



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS
REGULATION

Division of Insurance

Report on the Statutory Examination of
HPHC Insurance Company, Inc.

Wellesley, Massachusetts

As of December 31, 2007

NAIC COMPANY CODE: 18975

EMPLOYERS ID NUMBER: 04-3149694

Commonwealth of Massachusetts Division of Insurance
Report on the Statutory Examination of
HPHC INSURANCE COMPANY, INC.

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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

March 20, 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, 13th floor
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

HPHC Insurance Company, Inc.

at its Main Administrative Office located at:

93 Worcester Street
Wellesley, MA 02481-9181

The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

This statutory examination of HPHC Insurance Company, Inc., hereinafter referred to as “the Company,” or “HPHC Insurance Co.,” is as of December 31, 2007, 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 main administrative office in Wellesley, 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 liabilities 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, Deloitte & Touche LLP (D&T). Wherever possible and wherever deemed appropriate and effective, D&T's independent work product was used to define, support, document and expedite the overall examination process.

DESCRIPTION OF COMPANY

History

HPHC Insurance Co., formerly known as Harvard Pilgrim Insurance Company, Inc., is a wholly-owned, for-profit subsidiary of Harvard Pilgrim Health Care, Inc. (“HPHC, Inc.” or “Harvard Pilgrim”). HPHC Insurance Co. was incorporated on September 27, 1991 and commenced underwriting accident and health risks on January 1, 1992.

Organization

HPHC Insurance Co. operates as an indemnity insurance company and underwrites health insurance for group products, including a PPO indemnity product, a Medicare indemnity product and the out-of-network component of HPHC Inc.'s Point of Service (POS) product.

Plan of Rehabilitation

HPHC, Inc., together with Harvard Pilgrim Health Care of New England, Inc. ("HPHC NE"), was placed in temporary receivership for purposes of rehabilitation in January 2000. On May 24, 2000, a Plan of Rehabilitation (the "Plan") was approved by The Supreme Judicial Court for Suffolk County and on June 21, 2000, the temporary receivership was dismissed. As part of the court order, Harvard Pilgrim would remain subject to administrative supervision by the Insurance Commissioner of the Commonwealth of Massachusetts (the "Commissioner") for so long as the payment approval conditions by the Commissioner for principal and interest on the Massachusetts Health and Educational Facilities Authority Revenue Bonds Issue 1998 Series A are in effect. On June 15, 2006, having met all of the conditions of the Plan, HPHC, Inc. and HPHC NE were released from administrative supervision by the Commissioner. HPHC Insurance Co. was not party to the temporary receivership or plan of rehabilitation.

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>
2005	\$16,246,549	\$4,265,348	\$11,981,201
2006	31,373,093	8,160,076	23,213,017
2007	44,002,519	20,652,411	23,350,108

MANAGEMENT

Articles of Organization and By-Laws

The Company's By-Laws may be altered, amended or repealed at any annual or special meeting of the stockholders called for the purpose, of which the notice shall specify the subject matter of the proposed alteration, amendment or repeal or the sections to be affected, by vote of the stockholders. The By-Laws may also be altered, amended or repealed by vote of a majority of the Directors then in office.

BOARD OF DIRECTORS

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

- **Number:** At the annual meeting of stockholders, such stockholders as have the right to vote for the election of Directors shall fix the number of Directors at not less than five (5) and shall elect the number of Directors so fixed. The number of Directors may be increased at any time either by the stockholders or by the Directors by vote of a majority of the Directors then in office. The number of Directors may be decreased to any number permitted by law at any time either by the stockholders or by the Directors by a vote of a majority of the Directors then in office, but only to eliminate vacancies existing by reason of the death, resignation, removal or disqualification of one or more Directors. No Director need be a stockholder.
- **Tenure:** Each Director shall hold office until the next annual meeting of the stockholders and until his successor is duly elected and qualified, or until he sooner dies, resigns, is removed or becomes disqualified.
- **Powers:** Except as reserved to the stockholders by law, by the Articles of Organization or by the By-Laws, the business of the Company shall be managed by the Directors, who shall have and may exercise all the powers of

the Company. In particular, and without limiting the generality of the foregoing, the Directors may at any time issue all or any part of the capital stock of the Company authorized under the Articles of Organization but not issued and may determine, subject to any requirements of law, the consideration for which stock is to be issued and the manner of allocating such consideration between capital and surplus.

