

Report on Examination
of
Health Options, Inc.
Jacksonville, Florida
as of
December 31, 2004

By The
State of Florida
Office of Insurance Regulation

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Tallahassee, Florida

June 19, 2006

Kevin M. McCarty, Commissioner
Florida Office of Insurance Regulation
200 East Gaines Street
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 641.27, Florida Statutes (F.S.), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2004, of the financial condition and corporate affairs of:

Health Options, Inc.
4800 Deerwood Campus Parkway
Jacksonville, Florida 32246

hereinafter generally referred to as the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2002 through December 31, 2004. The Company was last examined by the Florida Office of Insurance Regulation (the "Office") as of December 31, 1997. In lieu of conducting statutory financial examinations of the Company for the years 1998 through 2001, the Office accepted the independent certified public accountant's (CPA) audit reports on the Company's statutory-basis financial statements for those years pursuant to Section 641.27(1), F.S.

Planning for the current examination began on December 16, 2005. The fieldwork commenced on December 19, 2005 and concluded on March 30, 2006. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This was a statutory financial condition examination conducted in accordance with the NAIC *Financial Examiners Handbook, Accounting Practices and Procedures Manual, and Annual Statement Instructions*, with due regard to the requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value, and integrity of the statement assets and the determination of liabilities, as they affect the Company's solvency.

The examination included a review of corporate and other selected records deemed pertinent to the Company's operations and practices. In addition, various ratio results, *Best's Insurance Reports*, the Company's independent audit reports, and certain work papers prepared by the Company's independent CPA were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the Company's assets and liabilities as reported by the Company in its 2004 annual statement. Transactions subsequent to December 31, 2004 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which require special explanation or description.

After considering the Company's control environment and the materiality level set for this examination, we relied on work performed by the Company's CPA in the area of contingent liabilities.

STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION

The prior examination report did not contain any significant adverse regulatory disclosures or findings related to the Company's solvency.

HISTORY

GENERAL

The Company was incorporated in Florida on February 29, 1984, and commenced business on October 1, 1984.

As of the date of this examination, the Company was authorized to transact business as a health maintenance organization (HMO) in accordance with Part I of Chapter 641, F.S.

Neither the Company's articles of incorporation nor its bylaws were amended during the period covered by this examination.

CAPITAL STOCK

As of December 31, 2004, the Company's capitalization was as follows:

Number of authorized common capital shares	500,000
Number of shares issued and outstanding	100,000
Total common capital stock	\$100,000
Par value per share	\$1.00

At December 31, 2004, the Company was wholly-owned and controlled by Diversified Health Services, Inc., which in turn was wholly-owned by Blue Cross and Blue Shield of Florida, Inc. (BCBSF). An abbreviated organizational chart appears on page 9.

PROFITABILITY

For the period of this examination, the Company reported the following:

(\$ Millions)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net premiums	\$1,978.7	\$2,008.1	\$2,223.5
Total revenues	\$1,979.3	\$2,009.5	\$2,224.7
Net income	\$98.3	\$137.3	\$100.4
Total capital & surplus	\$404.6	\$438.3	\$409.2

DIVIDENDS

The Company paid dividends in the amount of \$135 million and \$100.3 million during years 2004 and 2003, respectively. No dividends were paid in year 2002.

MANAGEMENT

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.0701 and 628.231, F.S. Directors serving as of December 31, 2004 were:

Directors

Name and Location	Principal Occupation
Henry H. Beckwith Jacksonville, Florida	Vice President - W.W. Gay Mechanical Contractors
Barbara G. Benevento Jacksonville, Florida	Group Vice President, Senior Markets Blue Cross Blue Shield of Florida, Inc.
R. Chris Doerr Jacksonville, Florida	Senior Vice President & Chief Financial Officer Blue Cross Blue Shield of Florida, Inc.
Joyce A. Kramzer Jacksonville, Florida	Group Vice President, Delivery Systems Blue Cross Blue Shield of Florida, Inc.
Daniel B. Lestage, M.D. Jacksonville, Florida	Vice President, Quality & Professional Relations Blue Cross Blue Shield of Florida, Inc.
Robert I. Lufrano, M.D. Jacksonville, Florida	Chairman of the Board & Chief Executive Officer Blue Cross Blue Shield of Florida, Inc.
Nickolas E. Stamatogiannakis Jacksonville, Florida	Senior Vice President, Health Business Blue Cross Blue Shield of Florida, Inc.

The following were the Company's senior officers as of December 31, 2004, as appointed by its board of directors in accordance with the Company's bylaws:

Senior Officers

Name	Title
R. Chris Doerr	Chief Executive Officer
Nickolas E. Stamatogiannakis	President
Deanna M. McDonald	Treasurer
Seth M. Phelps	Secretary

CONFLICT OF INTEREST PROCEDURE

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with Section 607.0832, F.S. No exceptions were noted during this examination.

