts. Activities of the committees were reported upon at various meetings of the Board.

**ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS AND PURCHASES OR SALES**

None.

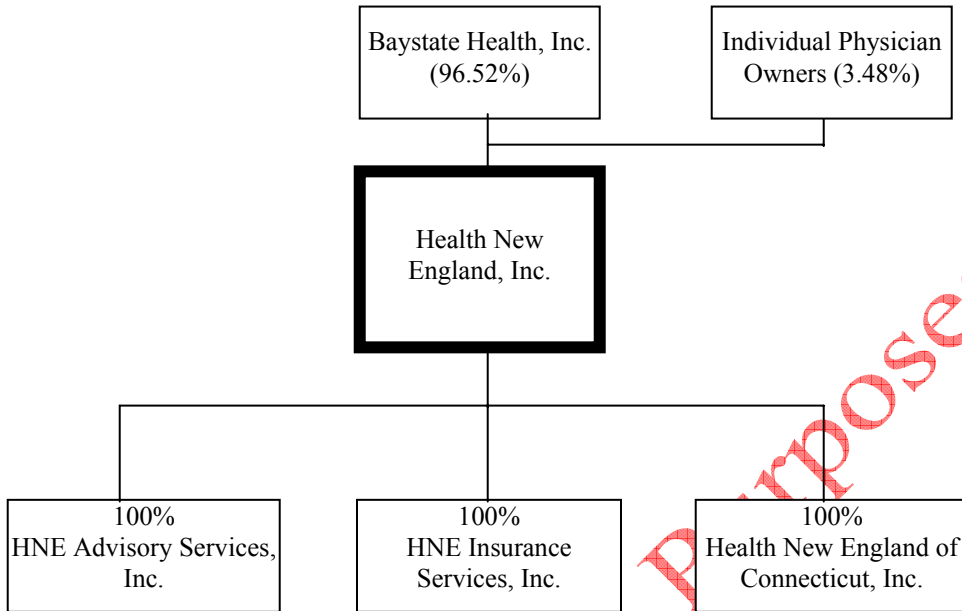
**MANAGEMENT CONTINUITY AND NATIONAL EMERGENCY**

The Company provides for the continuity of management and operations in the event of a catastrophe or national emergency in accordance with Massachusetts General Laws, Chapter 175 §§ 180M-180Q.

**AFFILIATED COMPANIES**

*Subsidiaries and Affiliated Companies*

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2005 is illustrated below:



**RELATED PARTY TRANSACTIONS**

The Company contributed capital in the amount of \$2 million to its subsidiary, HAS, in December 2005. The 2005 contribution was recorded as additional paid-in-capital. There were no capital contributions during 2004 or 2003.

HAS provides administration and claims processing services to the Company on behalf of self-insured employer sponsored health care benefit plans. Under a Management Services Agreement, the Company provides Management Services to HAS. Each month, the Company bills HAS for administrative duties performed on behalf of HAS. Total billings for the years ended December 31, 2005 and 2004 amounted to \$4,938,854 and \$5,197,449, respectively.

HIS collects commissions for placement of stop-loss coverage for Administrative Services Only (ASO) groups. For the years ended December 31, 2005 and 2004, the commissions collected were \$7,506 and \$8,676, respectively.

HNECT is an unlicensed shell company and continues to be dormant, only having insignificant Connecticut tax activity.

As of December 31, 2005, HAS owed the Company \$1,265,732, and HNECT owed the Company \$62,552. As of December 31, 2005, the Company owed HIS \$70,796.

**FIDELITY BOND AND OTHER INSURANCE**

The Corporation maintains fidelity bond coverage with an authorized Massachusetts insurer. The aggregate limit of liability is within the NAIC suggested minimum.

In addition to the bond insurance, the Corporation has other insurance purchased from authorized insurers in the form of professional liability and excess professional liability coverage.

