



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION

Division of Insurance

Report on the Statutory Examination of
Fallon Health and Life Assurance Company, Inc.

Worcester, Massachusetts

As of December 31, 2007

NAIC COMPANY CODE: 66828

EMPLOYERS ID NUMBER: 04-3169246

For Informational Purposes Only

Commonwealth of Massachusetts Division of Insurance
Report on the Statutory Examination of
FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.

Table of Contents

SALUTATION	1
SCOPE OF EXAMINATION	2
DESCRIPTION OF COMPANY	2
History	2
Capital and Surplus	3
MANAGEMENT	3
Articles of Organization and By-Laws	3
Stockholders	3
BOARD OF DIRECTORS	4
Committees of the Board	5
OFFICERS	5
CONFLICT OF INTEREST PROCEDURES	6
CORPORATE RECORDS	6
Articles of Incorporation and By-Laws	6
Board of Directors Minutes	7
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS AND PURCHASES OR SALES	7
MANAGEMENT CONTINUITY AND NATIONAL EMERGENCY	7
AFFILIATED COMPANIES	7
RELATED PARTY TRANSACTIONS	8
FIDELITY BOND AND OTHER INSURANCE	8
PENSION AND INSURANCE PLANS	8
SPECIAL DEPOSITS	8
TERRITORY AND PLAN OF OPERATION	8
Territory	8
Plan of Operation	8
PRODUCTS	9
PROVIDER CONTRACTS	9
UNPAID CLAIMS	9
INCOME TAXES	10
REINSURANCE	10
ACCOUNTS AND RECORDS	10
SUBSEQUENT EVENTS	10
COMMITMENTS AND CONTINGENCIES	10
Legal Proceedings	10
FINANCIAL STATEMENTS	11
Statutory Statement of Assets, Liabilities and Capital and Surplus as of Dec. 31, 2007	12
Statement of Revenue and Expenses for the Year Ended Dec. 31, 2007	13
Capital and Surplus for the Year Ended Dec. 31, 2007	14
Reconciliation of Capital and Surplus for the Three Year Period Ended Dec. 31, 2007	15
ACKNOWLEDGEMENT – Report of Certified Financial Examiner	16



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

NONNIE S. BURNES
COMMISSIONER OF INSURANCE

April 6, 2009

The Honorable Alfred W. Gross, Chair
Financial Condition (E) Committee, NAIC
Commissioner
Virginia Bureau of Insurance
State Corporation Commission
1300 East Main Street
Richmond, Virginia 23219

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
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 Massachusetts General Laws, Chapter 175, Section 4, an examination has been made of the financial condition and affairs of

Fallon Health and Life Assurance Company, Inc.

at its main administrative office located at:

10 Chestnut Street
Worcester, MA 01608-2810

The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

This statutory examination of Fallon Health and Life Assurance Company, Inc., hereinafter referred to as “the Company,” “the Corporation” or “FHLAC,” is as of December 31, 2007, including any material transactions and events occurring subsequent to the examination date and noted during the course of this statutory examination. KPMG LLP (“KPMG”) has applied certain agreed-upon procedures to selected records and transactions of the Company. Such procedures were reviewed and approved by the Commonwealth of Massachusetts Division of Insurance (the “Division”).

The current examination was conducted at the direction of and under the overall management and control of the examination staff of the Division. The statutory examination was performed at the Company's main administrative office in Worcester, Massachusetts. KPMG was engaged to perform certain agreed-upon procedures, which are in compliance with the *National Association of Insurance Commissioners (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, 2007. KPMG's Information Technology Advisory Services (ITAS) personnel were engaged to perform an Evaluation of Controls in Information Systems Questionnaire in a form substantially similar to the one established in the *NAIC Financial Condition Examiners' Handbook*. The ITAS specialists performed examination procedures pertaining to the examination of the IT systems as outlined in the *NAIC Financial Condition Examiners' Handbook*. All procedures were performed under the management and control and general supervision of the examination staff of the Division.

