



**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, 2004**

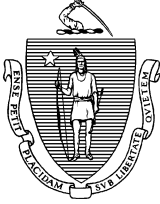
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**EMPLOYERS ID NO. 04-6143185**

# DENTAL SERVICE OF MASSACHUSETTS, INC.

## TABLE OF CONTENTS

	Page
Salutation	1
Scope of Examination	2
Status of Prior Examination Findings	2
History	3
Subsidiaries	3
Growth of Company	6
Management	7
Annual Meeting	7
Board of Directors	7
Committees of the Board of Directors	8
Officers	12
Conflict of Interest Procedures	12
Corporate Records	13
Organizational Chart	14
Fidelity Bonds and Other Insurance	15
Employee and Agent's Welfare and Pension Plans	15
Insurance Products and Related Practices	16
Territory and Plan of Operation	16
Subscriber Contracts	16
Participating Dentists' Agreements	16
Reinsurance	17
Accounts and Records	17
Financial Statements	18
Statement of Assets, Liabilities, Surplus and Other Funds	19
Summary of Operations	21
Statement of Surplus	22
Reconciliation of Surplus	23
Comments on Financial Statements	24
Conclusion	27



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

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JULIANNE M. BOWLER  
COMMISSIONER OF INSURANCE

November 28, 2005

The Honorable Alfred W. Gross, Chairman  
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Secretary, Southeastern Zone  
Commissioner of Insurance  
Bureau of Insurance  
Commonwealth of Virginia  
P. O. Box 1157  
Richmond, VA 23218

The Honorable Julianne M. Bowler  
Secretary, Northeastern Zone, NAIC  
Commissioner of Insurance  
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Office of Consumer Affairs and Business Regulation  
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Honorable Commissioners:

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

**DENTAL SERVICE OF MASSACHUSETTS, INC.**

**d/b/a**

**DELTA DENTAL PLAN OF MASSACHUSETTS**

**Boston, Massachusetts**

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

### SCOPE OF EXAMINATION

Dental Service of Massachusetts, Inc., d/b/a Delta Dental Plan of Massachusetts (hereinafter referred to as “the Company” or “DSM”) was last examined as of December 31, 2001, by the Massachusetts Division of Insurance (the “Division”). The current full scope examination was also conducted by the Division and covers the three year period from January 1, 2002 through December 31, 2004, including any material transactions and/or events occurring subsequent to the examination date and noted during 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 and prescribed by the NAIC’s 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, 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 2002 through 2004.

For a summary of findings contained within this report, refer to the “Notes to Financial Statements” and the “Comments and Recommendations” sections.

### STATUS OF PRIOR EXAMINATION FINDINGS

The current financial examination included a review to verify the current status of any exception conditions commented upon in the previous Report of Examination. The prior examination noted that investments of the Company were not approved by the board of directors in accordance with Chapter 175, Section 64 of the Massachusetts General Laws (“M.G.L.”). The current examination found that the board has been approving all investment transactions since the prior examination.

## HISTORY

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

In March 1969, the Company entered into an agreement with Blue Cross Blue Shield of Massachusetts, ("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. The amendment changed the requirements for the by-laws of a dental service company by limiting the Dental Society's involvement in selecting members and directors. The amendment separated Dental Service from the Massachusetts Dental Society.

In March 1985, Blue Cross and Blue Shield of Massachusetts, Inc. terminated their services agreement and the Company began to perform all administrative functions on its own.

## SUBSIDIARIES

In 1992 the Company established a wholly-owned subsidiary, DSM Insurance Services (formerly DentaQuest Insurance Services, Inc. and, prior to that, QIS, Ltd.), to be operated on a for-profit basis for activities which did not come under specific provisions of M.G.L. Chapter 176E, including processing of dental claims and premiums for out of state dental insurance providers. The Company and DSM Insurance Services, Inc. share facilities and the services of certain members of management.

During 1998, DSM Investments, Inc. (formerly DentaQuest Investments, Inc.) was established as a holding company for DSM Insurance Services, Inc. and DentaQuest Practice Management, Inc., which was also established in 1998. Subsequently, Dental Health Center, Inc. ("DHC") was established as a subsidiary of DentaQuest Practice Management, Inc. ("DQPM"). DHC is a dental clinic operated on a for-profit basis and its activities focus on treating the causes and risk factors of dental disease. The center is located in Southborough, Massachusetts. DQPM's shares in DHC were transferred to DSM Investments and Articles of Dissolution for DQPM were filed with the Secretary of State on July 8, 2002.

Dental Service of Massachusetts, Inc.

During 2000, DentaQuest Access Plans Inc. ("DQAP") was established as a subsidiary of DQI. DQAP was operated on a for-profit basis and was created to provide individuals without dental insurance access to discounted services from dentists. The company is located in Burlington, MA. DQAP's operations have been terminated and Articles of Dissolution were filed with the Secretary of State on July 8, 2002.

