

DENTAL SERVICE OF MASSACHUSETTS, INC.



**THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION**

DIVISION OF INSURANCE

***REPORT OF EXAMINATION OF*
DENTAL SERVICE OF MASSACHUSETTS, INC.**

Boston, Massachusetts

As of December 31, 2007

NAIC COMPANY CODE 52060

EMPLOYERS ID NO. 04-6143185

DENTAL SERVICE OF MASSACHUSETTS, INC.

TABLE OF CONTENTS

| | <u>Page</u> |
|--------------------------------------------------------------------|-------------|
| Salutation..... | 1 |
| Scope of Examination..... | 2 |
| Status of Findings from the Prior Examination..... | 2 |
| History..... | 3 |
| Subsidiaries..... | 3 |
| Growth of Company..... | 5 |
| Management..... | 5 |
| Annual Meeting..... | 5 |
| Board of Directors | 6 |
| Committees of the Board of Directors..... | 7 |
| Officers | 9 |
| Conflict of Interest Procedures | 10 |
| Corporate Records | 10 |
| Organization Chart | 12 |
| Transactions and Agreements with Subsidiaries and Affiliates | 13 |
| Fidelity Bonds and Other Insurance | 13 |
| Pension and Insurance Plans. | 13 |
| Statutory Deposits | 14 |
| Insurance Products and Related Practices | 14 |
| Territory and Plan of Operation | 14 |
| Treatment of Policyholders | 14 |
| Claim Settlement Practices | 14 |
| Reinsurance..... | 15 |
| Subsequent Events..... | 15 |
| Accounts and Records..... | 15 |
| Financial Statements | 16 |
| Statement of Assets, Liabilities, Capital and Surplus..... | 17, 18 |
| Statement of Revenue and Expenses..... | 19 |
| Statement of Surplus..... | 20 |
| Reconciliation of Capital and Surplus..... | 21 |
| Notes to Financial Statements..... | 22 |
| Conclusion..... | 24 |



COMMONWEALTH OF MASSACHUSETTS

Office of Consumer Affairs and Business Regulation

DIVISION OF INSURANCE

One South Station • Boston, MA 02110-2208

(617) 521-7794 • FAX (617) 521-7771

TTY/TDD (617) 521-7490

<http://www.mass.gov/doi>

DEVAL L. PATRICK
GOVERNOR

TIMOTHY P. MURRAY
LIEUTENANT GOVERNOR

GREGORY BIALECKI
SECRETARY OF HOUSING AND
ECONOMIC DEVELOPMENT

DANIEL C. CRANE
DIRECTOR

NONNIE S. BURNES
COMMISSIONER OF INSURANCE

February 16, 2009

The Honorable Alfred W. Gross
Chair, Financial Condition (E) Committee, NAIC
Commissioner of Insurance
The Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
Post Office Box 1157
Richmond, Virginia 23218

The Honorable Joel Ario
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
Pennsylvania Insurance Department
1326 Strawberry Square
Harrisburg, Pennsylvania 17120

The Honorable Nonnie S. Burnes
Commissioner of Insurance
The Commonwealth of Massachusetts
Office of Consumer Affairs and Business Regulation
Division of Insurance
One South Station
Boston, Massachusetts 02110-2208

Honorable Commissioners:

Pursuant to your instructions and in accordance with Section 9 of Massachusetts General Law, Chapter 176E, an examination has been made of the financial condition and affairs of

Dental Service of Massachusetts, Inc.

d/b/a

Delta Dental of Massachusetts, Inc.

at its home office located at 465 Medford Street, Charlestown, Massachusetts 02129. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Dental Service of Massachusetts, Inc., d/b/a Delta Dental of Massachusetts Inc. (“Company” or “DSM”) was last examined as of December 31, 2004, by the Massachusetts Division of Insurance (“Division”). The current full scope examination was also conducted by the Division and covers the three year period from January 1, 2005, through December 31, 2007, including any material transactions and/or events occurring subsequent to the examination date and noted in the course of this examination.

The examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners (“NAIC”) Financial Condition (E) Committee as well as with the requirements of the NAIC Financial Condition Examiner’s Handbook, the examination standards of the Division, and with Massachusetts General Laws (“MGL”). The principal focus of the examination was 2007 activity; however, transactions both prior and subsequent thereto were reviewed as deemed appropriate.

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, conflict of interest disclosure statements, fidelity bond and other insurance, employees’ pension and benefit plans, disaster recovery plan, treatment of policyholders, 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.

The Company has been audited annually by PricewaterhouseCoopers LLP (“PwC”), an independent certified public accounting firm, in accordance with Massachusetts Regulation 211 CMR 23.00. The firm expressed unqualified opinions on the Company’s financial statements for each of the calendar years 2005 through 2007.

For a summary of findings contained within this Report, refer to “Notes to Financial Statements” beginning on Page 22.

Status of Findings from the Prior Examination

This examination included a review to verify the current status of exception conditions commented upon in the Report of Examination as of December 31, 2004. That Report contained the following Recommendations:

- DSM should initiate the proper steps to properly age its inter-affiliate receivable balances. In addition, DSM should follow its inter-affiliate agreements which call for the timely settlement of balances among affiliates.
- When recording its electronic data processing equipment and software as assets, DSM must adhere to Section 8A of MGL Chapter 176E. DSM failed to observe this Section of statute which allows a dental service corporation to include as an asset available for payment of losses any electronic data processing equipment, provided that the cost is at least \$100,000.

This examination verified that DSM has addressed the Recommendations from the prior Report of Examination.

