



THE 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, 2004

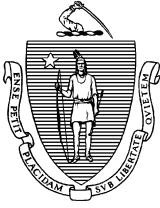
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EMPLOYERS ID NUMBER: 04-3169246

Commonwealth of Massachusetts Division of Insurance
REPORT ON THE STATUTORY EXAMINATION OF
FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.

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

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JULIANNE M. BOWLER
COMMISSIONER OF INSURANCE

March 10, 2006

Honorable Julianne M. Bowler
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
Division of Insurance
Commonwealth of Massachusetts
One South Station
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Honorable Alfred W. Gross
Chair, Financial Condition (E) Committee, NAIC
Commissioner, Bureau of Insurance
Commonwealth of Virginia
P. O. Box 1157
Richmond, VA 23218

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 the

FALLON HEALTH AND LIFE ASSURANCE COMPANY, INC.

at its home office located at:

10 Chestnut Street
Worcester, MA 01608

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", "FHLAC" or "the Corporation" is as of December 31, 2004, including any material transactions and/or 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 home office in Worcester, Massachusetts. KPMG was engaged to perform certain agreed-upon procedures, which are in compliance with the *NAIC Financial Condition Examiners' Handbook*. KPMG's actuaries were involved in the performance of those procedures to the extent that such procedures related to the Company's reserves for unpaid claims and loss adjustment expenses as of December 31, 2004. KPMG's Information Risk Management (IRM) 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 IRM Specialists performed examination procedures pertaining to the examination of the I/T 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 National Association of Insurance Commissioners (NAIC) Financial Condition (E) Committee and prescribed by the current *NAIC Financial Condition Examiners Handbook*.

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

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

DESCRIPTION OF COMPANY

History

Fallon Health and Life Assurance Company is a Massachusetts stock health and life insurance company operating under Chapter 175 of the Massachusetts General Laws. It is 100% owned by Fallon Community Health Plan, Inc. (the Plan), a federally qualified, non-for-profit health maintenance organization domiciled in Massachusetts.

In July 1990, the Corporation acquired the right to appoint the Corporate Members of the St. Vincent Hospital System (SVHS). Historically, Fallon has maintained a close working relationship with St. Vincent Hospital of Worcester, Massachusetts.

In March 1991, The Fallon Foundation was substituted for Fallon as the entity holding rights to appoint the Corporate Members of SVHS. Together with the Fallon Clinic, Inc. (the Clinic), the Fallon Foundation effectively created a vertically integrated health care delivery system.

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In 1996, Tenet Healthcare Corp. (Tenet) became the majority shareholder of St. Vincent Health Care, LLC (SVHLLC), formerly St. Vincent Hospital System. Tenet also acquired a minority interest in the Fallon Clinic (the Clinic) and had certain special liquidation preferences and minority shareholder rights, including representation on the Board of Directors and approval of most major transactions.

On October 1, 1996, FCHP, FHLAC, the Clinic and SVHLLC entered into long-term provider and administrative services agreements covering the majority of FCHP and FHLAC members. Under these agreements, referral, hospital and nursing home services, which were previously expensed as incurred, are capitated. The capitation is based on earned premiums. In addition, medical facilities costs in excess of the applicable capitation are subject to a risk sharing arrangement.

Effective January 1, 2004, the Board of Directors of both The Fallon Foundation, Inc. (the Foundation) and the Plan agreed to restructure the governance of the Plan. This restructuring was accomplished by a change in the bylaws of the Plan under which the Foundation ceased to: (a) be a member of the Plan; (b) elect members of the board of directors of the Plan; and (c) exercise approval powers over the Plan. While the Plan will remain a membership corporation, under the new bylaws, its members will at all times be those individuals then serving as directors. Consistent with this change, all directors of the Plan affiliated with the Foundation resigned.

Organization

The Company markets indemnity and preferred provider organization health insurance products and administrative services only (ASO) type arrangements primarily in Massachusetts. The Company and the Plan have an agreement for the purpose of providing a point-of-service health insurance product wherein the Company is responsible for health care services provided outside of the Plan's network.