Effective May 24, 2001, DentaQuest Ventures, Inc. ("DQV") was established as a subsidiary of the Company. DQV is operated on a for-profit basis and was created to acquire and run dental insurance businesses outside of Massachusetts. The Company is located in Boston, Massachusetts.

Effective June 6, 2001, the Company authorized a capital expenditure in the amount of \$11,250,000 for the acquisition of 17 shares of DQV Series A preferred stock. These shares were subsequently recapitalized to 11,250 shares valued at \$1,000 per share. On October 18, 2001, DQV acquired Consumer Dental Corp., Consumer Dental Care of Virginia, Inc., and CDC Management, Inc. (herein collectively, "CDC"). The purchase price of CDC was \$10,910,000. The purchase price was returned to DSM in 2002 in connection with the transactions described below.

Effective October 22, 2001, Consumer Dental Corp., Consumer Dental Care of Virginia, Inc., and CDC Management, Inc. were renamed to DentaQuest Mid-Atlantic, DentaQuest Virginia and DentaQuest Management Co., respectively.

On May 8, 2002, DSM purchased 549,999 shares of DQV common stock with a par value of \$.01 per share and paid for these shares by transferring certain assets and liabilities of the Company to DQV. In addition, DSM purchased 750 shares of Series A preferred stock for \$1,000 per share. The total purchase price for the two stock purchases was \$750,000 in cash and DQV's acquisition of various equipment, supplies and assumed liabilities from DSM. DSM had held one share of common stock of DQV from the initial formation of DQV.

In May 2002 the Company's wholly owned subsidiary, DentaQuest Ventures, Inc. agreed to sell to an outside investor, FdG DQV LLC (herein, "FdG" or "Series A investor"), an interest in DQV. As of May 2002, FdG purchased 12,000 shares of Series A Preferred stock of DQV for a price per share equal to \$1,000 per share, representing an aggregate purchase price of \$12,000,000. FdG's interest in DQV represents minority ownership of approximately 21% and DSM owns the remaining 79% at December 31, 2004.

On the close of the transaction with FdG, DQV is capitalized with 50,000 shares of Series A Preferred shares authorized, with 12,000 shares issued. In addition DQV has authorized 2,000,000 shares of common stock with 550,000 shares issued and owned by DSM.

As stated in the amended and restated Certificate of DentaQuest Ventures, Inc., FdG shall be entitled to be paid in cash for cumulative dividends at a rate of eight percent (8%) per annum out of funds available for the declaration of dividends, only as and if declared by

DQV's board of directors. Dividends for each share of Series A Preferred shall accrue on a quarterly basis at a rate of eight percent per annum of the sum of (a) the original conversion price per share plus (b) all accumulated and unpaid dividends thereon, from and including the original issue date of such share. In addition FdG shall be entitled to receive a management fee of \$100,000 per year (paid in advance), payable first upon the initial closing and then on each of the next four anniversaries of the initial closing date. This management fee shall be in lieu of any directors' or advisors' fees payable to the Series A Investor.

The Series A investor has the right to purchase additional shares in DQV at any time from the initial closing date to the third anniversary of the initial closing date (May 8, 2002). The Series A Investor agrees to purchase a number of shares as determined by DQV for a price per share equal to the original price per share up to an aggregate purchase price equal to the difference between (a) eight million dollars (\$8,000,000) and (b) the aggregate purchase price of shares previously purchased. Any subsequent investments shall have a minimum aggregate purchase price of at least \$5,000,000. Prior to the earlier of the third anniversary of the initial closing date or the subsequent closing date on which the Series A investor has purchased cumulatively shares with an aggregate purchase price equal to \$8,000,000, DQV may not issue, offer for sale or sell any equity other than the Series A preferred, and may not issue, offer for sale or sell any Series A preferred to any person other than the Series A investor. In addition the Series A investor has the right of first offer to invest in all shares of DQV or other equity issued by DQV up to an aggregate purchase price of \$10,000,000.

Under the terms of the agreement, in no event shall DQV be authorized to issue any class of voting securities that would result in the dilution of DSM's interest in the voting stock of DQV to less than fifty-one percent on a fully diluted converted basis. The Stockholders Agreement provides that DQV's board of directors will have seven directors of whom two are appointed by FdG. The remaining five directors are all appointed by DSM in the following manner: Two directors are appointed by DSM from among the current directors of DSM. Two directors are appointed by DSM but may not be current directors of DSM; and, a fifth director will be an individual appointed by DSM who never has been a director of DSM.

