



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION OF THE
FALLON COMMUNITY HEALTH PLAN, INC.

Worcester, Massachusetts

As of December 31, 2011

NAIC COMPANY CODE 95541

EMPLOYERS ID NUMBER 23-7442369

Fallon Community Health Plan, Inc.

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COMMONWEALTH OF MASSACHUSETTS

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May 28, 2013

Honorable Joseph G. Murphy
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner:

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

FALLON COMMUNITY HEALTH PLAN, INC.

at its home office located at 10 Chestnut Street, Worcester, Massachusetts, 01608-2810. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Fallon Community Health Plan, Inc. (hereinafter referred to as the "Company", "Fallon" or "FCHP") was last examined as of December 31, 2007 by the Massachusetts Division of Insurance ("Division"). The current examination covers the four-year period from January 1, 2008 through December 31, 2011, 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 current NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company, including corporate governance, identifying and assessing inherent risks within the company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, when applicable to domestic state regulations. All accounts and activities of the company were considered in accordance with the risk-focused examination process.

KPMG LLP ("KPMG") was engaged by the Division to perform certain agreed upon procedures consistent with the guidance provided in the NAIC *Financial Condition Examiners' Handbook*. KPMG's Health Actuaries were involved in the performance of those procedures to the extent that such procedures related to the Company's reserves for unpaid claims and loss adjustment expenses and provider risk sharing settlements as of December 31, 2011. KPMG's Information Technology Advisory Services personnel were engaged to perform a review of the Company's general controls over its information technology environment. All procedures were performed under the management and control and general supervision of the examination staff of the Division.

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, reinsurance treaties, conflict of interest disclosure statements, fidelity bond and other insurance, employees' pension and benefits 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.

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The Company was audited each of the years under examination by Ernst & Young LLP ("E&Y"), an independent certified public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2008 through 2011. A review and use of the E&Y's work papers were made to the extent deemed appropriate and effective. Effective for the 2012 annual audit, the Company replaced E&Y and retained PricewaterhouseCoopers LLP as its Certified Public Accountants. Additionally, the Company is required to comply with the Model Audit Rule ("MAR"). All control work papers associated with MAR compliance have been reviewed as a source of information and were tested and leveraged as deemed appropriate and effective.

Status of Findings from the Prior Examination

There were no findings from the previous Exam that require an update.

SUBSEQUENT EVENTS

On March 21, 2012, the Company and Magellan Health Services, Inc. ("Magellan") entered into a Joint Venture Development Agreement and are forming a Joint Venture to apply to participate in a new demonstration program that will provide integrated health care to individuals aged 21 to 64 years who are dually-eligible for Medicare and Medicaid in Massachusetts (the "Demonstration"). To most appropriately respond to this opportunity, FCHP and Magellan will develop an integrated care organization ("ICO") to be called "Fallon Total Care". The ICO will bring together Magellan's clinical expertise in behavioral health services and FCHP's capabilities and experience in managing the physical health care needs of dual-eligible individuals. There is no assurance that Massachusetts will proceed with the Demonstration or that Fallon Total Care will ultimately be selected as a participating ICO for the Demonstration. The joint venture will be structured with the Company owning 51 percent and Magellan owning 49 percent.

COMPANY HISTORY

General

Fallon Community Health Plan, Inc. is a Health Maintenance Organization ("HMO") providing comprehensive health care services on a prepaid basis to subscribing groups and individuals in Massachusetts. FCHP was incorporated in 1975 and commenced operations in 1977 through a joint effort of the Fallon Clinic, Inc. and Blue Cross and Blue Shield of Massachusetts, Inc. ("BCBSMA"). The Company is a not-for-profit organization, exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code.

FCHP was an early developer of HMO coverage for Medicare and Medicaid beneficiaries, having established the Fallon Senior Plan to serve Medicare beneficiaries and the Fallon Medicaid HMO to serve Medicaid beneficiaries in 1980.

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BCBSMA withdrew as a sponsoring organization of FCHP in 1988. In 1990, FCHP acquired the right to appoint the Corporate Members of the St. Vincent Hospital System ("SVHS") of Worcester, Massachusetts, which has historically maintained a close working relationship with FCHP. In 1991, the Fallon Foundation, Inc. ("Fallon Foundation") was substituted for FCHP as the entity which held rights to appoint the Corporate Members of SVHS; combined with the Fallon Clinic, this arrangement effectively created a vertically integrated health care delivery system.

