

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

REPORT OF EXAMINATION OF
HARVARD PILGRIM HEALTHCARE OF NEW ENGLAND, Inc.

Needham Heights, Massachusetts

As of December 31, 2010

NAIC COMPANY CODE 96717

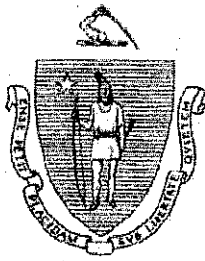
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HARVARD PILGRIM HEALTH CARE OF NEW ENGLAND, Inc.

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April 27, 2012

The Honorable Joseph G. Murphy
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
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Honorable Commissioner Murphy:

Pursuant to your instructions and in accordance with Massachusetts General Laws, Chapter 176G, Section 10 and 211 CMR, 3.00, an examination has been made of the financial condition and affairs of

Harvard Pilgrim Health Care of New England, Inc.

at its home office located at 93 Worcester Street, Wellesley, MA 02481-9181. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

This statutory examination of Harvard Pilgrim Health Care of New England Inc., hereinafter referred to as "Company", "Corporation", "New England", "HPHC NE" or "Plan", is as of December 31, 2010, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

The current examination was conducted at the direction of and under the overall management and control of the examination staff of the Massachusetts Division of Insurance ("Division") in accordance with standards established by the NAIC Financial Condition (E) Committee as well as with the requirements of the NAIC Financial Condition Examiners' Handbook, the examination standards of the Division and with Massachusetts General Laws ("M.G.L."). Representatives from the firm of KPMG LLP ("KPMG") were engaged by the Division to assist in the examination by performing certain examination procedures at the direction of and under the overall management of the Division's examination staff. This assistance included a review of accounting records, information systems, taxes, investments, and actuarially determined loss and loss adjustment expense reserves.

The principal focus of the examination was 2010 activity; however, transactions both prior and subsequent thereto were reviewed as deemed appropriate. The examination was conducted following the NAIC Risk Focused Examination Model.

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 ("Deloitte"). Wherever possible and wherever deemed appropriate and effective, Deloitte's independent work product was used to define, support, document and expedite the overall examination process.

Status of Prior Examination Findings

The prior report of examination did not have any findings.

HISTORY

General

Harvard Pilgrim Health Care of New England, Inc., a not-for-profit Massachusetts corporation, operates as a health plan, providing comprehensive health insurance, access to health care, and other related services in New Hampshire to group and Medicare members through contracts with physicians, established primary care and multi-specialty physician groups, hospitals, and other health care providers. New England was incorporated on November 16, 1978, and commenced operations as a health plan on October 1, 1980. New England is an affiliate of Harvard Pilgrim Health Care, Inc. ("HPHC, Inc.", "HPHC"), a not-for-profit Massachusetts corporation, operating as a not-for-profit health plan. New England terminated its Medicare private fee for service product effective December 31, 2010 and is offering a Medicare supplement product effective January 1, 2011 through an affiliated company.

Other affiliates of HPHC, Inc. include: HPHC Insurance Company, Inc. ("Insurance Company"), a Massachusetts for-profit corporation; Health Plans, Inc. (HPI), a Massachusetts for-profit corporation; Harvard Pilgrim Health Care Foundation, Inc., a Massachusetts not-for-profit corporation; and Harvard Pilgrim Health Care Institute, LLC, a Massachusetts limited liability company. New England, together with HPHC, Inc., the Insurance Company, and HPI, are collectively referred to herein as "Harvard Pilgrim."

The 2010 healthcare reforms contemplated in the Patient Protection and Affordability Act did not have a material impact on the financial statement of New England. The Company is continuing to assess the potential impact of reforms contemplated for 2014.

Growth of the Company

Capital and Surplus consists of capital contributed to the Company and the excess of revenues over expenses since inception. The total admitted assets, total liabilities and capital and surplus of the Company for the years ended 2008 through 2010 are shown in the following schedule:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
2008	\$81,024,853	\$47,312,718	\$33,712,135
2009	78,689,133	42,134,994	36,554,139
2010	64,744,778	33,066,325	31,678,453

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. Physician providers and such other organizations or individuals are and shall be deemed to be, for all purposes, independent contractors with the Company, and shall not be characterized as officers, employees or agents of the Company.

Harvard Pilgrim Health Care of New England, Inc.

The Company enters into contractual agreements with various health care providers to provide certain medical services to its members. Compensation arrangements vary by provider. Certain providers have entered into risk-sharing arrangements with the Company, whereby a settlement is calculated by comparing actual medical claims experience to a pre-approved and predetermined budgeted amount. These settlements are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. The agreements are in compliance with Massachusetts statutes and regulation 211 CMR § 52.

