

**Report on Examination**  
**of**  
**Aetna Health Inc.**  
**(a Florida corporation)**  
**Tampa, Florida**  
**as of**  
**December 31, 2004**

**By The**  
**State of Florida**  
**Office of Insurance Regulation**

## CONTENTS

SCOPE OF EXAMINATION .....	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION .....	2
HISTORY .....	3
GENERAL .....	3
CAPITAL STOCK .....	3
PROFITABILITY .....	4
DIVIDENDS .....	4
MANAGEMENT .....	4
CONFLICT OF INTEREST PROCEDURE .....	5
CORPORATE RECORDS .....	5
ACQUISITIONS AND MERGERS .....	6
AFFILIATED COMPANIES .....	7
MANAGEMENT AGREEMENT .....	7
TAX SHARING AGREEMENT .....	7
ORGANIZATIONAL CHART .....	8
FIDELITY BOND AND OTHER INSURANCE .....	9
PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS .....	9
STATUTORY DEPOSITS .....	9
INSURANCE PRODUCTS AND RELATED PRACTICES .....	10
TERRITORY AND PLAN OF OPERATION .....	10
TREATMENT OF MEMBERS .....	10
REINSURANCE .....	11
ACCOUNTS AND RECORDS .....	12
PROVIDER AND PHYSICIAN AGREEMENTS .....	12
INDEPENDENT AUDITOR AGREEMENT .....	12
CUSTODIAL AGREEMENT .....	12
FINANCIAL STATEMENTS PER EXAMINATION .....	13
ASSETS .....	14
LIABILITIES, CAPITAL AND SURPLUS .....	15
STATEMENT OF REVENUES AND EXPENSES .....	16
CAPITAL AND SURPLUS ACCOUNT .....	17
COMMENTS ON FINANCIAL STATEMENTS .....	18

COMPARATIVE ANALYSIS OF CHANGES IN CAPITAL AND SURPLUS .....	19
SUMMARY OF FINDINGS .....	20
COMPLIANCE WITH PREVIOUS DIRECTIVES .....	20
CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION .....	20
CONCLUSION .....	21

Tallahassee, Florida

April 17, 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:

**Aetna Health Inc. (a Florida corporation)  
4630 Woodlands Corporate Blvd.  
Tampa, Florida 33614**

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, 2001.

Planning for the current examination began on August 1, 2005. The fieldwork commenced on August 8, 2005 and concluded on February 3, 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 for the following accounts:

- Investment income due & accrued
- General expenses due or accrued
- Federal income tax payable
- Aggregate write-ins for other liabilities
- Amounts due to parent, subsidiaries and affiliates

### **STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION**

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2001, along with resulting action taken by the Company in connection therewith.

#### Management Agreement

The Company was in violation of Section 641.234(3), F.S., in that its management agreement with Aetna Health Management, Inc. did not provide that the agreement would be canceled upon issuance of an order by the Office. Resolution: The Company revised the agreement to comply with the provisions of Section 641.234(3), F.S.

#### Amounts Due From Parent, Subsidiaries and Affiliates

The Company incorrectly reported as admitted assets \$20.6 million and \$12.0 million due from affiliates Aetna Inc. and Aetna Health Management, Inc., respectively, in violation of Section 641.35(2)(i), F.S.

Resolution: The current examination did not result in similar findings. On February 15, 2002, the Company received from Aetna Inc. an infusion of capital consisting of \$33 million in cash.

## HISTORY

### GENERAL

The Company was incorporated in Florida on June 4, 1984 as “Physicians Health Plan of Florida, Inc.” Its name was changed on January 8, 1990 to “Partners Health Plan of Florida, Inc.”; on May 6, 1991 to “Aetna Health Plans of Florida, Inc.”; on April 10, 1997 to “Aetna U.S. Healthcare, Inc.”; and on February 14, 2002 to “Aetna Health Inc.”

The Company is 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	20,000
Number of shares issued and outstanding	10,906
Total common capital stock	\$1,091
Par value per share	\$0.10

At December 31, 2004, the Company was wholly-owned and controlled by Aetna Health Holdings, LLC, which in turn was wholly-owned by Aetna Inc. An abbreviated organizational chart appears on page 8.