In 1992, FCHP formed Fallon Health and Life Assurance Company, Inc. ("FHLAC"), a Massachusetts stock life and health insurance company. FHLAC commenced operations in 1993. FHLAC is a wholly-owned subsidiary of FCHP, and focuses on Preferred Provider Organization coverage, indemnity insurance and administrative services only arrangements.

Effective January 1, 2004, FCHP disaffiliated with the Fallon Foundation. Prior to this restructuring, the Fallon Foundation was the sole corporate member of FCHP. The Fallon Clinic was, in turn, the sole corporate member of the Fallon Foundation and had maintained majority representation on FCHP's Board of Directors. Concurrent with the disaffiliation, all FCHP Directors who were affiliated with either the Fallon Foundation or the Fallon Clinic resigned. Since the disaffiliation took effect, the Fallon Foundation has ceased to be a member of the Company, to elect members of the FCHP Board of Directors and to exercise approval powers over FCHP. FCHP has remained a membership corporation since the disaffiliation became effective, but pursuant to the Company's bylaws, its corporate membership consists of those individuals who serve as FCHP Directors.

CORPORATE RECORDS

Board of Directors Minutes

The minutes of meetings of the Board of Directors and its Committees for the period under examination were read and they indicated that all meetings were held in accordance with the Company's bylaws and the laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at meetings of the Board of Directors.

Company Bylaws

The Company's bylaws may be amended or repealed and new bylaws may be adopted, by the affirmative vote of the Board of Directors at any annual meeting of the Board of Directors or at any special meeting of the Board of Directors called for that purpose; provided, further that the notice of which shall either specify the articles to be affected or the subject matter of the proposed amendment or repeal.

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The Company's bylaws indicate the following regarding its corporate membership:

- The Corporation shall be a membership organization. The "Members" shall be comprised of individuals who are serving as members of the Board of Directors, excluding the President of FCHP.
- The meetings of the Members shall be held at the principal office of FCHP in Massachusetts or at such other place as may be named in the call of the meeting. The annual meeting of the Members shall be held in the month of June, at such hour and place as may be named in the call of the meeting, or at such other time and date as may be set by the Board of Directors. The purposes for which an annual meeting is to be held, in addition to those prescribed by the law, by the Articles of Organization, and by the Company's bylaws, may be specified by the Board of Directors or by a writing signed by any of the Chair of the Board, President, Vice Chair, or a quorum of the Directors. In the event the annual meeting is not held on such date, a special meeting in lieu of the annual meeting may be held with all the force and effect of an annual meeting.
- Special meetings of the Members may be called by the Chair of the Board, President, or by a quorum of the Directors, and shall be called by the Clerk, or in the case of the death, absence, incapacity or refusal of the Clerk, by any other officer of the Corporation. Such call shall state the time, place and purpose of the meetings.

The Company's bylaws were most recently amended as of June 21, 2012, however these changes were primarily clerical in nature.

Conflict of Interest Procedures

Pursuant to the Company's bylaws, the Company maintains a Conflict of Interest Policy that is approved by the Board of Directors. Every Director and officer, in a manner and form to be prescribed by the Conflict of Interest Policy, shall be required as a condition of the office to disclose fully any conflict of interest as defined in the Conflict of Interest Policy and the Company's bylaws. Should a conflict arise, the interested Director may make a presentation regarding the transaction in question to the Board and shall not be present during the discussion of, and vote on, the transaction in question. The Chair of the Board shall, if appropriate, appoint a disinterested Director or committee to investigate alternatives to the proposed transaction or arrangement. After exercising due diligence, the Board shall determine whether the Company, with reasonable efforts, can obtain a more advantageous transaction that would avoid the conflict of interest. If such an alternative is not available, the Board shall determine by a majority vote of the disinterested Directors whether the transaction is in the Company's best interest, for its own benefit, and is fair and reasonable to the Company. In case FCHP enters into a contract or business transaction that would involve a Director or officer conflict of interest consistent with these procedures, such contract or transaction is not invalidated by the fact that one or more Directors or officers have interests that may be adverse to the interests of FCHP.