RESERVES

The Company uses estimates for determining its claims incurred but not yet reported, which are based on historical claim payment patterns, healthcare trends and membership and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

KPMG Health Actuaries prepared independent estimates of the Unpaid Claim Liabilities ("UCL") as of December 31, 2010 and prior periods. For December 31, 2010, 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. The actuarial estimates, as determined by the KPMG Health actuaries, indicate that New England's UCL are reasonable as of December 31, 2010.

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, 2010. Based on KPMG's review, the UCL as of December 31, 2010 appears to be fairly stated.

REINSURANCE

New England carries reinsurance against excessive utilization on a per-member basis. Under a reinsurance agreement that is currently in place, New England is reimbursed 80% of certain hospital inpatient, outpatient, and pharmacy claims in excess of 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 of reinsurance recoveries on the statutory financial statements was immaterial for 2010, 2009 and 2008.

New England participated in the New Hampshire Small Employer Health Reinsurance Pool ("Pool"). As part of its participation in the Pool, New England ceded the losses related to specified members to the Pool and paid the related reinsurance premium to the Pool. As of December 31, 2008, the coverage under the Pool was terminated by the New Hampshire legislature. There is a two-year runout period for claims incurred on or before December 31, 2008, where claims may be submitted to the Pool for payment. The runout period ended on December 31, 2010. Net recoveries from the Pool for the years ended December 31, 2010, 2009 and 2008 were immaterial.

INCOME TAXES

New England is a tax-exempt organization under Section 501(c)(4) of the Internal Revenue Code and therefore not subject to income tax. New England has evaluated its uncertain tax positions and determined that New England did not have any unrecognized tax benefits as of December 31, 2010 and 2009.

MANAGEMENT AND CONTROL

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. Our review of the by-laws indicated there were no changes since the prior examination.

Members and Membership

The Company's by-laws indicate that the Company shall have one corporate membership. The sole member of this Company shall be Harvard Pilgrim Health Care, Inc.

Board of Directors

The Company's by-laws indicate the following regarding its board of directors ("Board"):

- The board of directors shall be composed of a number of directors to be fixed each year by the member and designated at the annual meeting or at any special meeting held in lieu thereof.
- Each director shall serve until the next annual meeting or special meeting held in lieu thereof, and until his/her successor is chosen.

Harvard Pilgrim Health Care of New England, Inc.

At December 31, 2010 the Board was comprised of three (3) directors, which is in compliance with the Company's by-laws. Directors duly elected and serving at December 31, 2010, with business affiliations, were as follows:

<u>Director</u>	<u>Class of Director</u>	<u>Principal Occupation</u>
Eric H. Schultz	Management Director	President and Chief Executive Officer, HPHC, Inc.
James W. DuCharme ¹	Management Director	Chief Financial Officer, HPHC, Inc.
Laura S. Peabody	Management Director	Senior Vice President and Chief Legal Officer, HPHC, Inc.

¹- James DuCharme was CFO and Treasurer until departing in January, 2012. Mr. DuCharme served as CFO and Treasurer from June 2008 – January 2012. As of the date of this examination report, Harvard Pilgrim continues its search for a replacement.

Committees of the Board

The board shall appoint from within or without its own membership such standing and special committees as it finds desirable in assisting in its management of the Company. Currently, there are no committees.

Officers

The Company's officers consist of a Chairperson, President, Treasurer and Clerk to serve for terms of one year or until their successors are elected and duly qualified. The Board may appoint such additional officers as it shall deem fit. The officers so elected and appointed shall be the officers of the Company. The President shall be the Chief Executive Officer of the Company.

The elected officers and their respective titles at December 31, 2010 were as follows:

<u>Officer</u>	<u>Elected Title</u>
Eric H. Schultz	President
James W. DuCharme ¹	Treasurer
Laura S. Peabody	Secretary

¹- James DuCharme was CFO and Treasurer until departing in January, 2012. Mr. DuCharme served as CFO and Treasurer from June 2008 – January 2012. As of the date of this examination report, Harvard Pilgrim continues its search for a replacement.

Conflict of Interest Procedures

HPHC, Inc., the parent of HPHC NE, has adopted a conflict of interest policy statement. HPHC, Inc. has an established procedure for the disclosure to the Board of any material interest or affiliation on the part of any officer or director which is in or is likely to conflict with his/her official duties.