## PROFITABILITY

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

(\$ Millions)	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net premiums	\$1,679.3	\$1,446.8	\$1,360.2
Total revenues	\$1,679.3	\$1,446.8	\$1,360.2
Net income (loss)	\$131.3	\$129.9	(\$40.2)
Total capital & surplus	\$225.5	\$187.5	\$44.0

## DIVIDENDS

The Company paid dividends in the amounts of \$115.1 million and \$14.3 million in 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

<b>Name and Location</b>	<b>Principal Occupation</b>
William E. Hauser, Jr., M.D. Alpharetta, Georgia	Senior Medical Director of the Company
Clarence C. King, II Dallas, Texas	President of the Company
Deborah M. Wightman Alpharetta, Georgia	Principal Financial Officer of the Company



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**

<b>Name</b>	<b>Title</b>
Clarence C. King, II	President
William E. Hauser, Jr. M.D.	Vice President & Senior Medical Director
Deborah M. Wightman	Principal Financial Officer
William C. Baskin, III	Vice President & Secretary
Russell P. Smith	Vice President & Treasurer
Willie F. Cobbin	Vice President - Operations
Gregory S. Martino	Vice President
James D. Weiss	Controller & Assistance Secretary
Kevin J. Casey	Senior Investment Officer
Alicia H. Bolton	Assistant Controller

**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 and Board of Directors 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.

## **ACQUISITIONS AND MERGERS**

On August 6, 1999, Aetna Inc. acquired Prudential Health Care Plan, Inc. ("Prudential"), an HMO domiciled in Texas with operations in Florida, as part of its acquisition of the group health business of The Prudential Insurance Company of America. In October 2000, Prudential members began transferring to the Company. This transfer was completed in April 2002. On July 1, 2002, Prudential and the Company entered into an agreement to transfer to the Company all Prudential liabilities arising out of or relating to Prudential's operation of an HMO in Florida. On January 6, 2003, Prudential voluntarily surrendered its Florida certificate of authority.

In 2002, ownership of the Company was transferred from Aetna Health Management, Inc. to an affiliate Aetna Health Management, LLC, (AHM) and on December 31, 2003 to another affiliate Aetna Health Holdings, LLC . However, control of the Company remained with its ultimate parent Aetna Inc.

## **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 March 31, 2005.

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

### **MANAGEMENT AGREEMENT**

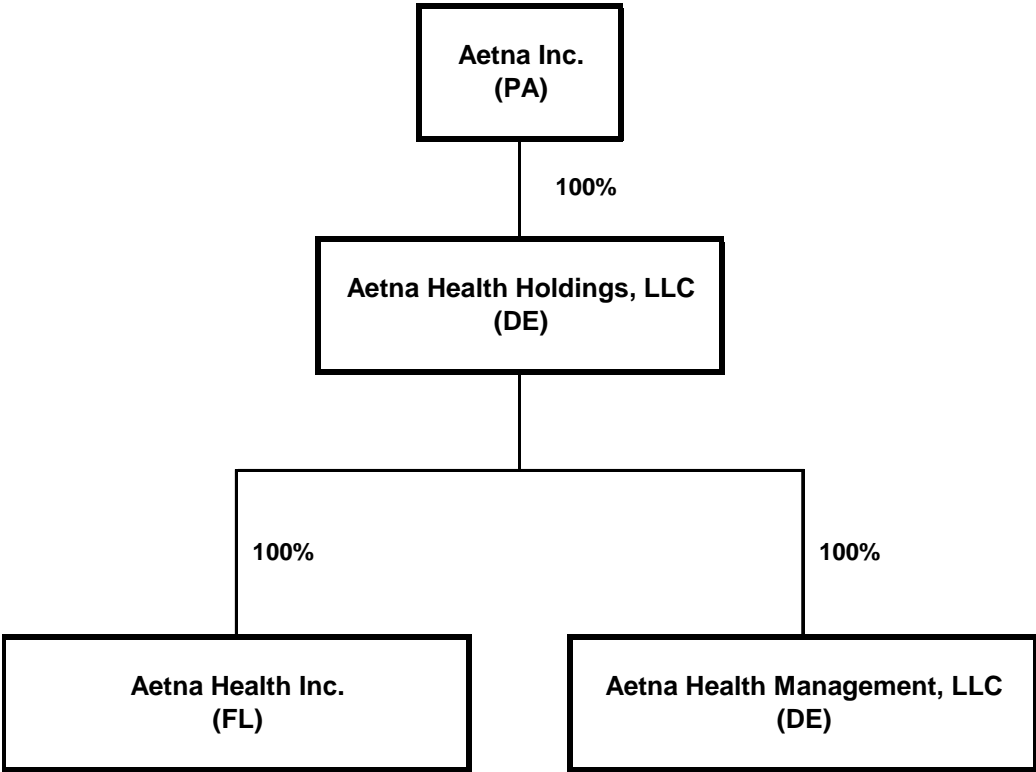
Pursuant to a management agreement with the Company, AHM provided substantially all management, marketing, financial, and administrative services to the Company, including accounting and processing of premiums and claims. Fees for these services amounted to \$218.9 million, \$195.1 million, and \$137.2 million in years 2004, 2003, and 2002, respectively. AHM is licensed in Florida as a third party administrator. Pursuant to the agreement, the Company received manufacturers' pharmacy rebates from AHM in the amounts of \$37.0 million, \$32.2 million, and \$31.3 million in years 2004, 2003, and 2002, respectively. Effective January 1, 2004, the Company remits 10% of its earned pharmacy rebates to AHM as a fee, which amounted to \$3.7 million in 2004.