The examination was conducted in accordance with standards and procedures established by the NAIC Financial Condition (E) Committee and prescribed by the current *NAIC Financial Condition Examiners' Handbook*. 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, provider contracts, reinsurance treaties, conflict of interest disclosure statements, fidelity bonds and other insurance, employees' pension and benefits plans, disaster recovery plan, and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk and examination efforts were directed accordingly.

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

DESCRIPTION OF COMPANY

History

FHLAC is a Massachusetts stock health and life insurance company operating under Massachusetts General Laws, Chapter 175. FHLAC was formed in 1992 and commenced operations in 1993. FHLAC is a wholly-owned subsidiary of Fallon Community Health Plan, Inc. (FCHP) and focuses on Preferred Provider Organization (PPO) coverage, indemnity insurance and administrative services only (ASO) arrangements.

On August 31, 2006, FHLAC acquired UltraBenefits, Inc. (UltraBenefits), a third party administrator in Massachusetts, for cash and future cash considerations based upon certain client retention provisions and profitability targets. UltraBenefits provides medical, dental and disability claims processing, as well as claims management services,

**Commonwealth of Massachusetts Division of Insurance
Report on the Statutory Examination of
FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.**

premium and fee-billing services and administration of Flexible Spending Accounts, Health Reimbursement Accounts and COBRA.

Capital and Surplus

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 and capital and surplus of the Company for the years ended 2005 through 2007 are shown in the following schedule:

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Capital and Surplus</u>
2007	\$7,232,339	\$3,612,823	\$3,619,516
2006	7,566,509	4,352,508	3,214,001
2005	5,475,725	2,482,270	2,993,455

MANAGEMENT

Articles of Organization and By-Laws

The Company's By-Laws may be amended or repealed and new By-Laws 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.

Stockholders

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

- The annual meeting of the stockholders 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 law, by the Articles of Organization and by the Company's By-Laws, 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.
- At any meeting of the stockholders, the presence of a majority of the outstanding and issued shares of the Corporation, represented in person or by proxy, shall constitute a quorum, but a smaller number of individuals 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, the vote of individuals holding a majority of all of the issued and outstanding shares 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 By-Laws.
- Any action required or permitted to be taken at any meeting of the stockholders may be taken without a meeting if all stockholders entitled to vote on the matter consent to the action in writing and the written consents are filed with the records of the meetings of stockholders. Such consents shall be treated for all purposes as a vote at a meeting.

BOARD OF DIRECTORS

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

- The Board of Directors shall have and may exercise all the powers of the Corporation except such powers as are conferred upon the stockholders by law, by the Articles of Organization, or by the Company's By-Laws.
- The Board of Directors shall consist of not less than five (5) nor more than thirteen (13) voting members, with the exact number being set by the Board. The President of the Corporation shall serve as an *ex officio* member of the Board 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 stockholders. 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 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 By-Laws.
- 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 stockholders 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. Any vacancy in the Board, 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.

**Commonwealth of Massachusetts Division of Insurance
Report on the Statutory Examination of
FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.**

At December 31, 2007, the Board was comprised of six (6) Directors, which is in compliance with the Company's By-Laws. Directors duly elected and serving at December 31, 2007, with addresses and business affiliations, were as follows:

<u>Director</u>	<u>Term Expires</u>	<u>Principal Occupation</u>
Charles R. Goheen Worcester, MA	June 2009	Chief Financial Officer, Fallon Community Health Plan, Inc.
Karen H. Green Worcester, MA	June 2010	President & CEO, VNA Care Network, Inc.
David W. Hillis Worcester, MA	June 2010	President & CEO, AdCare Hospital of Worcester, Inc.
Richard P. Houlihan, Esq. Holden, MA	June 2009	Retired Attorney
Christian W. McCarthy Worcester, MA	June 2010	Executive VP of Finance and Treasurer, Assumption College
Eric H. Schultz Worcester, MA	<i>Ex officio</i>	President and CEO, Fallon Community Health Plan, Inc.