Each director of the Board shall annually deliver to the Board, at or about the time of the Annual Meeting, a true and complete conflicts of interest statement ("Conflicts Statement") in the form approved by the Board; provided that each person described above shall deliver only one Conflicts Statement regardless of the number of positions listed above that he or she holds. Each director shall promptly update his or her most recent Conflicts Statement upon the occurrence of any event that makes the information contained in such Conflicts Statement no longer true or that would be required to be reported in such Conflicts Statement at the time it is delivered to the Board.

The completed Conflict of Interest Disclosure Statements for Directors, Officers and Senior Managers for 2008, 2009 and 2010 were reviewed. No discrepancies were noted in the response to the General Interrogatories regarding conflicts of interest as reflected in the Company's December 31, 2010 Annual Statement.

Corporate Records

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.

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.

Corporate Governance

The Company's board of directors has significant influence on the entity's control consciousness. The board, through its own activities and supported by its audit committee, is responsible for overseeing all financial reporting policies and procedures. The board appears appropriately experienced and qualified.

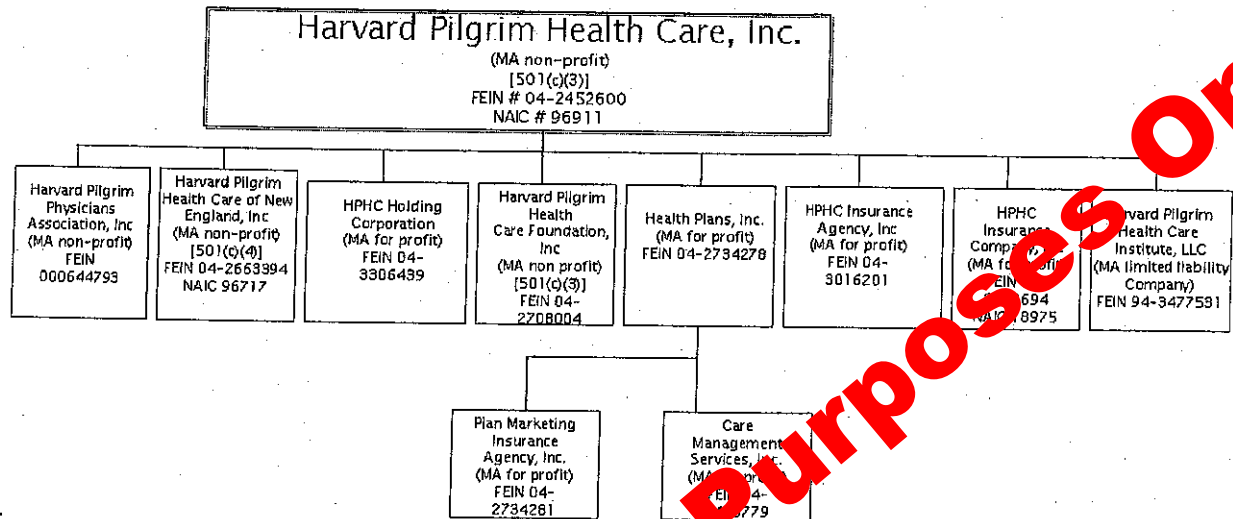
During the period under examination and through completion of examination fieldwork, it appears that the Company's internal audit department objectives and strategies are clear and well-documented. Audits were performed on a regular basis with results communicated to senior management, the respective department heads and external auditors. The Company's external auditors did not identify any deficiencies in internal controls that were considered to be material.

Harvard Pilgrim Health Care of New England, Inc.

AFFILIATED COMPANIES

Organization Chart

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2010 is illustrated below:



Related Party Transactions

HPHC, Inc. is the sole corporate member of New England. New England has no employees and, accordingly, HPHC, Inc. provides all administrative services to New England, including premium billing and collection, claim payments, and operational management. New England has a management and medical services agreement with HPHC, Inc., which provides for an allocation of hospital and medical and administrative costs, including claim adjustment expenses, from HPHC, Inc. to New England.

Hospital and medical expenses are charged based on the actual incurred claims experience of New England. Administrative expenses are charged to New England based on HPHC, Inc.'s departmental cost allocation methodology. For the years ended December 31, 2010 and 2009, total administrative and claims adjustment expenses charged to New England were \$27.7 million and \$27.4 million, respectively. New England had a receivable from Harvard Pilgrim of \$2.4 million as of December 31, 2010 and owed Harvard Pilgrim \$0.2 million as of December 31, 2009.

In 2009, the board of directors of HPHC, Inc. authorized a capital contribution to New England of \$15 million, which was recorded directly to statutory net worth. New England did not receive any capital contributions in 2010.