CORPORATE RECORDS

The recorded minutes of the shareholder, Board of Directors, and BCBSF Audit Committee meetings were reviewed for the period examined. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, F.S., including the authorization of investments as required by Section 641.35(7), F.S.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code (F.A.C.). Its latest holding company registration statement was filed with the State of Florida, as required by Section 628.801, F.S., and Rule 69O-143.046, F.A.C., on July 13, 2005.

The following agreements were in force between the Company and its affiliates:

ADMINISTRATIVE SERVICES AGREEMENT

BCBSF provides administrative, managerial, professional, and technical services to the Company pursuant to a February 1, 1999 agreement. Fees for services provided amounted to \$380.5 million, \$367.6 million, and \$390.1 million in years 2004, 2003, and 2002, respectively.

TAX ALLOCATION AGREEMENT

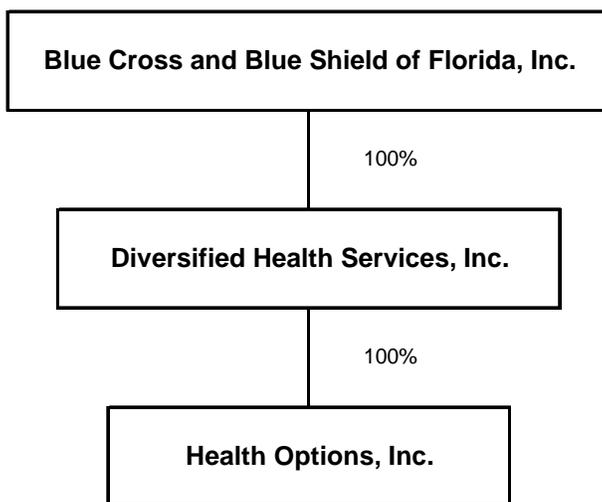
The results of the Company's operations are included in the consolidated federal income tax return of BCBSF pursuant to a January 1, 2001 tax allocation agreement that provides for the allocation of consolidated income tax. The agreement provides that a company included in the consolidated group with a net operating loss is reimbursed for the tax benefit associated with its loss in the year the loss is used in the consolidated return. Inter-company tax balances are settled annually.

GUARANTEE AGREEMENT

BCBSF has guaranteed the Company's liabilities including its subscriber claims. It has agreed to pay for services rendered by providers in the event the Company becomes insolvent, as well as any amounts owed to providers for continuation of services for the duration of the month in which the members paid their premiums. In addition, BCBSF has agreed to provide for the continuation of benefits for members who are confined in an inpatient facility on the date of insolvency until the date of discharge.

An abbreviated organizational chart as of December 31, 2004 reflecting the holding company system is shown below. Schedule Y of the Company's 2004 annual statement provided the names of all related companies in the holding company group.

**Health Options, Inc.
Organizational Chart
December 31, 2004**



FIDELITY BOND AND OTHER INSURANCE

The Company is included in the BCBSF insurance coverage and maintains acceptable levels of general liability insurance in compliance with Rule 69O-191.069, F.A.C. The Company is also included in the BCBSF fidelity bond in the amount of \$30 million and is, therefore, in compliance with Section 641.22, F.S.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company has no direct employees of its own; all personnel working on behalf of the Company are employed by BCBSF and are covered by the BCBSF pension and insurance plans.

STATUTORY DEPOSITS

The Company maintained on deposit with the Office an insolvency protection deposit of \$2 million in accordance with Section 641.285, F.S., and a Rehabilitation Administrative Expense Fund deposit of \$10,000 in accordance with Section 641.227, F.S.

INSURANCE PRODUCTS AND RELATED PRACTICES

TERRITORY AND PLAN OF OPERATION

At December 31, 2004, the Company was authorized to transact business in Florida as an HMO in accordance with Part I of Chapter 641, F.S. It holds a current health care provider certificate issued by the Florida Agency for Health Care Administration, pursuant to Part III of Chapter 641, F.S., which is valid until June 8, 2006.

The Company used a network of general agents, field sales representatives, and independent agents; operated as an individual practice association (IPA) model; and provided health care services to comprehensive and Medicare subscribers. Its total membership at December 31, 2004 was 566,378, of which approximately 95% consisted of comprehensive subscribers and approximately 5% consisted of Medicare subscribers.