Simultaneous with the FdG transaction as stated above, DSM and DQV entered into a "Services Agreement". Under the terms of this agreement in return for compensation, DQV agrees to provide DSM with all services of every kind and description currently being performed by or on behalf of DSM in order to market, sell and administer all of DSM's dental benefits (the "Business Services"). These Business Services shall include, without limitation, the following; claims processing, information technology services, accounting, legal services, enrollment, billing, human resources services, actuarial and underwriting, sales and marketing, customer service, managed care administration and regulatory filings and compliance. These Business Services shall also include those services currently being provided by DSM on behalf of DSM Dental's affiliates. DQV shall be responsible for and pay all direct and indirect costs and expenses of every kind and nature related to or arising out of provision of the Business Services, including



without limitation, insurance, legal, collection, travel and accounting, but DQV shall not pay commissions due to brokers separately contracted by DSM for sales and marketing of DSM's dental insurance products.

DSM agrees to pay DQV a monthly fee for business services in the amount of 11.08% of all dental claims paid by DQV on behalf of DSM during the first ten years of the initial term. At least six months prior to the end of the first ten years of the initial term, the parties shall enter into good faith negotiations regarding the calculation of the fee for the business services and the additional fee for any additional services to be paid by DSM to DQV during years eleven through fifteen of the renewal term. It is the intention of the parties that the fee and the additional fee, if any, to be paid by DSM to DQV during any renewal term is intended to pass along to DSM the cost savings realized by DQV, at that time, relative to the business services and additional services and shall be based on DQV's costs to administer DSM's business, as determined for the preceding fully audited fiscal year, plus a profit of fifteen percent (15%), adjusted against the total amount of dollar value of claims paid during the same preceding fully audited fiscal year.

#### GROWTH OF COMPANY

The growth of the Company for the years 2002 through 2004 is depicted in the following schedule, which was prepared from the Company's Annual Statements.

Year	Admitted Assets	Total Revenues	Surplus
2004	\$ 257,458,447	\$ 311,260,344	\$ 183,610,190
2003	231,327,915	310,224,489	163,820,752
2002	194,709,755	285,228,992	121,028,809



## 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 member to designate 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 2002 there were 11 members elected to serve three year terms until their successors are elected and until the adjournment of the annual meeting in 2005. In 2003 there were 12 members elected for three-year terms and in 2004 there were 14 members elected to serve three-year terms, 3 members elected to serve two year terms, and 2 members elected to serve 1 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 for the time being 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 September of 2004 the corporate members voted to fix the number of directors at 14. 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 for the time being shall constitute a quorum for the transaction of business, but a smaller number may adjourn from time to time. Except as otherwise provided in specific cases 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

## Dental Service of Massachusetts, Inc.

present and entitled to vote at a meeting shall be sufficient to decide any question brought before the meeting.

Directors duly elected and serving at December 31, 2004, with their business affiliation, are as follows:

<u>Directors</u>	<u>Business Affiliation</u>
Kathleen O'Loughlin, DMD	President
Douglas Harding	Senior Vice President Lahey Clinic (retired)
Hassell McClellan	Boston College Carrol Graduate School of Management
Neil Epstein, DMD	Pediatric Dentist
Terry Conner	Liberty Mutual Holding Company (retired)
Michael Nacey	President, Weston Partners
Donald Kenny	EquiServe, Inc.
Donald LeClair, DMD	General Dentist
Joseph O'Connor	Founder and Secretary, Draper Lab (retired)
Karen Kaplan	Hill, Holiday, Connors, Cosmopoulos, Inc.
Thomas Masiello	Administrator, Massachusetts Laborer's Benefit Funds
Frederick White, DMD	General Dentist
Page Palmer	John Hancock Financial Services (Retired)
H. Jay Sarles	Bank of America

### Committees of the Board of Directors

#### Audit Committee

The Audit Committee shall consist of up to seven directors, appointed by the board of directors of whom one shall be designated by the board of directors as chairman. The chairman of the board and 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 and to ensure that the recommended actions are taken, to periodically review investment managers, corporate investments and asset allocations, and the investment crisis recovery plan, as well as the investment consultant and the custodian, and make appropriate recommendations to the board as necessary; to review and monitor the Company's compliance plan and program and to assume any other responsibilities as may be assigned by the chairman of the board of directors from time to time.

The members of the Audit Committee are as follows:

Donald LeClair, DMD, Chairman  
Terry Conner  
Douglas Harding  
Donald Kenney  
Thomas Masiello  
Joseph O'Connor