Due to the significance of the transactions between New England and HPHC, Inc., the results of operations of New England may not be indicative of the results which would have been attained had New England not been an affiliate of HPHC, Inc.

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 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, 2010.

COMMITMENTS AND CONTINGENCIES

Related-Party Guarantees — HPHC, Inc. and its insurance affiliates, the Insurance Company and New England, 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 is jointly and severally liable for all obligations that may arise out of this G&I Agreement.

Minimum Net Worth — The Commonwealth of Massachusetts, under the Acts of 2003, Chapter 141, Sections 46 and 83, amended the General Law of Massachusetts, Chapter 176G Health Maintenance Organizations by adding Section 25 Net Worth of Health Maintenance Organizations which took effect on January 1, 2004. Section 25 sets forth minimum adjusted net worth requirements for health maintenance organizations to be phased in over a seven-year period beginning December 31, 2004. In addition, HMOs must maintain a minimum deposit of at least \$1 million with a trustee acceptable to the Massachusetts Division of Insurance. New England's minimum net worth requirement for New Hampshire as of December 31, 2010 and 2009 was \$22.6 million and \$27.0 million, respectively. New England's minimum net worth requirement for Massachusetts as of December 31, 2010 and 2009, was \$18.8 million and \$20.1 million, respectively. As of December 31, 2010 and 2009, the minimum net worth requirements had been satisfied.

PENSION AND OTHER POST RETIREMENT BENEFIT PLANS

HPHC, Inc. has no employees. Refer to Related Party Transactions section above.

TERRITORY AND PLAN OF OPERATION

The Corporation is licensed to transact business in the Commonwealth of Massachusetts and the state of New Hampshire. Harvard Pilgrim Health Care of New England, Inc. is headquartered in Wellesley, MA. As of December 31, 2010, the Company's primary service area is New England.

SPECIAL DEPOSITS

The special deposits of the Company at December 31, 2010 are as follows:

Description	On Deposit	Par or Book Value	Statement Value	Market Value
US Treasury Notes, 6.375%, 6/15/2027	Bank of America, Boston, MA – State of New Hampshire Collateral	\$1,500,000	\$1,930,320	\$1,930,560
US Treasury Notes, 6.375%, 6/15/2027	Citibank, New York, NY – Custodian for Commonwealth of Massachusetts Division of Insurance	1,000,000	1,286,880	1,287,040
Totals		\$2,500,000	\$3,217,200	\$3,217,600

LEGAL PROCEEDINGS

New England 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 New England, the outcome of which is likely to have a material adverse effect upon the statutory financial statements.

ACCOUNTS AND RECORDS

The books and records of the Company are audited annually by the independent certified public accounting (“CPA”) firm of Deloitte & Touche LLP, in accordance with 211 CMR 23.00. The CPA firm issued a qualified opinion for all 3 years ended December 31, 2010. The Company is also subject to review by an internal audit department.

As part of its engagement for the Division, KPMG performed a review and evaluation of the control environment of the Company’s IT systems. The NAIC’s Information Systems Questionnaire completed by the Company was reviewed and interviews with Company management and IT staff were conducted to gather supplemental information and corroborate the Company’s responses to the questionnaire. Included was a review of the documentation supporting management and organization controls, application systems development and maintenance controls, operating and processing controls, logical and physical security controls, contingency planning controls, personal computers, local area network (“LAN”), wide area network (“WAN”) and internet controls.

Harvard Pilgrim Health Care of New England, Inc.

The control environment of the Company's information systems was found to have in place sufficient internal controls. There were no material internal control weaknesses noted in connection with the examination, nor were any such matters reported in the CPA firm's filings with the Division. The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2010 Annual Statement. No material exceptions were noted.

For Informational Purposes Only

FINANCIAL STATEMENTS

The Financial Statement 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, 2010.

Harvard Pilgrim Health Care of New England, Inc.

Harvard Pilgrim Health Care of New England, Inc.
Statement of Assets, Liabilities and Capital & Surplus
As of December 31, 2010

