

Report on Examination
of
Health First Health Plans, Inc.
Rockledge, Florida
as of
December 31, 2005

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	5
CONFLICT OF INTEREST PROCEDURE.....	6
CORPORATE RECORDS	6
AFFILIATED COMPANIES.....	7
ADMINISTRATIVE AND FINANCIAL SERVICES AGREEMENT	7
TAX ALLOCATION AGREEMENT	7
THIRD PARTY ADMINISTRATOR AGREEMENT	7
LEASE AGREEMENT	8
ORGANIZATIONAL CHART	9
FIDELITY BOND AND OTHER INSURANCE.....	10
PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS.....	10
STATUTORY DEPOSITS.....	10
INSURANCE PRODUCTS AND RELATED PRACTICES	11
TERRITORY AND PLAN OF OPERATION.....	11
TREATMENT OF MEMBERS.....	11
REINSURANCE.....	11
ACCOUNTS AND RECORDS.....	12
INFORMATION SYSTEMS AGREEMENT	12
ADMINISTRATIVE SERVICES AGREEMENTS	12
INDEPENDENT AUDITOR AGREEMENT	12
ACTUARIAL CONSULTING AGREEMENT	13

FINANCIAL STATEMENTS PER EXAMINATION	14
ASSETS.....	15
LIABILITIES, CAPITAL AND SURPLUS	16
STATEMENT OF REVENUE AND EXPENSES	17
CAPITAL AND SURPLUS ACCOUNT	18
COMMENTS ON FINANCIAL STATEMENTS	19
COMPARATIVE ANALYSIS OF CHANGES IN CAPITAL & SURPLUS.....	20
SUMMARY OF FINDINGS	21
CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION	21
CONCLUSION.....	22

Tallahassee, Florida

June 25, 2007

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, 2005, of the financial condition and corporate affairs of:

Health First Health Plans, Inc.
6450 U.S. Highway 1
Rockledge, Florida 32955

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2003 through December 31, 2005. 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 January 22, 2007. The fieldwork commenced on January 29, 2007, and concluded on April 11, 2007. 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 certified public accountant (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 2005 annual statement. Transactions subsequent to December 31, 2005 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:

- Amounts receivable relating to uninsured plans
- Aggregate write-ins for other than invested assets
- Contingencies and commitments
- Amounts withheld or retained for the account of others
- Aggregate write-ins for other liabilities

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.

Components of Equity

In its 2001 annual statement, the Company incorrectly reported the components of its equity, shareholder dividends, and unrealized investment gains and losses. Upon examination, "unassigned funds" was decreased in the amount of \$8,124,763, "gross paid in and contributed surplus" was increased in the amount of \$7,100,000, and "aggregate write-ins for other surplus funds" was increased in the amount of \$1,024,763. As reported on page 19, the current examination resulted in a reclassification of the components of the Company's equity, as well.

HISTORY

GENERAL

The Company was incorporated in Florida on May 22, 1995, and commenced business on January 1, 1996.

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. , and as an insurance administrator pursuant to Part VII of Chapter 626, F.S.

The Company's bylaws were amended on January 17, 2005.

CAPITAL STOCK

As of December 31, 2005, the Company's capitalization was as follows:

Number of authorized common capital shares	2,000,000
Number of shares issued and outstanding	2,000,000
Total common capital stock	\$10,000
Par value per share	\$0.005

At December 31, 2005, the Company (a Florida for-profit corporation) was wholly-owned and controlled by Health First Holding Corp. (a Florida for-profit corporation) which in turn was wholly-owned by Health First, Inc. (HFI) (a Florida non-profit corporation). An abbreviated organizational chart appears on page 9.

PROFITABILITY

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Year-end enrollment	52,351	49,065	58,271
In millions:			
Net premium income	\$261.0	\$231.1	\$208.9
Total revenues	\$261.0	\$234.4	\$211.1
Net income (loss)	(\$0.1)	\$9.3	\$3.4
Total capital & surplus	\$14.4	\$21.4	\$14.7

DIVIDENDS

The Company paid shareholder dividends in the amounts of \$257,083, \$3,426,714, and \$9,338,258 during years 2003, 2004, and 2005, respectively.