Review of the 2011 Board of Directors records identifies no significant conflicts of interest and no financial conflicts of interest.

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 M.G.L., Chapter 175, Sections 180M-180Q.

MANAGEMENT AND CONTROL

Board of Directors

The Company's bylaws indicate the following regarding its Board of Directors:

- The Board of Directors shall have and may exercise all the powers of FCHP except such powers as are conferred upon the Members by law, by the Articles of Organization, or by the Company's bylaws.
- The Board of Directors will consist of not less than five (5) nor more than thirteen (13) voting members, with the exact number being set by the Board of Directors. The President of FCHP shall serve as an *ex officio* member of the Board of Directors with vote and shall be counted for purposes of determining the total number of Directors set forth in the preceding sentence.
- The terms of the Directors shall be staggered, with approximately one-third (1/3) of the total number of Directors to be elected at each annual meeting of the Board of Directors. Except as necessary to stagger the terms of the Directors, each Director shall be elected for a three-year term. Each Director, except for an *ex officio* Director, will be limited to a maximum of three terms, and shall serve until his or her respective successor is elected and qualified. A partial term or term of less than three years shall not be considered as a three-year term for purposes of the preceding. *Ex officio* Directors shall serve for so long as they hold their underlying office position.
- Regular meetings of the Board of Directors shall be held at such places, within or without the Commonwealth of Massachusetts, and at such times as the Board may determine by vote from time to time, provided that the Board of Directors shall meet at least quarterly.
- Special meetings of the Board of Directors may be held at any time and at any place, within or without the Commonwealth of Massachusetts, when called by the Chair of the Board, President or by two or more members of the Board.
- At any meeting of the Board, the presence of a majority of the Directors then in office shall constitute a quorum for the consideration of any questions, but a smaller number of Directors may adjourn any meeting, and the meeting so adjourned may be held without further notice when a quorum is secured. When a quorum is present at any meeting, subject to the

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provisions of the Company's Conflicts of Interest Policy regarding Interested Directors, the vote of a majority of all of the Directors then in office entitled to vote on the question shall decide any question brought before such meeting, except where a larger vote is required by law, by the Articles of Organization or by the Company's bylaws.

- Any action required or permitted to be taken at any meeting of the Board may be taken without a meeting if all Directors entitled to vote on the matter consent to the action in writing and the written consents are filed with the records of the meetings of the Board. Such consents shall be treated for all purposes as a vote at a meeting of the Board.
- Any Director may resign at any time by delivering his or her resignation in writing to a meeting of the Board of Directors or to the President. Any Director may be removed from office, with or without cause, by a vote of the majority of the remaining Directors then in office at any meeting called for that purpose, provided that an *ex officio* Director shall only be removed by removal from his or her underlying office position. Directors then in office may act despite a vacancy or vacancies in the Board, and shall for this purpose be deemed to constitute a full Board of Directors. Any vacancy in the Board of Directors, however occurring, may be filled by the election of a successor by majority vote of the remaining Directors then in office from a list of nominees prepared by the Nominating Committee. Each successor elected to fill a vacancy created by an unexpired term shall hold office for the balance of the unexpired term, and until his or her successor shall be elected or appointed and qualified.

At December 31, 2011, the Board was comprised of nine (9) Directors, which is in compliance with the Company's bylaws. Directors duly elected and serving at December 31, 2011, with business affiliations, were as follows:

<u>Director</u>	<u>Principal Occupation</u>
Christopher F. Egan	Former U.S. Ambassador to the Organization for Economic Cooperation and Development
Alan J. Gayer	Former CEO, Toronto Hospital for Sick Children and Atlanta Children's Healthcare Systems
W. Patrick Hughes	President & CEO, Fallon Community Health Plan, Inc.
David R. Grenon	Retired CEO, Protector Insurance Group, Inc.
David W. Hillis	President and Chief Executive Officer, AdCare Hospital of Worcester, Inc.
Richard P. Houlihan	Retired Attorney
Charles F. Monahan, Jr.	President, Massachusetts College of Pharmacy and Health Sciences
Rev. John J. Paris, S.J.	Professor of Bioethics, Boston College
Christian W. McCarthy	Executive Vice President and Treasurer, Assumption College

Committees of the Board of Directors

The Company's bylaws indicate the following regarding committees of the Board:

Executive Committee: The Board of Directors may appoint from its members, at its first meeting held after the annual meeting of the Members in each year, an Executive Committee consisting of not less than three (3) nor more than five (5) Directors, with the exact number being set by the Board of Directors. Such committee may be delegated, from time to time until further order of the Board of Directors, any or all of the powers of the Board in connection with the affairs of FCHP except as may be limited by the General Laws of Massachusetts, Chapter 180 – Corporations for Charitable and Certain Other Purposes. Quorum and voting requirements shall be the same for the Executive Committee as they are for the Board of Directors.