HISTORY

Dental Service of Massachusetts, Inc. is a non-profit dental service company which initially was incorporated as the Massachusetts Dental Service Company. It was sponsored by the Massachusetts Dental Society ("Dental Society") through introduction of enabling legislation, MGL Chapter 176E, enacted in July 1962. The Dental Society voted in January 1966 to provide \$25,000 for the Company's start up expenses and reserves and the Company was chartered in September 1966.

In March 1969, the Company entered into an agreement with Blue Cross and Blue Shield of Massachusetts, Inc. ("Blue Cross") by which Blue Cross provided enrollment, claims processing and other administrative services for the Company.

The Company's name was changed on September 3, 1974, to Dental Service of Massachusetts, Inc. The Company's enabling legislation was amended on July 17, 1981, and the amendment changed the requirements for the bylaws of a dental service company by limiting the Dental Society's involvement in selecting members and directors. The result was that the amendment separated the Company from the Dental Society. In March 1985, Blue Cross terminated the services agreement and the Company began to perform all administrative functions on its own.

SUBSIDIARIES

In 1998, the Company established a wholly-owned holding company, DSM Investments, Inc. ("DSM Investments"). DSM Investments has two wholly-owned subsidiaries, DSM Insurance Services, Inc. and Dental Health Center, Inc. ("DHC"), which are operated on a for-profit basis for activities which do not come under specific provisions of MGL Chapter 176E. The Company and DSM Insurance Services, Inc., share facilities and the services of certain members of management. DHC is a dental clinic located in Westborough, Massachusetts, with activities focused on treating the causes and risk factors of dental disease.

In 2000, the Oral Health Foundation, Inc. ("Foundation") was established under MGL Chapter 180. The mission of the Foundation is to award grants that promote oral health by enhancing access to appropriate dental care, promoting models of preventive care, and gathering and disseminating data on new dental technologies. Cumulative contributions to the Foundation by the Company were \$58,010,000 as of December 31, 2007. The Company made donation payments of \$2,810,000 and \$3,920,000 in 2007 and 2006, respectively, to the Foundation. The results of the Foundation are not consolidated into the Company as the Company does not have an economic interest in the Foundation and a majority of the directors of the Foundation do not participate on the board of the Company.

In October 2006, the Catalyst Institute, Inc. ("Institute") was established under the same laws as the Foundation. The Institute operates under a similar mission as the Foundation with the Company contributing to the Institute for the sole purpose of helping the Institute fulfill its mission. Contributions to the Institute by the Company totaled \$3,000,000 and \$1,000,000 in 2007 and 2006, respectively.

On May 24, 2001, DentaQuest Ventures, Inc. ("DQV") was established as a direct subsidiary of the Company. DQV, operated on a for-profit basis, was created to acquire and run dental insurance businesses outside of Massachusetts. In June 2001, DQV issued 11,250 shares of Series A redeemable convertible preferred stock to the Company in exchange for \$11,250,000. In October 2001, DQV acquired Consumer Dental Corp., Consumer Dental Care of Virginia, Inc. and CDC Management, Inc., for a total cost of \$10,910,000.

In May 2002, the Company purchased an additional 750 shares of DQV preferred stock for \$750,000. As part of a single integrated plan, the Company sold all of its preferred stock to an outside investor and contributed certain fixed assets and prepaid assets of \$4,410,000, and it waived reimbursement of certain expenses incurred in connection with the preferred stock of \$1,540,000. In exchange, the Company received an initial common equity ownership on a fully converted basis of 82.09% while the outside investor received an equity ownership of 17.91%.

The preferred stockholders could convert all of their preferred stock at any time into common stock of DQV at the conversion price. The conversion price was originally that amount that caused the original \$12,000,000 preferred stock investment to convert into 17.91% of the common stock of DentaQuest.

The preferred stockholders had the right to put their shares back to DQV if there was no liquidation event or qualified initial public offering within five years of the initial closing date of the preferred stock investment, May 8, 2002. The value for which the preferred stockholders were to put the preferred stock back to DQV was the greater of the market value or the liquidation preference of the preferred stock at the date of exercise. The market value was to be determined using several methodologies, depending on the amount preferred stockholders had purchased as of the date of exercise. The preferred stockholders had the right to use the methodology that produced the greatest value.

On April 2, 2004, DQV acquired substantially all of the assets of Doral Dental USA, LLC, including certain of its subsidiaries for approximately \$114,355,000 which included the purchase price consisting of cash paid, accrued amounts for a contingent payment and closing adjustments, and costs directly related to the acquisition. Assets acquired included tangible assets of \$8,749,000 and goodwill and intangible assets of \$105,606,000. The acquisition was financed with long-term debt of \$75,000,000 and existing cash. Doral is a third-party administrator of government dental benefits.

Until January 2006, DQV was a for-profit corporation which had been created in 2001 to acquire and to administer dental insurance businesses outside of Massachusetts; it was a partially owned,

direct subsidiary of the Company. On January 9, 2006, a major tax reorganization was completed whereby the newly formed DentaQuest, Inc. ("DentaQuest") was established as the uppermost parent company which was owned by the Company and an outside investor; DQV as DentaQuest Ventures, LLC, then succeeded DentaQuest Ventures, Inc., and became a subsidiary of the downstream DQ Massachusetts Business Trust. The reorganization preserved all interests and rights of the Company and it did not change its ownership percentage or control of DQV.

Subsequently, on February 2, 2007, DentaQuest repurchased all of the preferred stock, including accrued dividends from the outside investor for \$110,000,000.