Central Professional Committee

The Central Professional Committee (CPC) shall consist of at least five members appointed by the board of directors. The majority of the committee members must be dentists. The chairperson of the CPC shall be a dentist and shall be designated by the board of directors. The CPC shall have the following responsibilities: I. To review and evaluate all aspects of the following matters: (a) the standards of dental care to be furnished to subscribers and covered dependents; (b) the extent of dental benefits to be furnished to subscribers and covered dependents; (c) reimbursement policy for payments to participating dentists; (d) standard procedures, requirements and rules with respect to participation in the Company's plan by participating dentists, (e) dental research projects the Company undertakes and (f) fraud and abuse management. The CPC shall report the results of its review and evaluations to the board of directors for such action, if any, as the board may deem appropriate to take. II. To establish policies and procedures for the investigation and resolution of complaints and controversies relative to the provision of dental services or the conduct of participating or non-participating dentists, including any alleged false reporting of services rendered or other violation of the procedures, requirements and rules of the Company with regard to the Company's plans. In addition, the CPC is delegated the authority to conduct disciplinary hearings for the purpose of considering and, if appropriate, imposing sanctions on dentists, including suspension or revocation of a participating dentist's agreement with the corporation, in accordance with the bylaws and rules and regulations of the corporation.

The members of the Central Professional Committee are as follows:

Frederick White, DMD, Chairman  
Carol Blanchard, DDS  
Neil Epstein, DMD  
Karen Kaplan  
Donald LeClair, DMD  
Lorenzo Lepore, DMD  
Michael Nacey  
Kathleen O'Loughlin, DMD

Compensation and Benefits Committee

The Compensation and Benefits Committee shall consist of at least three directors, appointed by the board of directors of whom one shall be designated by the board of directors as chairman. The chairman of the board and the president and CEO may not serve on the compensation and benefits committee. The compensation and benefits committee is delegated the responsibility to review and recommend to the board of directors for its approval the following compensation and benefits matters: (a) the compensation plans and policies for both exempt and non-exempt employees of the Company; (b) the annual percentage amounts designated for merit and grade structure changes; (c) the annual bonus amounts to be awarded to exempt and non-exempt employees; (d) the specific details of compensation for the chairman, president and CEO, and other key executives; (e) directors compensation. The compensation and benefits committee shall periodically review the overall performance of the DQV retirement plan and employee benefit programs to determine whether DSM's employees should continue to participate in said programs

The members of the Compensation and Benefits Committee are as follows:

Joseph O'Connor, Chairman  
Douglas Harding  
Karen Kaplan  
Donald Kenney  
Frederick White, 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 four 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 executive committee is further delegated the power to review the annual budget of the Company and recommend its adoption to the board of directors, to review the quarterly financial performance of the Company as measured against the approved budget, to review and recommend to the board for its approval any matters which involve a long term financial commitment of the

Company such as major capital investments, lease commitments and the establishment of pension plans, to consult with and advise the Company's treasurer and other management personnel in all other aspects of the Company's financial affairs, to review the performance of the subsidiary DentaQuest Ventures, Inc. (DQV), both as an investment and under the Services Agreement between DSM and DQV, and to 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.

The members of the Executive Committee are as follows:

Neil Epstein, DMD, Chairman  
Douglas Harding  
Donald LeClair, DMD  
Hassell McClellan  
Joseph O'Connor  
Kathleen O'Loughlin, DMD  
Frederick White, DMD

#### Nominating and Governance Committee

The Nominating and Governance Committee shall consist of the chairman of the board and/or the vice chair—and up to five other directors appointed by the board of directors. One shall be designated by the board of directors as chairman. The chairman of the board and/or the vice chairman may not serve as chairman of the nominating and governance committee. The nominating and governance committee is delegated the responsibility for making recommendations as to the number of members and directors for election at the annual meeting of members, for nominating a slate of persons to be elected as members and directors at the annual meeting, for proposing a slate of officers to be elected at the first meeting of the board of directors following the annual meeting of members, and for nominating persons to be elected as directors of those subsidiaries for which DSM has nominating authority. The Committee will periodically review with the Board the appropriate skills and characteristics required on the Board in keeping with the strategic direction of the company. Furthermore, the Committee will exercise general oversight responsibility for the Board regarding the administration of the Company's conflict of interest policy.

The members of the Nominating and Governance Committee are as follows:

Douglas Harding, Chairman  
Terry Connor  
Neil Epstein, DMD  
Thomas Masiello  
Michael Nacey

### 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, however, to removal at any time by vote of a majority of the board of directors.

The elected senior officers and their respective titles at December 31, 2004 follows:

<u>Officers</u>	<u>Title</u>
Neil B. Epstein, DMD	Chairman of the Board
Joseph F. O'Connor	Vice Chairman of the Board
Kathleen O'Loughlin, DMD	President, Chief Executive Officer
Douglas B. Harding	Treasurer
Robert Schneider	Assistant Treasurer
Stephanie S. MacGregor	Corporate Clerk
David W. Rosenberg, Esq.	Assistant Clerk
Robert Compton, DDS	Compliance Officer

### CONFLICT OF INTEREST PROCEDURES

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 or activity and 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. In addition all board members and officers sign biographical affidavits, which are then notarized and submitted to the corporate clerk for filing. The completed questionnaires were reviewed

with no discrepancies noted regarding conflicts of interest as reflected in the Company's 2004 Annual Statement responses to the General Interrogatories Question 14.