Audit and Compliance Committee: The Audit & Compliance Committee's primary function is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing: (i) the systems of internal controls which management and Board of Directors have established; (ii) key elements of the Corporate Compliance Program; and (iii) the internal and external audit processes. In this regard, it focuses on three areas; (1) the adequacy of the Corporation's financial statements; (2) the effectiveness of the Corporate Compliance Program; and (3) the independence and performance of the Corporation's internal and external auditors.

Executive Evaluation and Compensation Committee: The Executive Evaluation & Compensation Committee of the Board of Directors of FCHP shall discharge the Board's responsibilities relating to compensation of the senior executives of FCHP.

Finance Committee: The Finance Committee shall oversee the finances of FCHP and recommend actions when needed. Address and provide oversight to all financial issues including, but not limited to: financial reporting and analysis, controllership issues, cash management, provider contracting and general contracts, claims payment and adjudication, tax issues, risk management, acquisition and divestitures, mergers, joint ventures, partnerships, cost reduction and budgeting, medical loss ratios, investments of reserves and employee retirement plans.

Governance and Nominating Committee: The Governance and Nominating Committee's primary function is to assist the Board of Directors in the following areas: (1) Nominations - Establish and manage the process that recommends individuals to serve on the Board of Directors. (2) Board Orientation, Education and Evaluation – Ensure the development and execution of materials and processes that provide a comprehensive orientation to new Board members of FCHP. (3) Bylaws - From time to time, FCHP bylaws may need revision. This committee will make recommendations for revision to the Board members. (4) Conflicts of Interest – The Board has a Conflict of Interest policy. This Committee will maintain this policy and address any questions that may arise.

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Service and Quality Oversight Committee: The Service and Quality Oversight Committee's primary purpose is to develop, implement and oversee the quality improvement programs of FCHP. The Service and Quality Oversight Committee reports to the Board of Directors, which is responsible for the improvement of the quality and the safety of the clinical care and service provided to members.

The current standing committees of the Board and committee membership as of December 31, 2011 were as follows:

<u>Committee</u>	<u>Membership</u>
Audit and Compliance Committee	Rev. John J. Paris, S.J. (Chair); Alan J. Gayer
Executive Evaluation and Compensation Committee	Richard P. Houlihan, Esq. (Chair); Christopher F. Egan; David R. Grenon; Christian W. McCarthy
Executive Committee	David W. Hillis (Chair); Richard P. Houlihan, Esq.; W. Patrick Hughes; Christian W. McCarthy; Charles F. Monahan, Jr.
Finance Committee	Christian W. McCarthy (Chair); Christopher F. Egan; David R. Grenon; W. Patrick Hughes
Governance and Nominating Committee	Charles F. Monahan, Jr. (Chair); David R. Grenon; Richard P. Houlihan; Rev. John J. Paris, S.J.
Service and Quality Oversight Committee	Charles F. Monahan (Chair); George Abraham, M.D.; Jerry Gurwitz, M.D.; Margaret M. Hudlin, M.D.

Officers

FCHP may have as its officers a Chair of the Board, a Vice Chair, a President and Chief Executive Officer ("President and CEO"), a Treasurer, a Clerk, and may have such other officers, including but not limited to Division Presidents and Executive Vice Presidents, as the Board in its discretion shall appoint. The Chair of the Board, the Vice Chair, the Treasurer and the Clerk shall be elected annually by the Board at the annual meeting after the Directors' election.

The Chair of the Board, the Vice Chair and the Treasurer shall be Directors. The Clerk shall be a resident of Massachusetts, but need not be a Director. So far as it is permitted by law, any two or more offices may be filled by the same person.