- Committees: The Directors may, by vote of a majority of the Directors then in office, elect from their number an Executive Committee and other committees and delegate to any such committees some or all of the powers of the Directors except those which by law, the Articles of Organization or the Company's By-Laws they are prohibited from delegating.
- Regular Meetings: Regular meetings of the Directors may be held without call or notice at such places and at such times as the Directors may determine, provided that reasonable notice of the first regular meeting following any such determination shall be given to absent Directors. A regular meeting of the Directors may be held without call or notice immediately after and at the same place as the annual meeting of the stockholders.
- Special Meetings: Special meetings of the Directors may be held at any time and at any place designated in the call of the meeting, when called by the Chairman, the Chief Executive Officer, the Treasurer or by two or more Directors, reasonable notice thereof being given to each Director by the Secretary or an Assistant Secretary, or, if there be none, by the Clerk or an Assistant Clerk, or by the officer or one of the Directors calling the meeting.
- Notice: It shall be sufficient notice to a Director to send notice by mail at least forty-eight hours before the meeting addressed to him at his usual or last known business or residence address, or to give notice to him in person or by telephone at least twenty-four hours before the meeting. Notice of a meeting need not be given to any Director if a written waiver of notice, executed by him before or after the meeting, is filed with records of the meeting, or to any Director who attends the meeting without protesting prior thereto or at its commencement the lack of notice to him. Neither such notice of a meeting nor waiver of notice need specify the purposes of the meeting.
- Quorum: At any meeting of the Directors, a majority of the Directors then in office, but not less than four (4) Directors, shall constitute a quorum. Any meeting may be adjourned by a majority of the votes cast upon the question, whether or not a quorum is present, and the meeting may be held as adjourned without further notice.
- Action by Vote: When a quorum is present at any meeting, a majority of the Directors present may take any action, except when a greater majority is required by law, the Articles of Organization or the Company's By-Laws.
- Action by Writing: Any action required or permitted to be taken at any meeting of the Directors may be taken without a meeting if all the Directors consent to the action in writing and the written consents are filed with the records of the meetings of the Directors. Such consents shall be treated for all purposes as a vote taken at a meeting.
- Presence through Communications Equipment: Members of the Board of Directors may participate in a meeting of the Board by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

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At December 31, 2007 the Board was comprised of five (5) 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>Class of Director</u>	<u>Principal Occupation</u>
Charles D. Baker Swampscott, MA	Management Director	President and Chief Executive Officer, HPHC, Inc.
Marie Montgomery ¹ Holliston, MA	Management Director	Chief Financial Officer, HPHC, Inc.
Bruce M. Bullen Weston, MA	Management Director	Chief Operating Officer, HPHC, Inc.
David Cochran, M.D. ² Norwell, MA	Management Director	Senior Vice President, Strategic Development, HPHC, Inc.
Laura S. Peabody Boston, MA	Management Director	Senior Vice President and General Counsel, HPHC, Inc.

¹Joseph Capezza was CFO of HPHC, Inc. and a Director of HPHC Insurance Co. until resigning in November 2007. Ms. Montgomery served as acting CFO of HPHC, Inc. and a Director of HPHC Insurance Co. from December 2007 – June 2008. Ms. Montgomery has been replaced as CFO of HPHC, Inc. and a Director of HPHC Insurance Co. by James W. DuCharme as of June 2, 2008.

²Dr. Cochran resigned from HPHC, Inc. as well as his position as a Director of HPHC Insurance Co. on April 1, 2008. Gary H. Lin, Senior Vice President, Actuarial Services and Chief Actuary of HPHC, Inc., was elected to replace Dr. Cochran as a Director of HPHC Insurance Co. on April 1, 2008.

Committees of the Board

The Board may, by vote of a majority of the Directors then in office, elect from their number an Executive Committee and other committees and delegate to any such committee or committees some or all of the powers of the Directors except those which by law, the Articles of Organization or the Company's By-Laws they are prohibited from delegating. The Board does not currently have any committees.

OFFICERS

The Company's officers consist of a President, Treasurer, Clerk and such other officers, if any, as the Directors or the President may determine. The Clerk shall be a resident of the Commonwealth of Massachusetts unless the Company has appointed a resident agent to receive service of process. A person may hold more than one office at the same time.

The officers of the Company shall be elected by the Directors at their first meeting following the annual meeting of the stockholders. Other officers, if any, may be elected or appointed by the Board of Directors at said meeting or at any other time.