The Corporation was incorporated on October 16, 1992 in Massachusetts. It is licensed to sell accident and health products. On October 28, 1994, FHLAC amended its certificate of authority to delete its "life – all kinds" line of business. FHLAC and its parent are established for the purpose of arranging for the delivery of comprehensive health care services, on a prepaid basis, to subscribing individuals and groups.

Capital and Surplus

Under the Commonwealth of Massachusetts Division of Insurance regulations, the Company is required to maintain minimum capital and surplus of \$2,800,000. In addition, life and health companies are subject to certain Risk-Based Capital (RBC) requirements as specified by the NAIC. Under these requirements, the amount of capital and surplus maintained by a life and health insurance company is to be determined based on the various risk factors related to it. At December 31, 2004, the Company exceeded these requirements.

At December 31, 2004, the Company has issued capital of \$3,676,000. Net worth represents the paid in capital from the parent as well as the accumulated excess of revenues over expenses after taxes, since inception. The total admitted assets, total liabilities and total capital and surplus of the Company from 2002 to 2004 is shown in the following schedule.

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Total Capital & Surplus</u>
2002	\$ 4,126,602	\$ 301,412	\$ 3,825,190
2003	\$ 4,164,482	\$ 385,247	\$ 3,779,235
2004	\$ 4,688,202	\$ 1,676,512	\$ 3,011,690

MANAGEMENT AND CORPORATE RECORDS

Articles of Organization and Bylaws

According to the Bylaws, the Board of Directors of the Company may exercise all of the powers of the Company except those which are reserved to the stockholders by law, by the Articles of Organization or by the Bylaws.

Administrative Service Agreement

The administrative service agreement was made on October 17, 1992 by and between FCHP and the Company. This agreement is intended to set forth the parties' respective obligations relative to the administration and operation of FHLAC's line of health insurance products including any products FHLAC markets in conjunction with FCHP in FCHP's capacity as a health maintenance organization.

Within the agreement between FCHP and FHLAC, FHLAC agrees to pay FCHP an administrative fee in an amount equal to nine percent (9%) of FHLAC's gross premiums for indemnity and POS products and seven percent (7%) of FHLAC's gross premiums for PPO products.

Territory and Plan of Operation

Territory

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

Plan of Operation

Commercial Territory Summaries

HMO Product

Previously the Corporation offered a one size fits all delivery system. After researching the health care market in Massachusetts and listening to feedback from members, providers and employees, the Corporation revised the product strategy and developed two sizes of networks to fit the needs of employers.

The Corporation created two networks, two service areas and two different sets of products however, both product sets still include core medical benefits including the Peace of Mind Program which allows members access to the Boston tertiary facilities, dental and benefits and discounts, and chiropractic care. In addition, the Corporation offers other features such as an "It Fits" program which rewards members who join a fitness facility or participate in Weight Watchers®. Members also receive vision care and the exclusive Naturally Well suite of complementary care discounts. Naturally Well gives members discounts on acupuncture, chiropractic care (in addition to any chiropractic benefit their plan may have) and massage therapy from the American Specialty Health Networks, Inc. (ASHN) credentialed network of qualified providers.

PPO Product

Fallon Preferred Care is a preferred provider organization (PPO) product that puts members in touch with a broad network of quality providers across the country. Members who see a network provider will receive the highest level of coverage. Members who choose to access a provider from outside the network will share a larger portion of the cost. The highlights of Fallon Preferred Care include a nationwide network of more than 383,000 providers, including Private Healthcare Systems (PHCS) and Fallon Clinic, in-network and out-of-network levels of benefits and no referrals required.