Committees of the Board

The Company's By-Laws indicate the following regarding committees of the Board:

The Board may appoint from within or without its own membership any standing or other committee it considers necessary to carry out the functions of the Corporation. All such committees shall have such duties as the Directors may prescribe and shall be subject to the general supervision of the Board and requirements of applicable law. Notwithstanding the foregoing, any committee that is delegated the power of the Board to act on behalf of the Corporation shall be comprised solely of Directors.

As of December 31, 2007, FHLAC had no standing committees of the Board.

OFFICERS

The Corporation shall 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 such other officers 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 the Corporation. The President and CEO shall have general control and charge over the management of the ordinary affairs of the Corporation. 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.

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

**Commonwealth of Massachusetts Division of Insurance
Report on the Statutory Examination of
FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.**

office, with or without cause, any officer appointed by the Board of Directors or 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, 2007 were as follows:

<u>Officer</u>	<u>Title</u>
Richard P. Houlihan, Esq. ¹	Chairman of the Board
David W. Hillis ²	Vice Chair
Eric H. Schultz	President and CEO
Karen H. Green	Clerk
Christian W. McCarthy	Treasurer

¹Mr. Houlihan resigned as Chairman of the Board effective February 19, 2009 and became Vice Chair.

²Mr. Hillis was elected to replace Mr. Houlihan as Chairman of the Board effective February 19, 2009.

CONFLICT OF INTEREST PROCEDURES

Pursuant to the Company's By-Laws, 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 By-Laws. 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 the Corporation 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 the Corporation.

Review of the 2007 Board of Directors records identified no significant conflicts of interest and no financial conflicts of interest.

CORPORATE RECORDS

Articles of Incorporation and By-Laws

The Company's By-Laws were most recently amended as of February 13, 2004; therefore, there were no substantive changes made during the examination period.

Board of Directors Minutes

The minutes of the Board for the period under statutory examination were reviewed and indicated that all meetings were held in accordance with the Company's By-Laws and the laws of the Commonwealth of Massachusetts.

ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS AND PURCHASES OR SALES

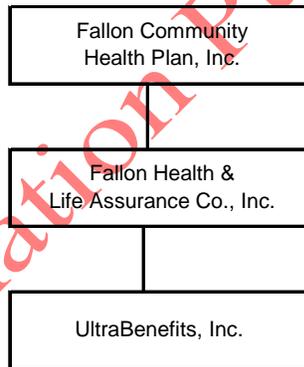
On August 31, 2006, FHLAC acquired UltraBenefits, Inc., for cash and future cash considerations based upon certain client retention provisions and certain profitability targets. The acquisition was accounted for under the statutory purchase method and FHLAC has recorded goodwill for the excess purchase price over the net book value of UltraBenefits. Amortization expense recorded as a change in unrealized losses in the statement of capital and surplus was \$242,000 and \$81,000 in 2007 and 2006, respectively.

MANAGEMENT CONTINUITY AND NATIONAL EMERGENCY

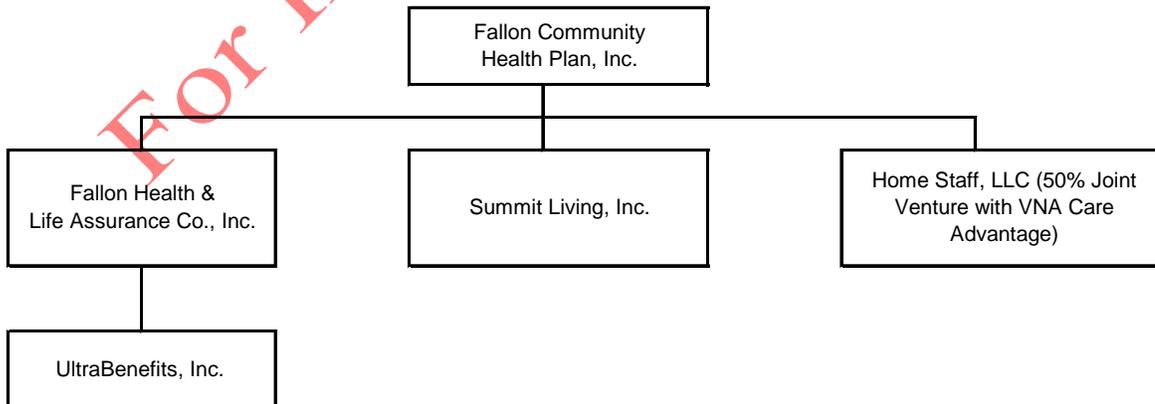
The Company provides for the continuity of management and operations in the event of a catastrophe or national emergency in accordance with Massachusetts General Laws, Chapter 175, Sections 180M-180Q.