**PENSION AND INSURANCE PLANS**

*Employees' Retirement Plan*

HNE provides a 401(k) Retirement Plan (the Plan) pursuant to § 401(k) of the Internal Revenue Code covering substantially all employees. Beginning January 1, 2002 employees may contribute up to 20% of pre-tax annual compensation, as defined in the Plan document. HNE matches 100% of the first 3% and 50% of the next 2% of employee contributions to the Plan. During 2005 and 2004, HNE contributed approximately \$474,000 and \$460,000, respectively, in matching contributions. An additional profit sharing contribution may be made by HNE at its discretion. In 2005 and 2004, HNE contributed approximately \$130,000 and \$127,000, respectively, in profit sharing, which amounted to approximately 1% of employees' compensation. Contributions and compensation levels are subject to certain limitations under the Internal Revenue Code.

All administrative costs associated with the Plan are the responsibility of HNE. The Plan administrative fees amounted to approximately \$40,405 and \$36,420 for the years ended December 31, 2005 and 2004, respectively.

**SPECIAL DEPOSITS**

The special deposits of the Company at December 31, 2005 are as follows:

<b>Description of Deposit</b>	<b>Where Deposited</b>	<b>Par or Book Value</b>	<b>Statement Value</b>	<b>Market Value</b>
<b><u>Held for the Benefit of Policyholders</u></b>				
UST Note 3%	Dreyfus Funds, Newark, NJ	\$ 1,500,000	\$ 1,488,646	\$ 1,479,300
<b><u>Restricted Cash</u></b>				
BASIC Money Market Fund	Dreyfus Funds, Newark, NJ			\$ 63,366
100% U.S. Treasury Money Market Fund	Dreyfus Funds, Newark, NJ			295,167
<b>TOTAL</b>				<b>\$ 358,533</b>

### TERRITORY AND PLAN OF OPERATION

The Company is only licensed to transact business in the Commonwealth of Massachusetts. The Company's service areas are predominantly the four western counties in Massachusetts; Hampden, Hampshire, Berkshire, and Franklin.

HNE offers a variety of plan choices, including health maintenance organization (HMO), point-of-service (POS) and preferred provider organization (PPO) plans. The Company does not have any direct Medicare Supplement Insurance in force.

Commercial Operations: HNE contracts with hospitals and physicians organizations such as Independent Practice Association (IPA) and Physician Hospital Organization (PHO) to provide hospital and medical services to group and individual enrollees. HNE pays "fee for service" (negotiated fees) and/or capitation for services rendered by its contracting providers. Terms of some hospital and physician contracts include withholds and risk sharing agreements (including Pay for Performance Agreements) whereby favorable and unfavorable claims experience and utilization is shared.

### PRODUCTS

The Company offers the following insured managed care products:

**HMO** (Health Maintenance Organization) – For an HMO member, each member is assigned a Primary Care Physician (PCP) who provides primary care, except in cases of emergency. Referrals out of the HNE network require approval by HNE. Co-payments and deductibles vary depending on the type of HMO plan. HNE offers Basic, High-Deductible, Value and Premium levels of HMO coverage.

**Advantage Plus POS** (Point of Service) – Members may choose from in-plan and out-of-plan care under HNE's three levels of POS plans. HNE offers High, Mid and Low option POS plans, with a progressively higher scale of co-payments from the High to Low options. When visiting a provider for authorized care within the plan network, members pay a copayment for services such as office visits, inpatient and outpatient care, and admissions for maternity, mental health or substance abuse treatment. No co-payment is required for other services such as diagnostic tests or routine pre- and post-natal care. Members may choose to go out-of-plan for care; for out-of plan care, members are subject to an annual deductible, after which HNE pays 80% of the costs of most out-of-plan services.

**Premier PPO** (Preferred Provider Organization) – The PPO product is available under Basic, Value and Premium options, with progressively higher co-payments from the Premium to Value to Basic options. Members can choose from in-network and out-of-network care. In-network care is not subject to a deductible, but care from participating providers in the HNE network is subject to lower co-payments than care from participating providers in the Private HealthCare Systems (PCHS) network. Out-of-network care is subject to an annual deductible, and HNE covers 80% of these costs after the deductible is satisfied.