BOARD OF DIRECTORS

The Company's Bylaws indicate the following regarding its Board of Directors (the Board):

- The Corporation shall have a Board of Directors which shall consist of not less than five (5) nor more than thirteen (13) voting members, with the exact number being set by the stockholders from time-to-time. The President of the Corporation 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.
- 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 Bylaws.
- 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 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, three-year 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 of Directors may, by vote from time to time, determine, provided that the Board of Directors shall meet at least quarterly. A regular meeting of the Board of Directors may be held without call or formal notice immediately after and at the same place as the annual meeting of the stockholders
- Special meetings of the Board of Directors may be held at any time and at any place when called by the Chair of the Board, President or by two or more members of the Board of Directors. Notice shall be given by a written notice at least three (3) days in advance of said special meeting. Such notice shall set forth the purposes for which the meeting is being called.
- Whenever notice of a meeting is required to be given to a Director under applicable law, the Articles of Organization or these Bylaws, a written waiver thereof, executed before or after the meeting by such Director and filed with the records of the meeting, shall be deemed equivalent to such notice.
- At any meeting of the Board of Directors, 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 from time-to-time, 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 a majority of all of the Directors then in office entitled to vote on the question, shall, except where a larger vote is required by law, by the Articles of Organization, or by there Bylaws, decide any question brought before such meeting.
- Any action required or permitted to be taken at any meeting of the Board of Directors 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 of Directors. Such consents shall be treated for all purposes as a vote at a meeting of the Board of Directors.
- 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 stockholders at any meeting called for that purpose, provided that an *ex officio* Director shall only be removed by removal from his/her underlying office position.

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- Directors then in office may act despite a vacancy or vacancies in the Board of Directors, 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 vote of the stockholders. 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, 2004, the Board was comprised of six (6) directors, which is in compliance with the Company Bylaws.

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

<u>Director</u>	<u>Principal Occupation</u>	<u>Term Expires</u> <u>June</u>
Charles Goheen	CFO – Fallon Community Health Plan Worcester, MA	2008
David W. Hillis	President & CEO - AdCare, Inc. Worcester, MA	2006
Richard Houlihan, Esq.	Attorney Worcester, MA	2007
Robert P. Restrepo, Jr.	President – Allmerica Financial Worcester, MA	2008
Eric H. Schultz	President - Fallon Community Health Plan Worcester, MA	2007
Nicola S. Tsongas	Program Development - Middlesex Community College Lowell, MA	2006

OFFICERS

The Company, shall have, as its officers, a Chair of the Board, a Vice Chair, a President and CEO, a Treasurer, a Clerk and such other officers as the Board of Directors, in its discretion, from time-to-time shall appoint. The Chair of the Board, the Vice Chair, the Treasurer and the Clerk shall be elected annually by the Board of Directors at the annual meeting after the Board of Directors election. The President and CEO shall be appointed by the Board of Directors in the manner and for the term set forth.

Officers serving as of December 31, 2004 were as follows:

<u>Name of Officer</u>	<u>Title</u>
Eric H. Schultz	President
Nicola S. Tsongas	Secretary
Robert P. Restrepo, Jr.	Treasurer

The officers are also members of the Board of Directors, as noted above.

CONFLICT OF INTEREST PROCEDURES

Each Director and Officer of FHLAC, in a manner and form prescribed by the Company's Conflict of Interest Policy, shall be required to disclose fully any conflict of interest as defined in the Policy or in the Company's Bylaws. Should a conflict arise, the interested Director may make a presentation regarding the transaction in question, after which the

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remaining disinterested directors discuss and vote on the transaction. If appropriate, a disinterested Director or committee may be appointed to investigate alternatives to the transaction in question. After exercising due diligence, the Board of Directors shall determine whether the Company, through reasonable efforts, can obtain a more advantageous transaction that would avoid the conflict of interest. If such an alternative is not available, the Board of Directors shall determine by a majority vote of the disinterested Directors whether the transaction is in the Company's best interest and whether it is fair and reasonable to the company. In case FHLAC enters into a contract or business transaction that would involve a Director or Officer conflict of interest, 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 Company.

The completed Conflict of Interest Statements were reviewed, and no discrepancies were noted in the response to the General Interrogatories regarding conflicts of interest as reflected in the Company's 2004 Annual Statement.