AFFILIATED COMPANIES

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2007 is illustrated below:



Based on transactional and acquisition events involving FCHP subsequent to the December 31, 2007 examination date, the Company's current organizational structure as of December 31, 2008 is illustrated below:



RELATED PARTY TRANSACTIONS

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. Total management fees for the years ended December 31, 2007 and 2006 amounted to \$3.78 million and \$2.97 million, respectively. As of December 31, 2007, FCHP owed FHLAC \$1.10 million and was due \$1.02 million from FHLAC. As of December 31, 2006, FCHP owed FHLAC \$1.94 million and was due \$0.75 million from FHLAC. Settlement of intercompany balances takes place monthly.

In 2007, FCHP made capital contributions to FHLAC totaling \$3.05 million. In 2006, FCHP made capital contributions to FHLAC totaling \$6.90 million. In 2005, FCHP made capital contributions to FHLAC totaling \$1.00 million.

On April 26, 2007, FHLAC issued a promissory note in the amount of \$50,000 to its wholly-owned subsidiary, UltraBenefits. The interest rate on this note is 5.82%. The note will mature in May 2010. There is no prepayment penalty on the note.

FIDELITY BOND 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, 2007.

PENSION AND INSURANCE PLANS

FHLAC has no employees. Refer to Related Party Transactions section above.

SPECIAL DEPOSITS

The Company held no special deposits at December 31, 2007.

TERRITORY AND PLAN OF OPERATION

Territory

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

Plan of Operation

FHLAC is headquartered in Worcester, MA. Together with FCHP, the Company historically focused on Worcester County, MA, but has since expanded its service area to most of Massachusetts.

PRODUCTS

The Company offers the following insured products:

FCHP Preferred Care – This PPO product offers access to a nationwide network of health care providers and has no referral requirements. Members may choose a higher percentage of plan coverage by visiting providers in the FCHP Preferred Care network or pay a higher percentage of the cost themselves by visiting a provider who is not a FCHP Preferred Care provider. FHLAC administers the Preferred Care PPO product.

Care Choice High Deductible Plans – Care Choice plans are high-deductible product choices that are compatible with the savings of tax-advantaged accounts, such as Health Savings Accounts (HSA). FCHP has partnered with Sovereign Bank as the HSA custodian for the Company's Care Choice plans. Care Choice plans are available for the Direct Care HMO, Select Care HMO and Preferred Care PPO products. FCHP administers the Care Choice HMO plans, while FHLAC administers the Care Choice PPO plans.

Administrative Services Only (ASO) – FHLAC administers employee health benefits for certain self-insured employer groups under various ASO contracts wherein it performs eligibility management, medical management, claims processing and disbursement activities in return for an administrative fee. The employer assumes all insurance risk under these arrangements.

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.

UNPAID CLAIMS

KPMG Health Actuaries prepared independent estimates of the Unpaid Claim Liabilities (UCL) as of December 31, 2007 and prior periods. For December 31, 2007, 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 FHLAC business pays fairly quickly, the range of estimates for the December 31, 2007 UCL is narrow and the actuarial estimates are similar to FHLAC's estimates with hindsight through September 30, 2008.