### **PROVIDER CONTRACTS**

The Company arranges for the provision of health care services to its subscribers and eligible dependents thereof through contracts with physician providers and other health care providers. Physician providers and such other organizations or individuals are and shall be deemed to be, for all purposes, independent contractors with the Company, and shall not be characterized as officers, employees or agents of the Company.

For the HMO product, the Company, participating hospitals and physicians are often parties to a variety of incentive agreements (including pay-for-performance agreements) whereby favorable and unfavorable claims experience is shared. Distribution of such retention is contingent upon the results of the risk incentive arrangements.

The agreements are in compliance with Massachusetts statutes and regulation 211 CMR § 43.10(1)(C).

### **RESERVES**

In conjunction with KPMG's examination of the statutory financial statements of HNE, KPMG was engaged by the Division to review the adequacy of the Unpaid Claim Liability (UCL) of HNE as of December 31, 2005, and to perform a premium adequacy analysis as of December 31, 2005.

KPMG actuaries prepared independent estimates of the unpaid claim liabilities for December 2005 and prior periods. For December 31, 2005, completion factors for the projection of ultimate incurred claims were developed using historical payment patterns and actuarial judgment. Adjustments were also made to the completion factors to reduce the effect of the retroactive adjustments due to claim overpayments. "Low" and "High" estimates were developed by subtracting the claims paid-to-date from KPMG's range of incurred claims estimates. As the HNE business pays fairly quickly, the range of estimates for the December 31, 2005 UCL is narrow and KPMG's estimates are similar to HNE's estimates with hindsight through September 30, 2006.

Based upon KPMG's review, the UCL at December 31, 2005 appears to be fairly stated in aggregate in all material respects. However, the redundancy in the reserve is approximately \$8 million, which is significant. Specifically, inpatient claim trends were negative in 2005, which was not expected. The Company experienced a decrease in the severity of admissions which, when coupled with a small decrease in utilization, resulted in a decrease in inpatient per member per month (PMPM) costs of approximately 3% from 2004 to 2005. Also contributing to the reserve redundancy is the fact that the Company adds an explicit margin to its reserve and has additional conservatism in the form of provisions for unpaid high cost claims and pended claims. The Company has been working with its external auditor to take steps to keep the amount of conservatism in its UCL estimate at a reasonable level.

KPMG reviewed HNE's premium deficiency reserve calculation and found it to be reasonable. The Company did not book a premium deficiency reserve at December 31, 2005. This appears appropriate based on recent financial results, and the Company's projections of revenues, claims and administrative expenses at that point in time. The Company, however, may want to consider performing a more detailed premium deficiency analysis in the future which projects revenues and expenses through the end of the rating period.

### **REINSURANCE**

HNE has reinsured its liability for certain catastrophic medical services and emergency out-of-area hospital and medical services. The reinsurance contract provided for coverage of any HMO member's cumulative inpatient and outpatient hospital facility claims in excess of \$200,000 and \$150,000 for 2005 and 2004, respectively, subject to certain limitations as defined in the contract. Total premiums of \$969,717 and \$854,227 were ceded relating to reinsurance coverage for the years ended December 31, 2005 and 2004, respectively. Recoveries realized under the

applicable reinsurance contract for years ended December 31, 2005 and 2004 were \$330,268 and \$1,908,416, respectively.

HNE does not write reinsurance contracts.

### **INCOME TAXES**

As part of KPMG's examination of the statutory financial statements of the Company, KPMG reviewed the Company's December 31, 2005 balances and rollforwards for federal income tax recoverable and net deferred tax asset. KPMG determined that HNE's net deferred tax asset for capital loss carryforwards, amounting to \$178,162, was properly accounted for and properly excluded from the admitted deferred tax asset due to the uncertainty of offsetting capital gains. KPMG reviewed HNE's one-year reversals relating to the deferred tax asset and found them to be reasonable. KPMG confirmed that the admitted deferred tax asset of \$1,621,927 was correct pursuant to SSAP No. 10, paragraph (a). Since HNE had sufficient taxable income during 2005, any reversals in one year can be carried back to recover taxes paid in 2005, pursuant to the guidance of SSAP No. 10, paragraph (a).