MANAGEMENT

The annual shareholder meeting for the election of directors was held in accordance with Section 607.0701, F.S. Directors serving as of December 31, 2005 were:

Directors

Name and Location	Principal Occupation
Andrew M. Atkinson, M.D. Melbourne Beach, Florida	Physician
Richard N. Baney, Jr., M.D. Indialantic, Florida	Physician
William T. Brennan Indialantic, Florida	Chief Executive Officer & President of The Bank Brevard
Robert C. Galloway Indialantic, Florida	Chief Financial Officer & Sr. Vice President of Health First, Inc.
Larry F. Garrison Cocoa Beach, Florida	Chief Operating Officer & Executive Vice President of Health First, Inc.
Rodney S. Ketcham Cocoa Beach, Florida	Real estate developer and Chairman of the Company's Board of Directors
Rosemary D. Laird, M.D. Melbourne, Florida	Physician
Richard M. Levine, M.D. Titusville, Florida	Physician
Michael D. Means Indian Harbour Beach, Florida	Chief Executive Officer & President of Health First, Inc.
Nicholas E. Pellegrino Cocoa Beach, Florida	President of Cody & Associates, Inc.
Jerry Senne Winter Park, Florida	Chief Executive Officer of the Company
Basil C. Theodotou, M.D. Merritt Island, Florida	Physician

The following were the Company's senior officers as of December 31, 2005, as appointed by its board of directors in accordance with the Company's bylaws:

Senior Officers

Name	Title
Jerry Senne	Chief Executive Officer & Secretary
Margaret A. Haney	Chief Operating Officer & President
Robert C. Galloway	Treasurer
David E. Mathias	Assistant Secretary
Michael P. Connolly	Vice President of Finance
Betty L. Kennard	Vice President of Operations & Compliance
Angela D. Handa	Vice President of Sales & Marketing
Joseph L. Collins, M.D.	Vice President & Medical Director
Peter J. Weiss, M.D.	Vice President & Medical Director
Bonnie J. Rudolph	Vice President of Medical Management

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 the 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. A review of the prior report of examination by the Office was documented in the September 2002 minutes of the Board.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), 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 April 3, 2006.

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

ADMINISTRATIVE AND FINANCIAL SERVICES AGREEMENT

HFI provided administrative and financial services to the Company pursuant to an agreement effective January 1, 1996, in return for monthly fees based on pro rata costs incurred. Fees paid pursuant to the agreement amounted to \$1.8 million, \$2.2 million, and \$2.5 million in years 2003, 2004, and 2005, respectively.

TAX ALLOCATION AGREEMENT

The results of the Company's operations were included in the consolidated federal income tax return of Health First Holding Corp. pursuant to a tax sharing agreement dated December 29, 2000, as amended on June 19, 2002. The income tax liability of the consolidated group was allocated to its members on a pro rata basis according to each member's separate return tax liability. Settlement of tax liabilities was required within 30 days after the filing of the consolidated tax return.

THIRD PARTY ADMINISTRATOR AGREEMENT

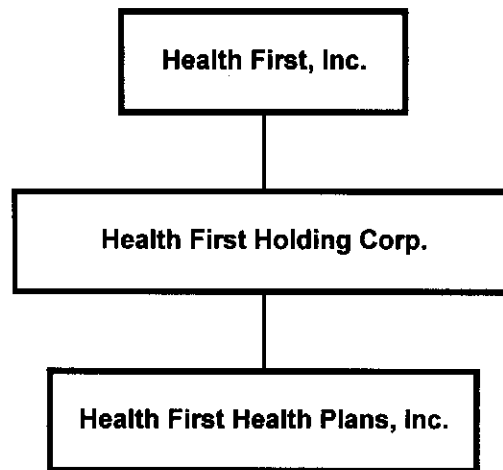
The Company provided claims processing and claims administration services to HFI pursuant to an agreement effective January 1, 2004. Fees received for these services amounted to \$918,358 and \$948,000 in years 2004 and 2005, respectively.

LEASE AGREEMENT

The Company leased a portion of its headquarters to HFI for a 20-year term pursuant to a September 17, 2002 agreement. Expenses are allocated to HFI on a pro rata basis, and payments are collected monthly. Rental income in the amounts of \$273,000, \$305,000, and \$288,314, was earned by the Company in years 2003, 2004, and 2005, respectively.

An abbreviated organizational chart as of December 31, 2005 reflecting the holding company system is shown below. Schedule Y of the Company's 2005 annual statement provided the names of all related companies in the holding company group.

**Health First Health Plans, Inc.
Organizational Chart
December 31, 2005**



FIDELITY BOND AND OTHER INSURANCE

The Company maintained acceptable levels of general and medical professional liability insurance in accordance with Rule 69O-191.069, F.A.C., and maintained a blanket fidelity bond in the amount of \$1 million in accordance with Section 641.22(7), F.S. As an individual practice association (IPA) model HMO, the Company maintained adequate professional liability insurance. It required in its provider contracts that its providers certify and maintain appropriate levels of medical malpractice insurance or its equivalent in accordance with Rule 69O-191.069, F.A.C.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company offered to eligible employees participation in benefits that included health insurance, dental insurance, educational assistance, paid leave, a 401(k) retirement plan, and an HFI defined contribution profit sharing plan.

