REPORT ON EXAMINATION

OF

HEALTH NET INSURANCE OF NEW YORK, INC.

AS OF

SEPTEMBER 30, 2003

DATE OF REPORT: **JANUARY 30, 2007**

EXAMINER: **PEARSON GRIFFITH**

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

Eliot Spitzer
Governor

Eric R. Dinallo
Acting Superintendent

January 30, 2007

Honorable Eric R. Dinallo
Acting Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and acting in accordance with directions contained in Appointment Number 22106 dated November 6th 2003, and annexed hereto, I have made an examination into the condition and affairs of Health Net Insurance of New York, Inc. (HNINY), an accident and health insurer domiciled in the State of New York, licensed pursuant to Article 42 of the New York Insurance Law. During the examination, the Company's statutory home office was located at 399 Knollwood Road, White Plains, New York 10603. However, the Company notified the Department on July 19, 2006 that such office was relocated to 150 East 42nd Street, New York, New York 10017. The primary location of the Company's books and records is 21650 Oxnard Street, Woodland Hills, California 91367. This examination was conducted at the Company's administrative office located at One Far Mill Crossing, Shelton, Connecticut 06484. The following report thereon as respectfully submitted deals with the findings concerning the manner in which HNINY conducts its business practices and fulfills its contractual obligations to policyholders and claimants.

Whenever the terms "Health Net Insurance", "Company" or "HNINY" appear herein without qualification, they should be understood to mean Health Net Insurance of New York, Inc. The term "Department" as used in this report refers to the New York State Insurance Department.

1. SCOPE OF EXAMINATION

The Company was previously examined as of December 31, 1998. This examination covers the period from January 1, 1999 through September 30, 2003. Where deemed appropriate by the examiners, transactions subsequent to the examination date were reviewed.

The examination comprised a complete verification of assets and liabilities as of September 30, 2003, in accordance with statutory accounting principles (SAP). The examination included a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

History of Company
Management and controls
Corporate records
Fidelity bonds and other insurance
Employees welfare and pension plans
Territory and plan of operation
Growth of Company
Business in force
Loss experience
Accounts and records
Market conduct activities

This report on examination is confined to the financial statements, and comments on those matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was originally licensed by the Department on December 3, 1990, as Citicorp International Trade Insurance, Inc. (CITI) and commenced operations on April 2, 1991, as a domestic property and casualty insurer, domiciled in the State of New York. On April 12, 1996, Physicians Health Services, Inc. acquired CITI from Citicorp International Trade Indemnity Inc., a subsidiary of Citicorp and changed the name to Physician Health Services Insurance of New York, Inc. In 1999 the Company began its first full active year in operation as a mono-line accident and health insurer.

On July 25, 2000, the board of directors of Physician Health Services Insurance of New York, Inc. executed an Adoption of the Certificate of Charter Amendment, to convert from an Article 41 insurance company to an Article 42 duly authorized to conduct the business of insurance in the State of New York. This amendment also deleted "Credit insurance," "Marine and inland marine insurance," and "Substantially similar kind of insurance" from the risks the Company was empowered to transact. HNINY is now licensed to transact "accident and health insurance" as defined in paragraph 3(i) of Section 1113(a) of the New York Insurance Law.

On December 17, 2001, the Department approved the amendment of the Company's Certificate of Incorporation to change its name to Health Net Insurance of New York, Inc.

HNINY's authorized, issued and outstanding capital consists of 1,000 shares of $1,000 par value common stock. The Company has no preferred capital stock issued or outstanding. The minimum capital and surplus is set at $2,050,000, pursuant to Section 4103(a)(1) of the New

York Insurance Law.

A. Management and controls

The charter and by-laws of the Company provide that the corporate powers be exercised by a board of directors through officers or committees elected or appointed by the board. The number of directors as of the examination date has been set at not less than thirteen (13) or more than twenty-one (21) directors.

The board of directors of Health Net Insurance of New York, Inc. met twelve (12) times during the period covered by this examination. A review of the minutes of the meetings of the board of directors revealed that meetings were adequately attended.

As of September 30, 2003, the board of directors consisted of the following ten (10) members:

Name and Residence	Principal Business Affiliation
Scott Breidbart, MD Mount Kisco, NY	Medical Director, Health Net Northeast, Inc.
John Caby Denville, NJ	Director of Finance Health Net, Inc.
Stephen Camper West Hartford, CT	Assistant Secretary, Health Net Insurance of New York, Inc.
Joseph Chiarella, MD Jackson Heights, NY	Medical Director, Health Net Northeast, Inc.
Pennell Hamilton Woodridge, CT	Treasurer Health Net Insurance of New York, Inc.

Name and Residence	Principal Business Affiliation
Joseph Kempf, Jr. Newtown, CT	Secretary, Health Net Insurance of New York, Inc.
Helane Mandelker New York, NY	Director of Care Management Health Net Northeast, Inc.
Susan Merola-Aylward Shelton, CT	Director of Finance Health Net of Northeast, Inc.
Daniel Sauer Towaco, NJ	Regional Vice President, Health Net Northeast, Inc.
Anju Sikka MD North Brunswick, NJ.	Vice President Health Net Insurance of New York, Inc.