Growth of Company

The growth of the Company for the years 2004 through 2007 is indicated in the following schedule which was prepared from information in Annual Statements:

| Year | Admitted Assets | Liabilities | Capital and Surplus | Premium Income | Member Months |
|------|--------------------|---------------|------------------------|-------------------|------------------|
| 2007 | \$ 242,317,534 | \$ 88,427,467 | \$ 153,890,067 | \$ 357,178,892 | 25,443,994 |
| 2006 | 281,538,648 | 85,181,820 | 196,356,828 | 333,360,591 | 25,051,410 |
| 2005 | 273,432,429 | 76,884,704 | 196,547,726 | 312,044,841 | 24,391,145 |
| 2004 | 257,097,286 | 73,816,353 | 183,280,933 | 311,260,344 | 23,411,123 |

Management

Annual Meeting

The Company is a non-profit dental service company; therefore, members of the Company govern the affairs of the organization instead of stockholders. A majority of the members of the Company shall at all times be persons who are not providers of health services licensed under the laws of the Commonwealth of Massachusetts. Organizations may be elected as members, with the chief executive officer of the organization designating in writing from time-to-time the particular individual who will act for it. Members serve three-year terms and are elected each year at the annual meeting. In 2005, there were thirteen (13) members elected to serve three-year terms until their successors are elected and until the adjournment of the annual meeting in 2008. In 2006, eleven (11) members were elected for three-year terms, and in 2007, fourteen (14) members were elected to serve three-year terms.

In accordance with the revised bylaws, effective April 29, 1998, the annual meeting of the members of the Company for the election by ballot of directors shall be held each year at the principal office of the Company or at such other place as may be stated in the call of the meeting on such date in March or April as may be determined by the chairman of the board. A majority of the members in office at the time shall constitute a quorum for the transaction of business, but a smaller number may adjourn from time-to-time. Each member of the Company shall be

entitled to one vote. The minutes of the annual meeting indicate that a quorum was obtained at each annual meeting held during the examination period.

Board of Directors

The bylaws provide that the affairs, property, and business of the Company shall be managed by a board of nine directors or such greater number as may be determined by the members of the Company at any annual or special meeting. In April 2007, the corporate members voted to fix the number of directors at seventeen. The directors need not be members of the Company.

A majority of the directors shall at all times be persons who are not providers of health services licensed under the laws of the Commonwealth of Massachusetts and who are or agree to be subscribers to the Company's non-profit dental service plan. At least one-third but less than one-half of the directors shall be dentists registered to practice dentistry in the Commonwealth of Massachusetts.

A majority of the directors in office shall constitute a quorum for the transaction of business, but a smaller number may adjourn from time-to-time. Except as otherwise provided by law, in the agreement of association or articles of organization of the Company, or in the bylaws, the vote of the majority of the directors present and entitled to vote at a meeting shall be sufficient to decide any question brought before the meeting.

At December 31, 2007, DSM's Board of Directors consisted of the following seventeen members:

| <u>Name of Director</u> | <u>Business Affiliation</u> |
|-------------------------|---------------------------------------------------------------------------|
| H. Jay Sarles, Chairman | Bank of America, Retired |
| Terry Conner | Liberty Mutual Holding Co, Retired |
| Fay Donohue | President and Chief Executive Officer, DSM |
| Neil Epstein, DMD | Pediatric Dentist, Retired |
| Carol Fulp | Vice President of Community Relations, John Hancock Financial Services |
| Thomas J. Galligan, III | Papa Gino's Holding Corp. |
| Raul Garcia, DMD | Boston University School of Dental Medicine |
| Douglas Harding | Lahey Clinic, Retired |
| Edward A. Hjerpe, III | Webster Bank |
| Marion Kane | Executive Director, Barr Foundation |
| Karen Kaplan | President, Boston Office, Hill, Holliday, Connors, Cosmopoulos, Inc. |
| Donald Kenney | EquiServe, Inc., Retired |
| Donald LeClair, DMD | Generalist in Beverly |

DENTAL SERVICE OF MASSACHUSETTS, INC.

| <u>Name of Director (continued)</u> | <u>Business Affiliation</u> |
|--------------------------------------------|------------------------------------------------------|
| Hassell McClellan | Boston College Carroll Graduate School of Management |
| Ann Page Palmer Vice Chair of the Board | John Hancock Financial Services, Retired |
| Frederick J. White, Jr., DMD | Generalist in Pembroke |
| Leslie Zide, DMD | Harbor Health Services |

Audit Committee

The Audit Committee shall consist of at least three and up to seven directors, appointed by the board of directors, one of whom shall be designated by the board as Chair. The president and CEO may not serve on the Audit Committee. The Audit Committee is delegated the responsibility of recommending outside auditors; meeting with the Company's outside auditors to review their annual audit plan, the results of their annual audit, and their evaluation of the financial operating procedures and internal accounting controls of the corporation and its subsidiaries; to discuss with management the results of their meeting with the auditors; to determine and recommend to the board any appropriate action based on their meetings with the outside auditors and with management. The Committee shall review and monitor the Company's compliance plan and program and it shall receive and review reports from Corporate Counsel on any pending litigation. At the date of examination, the following directors were members of the Audit Committee:

| | |
|--------------------------|---------------------|
| Donald Kenney - Chairman | Edward Hjerpe |
| Terry Conner | Marion Kane |
| Douglas Harding | Donald LeClair, DMD |

Executive Committee

The Executive Committee shall consist of the chairman of the board (who shall act as the Chairman of the Executive Committee), the vice-chairman of the board, the president and CEO, and up to six other directors. During the intervals between meetings of the board of directors, the Executive Committee shall possess and may exercise all of the powers granted to the board of directors by law and by the Company's bylaws other than those powers specifically delegated to other committees and other than the following powers: (a) to elect officers to fill vacancies, (b) to remove officers from office, (c) to authorize or effect major changes in the nature of the Company's activities, goals, or methods of conducting its affairs, or (d) to exercise any power of the board of directors not delegable by the board of directors under applicable law. The Committee shall exercise and carry out any other specific matters which may be referred to it from time-to-time for study and recommendation by the board of directors. The Executive Committee shall report all of its actions to the board of directors. At the date of examination, the members of the Executive Committee were as follows:

Jay Sarles – Chairman
Terry Conner
Thomas Galligan
Douglas Harding

Karen Kaplan
Donald Kenney
Donald LeClair, DMD
Ann Page Palmer

Investment Committee

The Investment Committee shall consist of up to six directors, appointed by the board of directors, one of whom shall be designated by the board as Chair. The president and CEO may not serve on the Committee. The Committee recommends overall investment policy to the board for its approval and approves guidelines for individual investment managers in accordance with the approved investment policy. The Committee selects the investment consultant who will work with management to choose investment managers and monitor their performance. The Committee approves the selection of investment managers and the investment custodian; annually reviews and approves the asset allocation plan to assure compliance with the Company's investment policy; annually reviews and approves the investment crisis recovery plan. At the date of examination, the members of the Investment Committee were the following directors:

| | |
|--------------------------|---------------------|
| Donald Kenney – Chairman | |
| Edward Hjerpe | Donald LeClair, DMD |
| Marion Kane | Hassell McCellan |

Nominating and Governance Committee

The Nominating and Governance Committee shall consist of up to seven directors appointed by the board of directors. One director shall be designated by the board as Chair. The chair of the board and/or the vice-chair, if appointed to the Committee, may not serve as chair of this Committee. The Committee shall make recommendations as to the number of corporate members and number of directors for election at the annual meetings. The Committee nominates a slate of persons to be elected as corporate members and directors at the annual meeting. The Committee exercises general oversight responsibility for the board regarding the administration of the Company's conflict of interest policy and periodically reviews with the board the appropriate skills and characteristics required on the board in keeping with the strategic direction of the Company. At the date of examination, the Committee consisted of the following directors:

| | |
|---------------------------|-------------------|
| Karen Kaplan (Chairwoman) | |
| Neil Epstein, DMD | Hassell McClellan |
| Carol Fulp | Ann Page Palmer |
| Raul Garcia, DMD | Leslie Zide, DMD |

Central Professional Committee

The Central Professional Committee shall consist of at least five members appointed by the board of directors. The majority of the Committee members must be dentists, and the majority of the Committee must be directors. The Chair of the Committee shall be a director who is also a dentist and shall be designated by the board of directors. The Committee shall conduct disciplinary hearings for the purpose of considering and, if appropriate, imposing sanctions on participating dentists, including suspensions or revocation of a participating dentist's agreement with the Company, in accordance with the bylaws and rules of the Company. At the date of examination, the Committee consisted of the following members:

| | |
|--------------------------------|----------------------|
| Donald LeClair, DMD (Chairman) | |
| Neil Epstein, DMD | Eric Weinstock, DMD |
| Carol Fulp | Frederick White, DMD |
| Raul Garcia, DMD | Leslie Zide, DMD |

Compensation Committee

The Compensation Committee shall consist of at least three directors appointed by the board of directors, of whom one shall be designated by the board as Chair. The president and CEO may not serve on the Committee. The Committee reviews the Company's compensation plans and policies for both exempt and non-exempt employees. The Committee periodically reviews the overall performance of the DentaQuest retirement plan and employee benefit programs to determine whether DSM's employees should continue to participate in said programs. At the date of examination, the members of this Committee were the following directors:

| | |
|------------------------------|----------------------|
| Ann Page Palmer (Chairwoman) | Karen Kaplan |
| Thomas Galligan | Donald Kenney |
| Douglas Harding | Frederick White, DMD |

Officers

The bylaws of the Company provide that the officers of the Company shall consist of a chairman of the board, a president, a treasurer, a clerk, one or more vice presidents, one or more assistant treasurers, and such subordinate officers as the board of directors shall from time-to-time elect with such powers and duties and for such terms of office as the directors may designate. The chairman of the board shall be chosen from among the directors of the Company, but other officers need not be chosen from among the directors of the Company.

Officers are elected by the board of directors at their annual meeting in each year. All of the officers shall hold their respective offices for one year and thereafter until their successors are elected and qualified, unless a different term shall be designated by the directors, subject to removal at any time by vote of a majority of the board of directors.

The elected and appointed officers with their respective titles at December 31, 2007, were the following:

| <u>Name of Officer</u> | <u>Title</u> |
|------------------------|---------------------------------------------------------------|
| Fay Donohue | President and Chief Executive Officer |
| Patricia C. Ma | Corporate Clerk |
| Gary D. Guengerich | Senior Vice President, Treasurer, and Chief Financial Officer |
| Douglas Harding | Assistant Treasurer |
| Robert Compton, DDS | Chief Dental Officer and Compliance Officer |

Conflict of Interest Procedure

The Company has adopted, by resolution of the board of directors, a formal Conflict of Interest Policy. The Company has an established procedure for the disclosure to the board of directors of any potential financial transaction, investment, material interest, activity, or affiliation on the part of any director, officer, or key employee, which might be contrary to the policy statement.

Annually, all directors, officers, and employees whose duties require them to transact any business, the nature of which might be contrary to the conflict of interest policy, are required to complete a Conflict of Interest Disclosure Statement. The completed questionnaires were reviewed with no discrepancies noted regarding conflicts of interest as reflected in the Company's 2007 Annual Statement response to General Interrogatories Question 16.

Corporate Records

Bylaws and Articles of Incorporation

The bylaws and articles of organization and amendments thereto were examined as part of this examination. During the examination period there were no changes made to these documents and all prior changes had been properly disclosed to regulatory authorities.