The elected officers and their respective titles at December 31, 2007 were as follows:

<u>Officer</u>	<u>Officer</u>
Charles D. Baker	President
Marie Montgomery ²	Treasurer
Laura S. Peabody	Secretary

²Ms. Montgomery was replaced as Treasurer of HPHC Insurance Co. by James W. DuCharme as of June 2, 2008.

CONFLICT OF INTEREST PROCEDURES

HPHC, Inc., the parent of HPHC Insurance Co., has adopted a conflict of interest policy statement. HPHC, Inc. has an established procedure for the disclosure to the President or Chairperson of any financial interest on the part of any officer or Director which is in or is likely to be in conflict with his/her official duties. The financial interest shall be made a matter of record through such annual or other reporting and certification procedure as the Board of Directors shall require from time to time. After disclosure of the financial interest and all material facts, and any discussion with the fiduciary, the Board shall determine whether any conflict of interest exists. The fiduciary shall leave the Board meeting while the determination of a conflict of interest is discussed and voted upon. The minutes of the Board meeting shall include the names of the fiduciaries who disclosed financial interests, the nature of the financial interests, and whether the Board determined there was a financial interest.

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

Our review of the By-Laws indicated there were no changes since the prior examination.

Board of Directors Minutes

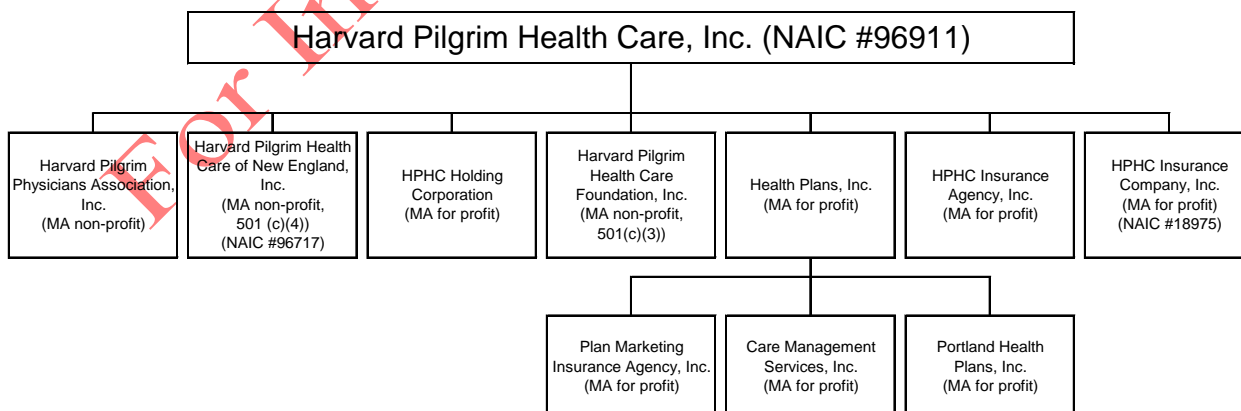
The minutes of the Board meetings for the period under statutory examination were reviewed and indicated that all meetings were held in accordance with the Company's By-Laws and the laws of the Commonwealth of Massachusetts.

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:



RELATED PARTY TRANSACTIONS

HPHC, Inc. provides all administrative and operational management services to HPHC Insurance Co. Administrative expenses are charged to HPHC Insurance Co. based on Harvard Pilgrim's departmental cost allocation methodology. For the years ended December 31, 2007 and 2006, total administrative expenses and claims adjustment expenses allocated to the Insurance Company were \$17.6 million and \$10.0 million, respectively. As of December 31, 2007, HPHC Insurance Co. owed HPHC, Inc. \$3.0 million and at December 31, 2006, HPHC, Inc. owed HPHC Insurance Co. \$1.8 million. In addition, HPHC, Inc.'s Board of Directors approved a \$10.0 million capital contribution to the Insurance Company in 2006.

Due to the significance of the transactions between HPHC Insurance Co. and HPHC, Inc., the results of operations of HPHC Insurance Co. may not be indicative of the results which would have been attained had HPHC Insurance Co. not been a wholly-owned subsidiary of HPHC, Inc.

FIDELITY BOND AND OTHER INSURANCE

The Company 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

HPHC Insurance Co. has no employees. Refer to Related Party Transactions section above.