### **TAX SHARING AGREEMENT**

The results of the Company's operations are included in the consolidated federal income tax return of Aetna Inc. pursuant to a tax sharing agreement. In accordance with the agreement, the Company's current federal income tax provisions are generally computed as if the Company filed a separate federal income tax return. Current income tax benefits, including those resulting from net operating losses, are recognized to the extent realized in the consolidated return.

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.

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



## **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained acceptable levels of general liability insurance as required by Rule 69O-191.069, F.A.C., and maintains a blanket fidelity bond in the amount of \$10 million, as required by Section 641.22, F.S. As an individual practice association (IPA) model HMO, as defined under Rule 69O-191.024, F.A.C., the Company maintained adequate professional liability insurance. In addition, it required in its provider contracts that its providers certify and maintain appropriate levels of medical malpractice insurance, or its equivalent, in compliance with Rule 69O-191.069, F.A.C.

## **PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS**

As a result of the management agreement discussed on page 7, the Company had no direct employees and, therefore, no employee benefit plans.

## **STATUTORY DEPOSITS**

The Company maintained on deposit with the Office an insolvency protection deposit of \$2.3 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 May 10, 2006.

The Company utilizes a network of 2,688 general agents and brokers, and operates as an individual practice association (IPA) model. It provides comprehensive health care services to members, which numbered 425,727 at December 31, 2004.

The Company operates in the Florida counties of Alachua, Baker, Brevard, Broward, Charlotte, Clay, Duval, Flagler, Hernando, Hillsborough, Indian River, Lake, Lee, Manatee, Marion, Martin, Miami-Dade, Nassau, Okeechobee, Orange, Osceola, Palm Beach, Pasco, Pinellas, Polk, Sarasota, Seminole, St. Johns, St. Lucie, and Volusia.

### **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.

## **REINSURANCE**

The Company entered into a specific excess of loss reinsurance agreement with Corporate Health Insurance Company, an authorized Florida insurer domiciled in Pennsylvania and a wholly-owned subsidiary of Aetna Inc., effective January 1, 2000. The agreement, which was filed with and approved by the Office, provides for the reimbursement of 100% of eligible paid losses in excess of \$500,000.

## **ACCOUNTS AND RECORDS**

An independent CPA audited the Company's statutory-basis financial statements annually for the 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 Tampa, Florida. A significant portion of its books and records are located in Blue Bell, Pennsylvania.

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

### **PROVIDER AND PHYSICIAN AGREEMENTS**

The Company contracted with various health care providers in order to procure health care services for its subscribers.

### **INDEPENDENT AUDITOR AGREEMENT**

The Company and its affiliates contracted with KPMG LLP to audit its financial statements during the examination period.

### **CUSTODIAL AGREEMENT**

The Company and its affiliates contracted with a financial institution to maintain custody of its investments. Under the agreement, the Company loaned certain securities to other institutions for short periods. The Company loaned securities with a fair value of approximately \$34.8 million, \$7.4 million, and \$23.1 million 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.