The Company operated in the Florida counties of: Alachua, Baker, Bradford, Brevard, Broward, Charlotte, Citrus, Clay, Columbia, Desoto, Dixie, Escambia, Flagler, Gilchrist, Hendry, Hernando, Hillsborough, Lake, Lee, Levy, Manatee, Marion, Martin, Miami-Dade, Nassau, Okaloosa, Okeechobee, Orange, Osceola, Palm Beach, Pasco, Pinellas, Polk, Santa Rosa, Sarasota, Seminole, St. Johns, St. Lucie, Sumter, Suwannee, Volusia, and Walton.

TREATMENT OF MEMBERS

The Company established procedures for handling written complaints in accordance with Section 641.511, F.S., and maintained a claims procedure manual that included detailed procedures for handling each type of claim.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for years 2002, 2003, and 2004, pursuant to Section 641.26(1)(c), F.S.

The Company's accounting records were maintained on a computerized system. Its balance sheet accounts were verified with the line items of its annual statement submitted to the Office.

The Company's main administrative office is located in Jacksonville, Florida, where this examination was conducted.

The following agreements were in effect between the Company and non-affiliates:

CUSTODIAL AGREEMENT

On May 1, 1990, the Company entered into an agreement with the Bank of New York for the holding and safekeeping of the Company's stocks, money certificates, bonds, and other securities. Fees related to this agreement were \$177,436, \$191,024, and \$78,393 in years 2004, 2003, and 2002, respectively.

INDEPENDENT AUDITOR AGREEMENT

The Company's parent BCBSF contracted with an independent CPA firm, PricewaterhouseCoopers LLP for conducting annual audits of the Company's statutory-basis financial statements. Fees related to the agreements were \$139,150, \$120,000, and \$110,000 in years 2004, 2003, and 2002, respectively.

FINANCIAL STATEMENTS PER EXAMINATION

The following four pages contain statements of the Company's financial position at December 31, 2004, as determined by this examination, and the results of its operations for the year then ended as reported by the Company.

Health Options, Inc.
Assets
December 31, 2004

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$482,619,387	\$0	\$482,619,387
Common stocks	158,972,961	0	158,972,961
Cash, cash equivalents, and short-term investments	17,245,388	0	17,245,388
Receivable for securities	<u>2,130,879</u>	<u>0</u>	<u>2,130,879</u>
	660,968,615	0	660,968,615
Investment income due and accrued	5,551,953	0	5,551,953
Uncollected premiums and agents' balances in the course of collection	5,144,663	0	5,144,663
Deferred premiums and agents balances	8,748,863	0	8,748,863
Accrued retrospective premiums	932,244	0	932,244
Amounts receivable relating to uninsured plans	10,840,089	0	10,840,089
Net deferred tax asset	287,781	0	287,781
Health care and other amounts receivable	90,050	0	90,050
Aggregate write-ins for other than invested assets	<u>29,872,568</u>	<u>0</u>	<u>29,872,568</u>
Totals	<u><u>\$722,436,826</u></u>	<u><u>\$0</u></u>	<u><u>\$722,436,826</u></u>

Health Options, Inc.
Liabilities, Capital and Surplus
December 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$159,194,784	\$0	\$159,194,784
Accrued medical incentive pool and bonus amounts	2,161,515	0	2,161,515
Unpaid claims adjustment expenses	7,507,913	0	7,507,913
Aggregate health policy reserves	13,033,223	0	13,033,223
Aggregate health claim reserves	5,118,900	0	5,118,900
Premiums received in advance	20,472,005	0	20,472,005
Current federal income taxes payable	7,645,975	0	7,645,975
Remittances and items not allocated	241,009	0	241,009
Amounts due to parent, subsidiaries and affiliates	79,757,108	0	79,757,108
Payable for securities	8,418,776	0	8,418,776
Liability for amounts held under uninsured A&H plans	740,234	0	740,234
Aggregate write-ins for other liabilities	13,495,917	0	13,495,917
Total liabilities	<u>317,787,359</u>	<u>0</u>	<u>317,787,359</u>
Capital and Surplus			
Common capital stock	100,000	0	100,000
Gross paid in and contributed surplus	167,284,475	0	167,284,475
Unassigned funds (surplus)	<u>237,264,992</u>	<u>0</u>	<u>237,264,992</u>
Total capital and surplus	<u>404,649,467</u>	<u>0</u>	<u>404,649,467</u>
Total liabilities, capital and surplus	<u><u>\$722,436,826</u></u>	<u><u>\$0</u></u>	<u><u>\$722,436,826</u></u>