FCHP made a separate provision for Loss Adjustment Expenses / Claim Adjustment Expenses (LAE/CAE) in 2007 and the resulting expense percentage levels used are within industry norms.

Based on KPMG's review, the UCL appears to be fairly stated in the aggregate in all material respects.

FHLAC recorded a Premium Deficiency Reserve (PDR) of \$67,000 and \$923,000 at December 31, 2007 and 2006, respectively. The need for such a reserve is apparent based on emerging 2008 financial results. Depending on the magnitude of FHLAC's continued underwriting losses, it is recommended that FHLAC re-examine the adequacy of its calculated premium deficiency reserve and possibly change its process for future years.

INCOME TAXES

FHLAC files a consolidated federal income tax return with its wholly-owned subsidiary, UltraBenefits. There is no intercompany allocation of taxes among entities. FHLAC's deferred tax asset was entirely non-admitted at December 31, 2007 and 2006. FHLAC has no unrecognized deferred tax liabilities.

REINSURANCE

FHLAC 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 \$800,000. The per member per year limit is \$2,000,000. Total premiums of \$6,000 and \$6,000 were ceded relating to reinsurance for the years ended December 31, 2007 and 2006, respectively. Recoveries realized under the applicable reinsurance contract for the years ended December 31, 2007 and 2006 were \$146,000 and \$0, respectively.

ACCOUNTS AND RECORDS

The books and records of the Company are audited annually by the independent certified public accounting firm of Ernst & Young LLP in accordance with 211 CMR 23.00. The CPA Firm issued an unqualified opinion on the December 31, 2007 audited financial statements. The Company is also subject to review by an internal audit department.

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

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

The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2007 Annual Statement. No material exceptions were noted.

SUBSEQUENT EVENTS

During 2008, FCHP made capital contributions to FHLAC totaling \$4.45 million. In turn, FHLAC made capital contributions during 2008 to UltraBenefits totaling \$75,000.

COMMITMENTS AND CONTINGENCIES

Legal Proceedings

FHLAC is involved in legal actions in the ordinary course of business. In the opinion of management, there are no legal proceedings pending against or involving FHLAC, the outcome of which is likely to have a material adverse effect upon the statutory financial statements.

FINANCIAL STATEMENTS

	<u>Page</u>
The Financial Statements section includes the following:	
Statutory Statement of Assets, Liabilities and Capital & Surplus as of December 31, 2007	12
Statement of Revenue and Expenses for the Year Ended December 31, 2007	13
Capital & Surplus for the Year Ended December 31, 2007	14
Reconciliation of Capital & Surplus for the Three Year Period Ended December 31, 2007	15

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance and by the National Association of Insurance Commissioners as of December 31, 2007.

For Information Purposes Only

Commonwealth of Massachusetts Division of Insurance
 Report on the Statutory Examination of
 FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.

Fallon Health and Life Assurance Company, Inc.
 Statutory Statement of Assets, Liabilities and Capital & Surplus
 As of December 31, 2007

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
<u>ASSETS</u>			
Stocks:			
Common stocks	321,400	-	321,400
Cash, cash equivalents and short-term investments	5,398,425	-	5,398,425
Other invested assets	40,948	-	40,948
Subtotals, cash and invested assets	5,760,773	-	5,760,773
Investment income due and accrued	14,318	-	14,318
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	256,058	-	256,058
Amounts receivable relating to uninsured plans	95,760	-	95,760
Receivables from parent, subsidiaries and affiliates	1,105,430	-	1,105,430
Total Assets	\$ 7,232,339	\$ -	\$ 7,232,339
<u>LIABILITIES</u>			
Claims unpaid	\$ 1,546,394	\$ -	\$ 1,546,394
Unpaid claims adjustment expenses	46,327	-	46,327
Aggregate health policy reserves	66,752	-	66,752
Premiums received in advance	227,786	-	227,786
General expenses due or accrued	50,966	-	50,966
Amounts due to parent, subsidiaries and affiliates	1,014,654	-	1,014,654
Liability for amounts held under uninsured accident and health plans	659,944	-	659,944
Total Liabilities	\$ 3,612,823	\$ -	\$ 3,612,823
<u>CAPITAL AND SURPLUS</u>			
Common capital stock	\$ 400,000	\$ -	\$ 400,000
Gross paid in and contributed surplus	14,226,000	-	14,226,000
Unassigned funds (surplus)	(11,006,484)	-	(11,006,484)
Total Capital and Surplus	\$ 3,619,516	\$ -	\$ 3,619,516
Total Liabilities, Capital and Surplus	\$ 7,232,339	\$ -	\$ 7,232,339