The President and CEO shall be appointed by the Board and shall be the chief executive of FCHP. The President and CEO shall have general control and charge over the management of the ordinary affairs of FCHP. The term of the President and CEO shall be determined by the Board and may be contained in any employment agreement between FCHP and the President and CEO.

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FCHP may have such Division Presidents and Executive Vice Presidents as recommended by the President and CEO and approved by the Board. Such Division Presidents and Executive Vice Presidents shall perform such duties and have such powers as are recommended by the President and CEO and approved by the Board.

Any officer or agent may resign at any time by delivering his or her resignation, in writing to the President and CEO, Chair of the Board or Clerk, or to a meeting of the Board of Directors. The Board of Directors may remove from office, with or without cause, any officer appointed by the Board of Directors, or may terminate or modify the authority of any such officer or any agent; provided, however, that in the case of the President and CEO, any such removal shall be consistent with the terms of any employment with such officer.

If the office of the Chair of the Board, the Vice Chair, the Treasurer, the Clerk, or any other officer becomes vacant by reason of death, resignation or removal, the Board of Directors may elect a successor. If the office of the President becomes vacant by reason of death, resignation or removal, the Board of Directors may appoint a successor. Each such successor shall hold office for the unexpired term, and continue thereafter until his or her successor shall be elected or appointed and qualified.

The Company's officers and their respective titles at December 31, 2011 were as follows:

<u>Officer</u>	<u>Title</u>
David W. Hillis	Chairman of the Board
W. Patrick Hughes	President and Chief Executive Officer
Charles F. Monahan Jr.	Clerk
Christian W. McCarthy	Treasurer
R. Scott Walker	Chief Financial Officer
Teena Osgood	Chief Human Resources Officer
David Przesiek	Senior VP Sales and Marketing
Richard Burke	President Senior Care Services & Govt. Programs, Chief Compliance Officer
Elizabeth Malko, M.D.	Chief Medical Officer
Richard Commander	Chief Operating Officer
Mary Ritter	Senior VP Strategic Planning & Corporate Communications

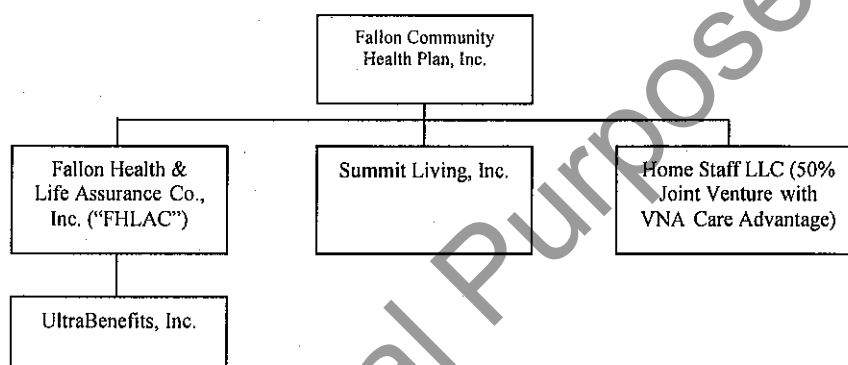
Fallon Community Health Plan, Inc.

Affiliated Companies

As stated in the Insurance Holding Company System Form B and Form C as filed with the Division, the Company is a member of a holding company system and is subject to the registration requirements of Section 206C of M.G.L., Chapter 175 and Regulation 211 CMR 7.06 (1). FCHP is the "ultimate controlling person" for the Company.

Organization Chart

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2011 is illustrated below:



Transactions and Agreements with Subsidiaries and Affiliates

FHLAC is a wholly-owned subsidiary of FCHP. FHLAC has no employees and FCHP accordingly provides all administrative services to FHLAC, including premium collection, claims processing and operational management in return for an administrative fee that is included as an offset to expense. Settlement of intercompany balances takes place monthly.

In order to offset poor operating results and maintain adequate levels of capital, FCHP has made capital contributions to FHLAC during the period covered by this exam as follows:

<u>Year</u>	<u>Amount</u>
2011	\$ 8,400,000
2010	11,300,000
2009	11,300,000
2008	4,500,000
Total	<u>\$35,500,000</u>

In 2012, FCHP made an additional capital contribution to FHLAC of \$10.6 million.