The Company made an Application for Change in Accounting Method to the Internal Revenue Service requesting permission to change its method of accounting of computing taxable income from a C Corporation to the method required under Section 832 of the Code for companies taxable as a Property and Casualty Company. Permission was granted by the IRS in August of 2005, effective for the taxable year ended December 31, 2004. This resulted in a net adjustment (decrease) in taxable income for 2004 which was taken fully in 2004. This adjustment was not accrued for in 2004 as the Company was awaiting approval from the IRS for the accounting method change.

### **ACCOUNTS AND RECORDS**

The books and records of the Company are audited annually by the Independent Certified Public Accounting firm of Ernst & Young LLP, in accordance with 211 CMR § 43.14. The CPA firm issued an unqualified opinion on the December 31, 2005 audited financial statements. The Company is also subject to internal audit reviews, which are conducted on a contract basis by the internal audit department of BHS.

The internal control structure was discussed with management through questionnaires and through a review of the work performed by the Corporation's Independent Certified Public Accountants, E&Y. No material internal control weaknesses were noted in connection with the examination, nor were any such matters reported in the CPA firm's filings with the Division.

The NAIC provides a questionnaire covering the evaluation of the controls in the IT environment. The questionnaire was completed by the Company and reviewed by KPMG's Information Technology Advisory Services (ITAS) team, which evaluated the adequacy of the IT controls. No material deficiencies were noted.

The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2005 Annual Statement. No material exceptions were noted.

### **SUBSEQUENT EVENTS**

- **October 2006** – HNE announced health care service agreements with a number of UMass Memorial Health Care providers, as well as affiliated physicians of Fallon Clinic, Inc. These health care service agreements allow HNE members to access the largest privately held doctors' group in Central Massachusetts. The agreements are expected to help HNE expand beyond its home area of Western Massachusetts, and address the changing needs of its employer base.

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- November 2006 – HNE requested that the Massachusetts Division grant formal approval for a surplus note interest payment (planned for December 29, 2006) amounting to approximately \$2.34 million. This payment represented interest accrued from the date of issuance (April 1999) through September 2006, and was made as scheduled on December 29, 2006.
- January 2007 – The Internal Revenue Service (the IRS) notified HNE in December 2006 that it would be auditing the Company’s 2004 tax return. HNE and the IRS held a kick-off meeting on January 18, 2007, at which time HNE fulfilled numerous items on the IRS’ data request list.

**COMMITMENTS AND CONTINGENCIES**

*Lease Obligations*

The Company leases certain equipment, vehicles, office space and storage facilities under non-cancellable leases expiring at various dates through 2010 with varying renewal options. Lease rental expense was \$516,000 and \$629,000 for the years ended December 31, 2005 and 2004, respectively. Lease equipment expense was \$321,917 and \$44,547 for the years ended December 31, 2005 and 2004, respectively. During 2005, HNE’s equipment lease expense increase was due primarily to the Company’s upgrade of the Amisys platform; the Company entered into a \$1.9 million lease with Bank of America, which runs through August 1, 2010. The Company paid \$266,636 toward this lease during 2005. Minimum annual lease commitments for these operating leases are as follows:

2006	\$ 1,200,269
2007	1,191,670
2008	1,192,299
2009	1,012,573
2010	289,666

*Legal Proceedings*

The Company is periodically involved in litigation arising in and out of the normal course of business. While the Company is not aware of any actions or allegations which should reasonably give rise to any material adverse effect, the outcome of litigation cannot be foreseen with certainty. It is the opinion of management, after consultation with legal counsel, that the ultimate resolution of these matters will not materially affect its financial position, results of operations or liquidity.

**FINANCIAL STATEMENTS**

The Financial Statements section includes the following:	<u>Page</u>
Statutory Statement of Assets, Liabilities and Capital & Surplus as of December 31, 2005	19
Analysis of Assets Exhibit as of December 31, 2005	20
Statement of Revenue and Expenses for the Year Ended December 31, 2005	21
Capital & Surplus for the Year Ended December 31, 2005	22

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and by the NAIC as of December 31, 2005.