	Per Company	Examination Changes	Per Statutory Examination
Assets			
Bonds	\$ 56,856,293	\$ 0	\$ 56,856,293
Cash, cash equivalents and short-term investments	725,535		725,535
Subtotals, cash and invested assets	\$ 57,581,828	\$ 0	\$ 57,581,828
Investment income due and accrued	\$ 429,328	\$ 0	\$ 429,328
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	1,476,691		1,476,691
Amounts receivable relating to uninsured plans	1,608,079		1,608,079
Receivables from parent, subsidiaries and affiliates	2,390,737		2,390,737
Health care and other amounts receivable	1,258,115		1,258,115
Total Assets	\$ 64,744,778	\$ 0	\$ 64,744,778
Liabilities			
Claims unpaid	\$ 24,690,740	\$ 0	\$ 24,690,740
Unpaid claims adjustment expenses	294,524		294,524
Premiums received in advance	4,043,015		4,043,015
General expenses due or accrued	2,519,763		2,519,763
Liability for amounts held under unfunded plans	1,518,283		1,518,283
Total Liabilities	\$ 33,066,325	\$ 0	\$ 33,066,325
Capital and Surplus			
Gross paid in contributed surplus	\$ 25,000,000		\$ 25,000,000
Unassigned funds (surplus)	6,678,453		6,678,453
Total Capital and Surplus	\$ 31,678,453	\$ 0	\$ 31,678,453
Total Liabilities, Capital and Surplus	\$ 64,744,778	\$ 0	\$ 64,744,778

Harvard Pilgrim Health Care of New England, Inc.

Harvard Pilgrim Health Care of New England, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2010

	Per Company	Examination Changes	Per Statutory Examination
Member Months	630,605	-	630,605
Net premium income	\$ 301,244,108	\$ 0	\$ 301,244,108
Total revenues	\$ 301,244,108	\$ 0	\$ 301,244,108
Hospital and Medical:			
Hospital/medical benefits	202,194,658		202,194,658
Other professional services	11,289,069		11,289,069
Outside referrals	3,743,365		3,743,365
Emergency room and out-of-area	9,029,024		9,029,024
Prescription drugs	41,383,573		41,383,573
Aggregate write-ins for other hospital/medical	1,638,778		1,638,778
Subtotal	269,278,467	0	269,278,467
Less:			
Net reinsurance recoveries	754,666		754,666
Total medical and hospital	268,523,801	0	268,523,801
Claims adjustment expenses	5,482,492		5,482,492
General administrative expenses	33,296,691		33,296,691
Total underwriting deductions	307,302,984	0	307,302,984
Net underwriting loss	(6,058,876)	0	(6,058,876)
Net investment income earned	2,276,755		2,276,755
Net realized capital losses	(181,488)		(181,488)
Net investment gains	2,095,267	0	2,095,267
Net income before taxes	(3,963,609)	0	(3,963,609)
Federal and foreign income taxes incurred	0		0
Net income	\$ (3,963,609)	\$ 0	\$ (3,963,609)

Harvard Pilgrim Health Care of New England, Inc.

Harvard Pilgrim Health Care of New England, Inc.
Capital & Surplus
For the Year Ended December 31, 2010

	Per Company	Examination Changes	Per Statutory Examination
Statutory net worth, December 31, 2009	\$ 36,554,139	\$ 0	\$ 36,554,139
Net loss	(3,963,609)		(3,963,609)
Change in net unrealized gain	238,468		238,468
Decrease in nonadmitted assets	(1,150,545)		(1,150,545)
Statutory net worth, December 31, 2010	<u>\$ 31,678,453</u>	<u>\$ 0</u>	<u>\$ 31,678,453</u>

Harvard Pilgrim Health Care of New England, Inc.

Harvard Pilgrim Health Care of New England, Inc.
Statement of Changes in Capital & Surplus
For Three Year Period Ended December 31, 2010

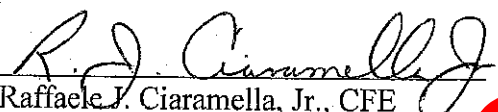
	2010	2009	2008
Statutory net worth, prior year	\$ 36,554,139	\$ 33,712,135	\$ 28,621,180
Net loss	(3,963,609)	(12,420,818)	(4,479,849)
Change in net unrealized capital gains (losses)	238,468	116,748	(355,218)
Surplus adjustments - Paid in	0	15,000,000	10,000,000
Change in nonadmitted assets	(1,150,545)	146,074	(73,972)
Net change in capital and surplus	(4,875,686)	2,842,004	5,197,141
Statutory net worth, December 31, current year	\$ 31,678,453	\$ 36,554,139	\$ 33,818,321

ACKNOWLEDGEMENT

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 Harvard Pilgrim Health Care of New England, Inc. in order for the Division to fulfill the Commonwealth of Massachusetts' 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 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 of New England, Inc. extended to all examiners during the course of the examination is hereby acknowledged.


Raffaele J. Ciaramella, Jr., CFE
Supervising Examiner and Examiner-in-Charge
Commonwealth of Massachusetts
Division of Insurance