Board of Directors Minutes

Review of the minutes of the board of directors and committees in place for the period under examination indicated that all meetings were held in accordance with the Company's bylaws and laws of the Commonwealth of Massachusetts. Actions of the board and committees were ratified at each meeting either by vote or by consent.

Disaster Recovery and Business Continuity

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 Sections 180M-180Q.

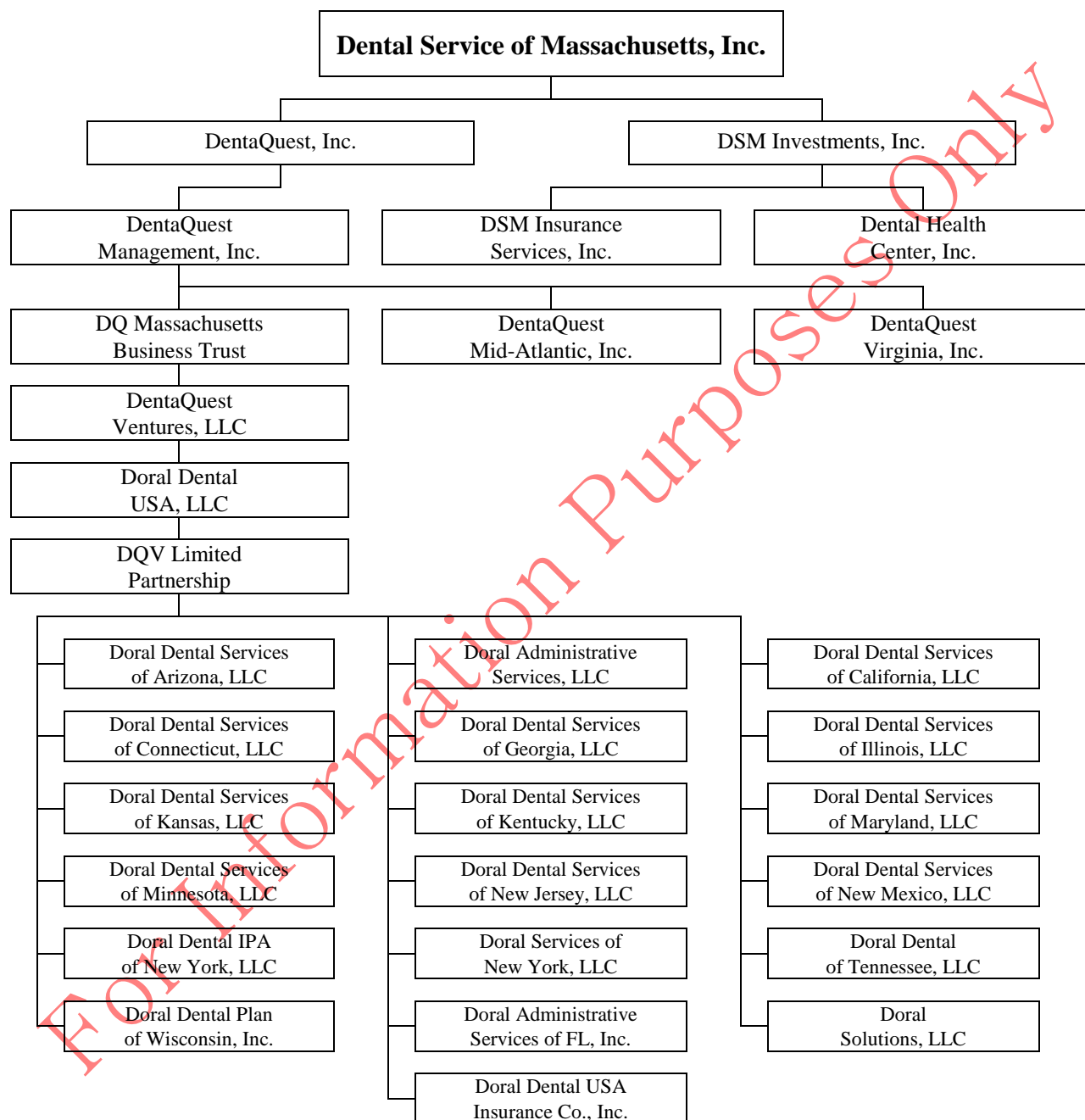
AFFILIATED COMPANIES

The Company is the ultimate controlling entity in a hierarchy of numerous for-profit and not-for-profit subsidiaries and affiliates; however, in that it was formed and continues to operate under MGL Chapter 176E, it claims exemption per Section 14 of such statute from the requirement to file the holding company system annual registration statements (Forms A, B, C, and D) as otherwise required by Section 206C of MGL Chapter 175 and Regulation 211 CMR 7.00.

For Information Purposes Only

ORGANIZATION CHART

The corporate organization of which DSM was a member at December 31, 2007, is represented as follows:



Oral Health Foundation, Inc., and Catalyst Institute, Inc., are not shown in the chart above because these two entities are not consolidated with the Company even though the Company is

the sole member of each corporation; they are charity organizations which rely on the Company's multi-million dollar annual contributions for their continued operations.

Transactions and Agreements with Subsidiaries and Affiliates

Service Agreement

Per the terms of a written services agreement between the Company and DQV effective in 2002, the Company receives management, general administrative, underwriting, claims, financial accounting, and other services. The Company compensated DQV at a rate of 11.08% of claims paid on a monthly basis and reimbursed DQV for certain other specified direct costs and expenses.