STATUTORY DEPOSITS

The Company maintained on deposit with the Office an insolvency protection deposit of \$2,535,290 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, 2005, the Company was authorized to transact business in Florida as an HMO in accordance with Part I of Chapter 641, F.S. It held 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 November 27, 2007.

The Company utilized a network of general agents, brokers, and employees for marketing. It operated as an IPA model HMO and provided health care services to comprehensive and Medicare members. Its total membership at December 31, 2005 was 52,351, of which 62% was Medicare.

The Company operated in the Florida counties of Brevard and Indian River.

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 maintained stop-loss reinsurance coverage with Employers Reinsurance Corporation. The reinsurance agreement was reviewed and found to comply with NAIC standards with respect to the standard insolvency and arbitration clauses, transfer of risk, and reporting and settlement information deadlines.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory-basis financial statements annually for years 2003, 2004, and 2005, 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 was located in Rockledge, Florida, where this examination was conducted.

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

INFORMATION SYSTEMS AGREEMENT

Synertech Health Systems Solutions, Inc. provided health care software systems to the Company pursuant to a February 1, 2001 agreement. Fees related to the agreement were \$1.3 million, \$1.3 million, and \$1.6 million in years 2003, 2004, and 2005, respectively.

ADMINISTRATIVE SERVICES AGREEMENTS

The Company provided claims processing and administrative services to certain local governmental entities pursuant to administrative services agreements. Fees received for these services amounted to \$1.9 million, \$2.1 million, and \$2.3 million in years 2003, 2004, and 2005, respectively.

INDEPENDENT AUDITOR AGREEMENT

The Company contracted with Ernst & Young LLP to conduct annual audits of the Company's statutory-basis financial statements. Fees related to this agreement were \$42,000, \$44,100, and \$46,300 for years 2003, 2004, and 2005, respectively.

ACTUARIAL CONSULTING AGREEMENT

On March 31, 2005, the Company contracted with an independent actuarial firm, Wakely Actuarial Services, Inc., to provide general actuarial support services to the Company. Fees related to this agreement were \$83,418 in year 2005.

FINANCIAL STATEMENTS PER EXAMINATION

The following four pages contain statements of the Company's financial position at December 31, 2005, as determined by this examination, and the results of its operations for the year then ended as reported by the Company.

Health First Health Plans, Inc.
Assets
December 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$22,258,525	\$0	\$22,258,525
Properties occupied by the company	4,869,625	0	4,869,625
Cash, cash equivalents, and short-term investments	<u>10,711,059</u>	<u>0</u>	<u>10,711,059</u>
	37,839,209	0	37,839,209
Investment income due and accrued	185,781	0	185,781
Uncollected premiums and agents' balances	1,505,275	0	1,505,275
Amounts recoverable from reinsurers	94,466	0	94,466
Amounts receivable relating to uninsured plans	37,052	0	37,052
Current federal income tax recoverable	19,373	0	19,373
Net deferred tax asset	1,766,947	0	1,766,947
Health care and other amounts receivable	300,000	0	300,000
Aggregate write-ins for other than invested assets	<u>32,360</u>	<u>0</u>	<u>32,360</u>
Total	<u><u>\$41,780,463</u></u>	<u><u>\$0</u></u>	<u><u>\$41,780,463</u></u>

Health First Health Plans, Inc.
Liabilities, Capital and Surplus
December 31, 2005

	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$19,184,411	\$0	\$19,184,411
Unpaid claims adjustment expenses	347,226	0	347,226
Premiums received in advance	3,573,069	0	3,573,069
General expenses due or accrued	1,540,222	0	1,540,222
Amounts withheld or retained for the account of others	117,742	0	117,742
Amounts due to parent, subsidiaries and affiliates	2,522,849	0	2,522,849
Aggregate write-ins for other liabilities	120,488	0	120,488
Total liabilities	<u>27,406,007</u>	<u>0</u>	<u>27,406,007</u>
Common capital stock	10,000	0	10,000
Gross paid in and contributed surplus	3,707,879	15,471,114	19,178,993
Unassigned funds	<u>10,656,577</u>	<u>(15,471,114)</u>	<u>(4,814,537)</u>
Total capital and surplus	<u>14,374,456</u>	<u>0</u>	<u>14,374,456</u>
Total liabilities, capital and surplus	<u>\$41,780,463</u>	<u>\$0</u>	<u>\$41,780,463</u>

Health First Health Plans, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2005