### 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 all regulatory authorities.

#### Board of Directors Minutes

Our review of the minutes of the board of directors and committees in place for the period under the statutory 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 consent.

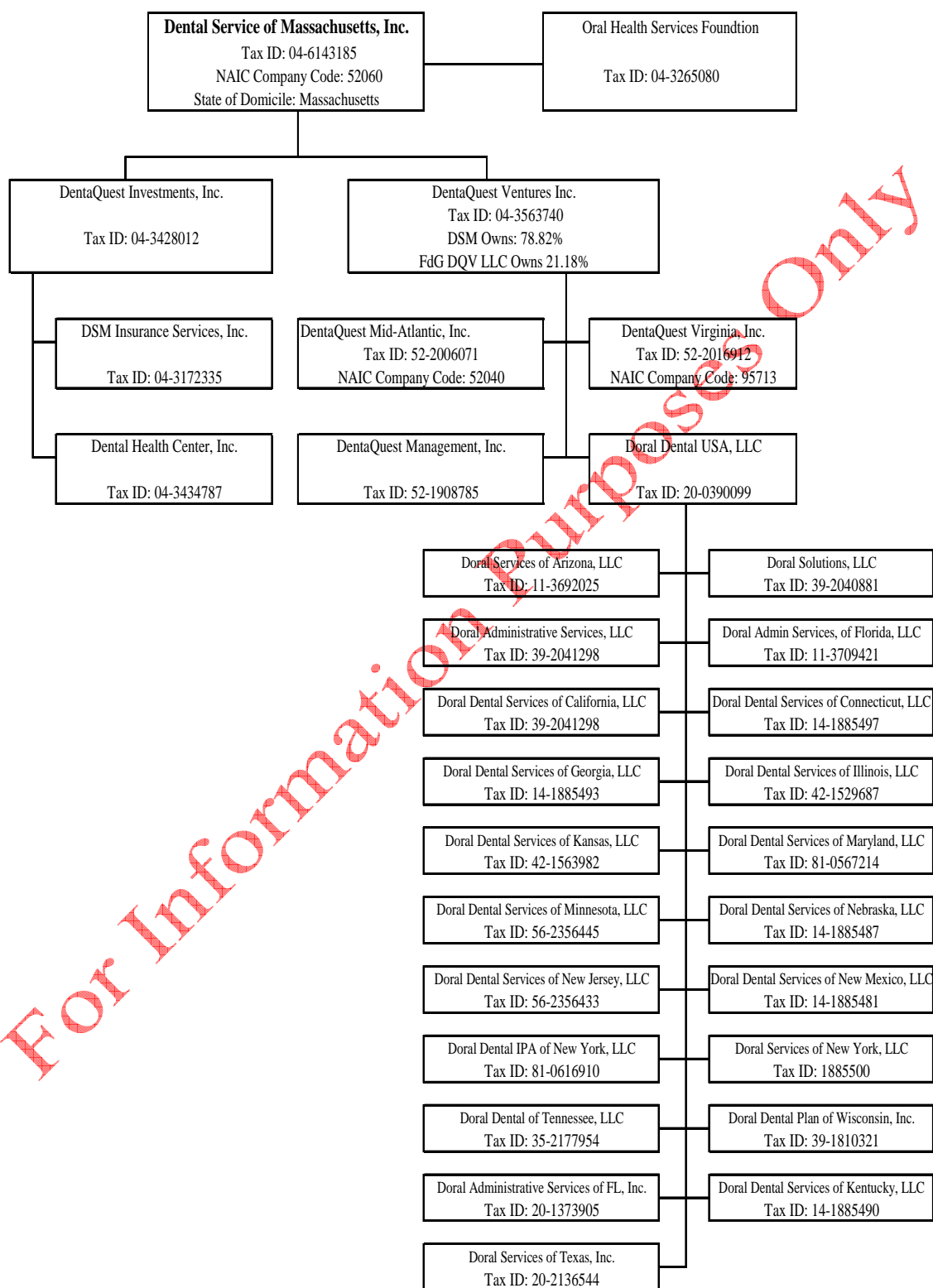
#### Disaster Recovery and Business Continuity

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 Section 180M-180Q.



# Dental Service of Massachusetts, Inc.

## ORGANIZATIONAL CHART



### FIDELITY BOND AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized insurer, consistent with Massachusetts General Laws Chapter 175 Section 60. The aggregate limit of the liability exceeds the National Association of Insurance Commissioners' minimum requirements. The Company further protected its interest and property by covering itself 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.