FIDELITY BONDS AND OTHER INSURANCE

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

In addition to the bond insurance, the Company has further protected its interests and properties by acquiring policies of insurance covering other insurable risks. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts and was in force as of December 31, 2011.

PENSION AND INSURANCE PLANS

Defined Benefit Plan

The Company amended its defined benefit pension plan to freeze the plan for current participants and close the plan for new entrants as of December 31, 2006. Participants who were employed on December 31, 2006, and had earned at least one year of credited service as of that date had their accrued December 31, 2006 benefits enhanced by the addition of 1 to 5 years depending on their years of service at December 31, 2006, to their actual credited service for purposes of determining their frozen accrued benefits as of December 31, 2006. No new pension plan benefits have been accrued after December 31, 2006. In December 2011, the Company's Board of Directors approved a resolution to terminate the plan effective December 31, 2011, and to liquidate the plan in accordance with the terms and conditions of the plan and any rules or regulations promulgated by the Pension Benefit Guaranty Corporation and the Internal Revenue Service. At December 31, 2011, the defined plan was under funded, as the actuarial present value of the accumulated benefit obligations exceeded the value of plan assets by \$5.9 million. During 2012, the Company settled the plan liability and made final payment on December 11, 2012 to liquidate the pension benefit plan. As of December 31, 2012, there are no longer any assets held within the Company's defined benefit pension plan.

Defined Contribution Plan

FCHP has a 401(k) savings plan for eligible employees. During the years under exam, the Company contributed 100% of the first 3% that the employee contributed and 66.67% of the next 3% of compensation that the employee contributed for a total match of 5% of the first 6% of compensation that the employee contributed subject to a pretax Internal Revenue Service limit.

Contributions are maintained in investment funds established under the employee savings plan. Total Company contributions charged to operations amounted to \$2,190,000 in 2011 and \$2,038,000 in 2010, \$3,466,000 in 2009 and \$3,418,000 in 2008.

TERRITORY AND PLAN OF OPERATION

The Company is headquartered in Worcester, Massachusetts and only licensed to transact business in Massachusetts. FCHP historically focused on Worcester County but has since expanded its service area to most of Massachusetts. FCHP's Direct Care service area includes communities primarily in Central Massachusetts and suburban Boston. FCHP's Select Care service area encompasses communities statewide, excluding portions of Southeastern Massachusetts, Cape Cod, Martha's Vineyard and Nantucket.

GROWTH OF COMPANY

Capital and Surplus consists of capital contributed to the Company and the excess of revenues over expenses since inception. The total admitted assets, total liabilities, capital and surplus and net premium income of the Company for the years ended 2008 through 2011, which was prepared from the Company's annual statements, are shown in the following schedule:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Net Premium Income</u>
2011	\$ 342,858,277	\$ 214,943,079	\$ 127,915,198	\$ 1,096,293,663
2010	296,395,049	202,819,069	93,575,980	1,093,534,202
2009	272,286,984	171,333,828	100,953,156	1,075,828,891
2008	281,443,431	158,933,845	122,509,586	987,350,584

LOSS EXPERIENCE

Unpaid Claims

KPMG Health Actuaries prepared independent estimates of the Unpaid Claim Liabilities ("UCL") as of December 31, 2011 and prior periods. For December 31, 2011, completion factors for the projection of ultimate claims were developed using historical payment patterns and actuarial judgment. "Low" and "High" estimates were developed by subtracting the claims paid-to-date from the actuarial range of incurred estimates. As the FCHP business pays fairly quickly, the range of estimates for the December 31, 2011 UCL is narrow and the actuarial estimates are similar to FCHP's estimates with hindsight through September 30, 2012.

FCHP made a separate provision for Loss Adjustment Expenses / Claim Adjustment Expenses in 2011 and the resulting expense percentage levels used are within industry norms.

Based upon KPMG's review, the UCL as of December 31, 2011 appears to be fairly stated but conservative. KPMG noted that some conservatism is not unreasonable given the exposure to

factors that impact the reserves and cause uncertainty when developing reserve estimates. The amount of conservatism in the December 31, 2011 reserves appears to be consistent with current industry results.