On July 14, 2008, the agreement was amended to reflect the new corporate entity, DentaQuest Ventures, LLC, which had been formed in 2006 as part of the tax reorganization. In addition, the amendment changed the reimbursement terms whereby the Company shall reimburse DQV for the actual cost of providing the services of information technologies, accounting, legal, cash management, human resources, professional relations, credentialing of dentists, and regulatory filings and compliance. DQV charges the Company a fee equal to DQV's cost plus a 7% margin for providing executive and managerial support overseeing the business services and the services related to managing facilities and office space. DQV also charges the Company a fee equal to DQV cost plus a 15% margin for providing the services of claims processing, enrollment, actuarial and underwriting, billing, sales and marketing and customer service.

FIDELITY BOND AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized insurer, consistent with Section 60 of MGL Chapter 175. The aggregate limit of the liability exceeds the minimum fidelity bond amount recommended by the NAIC. The Company further protected its interests and property with insurance covering other insurable interests, such as a crime policy that covers employee dishonesty and outside thefts. The Company also has in place numerous other insurance coverages including "all risk" property coverage, managed care liability coverage, workers compensation, and an umbrella policy.

PENSION AND INSURANCE PLANS

The employees of the Company and its subsidiaries participate in a defined contribution retirement plan consisting of employee 401(k) salary deferrals with an employer match and a discretionary employer profit sharing contribution.

All employees of the Company, DentaQuest, Inc., DentaQuest Mid-Atlantic, Doral Dental USA, LLC, and the Oral Health Center who have completed at least one year of eligible service are eligible to participate in the discretionary employer profit sharing contribution of the plan. A year of eligible service is defined as the first anniversary year (12 consecutive months) and when the employee completes at least one-thousand hours of service.

The retirement plan also includes an employee 401(k) contribution, whereby eligible employees of the plan may contribute up to 6% of compensation on a pre-tax basis, subject to certain limitations. The Company makes matching contributions up to 100% of the first 2% of eligible compensation, and up to 50% of the next 2% eligible compensation.

The Company offers various insurance plans, including health, dental, short-term disability or salary continuance benefits, long-term disability, and several life insurance options to all full-time and qualified part-time employees.

STATUTORY DEPOSITS

The Company is licensed to transact business and restricts its writings to businesses only in the Commonwealth of Massachusetts. It does not have statutory deposits with the Commonwealth.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company's Certificate of Authority in Massachusetts was current and in force. The Company writes coverage provided through a small network of independent agents. Although the Company currently is licensed to write business only in the Commonwealth of Massachusetts, it in effect provides coverage in numerous states through affiliated subsidiaries operating with slight distinguishing identities under the group name of Doral or Delta Dental in other jurisdictions.

Treatment of Policyholders

Claim Settlement Practices

Procedures performed in conjunction with the claims testwork indicated that the Company investigated and appeared to settle claims on a timely and equitable basis.

REINSURANCE

The Company did not participate in any reinsurance programs in the period under examination. DSM therefore retains the underwriting risk of its policies and is solely responsible to policyholders and claimants for incurred losses, claims, claim adjustment expenses, and underwriting expenses.

SUBSEQUENT EVENTS

Subsequent to 2007, the Company's downstream subsidiaries DentaQuest, Inc., and Doral Dental USA, LLC, acquired Healthcare Atlantic, Inc., and its three subsidiaries. At December 31, 2007, the Company reported its investment in DentaQuest, Inc., at negative equity as the allowed per NAIC SSAP #97; following this recent acquisition, the Company's carrying value of DentaQuest decreased a further \$17.2 million to (\$53.26) million as of June 30, 2008.

ACCOUNTS AND RECORDS

The internal control structure of DSM was discussed with management through questionnaires and through a review of work performed by the Company's independent certified public accountants. No material deficiencies were noted.

The NAIC provides a questionnaire covering the evaluation of controls in the information systems environment. The questionnaire was completed by the Company and was reviewed by the Division to evaluate the adequacy of the controls in DSM's information systems. No material weaknesses were noted.

The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to annual statements with no discrepancies noted.

In accordance with 211 C.M.R. 23.00, the books and records of the Company are audited annually by a firm of independent certified public accountants. Throughout the examination period, the Company was audited by PwC.

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division and the NAIC as of December 31, 2007:

- Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2007
- Statement of Revenue and Expenses for the Year Ended December 31, 2007
- Statement of Surplus for the year ended December 31, 2007
- Reconciliation of Capital and Surplus for each year in the Three-Year Period Ended December 31, 2007

For Information Purposes Only

Dental Service of Massachusetts, Inc.
Statement of Assets, Liabilities, Capital and Surplus
As of December 31, 2007

| Assets | Per Company | Examination Changes | Per Examination | Notes |
|----------------------------------------------------------------------|-----------------------|------------------------|-----------------------|-------|
| Bonds | \$ 185,769,904 | \$ 0 | \$ 185,769,904 | |
| Preferred stocks | 1,267,996 | | 1,267,996 | |
| Common stocks | 49,925,281 | | 49,925,281 | |
| Cash, cash equivalents and short-term investments | (2,336,936) | | (2,336,936) | |
| Receivables for securities | 845,029 | | 845,029 | |
| Aggregate write-ins for invested assets: | | | | |
| Investment in DSM Investments, Inc. | 3,162,314 | (3,162,314) | 0 | (1) |
| Investment in DentaQuest, Inc. | (36,056,221) | | (36,056,221) | (1) |
| Subtotals, cash and invested assets | 202,577,367 | (3,162,314) | 199,415,053 | |
| Investment income due and accrued | 2,152,725 | | 2,152,725 | |
| Premiums and considerations: | | | | |
| Uncollected premiums and agents' balances in course of collection | 29,310,066 | (976,950) | 28,333,116 | (2) |
| Electronic data processing equipment and software | 1,783,432 | | 1,783,432 | |
| Receivables from parent, subsidiaries, and affiliates | 78,944 | | 78,944 | |
| Aggregate write-ins for other than invested assets: | | | | |
| Other receivables and assets | 911,000 | | 911,000 | |
| Management fee due from DentaQuest | 5,504,000 | | 5,504,000 | |
| Total Assets | <u>\$ 242,317,534</u> | <u>\$ (4,139,264)</u> | <u>\$ 238,178,270</u> | |