SPECIAL DEPOSITS

The special deposits of the Company at December 31, 2007 were as follows:

Description of Deposit	Where Deposited	Par Value	Statement Value	Market Value
FNMA NonCallable 3.05% 7/16/2008; Money Market Funds	KeyBanc Capital Markets, Augusta, ME – State of Maine Reserve	\$ 117,332	\$ 117,025	\$ 116,559
FNMA, 4.375%, 3/15/2013; U.S. Treasury, 6.25%, 8/15/2023; U.S. Treasury, 6.375%, 8/15/2027; Money Market Funds	Bank of America, Boston, MA – Custodian for State of New Hampshire Insurance Division	1,183,677	1,294,424	1,339,195
		<u>\$ 1,301,009</u>	<u>\$ 1,411,449</u>	<u>\$ 1,455,754</u>

TERRITORY AND PLAN OF OPERATION

Territory

The Company is licensed to transact business in the Commonwealth of Massachusetts and the States of Connecticut, Maine and New Hampshire.

Plan of Operation

HPHC Insurance Company, Inc. is headquartered in Wellesley, MA.

PRODUCTS

The Company offers the following insured products:

Point of Service (POS) - The POS plan is available through employers in Massachusetts, New Hampshire and Maine. HPHC Insurance Co. writes the out-of-network coverage for the POS product, while in-network coverage is written by either HPHC, Inc. or HPHC NE. The Harvard Pilgrim POS Plan features comprehensive coverage for a wide range of preventive and medical services, including routine office visits, well-baby care, immunizations, hospitalization and worldwide emergency care. In most benefit packages, prescription drug coverage is also included. The POS Plan allows members to choose a primary care physician (PCP), but also to receive care from specialists without their PCP's referral. In addition, POS members can visit doctors, hospitals and other providers that do not belong to Harvard Pilgrim's participating provider network. When provided or arranged by a PCP, services are typically covered in full with co-payments. Services received without a PCP referral or outside Harvard Pilgrim's participating provider network are subject to deductibles and coinsurance.

Preferred Provider Organization (PPO) – The PPO plan is available through employers in Massachusetts, New Hampshire and Maine. HPHC, Inc. underwrites the PPO product in Massachusetts that has no in-network co-insurance and HPHC Insurance Co. underwrites all other PPO products in Massachusetts. HPHC Insurance Co. also underwrites the PPO product in Maine and New Hampshire. The Harvard Pilgrim PPO features comprehensive coverage for a wide range of preventive and medical services, including routine office visits, well-baby care, immunizations, hospitalization and worldwide emergency care. In most benefit packages, prescription drug coverage is also included. PPO members can choose to receive care for covered services from providers and hospitals that belong to Harvard Pilgrim's participating provider network or from out-of-network providers and hospitals. Outside of Massachusetts, Maine, New Hampshire and Rhode Island, participating providers also include the Private Healthcare Systems network of more than 360,000 providers and 3,500 hospitals across the United States. When provided or arranged by participating providers, services are typically covered in full with co-payments. Services received outside of Harvard Pilgrim's participating provider network are subject to deductibles and coinsurance.

Administrative Services Only (ASO) – HPHC Insurance Co. 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.

Best Buy PPO – HPHC Insurance Co. offers the Best Buy PPO in New Hampshire. Harvard Pilgrim Best Buy plans have many of the same features as traditional PPO plans, but offer lower premiums. That is due in part to additional cost-sharing features like deductibles, coinsurance or higher co-payments for certain services.

Best Buy Health Savings Account (HSA) PPO - HPHC Insurance Co. offers a qualified high deductible HSA PPO health plan through employers in Massachusetts, Maine and New Hampshire. The Best Buy HSA PPO may help members save money on their annual premium and put money aside in an HSA to help offset medical costs.

Harvard Pilgrim Choice Plus & Options PPO Plans – Harvard Pilgrim Choice Plus & Options PPO Plans are offered in conjunction with United HealthCare Services, Inc. through HPHC Insurance Co. These plans are designed to meet the needs of Massachusetts employers with work sites in other states. Members are not required to choose a primary care physician and are free to visit doctors or hospitals at any time without a referral. When a member sees a provider in the national network, the member will have lower out-of-pocket costs and no bill or claim forms to submit. If the member seeks a non-participating provider, out-of-pocket costs will generally be higher and more paperwork is required.