Commonwealth of Massachusetts Division of Insurance
 Report on the Statutory Examination of
 FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.

Fallon Health and Life Assurance Company, Inc.
 Statement of Revenue and Expenses
 For the Year Ended December 31, 2007

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Member Months	20,648	-	20,648
Net premium income	\$ 8,486,407	\$ -	\$ 8,486,407
Total revenues	8,486,407	-	8,486,407
Hospital and Medical:			
Hospital/medical benefits	10,190,086	-	10,190,086
Other professional services	37,789	-	37,789
Prescription drugs	1,077,769	-	1,077,769
Other hospital and medical	141,869	-	141,869
Subtotal	11,447,513	-	11,447,513
Less:			-
Net reinsurance recoveries	145,921	-	145,921
Total hospital and medical	11,301,592	-	11,301,592
Claims adjustment expenses	90,335	-	90,335
General administrative expenses	762,635	-	762,635
Increase (decrease) in reserves for accident and health contracts	(856,209)	-	(856,209)
Total underwriting deductions	11,298,353	-	11,298,353
Net underwriting gain (loss)	(2,811,946)	-	(2,811,946)
Net investment income earned	195,560	-	195,560
Net realized capital gains (losses)	-	-	-
Net investment gains	195,560	-	195,560
Other income	305	-	305
Net income (loss) after capital gains tax and before all other federal income taxes	(2,616,081)	-	(2,616,081)
Federal and foreign income taxes incurred	-	-	-
Net income (loss)	\$ (2,616,081)	\$ -	\$ (2,616,081)

Fallon Health and Life Assurance Company, Inc.
 Capital & Surplus
 For the Year Ended December 31, 2007

	Annual Statement	Statutory Examination Adjustment	Per Statutory Examination
Capital and Surplus, December 31, 2006	\$ 3,214,001	\$ -	\$ 3,214,001
Net income or (loss)	(2,616,081)	-	(2,616,081)
Change in net unrealized capital gains and losses less capital gains tax	(321,384)	-	(321,384)
Change in nonadmitted assets	292,980		292,980
Surplus adjustments:			
Paid in	3,050,000		3,050,000
Net change in capital and surplus	405,515	-	405,515
Capital and Surplus, December 31, 2007	<u>\$ 3,619,516</u>	<u>\$ -</u>	<u>\$ 3,619,516</u>

For Information Purposes Only

Fallon Health and Life Assurance Company, Inc.
Reconciliation of Capital & Surplus
For the Three Year Period Ended December 31, 2007

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Capital and Surplus, December 31, prior year	\$ 3,214,001	\$ 2,993,455	\$ 3,011,690
Net income or (loss)	(2,616,081)	(4,490,787)	(1,018,235)
Change in net unrealized capital gains and losses less capital gains tax	(321,384)	41,596	-
Change in nonadmitted assets	292,980	(2,230,263)	-
Surplus adjustments:			
Paid in	3,050,000	6,900,000	1,000,000
Net change in capital and surplus	<u>405,515</u>	<u>220,546</u>	<u>(18,235)</u>
Capital and Surplus, December 31, current year	<u>\$ 3,619,516</u>	<u>\$ 3,214,001</u>	<u>\$ 2,993,455</u>

For Information Purposes Only

ACKNOWLEDGMENT

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

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

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

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

For Information Purposes ONLY