CORPORATE RECORDS

Articles of Incorporation and Bylaws

The Bylaws and Articles of Incorporation and amendments were reviewed for the examination period. The Corporation is operating in accordance with the purpose, functions and policies as set forth in the Bylaws and Articles of Incorporation.

Board of Directors Minutes

The minutes of the Board of Directors meetings were reviewed and found to contain all the necessary votes and authorizations, which are in compliance with the Corporation's Bylaws and laws of the Commonwealth of Massachusetts.

ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS AND PURCHASES OR SALES

None.

MANAGEMENT CONTINUITY AND NATIONAL EMERGENCY

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

AFFILIATED COMPANIES

Parent and Affiliated Companies

The Company is a wholly-owned subsidiary of Fallon Community Health Plan, Inc. (FCHP). FCHP is a not-for-profit health maintenance organization domiciled in Massachusetts. Both FCHP and the Company are established for the purpose of arranging for the delivery of comprehensive health care services, on a pre-paid basis, to subscribing individuals and groups. The Company has no employees and, accordingly, FCHP provides all administrative services to the Company, including premium collection, claims processing and operational management in return for an administrative fee.

RELATED PARTY TRANSACTIONS

The Plan provides management and administrative services with respect to operations and claims processing for indemnity, PPO and ASO products. Management and administrative expenses relating to indemnity, PPO and ASO products of approximately \$871,000 and \$462,000 in 2004 and 2003, respectively.

The amount due from parent represents collections of premiums from indemnity and PPO products and revenues from ASO contracts by the Plan on behalf of the Company. The amount due to parent represents payments by the Plan for medical claims, capitation, and general and administrative charges on behalf of the Company. These amounts are settled monthly.

FIDELITY BOND AND OTHER INSURANCE

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

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

PENSION AND INSURANCE PLANS

Fallon Community Health Plan, Inc. has a noncontributory defined benefit pension plan covering substantially all employees. The funding policy is to contribute amounts permitted by the Internal Revenue Code of 1986. Pension plan assets principally consist of common stock, debt securities and mutual funds. At December 31, 2004, the plan was not adequately funded as assets were exceeded by the actuarial present value of benefit obligations. While the Company (Fallon Health and Life Assurance Company, Inc.) does not have any employees, its applicable expenses are shared as part of a management services agreement.

SPECIAL DEPOSITS

None reported at December 31, 2004.

PRODUCTS

The Company offers the following insured managed care products:

Administrative Services Only (ASO) – This product offers administration of self-funded health plans to employers. Services include claims processing, network development and maintenance, medical management, and customer service.

Fallon Community Health Plan Flex Care Direct and Select - These point-of-service (POS) plans give members access to a wider selection of providers. With a Flex Care plan, the member gets the same benefits and network of physicians as the HMO plans. Plus, the member has the choice to see a provider outside the network by paying a higher percentage of the cost. Flex Care Direct and Flex Care Select plans use the respective networks offered by the Direct Care and Select Care HMO's.

Fallon Major Medical – This plan is a traditional indemnity insurance product that helps members get care even if they live or work outside of the service area. Members can access any providers they like, while Fallon pays a percentage of the fee for any covered services.

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Fallon Preferred Care – This preferred provider organization (PPO) product offers access to a nationwide network of health care providers and no referral requirements. Members may also choose to access out-of network providers by paying a higher percentage of the cost.

PROVIDER CONTRACTS

The Corporation has entered into a variety of contractual agreements (Health Service Agreements or “HSAs”) with providers of health care services including physicians, hospitals and ancillary providers (e.g., lab services, MRIs, pharmacies, etc.). Some of these contracts are with provider organizations such as hospitals, IPAs, PHOs, Group Practices and individual physicians. The HSAs specify the services to be covered and the financial arrangements between the parties. The HSAs are typically a one-year initial term with a twelve (12) month auto-renew thereafter until a written notice of non-renewal is sent by either party no less than 60 days prior to the automatic renewal date. A few of the Corporation’s major HSAs have multi-year terms.