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 HPHC Insurance Co. business pays fairly quickly, the range of estimates for the December 31, 2007 UCL is narrow and the actuarial estimates are similar to HPHC Insurance Co. estimates with hindsight through September 30, 2008. The Company made a separate provision for Loss Adjustment Expenses / Claim Adjustment Expenses (LAE/CAE) in 2007 and the resulting expense percentage levels are slightly lower than industry norms.

The Company's premium deficiency reserve calculation was reviewed and found to be reasonable. The calculation indicated that no premium deficiency reserves were required as of December 31, 2007. Based upon KPMG's review, the UCL as of December 31, 2007 appears to be fairly stated.

INCOME TAXES

HPHC Insurance Co. is a taxable entity, and as such, files a separate federal income tax return. HPHC Insurance Co. is not subject to state income taxes, but does pay taxes based on a percentage of premiums written and on gross investment income.

As part of KPMG's examination of the statutory financial statements of the Company, KPMG reviewed the Company's December 31, 2007 balance and rollforward for federal income tax recoverable, net deferred tax asset and net deferred tax liability. KPMG reviewed the Company's admitted deferred tax asset of \$433,151 and deferred tax liability of \$46,473 and determined that these were correctly calculated pursuant to Statement of Statutory Accounting Principles No. 10, *Income Taxes*, paragraph 6.

REINSURANCE

HPHC Insurance Co. carries reinsurance against excessive utilization on a per-member basis. Under its reinsurance policies, HPHC Insurance Co. is reimbursed 80% of certain hospital inpatient, hospital outpatient and pharmacy claims over the policy deductibles, which range from \$500,000 to \$1,000,000. Inpatient hospital, outpatient hospital and pharmacy claims are subject to additional policy sub-limits. The maximum recoverable under the reinsurance agreement is \$2,000,000 per member per lifetime. The impact on reinsurance recoveries under these policies on the financial statements is immaterial.

In 2007, HPHC Insurance Co. entered into various quota share reinsurance agreements with an authorized reinsurer. HPHC Insurance Co. assumed \$21.0 million of premium income and \$18.0 million of incurred medical and hospital expense and ceded premium income of \$17.5 million and \$15.8 million of incurred medical and hospital expense for the year ended December 31, 2007. As of December 31, 2007, HPHC Insurance Co. had a net receivable from the reinsurer of \$1.7 million, which represents the net amount of premiums due from the reinsurer offset by the amount of paid claims that HPHC Insurance Co. owes to the reinsurer for the quota share business. The claims unpaid and

accrued medical incentive pool liability includes assumed losses of \$2.4 million and has been reduced for ceded losses of \$2.8 million as of December 31, 2007.

ACCOUNTS AND RECORDS

The books and records of the Company are audited annually by the independent certified public accounting firm of Deloitte & Touche 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 Company's Independent Certified Public Accountants (Deloitte & Touche 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

No material events involving HPHC Insurance Co. were observed subsequent to December 31, 2007.

COMMITMENTS AND CONTINGENCIES

Related Party Guarantee

HPHC, Inc. and its insurance affiliates, HPHC Insurance Co. and HPHC NE, participate in an intercompany Guaranty and Indemnity Agreement ("G&I Agreement"). Under the terms of the G&I Agreement, each entity guarantees the payment and performance of the others. In addition, each entity has joint and several liability for all obligations that may arise out of this G&I Agreement.

Legal Proceedings

HPHC Insurance Co. 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 HPHC Insurance Co., the outcome of which is likely to have a material adverse effect upon the statutory financial statements.

FINANCIAL STATEMENTS

The Financial Statements section includes the following:

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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, 2007.