**For Information Purposes Only**

Commonwealth of Massachusetts Division of Insurance  
**REPORT ON THE STATUTORY EXAMINATION OF  
HEALTH NEW ENGLAND, INC.**

**Health New England, Inc.**  
**Statutory Statement of Assets, Liabilities and Capital & Surplus**  
**As of December 31, 2005**

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
<b><u>ASSETS</u></b>			
Bonds	\$ 56,479,957	\$ -	\$ 56,479,957
Stocks:			
Common stocks	(219,767)	-	(219,767)
Cash, cash equivalents and short-term investments	5,709,288	-	5,709,288
Subtotals, cash and invested assets	61,969,478	-	61,969,478
Investment income due and accrued	392,843	-	392,843
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	733,589	-	733,589
Reinsurance:			
Amounts recoverable from reinsurers	800	-	800
Net deferred tax asset	1,621,927	-	1,621,927
Electronic data processing equipment and software	462,976	-	462,976
Receivables from parent, subsidiaries and affiliates	1,328,284	-	1,328,284
Health care and other amounts receivable	962,893	-	962,893
<b>Total Assets</b>	<b>\$ 67,472,790</b>	<b>\$ -</b>	<b>\$ 67,472,790</b>
<b><u>LIABILITIES</u></b>			
Claims unpaid	\$ 27,141,827	\$ -	\$ 27,141,827
Accrued medical incentive pool and bonus amounts	2,471,025	-	2,471,025
Unpaid claims adjustment expenses	2,099,937	-	2,099,937
Premiums received in advance	5,000,426	-	5,000,426
General expenses due or accrued	5,030,854	-	5,030,854
Current federal and foreign income tax payable and interest thereon	962,976	-	962,976
Amounts due to parent, subsidiaries and affiliates	70,796	-	70,796
<b>Total Liabilities</b>	<b>\$ 42,777,841</b>	<b>\$ -</b>	<b>\$ 42,777,841</b>
<b><u>NET WORTH</u></b>			
Common capital stock	\$ 5,151,452	\$ -	\$ 5,151,452
Gross paid in and contributed surplus	1,073,490	-	1,073,490
Surplus notes	4,000,000	-	4,000,000
Unassigned funds (surplus)	14,470,007	-	14,470,007
<b>Total Capital and Surplus</b>	<b>\$ 24,694,949</b>	<b>\$ -</b>	<b>\$ 24,694,949</b>
<b>Total Liabilities, Capital and Surplus</b>	<b>\$ 67,472,790</b>	<b>\$ -</b>	<b>\$ 67,472,790</b>

**Commonwealth of Massachusetts Division of Insurance  
REPORT ON THE STATUTORY EXAMINATION OF  
HEALTH NEW ENGLAND, INC.**

**Health New England, Inc.  
Analysis of Assets Exhibit  
As of December 31, 2005**

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
<b><u>ASSETS</u></b>					
Bonds	\$ 56,479,957	\$ -	\$ 56,479,957	\$ -	\$ 56,479,957
Stocks:					
Common stocks	590,239	810,006	(219,767)	-	(219,767)
Cash, cash equivalents and short-term investments	5,709,288	-	5,709,288	-	5,709,288
Subtotals, cash and invested assets	<u>62,779,484</u>	<u>810,006</u>	<u>61,969,478</u>	<u>-</u>	<u>61,969,478</u>
Investment income due and accrued	392,843	-	392,843	-	392,843
Premiums and considerations:					
Uncollected premiums and agents' balances in the course of collection	990,329	256,740	733,589	-	733,589
Reinsurance:					
Amounts recoverable from reinsurers	800	-	800	-	800
Net deferred tax asset	1,993,738	371,811	1,621,927	-	1,621,927
Electronic data processing equipment and software	752,051	289,075	462,976	-	462,976
Furniture and equipment	430,939	430,939	-	-	-
Receivables from parent, subsidiaries and affiliates	1,328,284	-	1,328,284	-	1,328,284
Health care and other amounts receivable	1,087,459	124,566	962,893	-	962,893
Other than invested assets	905,086	905,086	-	-	-
<b>Total Assets</b>	<u>\$ 70,661,013</u>	<u>\$ 3,188,223</u>	<u>\$ 67,472,790</u>	<u>\$ -</u>	<u>\$ 67,472,790</u>