### EMPLOYEE AND AGENT'S WELFARE AND PENSION PLANS

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. The employees participate in a defined contribution plan. All employees who have attained age 18 and have completed one year and 1,000 hours of service per year are eligible to participate in the plan as of the first day of the month following the fulfillment of the eligibility requirements. Employees who work 15 or more hours per week are eligible to participate in the dental plan whose costs are shared between the Company and the employee. The medical plan is open to employees who work 20 hours per week and the cost is shared between the Company and the employee. The life insurance plan is paid by the Company and covers two times the rate of basic pay up to \$500,000. The Company also provides a short-term disability plan whose cost is paid by the Company, with the plan paying up to 70% income protection if an employee is disabled by a covered accident or illness.

The Company had a qualified retirement plan in place at year-end 2004. The Retirement Plan had two components; the employer discretionary and the 401(k) Plan. The Retirement Plan was effective in 1988 and the board of directors votes the amount to be contributed to the Retirement Plan each year based on organizational net income. The board has voted a contribution equal to 8% of participant pay each year that the plan has been in existence. Employees become participants in the plan after completing one year of service in which the employee has worked at least 1,000 hours. Employees hired prior to January 1, 2000, were immediately vested. Employees hired after January 1, 2000, are subject to a five year vesting schedule.

The 401(k) plan was effective in 1997. All employees are eligible to participate in the plan and have the option of contributing up to 15% of their gross annual salary each year. Effective January 2001, the Company now matches employee contributions to the 401(k) Plan with a 100% match on the first 2% of employee contributions and a 50% match on the next 2%, for a potential total match of 3%. Employer contributions are subject to a three-year vesting schedule.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

The Company is licensed to transact business only in the Commonwealth of Massachusetts.

The operation of the Company is set forth under the following contracts and agreements:

### Subscriber Contracts

Dental programs are available to employer groups with five or more full time employees. Benefit variations are dependent on group size.

The Delta Premier Plan provides benefits for three types of services. Type 1 includes services to prevent or detect tooth decay and other forms of oral disease. Type 2 includes services to: (i) restore decayed or fractured teeth; (ii) remove diseased or damaged natural teeth; (iii) treat oral disease; (iv) repair dentures or bridges; (v) rebase or reline dentures; and (vi) re-cement bridges, crowns and on-lays. Type 3 includes services and supplies to replace missing natural teeth with artificial ones and restore severely decayed or fractured teeth. It can be modified through different levels of benefits, coinsurance amounts, deductibles and maximums to meet the financial needs of the group. Orthodontic coverage is available to groups that meet certain enrollment requirements.

### Participating Dentists' Agreement

Under this agreement, dentists agree to furnish to subscribers and covered dependents dental services in accordance with the provisions of contracts made between the Company and its subscribers.

The Company will pay a participating dentist for services rendered on a variety of bases of compensation approved by the Board of Directors and the Commissioner of Insurance. Payments to participating dentists are required by law to be less than the participating dentist's usual fee or less than such other benefit or allowance amount as may be applicable under the agreement. The percent or percentages by which payments are reduced are approved by the Commissioner and are stated in the Delta Dental Plan Rules and Regulations.

The participating dentists agree to accept such payment as full compensation when it is based on his usual fee or on a profile fee to which they agreed. When such payment is based on an amount less than his usual or profile fee, the participating dentist agrees to charge the patient no more than the difference between the amount on which the DSM payment is based (not the amount paid) and their usual fee.

The participating dentist agrees to report services provided to a member to the Company monthly or within thirty days from the date of the completion of such services. The Company, when making payment to the participating dentist, shall render an itemized accounting. This contract shall be in effect until terminated either by the participating dentist or the Company with 90 days written notice. The participating dentist agrees to abide by the bylaws and rules and regulation of the Company as they may be amended from time to time.

#### REINSURANCE

The Company does not have any reinsurance coverage.

#### ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires and through a review of the work performed by the Company's independent Certified Public Accountants. PwC noted a "Reportable Condition" during its 2004 audit. In its Letter of Comments and Recommendations and Internal Control, they noted "That timely and complete reconciliations were not being performed for certain balance sheet accounts." The Company has allocated significant resources towards addressing this condition in 2005. We reviewed the account reconciliations prepared during October, 2005 for the September 30, 2005, account balances and noted significant improvements.

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The Company completed the questionnaire and the Division's IT auditor 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 2004 Annual Statement. No material deficiencies were noted.

As part of our review of premiums and billings, we noted that 12 of the 60 files reviewed did not have properly executed current rate agreements (Appendix A) with its subscribers.

FINANCIAL STATEMENTS

The following financial statements reflect the Company's assets, liabilities and surplus as determined by our examination, showing the Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2004, together with a Summary of Operations for the year ended December 31, 2004, Statement of Surplus as of December 31, 2004, and a Reconciliation of Surplus for the three year period ended December 31, 2004.

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, 2004.

For Information Purposes Only

Dental Service of Massachusetts, Inc.