The Company's premium deficiency reserve calculation was reviewed and found to be reasonable. The Company has calculated the reserve by looking at projected deficiency separately for each large group. The projected deficiency is defined as the difference between the premium sold on the contract and the premium (claims and expenses) required by the underwriting department for the months remaining in the rating period. The calculation indicated that a premium deficiency reserve of \$15.6 million was required as of December 31, 2011.

Provider Contracts

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

The agreements are in compliance with Massachusetts statutes and regulation 211 CMR 52.00.

REINSURANCE

Ceded Reinsurance

FCHP carries reinsurance against excessive claims utilization. Under its reinsurance policy, the Company is reimbursed for 90% of all claims over the policy deductible, which is \$1,000,000. The per member per year limit is \$2,000,000. Total premiums of \$1,227,000, \$1,298,000, \$1,163,000 and \$870,000 were ceded relating to reinsurance for the years ended December 31, 2011, 2010, 2009 and 2008, respectively. Recoveries realized under the applicable reinsurance contract for the years ended December 31, 2011, 2010, 2009 and 2008 were \$0, \$386,000, \$1,245,000 and \$2,120,000, respectively.

ACCOUNTS AND RECORDS

During the years under exam, the books and records of the Company were audited annually by the independent certified public accounting firm of E&Y in accordance with 211 CMR 23.00. E&Y issued an unqualified opinion on the audited financial statements for all years under exam. The Company is also subject to review by an internal audit department and subject to the requirements of MAR.

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

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The questionnaire was completed by the Company and reviewed by the Division's consultants from KPMG's Technology Advisory Services team to evaluate the adequacy of the IT controls. In addition to the questionnaire, interviews with Company staff were conducted to gather supplemental information and corroborate the Company's responses to the questionnaire. A review was also made of the documentation supporting Management and Organization Controls, Application Systems Development and Maintenance Controls, Operating and Processing Controls, Logical and Physical Security Controls, Contingency Planning Controls, Personal Computer, Local Area Network, Wide Area Network and Internet Controls. No material deficiencies were noted.

The Company maintains its accounts and records on an electronic data processing basis. All entries are input to this data processing system, which then generates general ledger and supporting reports as well as other reports common to the insurance industry. No material exceptions were noted.

SPECIAL DEPOSITS

The special deposits of the Company at December 31, 2011 were as follows:

<u>Description of Deposit</u>	<u>Purpose of Deposit</u>	<u>Book Value</u>	<u>Fair Value</u>
U.S. Treasury Note, 2.75%, 11/30/2016 Maturity	Massachusetts – Protection for All Policyholders	\$ 1,090,434	\$ 1,091,800

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance of the Commonwealth of Massachusetts and by the National Association of Insurance Commissioners as of December 31, 2011:

Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2011

Statement of Revenue and Expenses for the year ended December 31, 2011

Statement of Capital and Surplus for the year ended December 31, 2011

Reconciliation of Capital and Surplus for Each Year in the Four-Year Period Ended December 31, 2011

For Informational Purposes Only

Fallon Community Health Plan, Inc.
Statement of Assets, Liabilities, Capital and Surplus
as of December 31, 2011

	Per Company	Examination Changes	Per Examination
Assets			
Bonds	\$154,103,845	\$0	\$154,103,845
Common Stocks	141,956,434		141,956,434
Cash on hand and on deposit	16,698,248		16,698,248
Other invested assets	3,911,204		3,911,204
Subtotals, cash and invested assets	316,669,731		316,669,731
Investment income due and accrued	1,257,985		1,257,985
Premiums and considerations:			
Uncollected premiums and agents' balances	15,614,503		15,614,503
Receivable from parent, subsidiaries and affiliates	1,704,027		1,704,027
Healthcare and other amounts receivable	7,612,031		7,612,031
 Total Assets	 <u>\$342,858,277</u>	 <u>\$0</u>	 <u>\$342,858,277</u>
Liabilities, Capital and Surplus			
Claims unpaid	\$119,349,641	\$0	\$119,349,641
Accrued medical incentive pool and bonus amounts	16,909,856		16,909,856
Unpaid claim adjustment expense	1,480,895		1,480,895
Aggregate health policy reserves	28,300,000		28,300,000
Premiums received in advance	15,170,131		15,170,131
General expense due or accrued	9,905,363		9,905,363
Amounts due parent, subsidiaries and affiliates	3,038,514		3,038,514
Payable for securities	851,658		851,658
Aggregate write-ins for other liabilities	19,937,021		19,937,021
Total Liabilities	214,943,079		214,943,079
 Unassigned funds (surplus)	 <u>127,915,198</u>		 <u>127,915,198</u>
Total capital and surplus	127,915,198		127,915,198
 Total liabilities, capital and surplus	 <u>\$342,858,277</u>	 <u>\$0</u>	 <u>\$342,858,277</u>