For Information Purposes Only

**Commonwealth of Massachusetts Division of Insurance  
REPORT ON THE STATUTORY EXAMINATION OF  
HEALTH NEW ENGLAND, INC.**

**Health New England, Inc.  
Statement of Revenue and Expenses  
For the Year Ended December 31, 2005**

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Member Months	805,061	-	805,061
Net premium income	\$ 228,149,743	\$ -	\$ 228,149,743
Total revenues	228,149,743	-	228,149,743
Hospital and Medical:			
Hospital/medical benefits	117,244,982	-	117,244,982
Other professional services	3,568,641	-	3,568,641
Outside referrals	18,967,733	-	18,967,733
Emergency room and out-of-area	7,010,401	-	7,010,401
Prescription drugs	34,542,077	-	34,542,077
Other hospital and medical	6,259,461	-	6,259,461
Incentive pool, withhold adjustments and bonus amounts	3,937,634	-	3,937,634
Subtotal	191,530,929	-	191,530,929
Less:			-
Net reinsurance recoveries	1,130,948	-	1,130,948
Total medical and hospital	190,399,981	-	190,399,981
Claims adjustment expenses	8,351,829	-	8,351,829
General administrative expenses	18,612,191	-	18,612,191
Total underwriting deductions	217,364,001	-	217,364,001
Net underwriting gain	10,785,742	-	10,785,742
Net investment income earned	1,718,964	-	1,718,964
Net realized capital gains	(133,304)	-	(133,304)
Net investment gains	1,585,660	-	1,585,660
Net gain or (loss) from premium balances charged off	(50,292)	-	(50,292)
Other income (expense)	1,249	-	1,249
Net income before federal income taxes	12,322,359	-	12,322,359
Federal and foreign income taxes incurred	85,807	-	85,807
Net Income	\$ 12,236,552	\$ -	\$ 12,236,552

Commonwealth of Massachusetts Division of Insurance  
**REPORT ON THE STATUTORY EXAMINATION OF  
HEALTH NEW ENGLAND, INC.**

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**Health New England, Inc.  
Capital & Surplus  
For the Year Ended December 31, 2005**

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Capital and Surplus, December 31, 2004	\$ 17,076,230	\$ -	\$ 17,076,230
Net income or (loss)	12,236,552	-	12,236,552
Change in net deferred income tax	(4,191,195)	-	(4,191,195)
Change in nonadmitted assets	584,801		584,801
Capital changes: Paid in	(34,971)		(34,971)
Subsidiary Net Loss	(976,468)		(976,468)
Net change in capital and surplus	<u>7,618,719</u>	<u>-</u>	<u>7,618,719</u>
Capital and Surplus, December 31, 2005	<u>\$ 24,694,949</u>	<u>\$ -</u>	<u>\$ 24,694,949</u>

For Information Purposes Only



**ACKNOWLEDGMENT**

This is to certify that the undersigned is a duly qualified Certified Financial Examiner (CFE) and that, in conjunction with KPMG LLP, applied certain agreed-upon procedures to the accounting and corporate records of Health New England, Inc. in order for the Division of Insurance of the Commonwealth of Massachusetts to fulfill the Commonwealth's requirements regarding periodic Statutory Examinations of Massachusetts domiciled insurers.

The undersigned's participation in this Statutory Examination as the Examiner-in-Charge encompassed responsibility for the coordination and direction of the statutory examination performed which was in accordance with, and substantially complied with, those standards established by the Financial Condition (E) Committee of the NAIC and the *NAIC Financial Condition Examiners' Handbook*. This participation consisted of involvement in the planning (development, supervision and review of agreed upon procedures), administration, review of work papers and preparation of the statutory examination report.

The cooperation and assistance of the officers and employees of Health New England, Inc. extended to all examiners during the course of the examination is hereby acknowledged.

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John Curran, CFE  
Supervising Examiner & Examiner in Charge (EIC)  
Commonwealth of Massachusetts  
Division of Insurance  
Boston, MA

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