Statement of Assets, Liabilities, Surplus and Other Funds

As of December 31, 2004

Assets	As Reported by the Company	Examination Changes	Per Statutory Examination	Notes
Bonds	\$ 169,719,937	\$ 0	\$ 169,719,937	
Common stocks	50,801,315		50,801,315	
Cash on hand and on deposit	5,611,459		5,611,459	
Subtotals, cash and invested assets	226,132,711		226,132,711	
Premiums and considerations:				
Uncollected premiums, agents' balances in course of collection	23,599,637		23,599,637	
Investment income due and accrued	2,018,760		2,018,760	
Amounts due from parent, subsidiaries and affiliates	672,106	(346,015)	326,091	( 1 )
Electronic data processing equipment	15,145	(15,145)	-	( 2 )
Aggregate write-ins for other invested assets	5,020,088		5,020,088	
Total Assets	\$ 257,458,447	\$ (361,160)	\$ 257,097,287	

Dental Service of Massachusetts, Inc.

Delta Dental Plan of Massachusetts  
Statement of Assets, Liabilities, Surplus and Other Funds (Continued)  
As of December 31, 2004

Liabilities	As Reported by the Company	Examination Changes	Per Statutory Examination	Notes
Claims unpaid	\$ 16,680,597	\$ 0	\$ 16,680,597	(1)
Unpaid claims adjustment expenses	2,849,563		2,849,563	(1)
Aggregate policy reserves	10,694,999		10,694,999	
Premiums received in advance	3,203,130	78,970	3,282,100	(3)
General expenses due or accrued	2,401,510		2,401,510	
Amounts withheld or retained for the account of others	31,528,230		31,528,230	
Amounts due to parent, subsidiaries and affiliates	673,517	(31,901)	641,616	(2)
Aggregate write-ins for liabilities	5,816,711	(78,970)	5,737,741	
Total Liabilities	<u>73,848,257</u>	<u>(31,901)</u>	<u>73,816,356</u>	
Unassigned funds (surplus)	<u>183,610,190</u>	<u>(329,259)</u>	<u>183,280,931</u>	(4)
Total Surplus	<u>183,610,190</u>	<u>(329,259)</u>	<u>183,280,931</u>	
Total Liabilities and Surplus	<u>\$ 257,458,447</u>	<u>\$ (361,160)</u>	<u>\$ 257,097,287</u>	



Dental Service of Massachusetts, Inc.

Delta Dental Plan of Massachusetts  
Summary of Operations  
For the Year Ended December 31, 2004

	As Reported by the Company	Examination Changes	Per Statutory Examination
Net premium income	\$ 311,260,344	\$ 0	\$ 311,260,344
Total revenues	311,260,344		311,260,344
Other professional services	251,603,921		251,603,921
General administrative expenses	47,233,880		47,233,880
Total underwriting deductions	298,837,801		298,837,801
Net underwriting gain	12,422,543		12,422,543
Net investment income earned	7,449,349		7,449,349
Net realized capital gains or (losses)	11,903,940		11,903,940
Aggregate write-ins for other income or expenses	(7,500,000)		(7,500,000)
Net income before federal income taxes	24,275,832		24,275,832
Federal and foreign income taxes incurred	0		0
Net Income	\$ 24,275,832	\$ 0	\$ 24,275,832

Dental Service of Massachusetts, Inc.

Delta Dental Plan of Massachusetts  
Statement of Surplus  
For the Year Ended December 31, 2004

	As Reported by the Company	Examination Changes	Per Statutory Examination	Notes
Surplus, December 31, 2003	\$163,820,752	\$ 0	\$163,820,752	
Net income	24,275,832		24,275,832	
Net unrealized capital gains or losses	(13,604,928)		(13,604,928)	
Change in nonadmitted assets and related items	8,468,534	(329,259)	8,139,275	( 4 )
Aggregate write-ins for gains and losses in surplus	650,000		650,000	
Net change in surplus for the year	19,789,438	(329,259)	19,460,179	
Surplus, December 31, 2004	\$183,610,190	\$ (329,259)	\$183,280,931	

Dental Service of Massachusetts, Inc.

Delta Dental Plan of Massachusetts  
Reconciliation of Surplus  
For the Three Year Period Ended December 31, 2004

	<u>2004 *</u>	<u>2003</u>	<u>2002</u>
Surplus, December 31, prior year	<u>\$ 163,820,752</u>	<u>\$ 121,028,809</u>	<u>\$ 99,056,078</u>
Net income	24,275,832	26,834,172	19,090,861
Net unrealized capital gains		21,364,762	(3,324,122)
Change in net unrealized capital gains or (losses)	(13,604,928)		
Change in non-admitted assets and related items	8,139,275	(4,186,081)	4,998,915
Cumulative effect of changes in accounting principles		(1,220,910)	1,220,910
Aggregate write-ins for gains and (losses) in surplus	<u>650,000</u>	<u></u>	<u>(13,833)</u>
Net change in surplus for the year	<u>19,460,179</u>	<u>42,791,943</u>	<u>21,972,731</u>
Surplus, December 31, current year	<u><u>\$ 183,280,931</u></u>	<u><u>\$ 163,820,752</u></u>	<u><u>\$ 121,028,809</u></u>