Dental Service of Massachusetts, Inc.
Statement of Assets, Liabilities, Capital and Surplus
As of December 31, 2007

| | Per Company | Examination Changes | Per Examination | Notes |
|--------------------------------------------------------|-----------------------|------------------------|-----------------------|-------|
| Liabilities | | | | |
| Claims unpaid | \$ 21,390,940 | \$ 0 | \$ 21,390,940 | (3) |
| Unpaid claims adjustment expenses | 3,679,756 | | 3,679,756 | (4) |
| Aggregate health policy reserves | 9,574,900 | | 9,574,900 | |
| Premiums received in advance | 8,894,815 | | 8,894,815 | |
| General expenses due or accrued | 2,021,881 | | 2,021,881 | |
| Amounts withheld or retained for the account of others | 34,509,591 | (976,950) | 33,532,641 | (2) |
| Amounts due to parents, subsidiaries, and affiliates | 640,851 | | 640,851 | |
| Payable for securities | 1,586,702 | | 1,586,702 | |
| Aggregate write-ins for other liabilities: | | | | |
| Management fee due to DentaQuest | 5,188,586 | | 5,188,586 | |
| Other unapplied receipts | 68,244 | | 68,244 | |
| Payable to Doral Dental USA, LLP | 871,201 | | 871,201 | |
| Total Liabilities | <u>88,427,467</u> | <u>(976,950)</u> | <u>87,450,517</u> | |
| Common capital stock | | | | |
| Gross paid-in and contributed surplus | | | | |
| Unassigned funds (surplus) | 153,890,067 | (3,162,314) | 150,727,753 | (1) |
| Total capital and surplus | <u>153,890,067</u> | <u>(3,162,314)</u> | <u>150,727,753</u> | |
| Total Liabilities, Capital, and Surplus | <u>\$ 242,317,534</u> | <u>\$ (4,139,264)</u> | <u>\$ 238,178,270</u> | |

Dental Service of Massachusetts, Inc.
Statement of Revenue and Expenses
As of December 31, 2007

| | Per Company | Examination Changes | Per Examination | Notes |
|-------------------------------------------------------------------------------------------------------|----------------|------------------------|--------------------|-------|
| Net premium income | \$ 357,178,892 | \$ 0 | \$ 357,178,892 | |
| Hospital and medical: other professional services | 286,218,343 | | 286,218,343 | |
| Claim adjustment expenses | 0 | | 0 | (4) |
| General administrative expenses | 60,199,481 | | 60,199,481 | |
| Total underwriting deductions | 346,417,824 | 0 | 346,417,824 | |
| Net underwriting gain | 10,761,068 | 0 | 10,761,068 | |
| Net investment income earned | 10,153,112 | | 10,153,112 | |
| Net realized capital gains | 1,836,295 | | 1,836,295 | |
| Net investment gain | 11,989,407 | 0 | 11,989,407 | |
| Aggregate write-in for other income or (expenses): | | | | |
| Charitable contributions | (24,919,618) | | (24,919,618) | |
| Total other income or (expenses) | (24,919,618) | 0 | (24,919,618) | |
| Net income or (loss) after capital gains tax and before all other federal and foreign income taxes | (2,169,143) | | (2,169,143) | |
| Federal and foreign income taxes incurred | 0 | | 0 | |
| Net Income (Loss) | \$ (2,169,143) | \$ 0 | \$ (2,169,143) | |

Dental Service of Massachusetts, Inc.
Statement of Surplus
For the Year Ended December 31, 2007

| | <u>As Reported by the Company</u> | <u>Examination Changes</u> | <u>Per Examination</u> | <u>Notes</u> |
|------------------------------------------------------|---------------------------------------|--------------------------------|------------------------------|--------------|
| Surplus, December 31, 2006 | \$ 196,356,828 | | \$ 196,356,828 | |
| Net income (loss) | (2,169,143) | | (2,169,143) | |
| Change in net unrealized capital gains or (losses) | 20,353,023 | | 20,353,023 | |
| Change in non-admitted assets | (19,351,725) | (3,162,314) | (22,514,039) | (1) |
| Aggregate write-ins for gains or (losses) in surplus | <u>(41,298,916)</u> | <u></u> | <u>(41,298,916)</u> | |
| Net change in surplus for the year | <u>(42,466,761)</u> | <u>(3,162,314)</u> | <u>(45,629,075)</u> | |
| Surplus, December 31, 2007 | <u><u>\$ 153,890,067</u></u> | <u><u>\$ (3,162,314)</u></u> | <u><u>\$ 150,727,753</u></u> | |

Dental Service of Massachusetts, Inc.
Reconciliation of Capital and Surplus
For the Three Year Period Ended December 31, 2007

| | <u>2 0 0 7</u> | <u>2 0 0 6</u> | <u>2 0 0 5</u> |
|-----------------------------------------------------|-------------------------|-----------------------|-----------------------|
| Capital and surplus as of December 31, prior year | \$ 196,356,828 | \$ 196,547,726 | \$ 183,280,933 |
| Net income or (loss) | (2,169,143) | (1,566,963) | 14,577,903 |
| Change in net unrealized capital gains or (losses) | 20,353,023 | 2,125,292 | (3,712,819) |
| Change in non-admitted assets | (19,351,725) | (749,227) | 2,401,709 |
| Equity in DentaQuest, Inc. | (41,301,510) | | |
| Miscellaneous adjustment | 2,594 | | |
| Total of adjustments by this examination | <u>(3,162,314)</u> | | |
| Net change capital and surplus for the year | <u>(45,629,075)</u> | <u>(190,898)</u> | <u>13,266,793</u> |
| Capital and surplus as of December 31, current year | * <u>\$ 150,727,753</u> | <u>\$ 196,356,828</u> | <u>\$ 196,547,726</u> |
| * Per Examination | | | |