The provider organizations must participate in the Corporation’s utilization review and quality assurance program.

The HSAs specify the services to be covered and the financial arrangements between the Corporation and the various individual providers, groups and hospitals. The HSAs prohibit providers or provider organizations from balance billing enrollees for covered services rendered under the agreement.

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

RESERVES

In conjunction with KPMG’s examination of the statutory financial statements of the Fallon Health & Life Assurance Co., Inc., KPMG was engaged by the Division to review the adequacy of the Unpaid Claim Liability (UCL) of FHLAC as of December 31, 2004.

KPMG actuaries prepared independent estimates of the unpaid claim liabilities for several periods prior to September 2005 based on the data provided. For December 31, 2004, completion factors for the projection of ultimate incurred claims were developed using historical payment patterns and actuarial judgment. “Low” and “High” estimates were developed by subtracting the claims paid-to-date from KPMG’s range of incurred claims estimates. KPMG’s estimates are similar to FHLAC’s estimates with hindsight through September 30, 2005.

Based upon KPMG’s review, the Unpaid Claims Liability at December 31, 2004 appears to be fairly stated in aggregate in all material respects. FCHP made a separate provision for Claim Adjustment Expenses (LAE/CAE) in 2004 in accordance with standard actuarial practice. The resulting expense percentage levels used are within industry norms.

FHLAC did not book a Premium Deficiency Reserve (PDR) at year end, 2004. This does not appear reasonable based on emerging 2005 financial results. Based on additional analysis done by the company, a deficiency reserve would have been appropriate as of December 31, 2004, although the amount was considered to be immaterial. It is recommended that FHLAC prepare a premium deficiency analysis on an annual basis going forward.

REINSURANCE

The Company carries reinsurance against excessive hospital utilization. Under this policy, the Company is reimbursed 50% to 90% of certain hospital claims over the policy deductibles, which range from \$250,000 to \$500,000. The maximum reinsurance for inpatient claims over a member's lifetime is limited to \$2,000,000.

The Company remains obligated for amounts ceded in the event the reinsurer does not meet its obligations. There were no reinsurance recoveries or related receivables for 2004 and 2003.

ACCOUNTS AND RECORDS

The books and records of the Company are audited annually by the independent certified public accounting firm of Ernst & Young LLP, in accordance with 211 CMR 43.14. The CPA Firm issued an unqualified opinion on the December 31, 2004 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 I/T systems environment. The questionnaire was completed by the Company and reviewed by KPMG's Information Risk Management (IRM) team that evaluated the adequacy of the I/T 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 exceptions were noted.

SUBSEQUENT EVENTS

- First Quarter 2005 – FCHP made a capital contribution of \$500,000 to FHLAC.
- Third Quarter 2005 – FCHP made a capital contribution of \$250,000 to FHLAC.
- Fourth Quarter 2005 – FCHP made a capital contribution of \$250,000 to FHLAC.

COMMITMENTS AND CONTINGENCIES

The Company does not have any commitments at December 31, 2004.

The Company has committed no reserves to cover any contingent liability at December 31, 2004.

Legal Proceedings

The Company is involved in litigation incidental to its business. Management and legal counsel believe that the results of such proceedings, in the aggregate, will not have a material adverse effect on the Company's operations or financial position.

FINANCIAL STATEMENTS

The Financial Statement section includes the following:	<u>Page</u>
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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, 2004.