\* Per Examination

COMMENTS ON FINANCIAL STATEMENTS

**ASSETS** At December 31, 2004, the net admitted asset reported by the Company totaled \$257,458,447. The Company has no investment in real estate or mortgage loans on real estate, nor does it issue derivate financial instruments. The Company has a clear and concisely documented investment policy statement with the purpose of setting forth Company goals, and objectives as well as to establish guidelines for the implementation of an investment strategy.

**Note (1) Amounts due from parent, subsidiaries and affiliates**

Examination of the asset, "Amounts due from parent, subsidiaries and affiliates" found the account to be overstated by \$ 346,015 resulting in the examination net admitted asset balance of \$ 326,091. The decrease in the asset balance is due to an un-documented note receivable from Dental Health Center for \$ 225,000 that had been improperly classified as an asset having an economic value. (See Statement of Statutory Accounting Practice (SSAP) No. 4) The remaining decrease of \$ 121,015 is the result of non-admitting all receivable balances and management fee due over 90 days past year-end 2004, and remaining uncollected as of the time of the examination.

The Company should initiate the proper steps to properly age their intercompany receivable balances. In addition the Company should follow their intercompany agreements which call for the timely settlement of balances. The examiners found that the Company did not follow their intercompany agreements in the timely settlement of amounts due from affiliates.

**Note (2) Electronic data processing equipment and software**

The examination of the asset "Electronic data processing equipment and software" found this account to be overstated by \$15,145, resulting in the examination net admitted asset balance of \$0. The decrease in the asset balance is due to the Company's failure to adhere to Chapter 176E Section 8A, which states that the Company may include as an asset available for payment of losses any electronic data processing equipment, provided that the cost is at least \$ 100,000.

It is recommended that the Company adhere to Chapter 176E when recording assets as Electronic data processing equipment and software.

**LIABILITIES** As of December 31, 2004, the Company reported total liabilities amounting to \$73,848,254, and total unassigned funds amounting to \$183,610,190. At the date of the examination the Company did not have any borrowed money.

**Note (1) Claims Unpaid and Unpaid Claims Adjustment Expense  
\$19,530,160**

The Company retained the services of Milliman, Inc., Consultants and Actuaries, to perform an in-depth analysis of the reserves and to provide an actuarial opinion on the reasonableness of the reserves carried by the Company as of December 31, 2004.

The table below summarizes Milliman's and PricewaterhouseCoopers' review of the Company's reserve ranges and select point estimates as of December 31, 2004:

Dental Service of Massachusetts, Inc. Unpaid Claims Reserve	PwC Reserve	Milliman, Inc. Mid-Point *
\$19,530,160	\$19,531,000	\$18,230,858

\*Excludes \$1,372,563 of reserves allocated to the Loss adjustment expenses for cost plus business.

**Note (2) Amounts due to parent, subsidiaries and affiliates**

Examination of the liability, "Amounts due to parent subsidiaries and affiliates" found the account to be overstated by \$31,901, resulting in a net liability balance of \$641,616. The decrease in the liability balance is due to amounts that had not been properly reported as intercompany receivable.

The Company should initiate the proper steps to properly age their intercompany receivable and payable balances. In addition the Company should follow their intercompany agreements which call for the timely settlement of balances. The examiners found that the Company did not follow their intercompany agreements in the timely settlement of amounts due to/from subsidiaries.

**Note (3) Premiums received in advance and Aggregate write-ins for liabilities**

The examination of the liability, "Premiums received in advance", was found to be understated due to a reclassification error in the amount of \$ 78,970.

The examination of the liability, "Aggregate write-ins for liabilities", was found to be overstated due to a reclassification error in the amount of \$ 78,970.

**Note (4) Unassigned funds (Surplus)**

The Company's unassigned funds have been reduced by \$ 329,259. This adjustment is the result of adjusting the receivable and payable from/to subsidiaries as described in the Asset Notes (1) and (2) and Liabilities Note (2)

For Information Purposes Only

CONCLUSION

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

The assistance rendered by the following Commonwealth of Massachusetts Division of Insurance examiner who participated in this examination is hereby acknowledged:

Algernon Flowers, Examiner II

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Hilton A. Irizarry, CFE  
Examiner-in-Charge  
Commonwealth of Massachusetts  
Division of Insurance

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Kenneth R. Brenner, CPA  
Supervising Examiner  
Commonwealth of Massachusetts  
Division of Insurance

For Information Purposes Only