NOTES TO FINANCIAL STATEMENT**NOTE 1:**Aggregate Write-In for Invested Assets:

| | |
|-----------------------------------------------------|-------------------|
| <u>Investment in DSM Investments, Inc.</u> | \$ 3,162,314 . |
| <u>Examination Adjustment</u> | (\$ 3,162,314) |
| <u>Restated Investment in DSM Investments, Inc.</u> | \$ - 0 - . |
| <u>Investment in DentaQuest, Inc.</u> | (\$ 36,056,221) |

For statutory purposes, the valuation of three of the Company's wholly owned subsidiaries, DSM Investments, Inc., and its two subsidiaries, Dental Health Center, Inc., and DSM Insurance Services, Inc., has been non admitted for examination purposes. Per NAIC SSAP #97, audited financial statements of subsidiary holdings are necessary for valuation purposes. The subject subsidiaries of the Company do not have separate audited financial statements; further, the majority of the value of Dental Health Center appears to be its investment in furniture and equipment which is non-admitted under statutory accounting principles. Thus, the examination has not admitted the Company's valuations of DSM Investments, DSM Insurance Services, Inc., and Dental Health Center, Inc., for the period ended December 31, 2007.

The Company has properly valued its investment in DentaQuest, Inc., in accordance with NAIC SSAP #97. The negative valuation is the result of non-admitting the goodwill in DentaQuest, Inc., for statutory accounting purposes.

NOTE 2:

| | |
|-----------------------------------------------|---------------|
| <u>Uncollected Premiums</u> | \$ 28,333,116 |
| <u>Amounts Withheld for Account of Others</u> | \$ 33,532,641 |

The Company increased the required deposits for selected cost-plus groups by increasing the liability account "Amounts Withheld for Account of Others" while recording an offsetting receivable for the billed group deposits. The Company reported \$29,310,066 as the net admitted asset for "Uncollected Premiums and Agents' Balances in the Course of Collection" as of December 31, 2007, and the liability "Amounts Withheld for Account of Others" was reported as \$34,509,591. These amounts included a receivable balance of \$976,950 for group deposit premiums and an offsetting liability for the same amount. The examination found that the Company had not collected the receivable as of year-end; therefore, the examination reversed the original additional group deposit receivable and adjusted the liability accordingly, with no effect on statutory surplus.

NOTE 3:

| | |
|------------------------------------------|---------------|
| <u>Claims Unpaid</u> | \$ 21,390,940 |
| <u>Unpaid Claims Adjustment Expenses</u> | \$ 3,679,756 |

The Company retained the services of Milliman, Inc., Consultants and Actuaries, to develop the Company's year-end reserves and to provide the Actuarial Opinion on the reasonableness of the reserves carried by the Company as of December 31, 2007.

The auditing firm of PricewaterhouseCoopers, LLP, performed an independent actuarial review of the Company's reserves and the table below summarizes the reserve range estimates as of December 31, 2007:

| DSM – Claims Unpaid & Unpaid Claims Adjustment Expenses | PwC - Low Range | PwC - High Range |
|------------------------------------------------------------|--------------------|---------------------|
| \$25,070,696 | \$23,066,901 | \$26,709,043 |

As part of the examination, the Examiners reviewed the reports and the Statement of Actuarial Opinion issued by Milliman, Inc., and performed, as they deemed appropriate, their own testwork and evaluation of DSM's reserve liabilities as of December 31, 2007, with payment developments through June 30, 2008. Based on such reviews and testwork and with reliance on the professional judgment of the Appointed Actuary in his Statement of Actuarial Opinion as to the appropriateness of DSM's reserving methods and compliance with the requirements of Massachusetts statute, the Examiners concluded that the reserves reported by DSM in its Annual Statement as of December 31, 2007, appear to be reasonable and adequate to enable DSM to fulfill its contractual obligations.

NOTE 4:

| | |
|------------------------------------------|--------------|
| <u>Unpaid Claims Adjustment Expenses</u> | \$ 3,679,756 |
|------------------------------------------|--------------|

As stated above in Note 3, examination of the Company's liability found the reserve balance to be fairly stated; however, the Company does not properly present the paid claim adjustment expenses within the Annual Statement. The Company did not report any paid claim adjustment expenses on the Statement of Revenue and Expenses, the Five Year Historical Data, the Analysis of Operations by Lines of Business, and various parts of the Underwriting and the Investment Exhibit in the Annual Statement. It is recommended that the Company fully comply with all aspects of the NAIC's Annual Statement Instructions in order to present its financial condition in compliance with statutory accounting standards.

CONCLUSION

Acknowledgment is made of the cooperation and courtesies extended by the officers and employees of the Company to all examiners during the examination.

The assistance rendered by Linda Dow, Insurance Examiner II with the Commonwealth of Massachusetts Division of Insurance who participated in this examination is hereby acknowledged.

Richard Looney, AFE, CIE
Examiner-in-Charge
Commonwealth of Massachusetts
Division of Insurance

Kenneth Plumb, CPA, CFE
Supervising Examiner
Commonwealth of Massachusetts
Division of Insurance

For Information Purposes Only