For Information Purposes Only

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Fallon Health and Life Assurance Co., Inc.
Statutory Statement of Assets, Liabilities and Capital & Surplus
As of December 31, 2004

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
<u>ASSETS</u>			
Bonds	\$ 2,000,000	\$ -	\$ 2,000,000
Cash, cash equivalents and short-term investments	1,901,899	-	1,901,899
Subtotals, cash and invested assets	3,901,899	-	3,901,899
Investment Income due and accrued	9,722	-	9,722
Premiums and Considerations:			
Uncollected premiums and agents' balances in the course of collection	18,222	-	18,222
Amounts receivable relating to uninsured plans	337,200	-	337,200
Receivables from parent, subsidiaries and affiliates	421,159	-	421,159
Total Assets	\$ 4,688,202	\$ -	\$ 4,688,202
<u>LIABILITIES</u>			
Claims unpaid	\$ 560,056	\$ -	\$ 560,056
Unpaid claims adjustment expenses	17,322	-	17,322
Premiums received in advance	81,338	-	81,338
General expenses due or accrued	57,203	-	57,203
Amounts due to parent, subsidiaries and affiliates	285,593	-	285,593
Liability for amounts held under uninsured accident and health plans	675,000	-	675,000
Total Liabilities	\$ 1,676,512	\$ -	\$ 1,676,512
<u>CAPITAL & SURPLUS</u>			
Common capital stock	\$ 400,000	\$ -	\$ 400,000
Gross paid in and contributed surplus	3,276,000	-	3,276,000
Unassigned funds (surplus)	(664,310)	-	(664,310)
Total Capital and Surplus	\$ 3,011,690	\$ -	\$ 3,011,690
Total Liabilities, Capital and Surplus	\$ 4,688,202	\$ -	\$ 4,688,202

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Fallon Health and Life Assurance Company, Inc.
Analysis of Assets Exhibit
As of December 31, 2004

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
<u>ASSETS</u>					
Bonds	\$ 2,000,000	\$ -	\$ 2,000,000	\$ -	\$ 2,000,000
Cash, cash equivalents and short-term investments	1,901,899	-	1,901,899	-	1,901,899
Subtotals, cash and invested assets	3,901,899	-	3,901,899	-	3,901,899
Investment Income due and accrued	9,722	-	9,722	-	9,722
Premiums and Considerations:					
Uncollected premiums and agents' balances in the course of collection	18,222	-	18,222	-	18,222
Amounts receivable relating to uninsured plans	337,200	-	337,200	-	337,200
Receivables from parent, subsidiaries and affiliates	421,159	-	421,159	-	421,159
Total Assets	\$ 4,688,202	\$ -	\$ 4,688,202	\$ -	\$ 4,688,202

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**Fallon Health and Life Assurance Company, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2004**

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Member Months	14,092	-	14,092
Net premium income	\$ 3,676,694	\$ -	\$ 3,676,694
Total Revenues	3,676,694	-	3,676,694
Hospital and Medical:			
Hospital/medical benefits	3,516,235	-	3,516,235
Other professional services	1,825	-	1,825
Prescription drugs	508,611	-	508,611
Other Medical	76,027	-	76,027
Subtotal	4,102,698	-	4,102,698
General administrative expenses	403,091	-	403,091
Total underwriting deductions	4,505,789	-	4,505,789
Net underwriting (loss)	(829,095)	-	(829,095)
Net investment income earned	61,549	-	61,549
Net Income (Loss)	\$ (767,546)	\$ -	\$ (767,546)

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.
Net Worth
For the Year Ended December 31, 2004**

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Capital and Surplus, December 31, 2003	\$ 3,779,236	\$ -	\$ 3,779,236
Net income or (loss)	(767,546)	-	(767,546)
Net change in capital and surplus	<u>(767,546)</u>	<u>-</u>	<u>(767,546)</u>
Capital and Surplus, December 31, 2004	<u>\$ 3,011,690</u>	<u>\$ -</u>	<u>\$ 3,011,690</u>

For Information Purposes Only

ACKNOWLEDGMENT

This is to certify that the undersigned is a duly qualified Certified Financial Examiner (CFE) and that, in conjunction with KPMG LLP, applied certain agreed-upon procedures to the accounting and corporate records of the Fallon Health and Life Assurance 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 National Association of Insurance Commissioners (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 of Fallon Health and Life Assurance Company, Inc. extended to all examiners during the course of the examination is hereby acknowledged.

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