Net premium income		\$260,991,653
Hospital/medical benefits	\$180,793,396	
Other professional services	16,253,474	
Emergency room and out-of-area	18,875,802	
Prescription drugs	<u>24,003,614</u>	
	239,926,286	
Net reinsurance recoveries	<u>239,213</u>	
Total hospital and medical	239,687,073	
Claims adjustment expenses	5,321,277	
General administrative expenses	<u>17,127,879</u>	
Total underwriting deductions		<u>262,136,229</u>
Net underwriting gain (loss)		(1,144,576)
Net investment income earned	1,883,323	
Net realized capital gains (losses)	<u>(278,087)</u>	<u>1,605,236</u>
Net income before federal income taxes		460,660
Federal income taxes incurred		<u>605,299</u>
Net income (loss)		<u><u>(\$144,639)</u></u>

Health First Health Plans, Inc.
Capital and Surplus Account
For the Year Ended December 31, 2005

Capital and surplus, December 31, 2004	\$21,396,807
Net income	(144,639)
Change in net deferred income tax	943,124
Change in nonadmitted assets	1,787,889
Dividends to stockholders	(9,338,258)
Aggregate write-ins for gains or (losses) in surplus	<u>(270,467)</u>
	14,374,456
Examination adjustments	<u>0</u>
Capital and surplus, December 31, 2005	<u><u>\$14,374,456</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Bonds **\$22,258,525**

Statement of Statutory Accounting Principles (SSAP) No. 26 establishes statutory accounting principles for bonds, excluding loan-backed and structured securities. During 2005, the Company determined that errors had occurred in accounting for certain of its bond transactions and that its accounting for the transactions was not in accordance with SSAP No. 26, and corrected those errors. During this examination, examiners encountered additional errors in accounting for the Company's bond transactions. Because the amount reported by the Company as bonds in its 2005 annual statement was not materially misstated, no examination adjustments were necessary.

Losses and Loss Adjustment Expenses **\$19,531,637**

The Company's appointed actuary rendered an opinion that the amounts carried in the Company's balance sheet as of December 31, 2005 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.

Gross Paid In and Contributed Surplus **\$19,178,993**
Unassigned Funds **\$(4,814,537)**

In its 2005 annual statement, the Company incorrectly reported the components of its equity. As a result, "gross paid in and contributed surplus" has been increased by \$15,471,114, and "unassigned funds" has been decreased by the same amount. As reported on page 2, the Company incorrectly reported the components of its equity in its 2001 annual statement, as well.

Health First Health Plans, Inc.
Comparative Analysis of Changes in Capital & Surplus
December 31, 2005

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

	<u>Per Company</u>	<u>Per Exam</u>	<u>Increase (Decrease) in Surplus</u>	
Capital & Surplus - December 31, 2005, per annual statement				\$14,374,456
Assets	\$41,780,463	\$41,780,463	\$0	
Liabilities	\$27,406,007	\$27,406,007	<u>\$0</u>	
Net change in capital & surplus				<u>0</u>
Capital & Surplus - December 31, 2005, per examination				<u><u>\$14,374,456</u></u>

SUMMARY OF FINDINGS

CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2005.

Bonds

As reported on page 19, the Company determined that errors had occurred in accounting for certain of its bond transactions and that its accounting for the transactions was not in accordance with SSAP No. 26, and corrected those errors. During this examination, examiners encountered additional errors in accounting for the Company's bond transactions. Because the amount reported by the Company as bonds in its 2005 annual statement was not materially misstated, no examination adjustments were necessary. **We recommend that the Company comply with SSAP No. 26, which establishes statutory accounting principles for bonds, excluding loan-backed and structured securities.**

Components of Equity

As reported on page 19, the Company incorrectly reported the components of its equity in its 2005 annual statement. As a result, "gross paid in and contributed surplus" has been increased by \$15,471,114, and "unassigned funds" has been decreased by the same amount. As reported on page 2, the Company incorrectly reported the components of its equity in its 2001 annual statement, as well. **We recommend that the Company correctly report the components of its equity in its annual statements in accordance with the NAIC *Annual Statement Instructions*.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Health First Health Plans, Inc.** as of December 31, 2005, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's total capital and surplus was \$14,374,456, which was in compliance with Section 641.225, F.S. Its required minimum capital and surplus at December 31, 2005 was \$5,219,833.

In addition to the undersigned, the following participated in this examination: Christine N. Afolabi, Financial Examiner/Analyst; M. Alison Miele, Financial Examiner/Analyst; David C. Schleit, Financial Examiner/Analyst Supervisor; and Richard Tan, Actuary.

Respectfully submitted,

Robert Y. Meszaros, Financial Specialist
Florida Office of Insurance Regulation