Fallon Community Health Plan, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2011

	Per Company	Examination Changes	Per Examination
Member months	1,897,433	0	1,897,433
Net premium income	\$1,096,293,663	\$0	\$1,096,293,663
Total revenue	1,096,293,663		1,096,293,663
Less:			
Hospital/medical benefits	772,091,361		772,091,361
Other professional services	48,239,882		48,239,882
Outside referrals	3,115,310		3,115,310
Emergency room and out-of-area	2,265,680		2,265,680
Prescription Drugs	100,249,357		100,249,357
Aggregate write-ins for other hospital and medical	4,903,820		4,903,820
Incentive pool, withhold adjustment & bonus amounts	13,167,992		13,167,992
Total hospital and medical	944,033,402		944,033,402
Claims adjustment expense	13,128,586		13,128,586
General administrative expense	97,090,812		97,090,812
Increase in reserves for life and accident and health contracts	10,226,182		10,226,182
Total underwriting deductions	1,064,478,982		1,064,478,982
Net underwriting gain	31,814,681		31,814,681
Net investment income earned	10,261,313		10,261,313
Net realized capital gains	3,828,226		3,828,226
Net investment gains or (losses)	14,089,539		14,089,539
Aggregate write-ins for other income or expenses	349,042		349,042
Net income or (loss) after capital gains tax and before all other federal income taxes	46,253,262		46,253,262
Net Income	\$46,253,262	\$0	\$46,253,262

Fallon Community Health Plan, Inc.
Statement of Capital and Surplus
For the Year Ended December 31, 2011

	Per Company	Examination Changes	Per Examination
Surplus as regards policyholders, December 31 prior year	\$93,575,980	\$0	\$93,575,980
Net income	46,253,262		46,253,262
Change in net unrealized capital gains (losses)	(15,792,963)		(15,792,963)
Change in non-admitted assets	1,381,107		1,381,107
Aggregate write-ins for gains or (losses) in surplus	2,497,812		2,497,812
Net change in capital and surplus	34,339,218		34,339,218
Surplus as regards policyholders, December 31 current year	<u>\$127,915,198</u>	<u>\$0</u>	<u>\$127,915,198</u>

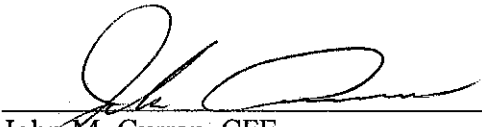
Fallon Community Health Plan, Inc.
Reconciliation of Capital and Surplus
For Each Year in the Four-Year Period Ended December 31, 2011

	2011	2010	2009	2008
Capital and surplus, December 31 prior year	<u>\$93,575,980</u>	<u>\$100,953,156</u>	<u>\$122,509,586</u>	<u>\$171,469,950</u>
Net income (loss)	46,253,262	4,092,619	(19,019,790)	11,628,094
Change in net unrealized capital gains (losses)	(15,792,963)	(10,780,060)	11,756,339	(40,122,301)
Change in nonadmitted assets	1,381,107	245,889	(16,458,632)	(14,329,490)
Aggregate write-ins for gains or (losses)	2,497,812	(935,624)	2,165,653	(6,136,667)
Net change in capital and surplus	<u>34,339,218</u>	<u>(7,377,176)</u>	<u>(21,556,430)</u>	<u>(48,960,364)</u>
Capital and surplus, December 31 current year	<u><u>\$127,915,198</u></u>	<u><u>\$93,575,980</u></u>	<u><u>\$100,953,156</u></u>	<u><u>\$122,509,586</u></u>

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by KPMG LLP who participated in this examination hereby is acknowledged.



John M. Curran, CFE
Supervising Examiner & Examiner-In-Charge
Commonwealth of Massachusetts
Division of Insurance