Health Options, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2004

Net premium income		\$1,978,657,317
Change in unearned premium reserves		<u>633,031</u>
		1,979,290,348
Hospital/medical benefits	\$1,118,032,458	
Outside referrals	33,633,092	
Emergency room and out-of-area	66,284,495	
Prescription drugs	232,862,383	
Aggregate write-ins for other hospital and medical	32,567,472	
Incentive pool, withhold adjustments and bonus amounts	<u>2,146,553</u>	
Total hospital and medical	1,485,526,453	
Claims adjustment expenses	100,030,060	
General administrative expenses	273,187,026	
Increase in reserves for life and A&H contracts	<u>8,713,706</u>	
Total underwriting deductions		<u>1,867,457,245</u>
Net underwriting gain		111,833,103
Net investment income earned	\$29,178,371	
Net realized capital gains	<u>8,746,741</u>	
Net investment gains		37,925,112
Aggregate write-ins for other income or expenses		<u>142,665</u>
Net income before federal income taxes		149,900,880
Federal income taxes incurred		<u>51,627,768</u>
Net income		<u><u>\$98,273,112</u></u>

Health Options, Inc.
Capital and Surplus Account
For the Year Ended December 31, 2004

Capital and surplus, December 31, 2003		\$438,268,470
Net income	\$98,273,112	
Net unrealized capital gains	2,285,387	
Change in net deferred income tax	3,460,803	
Change in non-admitted assets	(2,638,305)	
Dividends to stockholder	<u>(135,000,000)</u>	
	(33,619,003)	
Examination adjustments	<u>0</u>	<u>(33,619,003)</u>
Capital and surplus, December 31, 2004		<u><u>\$404,649,467</u></u>

COMMENTS ON FINANCIAL STATEMENTS

ASSETS

Investments

Section 641.35(15)(a), F.S., provides, in part, that after satisfying the requirements of Part I of Chapter 641, F.S., any funds of an HMO in excess of its statutorily required reserves and surplus may be invested in such other investments not specifically authorized by that part, provided such investments do not exceed the lesser of 5% of its admitted assets or 25% of the amount by which its surplus exceeds its statutorily required minimum surplus. It further provides that an HMO may exceed these limitations with the prior written approval of the Office. On December 28, 2004, the Office approved the Company's request to be allowed to invest up to 8% of its admitted assets, excluding goodwill, under the provisions of the above statute.

Aggregate Write-Ins For Other Than Invested Assets

\$29,872,568

On August 7, 2001, the Office issued a consent order permitting the Company to admit certain goodwill resulting from acquisitions prior to January 1, 2001 in its statutory-basis financial statements, subject to the restrictions of Statement of Statutory Accounting Principles (SSAP) No. 68 and other terms and conditions. The consent order specifies that: goodwill generated by acquisitions and mergers occurring prior to January 1, 2001 shall not be considered an admitted asset for the purpose of calculating the Company's compliance with the minimum required capital and surplus requirements; the Company will maintain surplus at least equivalent to 20% of its total liabilities; and the Company's then-current monetary deposit will remain in effect. The consent order was subsequently renewed and will expire on March 15, 2007 unless renewed prior to then.

LIABILITIES**Claims, Reserves, and Related Obligations****\$187,016,335**

An outside actuarial firm appointed by the Board of Directors rendered an opinion that the amounts carried in the Company's balance sheet as of December 31, 2004 reasonably provided for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements. The Office actuary reviewed work papers provided by the Company and concurred with this opinion. Based on the results of the Office actuary's review and analysis of work papers and data provided by the Company, we concluded that the aggregate liability was not materially misstated.

Health Options, Inc.
Comparative Analysis of Changes in Capital and Surplus
December 31, 2004

The following is a reconciliation of total capital and surplus between that reported by the Company and as determined by the examination.

Capital & Surplus - December 31, 2004, per annual statement			\$404,649,467
	<u>Per Company</u>	<u>Per Exam</u>	<u>Increase (Decrease) in Surplus</u>
Assets	\$722,436,826	\$722,436,826	\$0
Liabilities	\$317,787,359	\$317,787,359	<u>\$0</u>
Net change in capital & surplus			<u>0</u>
Capital & Surplus - December 31, 2004, per examination			<u><u>\$404,649,467</u></u>

SUMMARY OF FINDINGS

COMPLIANCE WITH PREVIOUS DIRECTIVES

The prior examination report did not contain any significant adverse regulatory disclosures or findings related to the Company's solvency.

CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION

The current financial condition examination did not result in any material findings of non-compliance with statutes, rules, or other requirements on the part of the Company.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Health Options, Inc.** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's total capital and surplus was \$404,649,467, which was in compliance with Section 641.225, F.S.

In addition to the undersigned, M. Alison Miele, Financial Examiner/Analyst, David C. Schleit, CPA, Financial Examiner/Analyst Supervisor, Steven A. Steele, Financial Specialist, and Richard Tan, Actuary, participated in this examination.

Respectfully submitted,

Walter F. Banas, CIE
Financial Specialist
Florida Office of Insurance Regulation