For Information Purposes Only

HPHC Insurance 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>			
Bonds	\$ 30,800,546	\$ -	\$ 30,800,546
Stocks:			
Preferred stocks	262,715	-	262,715
Cash, cash equivalents and short-term investments	(82,796)	-	(82,796)
Subtotals, cash and invested assets	30,980,465	-	30,980,465
Investment income due and accrued	294,207	-	294,207
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	3,377,107	-	3,377,107
Reinsurance:			
Other amounts receivable under reinsurance contracts	1,711,360	-	1,711,360
Amounts receivable relating to uninsured plans	5,228,963	-	5,228,963
Current federal and foreign income tax recoverable and interest thereon	1,281,728	-	1,281,728
Net deferred tax asset	433,151	-	433,151
Health care and other amounts receivable	695,538	-	695,538
Total Assets	\$ 44,002,519	\$ -	\$ 44,002,519
<u>LIABILITIES</u>			
Claims unpaid	\$ 10,793,068	\$ -	\$ 10,793,068
Unpaid claims adjustment expenses	134,472	-	134,472
Aggregate health policy reserves	2,585,882	-	2,585,882
Premiums received in advance	1,150,532	-	1,150,532
General expenses due or accrued	2,567,898	-	2,567,898
Net deferred tax liability	46,473	-	46,473
Amounts due to parent, subsidiaries and affiliates	3,026,332	-	3,026,332
Liability for amounts held under uninsured accident and health plans	347,754	-	347,754
Total Liabilities	\$ 20,652,411	\$ -	\$ 20,652,411
<u>CAPITAL AND SURPLUS</u>			
Common capital stock	\$ 1,067,000	\$ -	\$ 1,067,000
Gross paid in and contributed surplus	17,334,000	-	17,334,000
Unassigned funds (surplus)	4,949,108	-	4,949,108
Total Capital and Surplus	\$ 23,350,108	\$ -	\$ 23,350,108
Total Liabilities, Capital and Surplus	\$ 44,002,519	\$ -	\$ 44,002,519

HPHC Insurance 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	310,759	-	310,759
Net premium income	\$ 95,263,930	\$ -	\$ 95,263,930
Change in unearned premium reserves and reserve for rate credits	(2,585,882)	-	(2,585,882)
Total revenues	92,678,048	-	92,678,048
Hospital and Medical:			
Hospital/medical benefits	58,113,658	-	58,113,658
Other professional services	1,420,493	-	1,420,493
Outside referrals	2,173,733	-	2,173,733
Emergency room and out-of-area	1,636,829	-	1,636,829
Prescription drugs	11,804,876	-	11,804,876
Subtotal	75,149,589	-	75,149,589
Less:			-
Net reinsurance recoveries	(2,274,070)	-	(2,274,070)
Total medical and hospital	77,423,659	-	77,423,659
Claims adjustment expenses	5,243,675	-	5,243,675
General administrative expenses	11,082,506	-	11,082,506
Total underwriting deductions	93,749,840	-	93,749,840
Net underwriting gain (loss)	(1,071,792)	-	(1,071,792)
Net investment income earned	1,416,846	-	1,416,846
Net realized capital gains (losses)	(8,097)	-	(8,097)
Net investment gains	1,408,749	-	1,408,749
Net income after capital gains tax and before all other federal income taxes	336,957	-	336,957
Federal and foreign income taxes incurred	297,358	-	297,358
Net income	\$ 39,599	\$ -	\$ 39,599

HPHC Insurance Company, Inc.
Capital & Surplus
For the Year Ended December 31, 2007

	<u>Annual Statement</u>	<u>Statutory Examination Adjustment</u>	<u>Per Statutory Examination</u>
Capital and Surplus, December 31, 2006	\$ 23,213,017	\$ -	\$ 23,213,017
Net income or (loss)	39,599	-	39,599
Change in net deferred income tax	229,385	-	229,385
Change in nonadmitted assets	(131,893)	-	(131,893)
Net change in capital and surplus	<u>137,091</u>	<u>-</u>	<u>137,091</u>
Capital and Surplus, December 31, 2007	<u>\$ 23,350,108</u>	<u>\$ -</u>	<u>\$ 23,350,108</u>

For Information Purposes Only

HPHC Insurance 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	\$ 23,213,017	\$ 11,981,201	\$ 9,595,114
Net income or (loss)	39,599	1,210,161	2,585,086
Change in net deferred income tax	229,385	68,629	(821,790)
Change in nonadmitted assets	(131,893)	(46,974)	622,791
Surplus adjustments:			
Paid in	-	10,000,000	-
Net change in capital and surplus	<u>137,091</u>	<u>11,231,816</u>	<u>2,386,087</u>
Capital and Surplus, December 31, current year	<u><u>\$ 23,350,108</u></u>	<u><u>\$ 23,213,017</u></u>	<u><u>\$ 11,981,201</u></u>

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 HPHC 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 Harvard Pilgrim Health Care, Inc. extended to all examiners during the course of the examination is hereby acknowledged.

John Turchi, CFE, CPCU
Supervising Examiner & Examiner-in-Charge (EIC)
Commonwealth of Massachusetts
Division of Insurance
Boston, MA