**Aetna Health Inc.**  
**Assets**  
**December 31, 2004**

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$385,127,352	\$0	\$385,127,352
Cash, cash equivalents, & short-term investments	<u>39,978,633</u>	<u>0</u>	<u>39,978,633</u>
	425,105,985	0	425,105,985
Investment income due & accrued	4,607,648	0	4,607,648
Uncollected premiums & agents' balances in the course of collection	<u>18,574,002</u>	<u>0</u>	<u>18,574,002</u>
Totals	<u><u>\$448,287,635</u></u>	<u><u>\$0</u></u>	<u><u>\$448,287,635</u></u>

**Aetna Health Inc.**  
**Liabilities, Capital and Surplus**  
**December 31, 2004**

<b>Liabilities</b>	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Claims unpaid	\$162,194,309	\$0	\$162,194,309
Unpaid claims adjustment expenses	3,936,127	0	3,936,127
Aggregate health policy reserves	30,380,272	0	30,380,272
Aggregate health claim reserves	7,164,819	0	7,164,819
Premiums received in advance	2,077,285	0	2,077,285
General expenses due or accrued	4,232,553	0	4,232,553
Current income tax payable	5,390,802	0	5,390,802
Ceded reinsurance premiums payable	388,004	0	388,004
Amounts due to parent, subsidiaries and affiliates	620,989	0	620,989
Payable for securities	6,172,130	0	6,172,130
Aggregate write-ins for other liabilities	<u>232,200</u>	<u>0</u>	<u>232,200</u>
Total liabilities	<u>222,789,490</u>	<u>0</u>	<u>222,789,490</u>
<b>Capital and Surplus</b>			
Common capital stock	1,091	0	1,091
Gross paid in and contributed surplus	168,437,300	0	168,437,300
Unassigned funds (surplus)	<u>57,059,754</u>	<u>0</u>	<u>57,059,754</u>
Total capital and surplus	<u>225,498,145</u>	<u>0</u>	<u>225,498,145</u>
Total liabilities, capital and surplus	<u><u>\$448,287,635</u></u>	<u><u>\$0</u></u>	<u><u>\$448,287,635</u></u>

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

Net premium income		\$1,679,265,653
Hospital/medical benefits	\$991,623,489	
Other professional services	25,769	
Outside referrals	48,035,786	
Emergency room and out-of-area	50,428,981	
Prescription drugs	<u>175,715,690</u>	
	1,265,829,715	
Net reinsurance recoveries	<u>6,710,560</u>	
Total hospital and medical	1,259,119,155	
Claims adjustment expenses	34,177,402	
General administrative expenses	206,436,208	
Increase in reserves for contracts	<u>(1,334,646)</u>	
Total underwriting deductions		<u>1,498,398,119</u>
Net underwriting gain		180,867,534
Net investment income earned	18,666,293	
Net realized capital gains	<u>1,211,633</u>	<u>19,877,926</u>
Net income before federal income taxes		200,745,460
Federal income taxes incurred		<u>69,463,561</u>
Net income		<u><u>\$131,281,899</u></u>

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

Capital and surplus, December 31, 2003		\$187,545,289
Net income	\$131,281,899	
Net unrealized capital gains and losses	(174,301)	
Change in net deferred income tax	(3,016,123)	
Change in nonadmitted assets	24,961,381	
Dividends to stockholders	<u>(115,100,000)</u>	
	37,952,856	
Examination adjustments	<u>0</u>	<u>37,952,856</u>
Capital and surplus, December 31, 2004		<u><u>\$225,498,145</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

**Losses and Loss Adjustment Expenses** **\$203,675,527**

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.

**Aetna Health 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.

<b>Capital &amp; Surplus - December 31, 2004, per annual statement</b>			<b>\$225,498,145</b>
	<u>Per Company</u>	<u>Per Exam</u>	<u>Increase (Decrease) in Surplus</u>
Assets	\$448,287,635	\$448,287,635	\$0
Liabilities	\$222,789,490	\$222,789,490	<u>\$0</u>
Net change in capital & surplus			<u>0</u>
<b>Capital &amp; Surplus - December 31, 2004, per examination</b>			<u><u>\$225,498,145</u></u>

## **SUMMARY OF FINDINGS**

### **COMPLIANCE WITH PREVIOUS DIRECTIVES**

The Company has taken the necessary actions to comply with the comments contained in the 2001 examination report issued by the Office.

### **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 **Aetna Health 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 \$225,498,145, which was in compliance with Section 641.225, F.S. Its required minimum capital and surplus at December 31, 2004 was \$33,585,313.

In addition to the undersigned, Russell K. Judge, Financial Examiner/Analyst, David C. Schleit, CPA, Financial Examiner/Analyst Supervisor, and Richard Tan, Actuary, participated in this examination.

Respectfully submitted,

---

Robert Y. Meszaros  
Financial Specialist  
Florida Office of Insurance Regulation