A review of the jurat page of the filed September 30, 2003 quarterly statement revealed that the Company's board of directors consisted of only nine members. A review of the minutes of meetings held during the examination period indicated that the Company, in fact, had ten members on its board of directors as of September 30, 2003. This condition conflicts with its own by-laws and violates Section 1201 (a)(5)(B)(v) of the New York Insurance Law which states in part:

> *"the number of directors, or that it shall be not less than a stated minimum nor more than a stated maximum. Except as provided in section six thousand four hundred two of this chapter the number of directors shall not be less than thirteen…"*

It is imperative that the Company seek to fill vacancies of its board of directors in a timely manner in order to be in compliance with its by-laws and Section 1201 (a)(5)(B)(v) of the New York Insurance Law. It was noted that a similar recommendation was made in the prior report on examination. The Company in its actions taken or proposed as regards the prior report on examination represented that *"[It] has been in full compliance with the above New York Insurance Law…"*

In addition, Section 307(a)(2) of the New York Insurance Law states in part:

> *"The superintendent shall from time to time prescribe the form of such annual statement, which may be a printed document and/or electronic media, and which may be varied as to different types of insurers, corporations, societies, pension funds and retirement systems, as shall seem to him best adapted to elicit a true exhibit of the condition of each such entity, in respect to every matter which he may deem material…"*

It is recommended that the Company comply with the provisions of its by-laws and the provisions of Section 1201(a)(5)(B)(v) of the New York Insurance Law by maintaining the requisite number of members of the board of directors.

It is also recommended that the Company exercise prudence by reporting an accurate schedule of directors in its statements filed with the Department pursuant to Section 307(a)(2) of the New York Insurance Law.

Subsequent to the examination date on October 30, 2003, the Company appointed three new directors to fill the vacancies on its board of directors.

As of the September 30, 2003, the principal officers of the Company were as follows:

Name	Title
Vacant	President
Anju Sikka, MD	Vice President
John Kempf, Jr.	Secretary
Pennell Hamilton	Treasurer

On October 30, 2003, subsequent to the examination date, the position of President was filled by Eileen Auen.

B. Territory and Plan of Operation

The Company is licensed in New York to write accident and health insurance as defined in paragraph 3(i) of Section 1113(a) of the New York Insurance Law.

HNINY offers accident and health insurance products via two general methods: (i) as an out-of-network companion coverage offered as part of a single point-of-service (POS) product in conjunction with its licensed affiliate, Health Net of New York, Inc. and (ii) as a stand-alone preferred provider organization group contract (PPO) and as an exclusive provider organization (EPO.)

The following schedule shows direct premiums written in the State of New York for the examination period:

Year	Direct premiums written
1999	$ 19,376,912
2000	115,322,501
2001	144,023,374
2002	178,243,330
2003 ytd	157,580,310

As of September 30, 2003, HNINY provided health care services to 62,580 members. The following chart shows the member increase by number and percentage:

	1999	2000	2001	2002	2003 ytd
Members	93	45,938	54,741	55,866	62,580
Growth %		*	19.2%	2.1%	12.0%

* - Not measured as result is deemed not meaningful.

C. Holding Company System

The Company is a wholly owned subsidiary of Health Net of Northeast, Inc. (formerly known as Physicians Health Services, Inc.,) which is itself a wholly owned subsidiary of Health Net Inc. (formerly known as Foundation Health Systems, Inc.) Registration statements were filed pursuant to the provisions of Article 15 of the New York Insurance Law and Department Regulation 52, (11 NYCRR 80-1.)

The following is a chart of the Company's holding company system as of September 30, 2003:

As of 9/30/03

Health Net, Inc. (DE)

95-4288333

(All Subsidiaries wholly owned unless otherwise indicated)

- **Health Net of California, Inc. (CA)** 95-4402957 933-0300
  - **Health Net Life Insurance Company (CA)** 73-0654885 66141
- **Health Net of the Northeast, Inc. (DE)** 06-1116976
  - **Physicians Health Services (Bermuda) Ltd. (Bermuda)** 98-0153069
  - **Health Net of Connecticut, Inc. (CT)** 06-1084283 95968
  - **Health Net of New York, Inc. (NY)** 06-1174953 95305
  - **Health Net Insurance of New York, Inc. (NY)** 13-3584296 43893
  - **Health Net Insurance Services, Inc. (CT)** 06-1254380
  - **Health Net Insurance of Connecticut, Inc. (CT)** 06-1434898 10360
  - **PHS Real Estate, Inc. (DE)** 06-1467640
    - > **PHS RealEstate II, Inc. (DE)** 06-1459019
- **Questium, Inc. (DE)** 68-0443608
  - **FOHP, Inc. (NJ)** 22-3314813
    - > **Health Net of New Jersey, Inc. (NJ)** 22-3241303 95351
    - > **First Option Health Plan of Pennsylvania, Inc. (PA)** 52-1935749
    - > **FOHP Agency, Inc. (NJ)** 22-3409934
- **QualMed, Inc. (DE)** 84-1175468
  - **QualMed Plans for Health of Colorado, Inc. (CO)** 84-0975985 95775
  - **Health Net Health Plan of Oregon, Inc. (OR)** 93-1004034 95800
- **HSI Eastern Holdings, Inc. (PA)** 23-2424663
  - **Greater Atlantic Health Service, Inc. (DE)** 23-2632680
    - > **Health Net of Pennsylvania Inc.(PA)** 23-2348627 95079
    - > **Greater Atlantic Preferred Plus, Inc. (PA)** 23-2665783
    - > **Employ Better Care, Inc. (PA)** 23-2697017
- **HSI Advantage Health Holdings, Inc. (DE)** 23-2867299
  - **QualMed Plans for Health of Ohio and West Virginia, Inc. (OH)** 25-1803681 95687
  - **QualMed Plans for Health of Western Pennsylvania, Inc. (PA)** 23-2867300 95010
  - **Pennsylvania Health Care Plan, Inc. (PA)** 25-1516632
- **National Pharmacy Services, Inc. (DE)** 84-1301249
  - **Integrated Pharmacy Systems, Inc. (PA)** 1 23-2789453
- **QualMed Plans for Health of Pennsylvania, Inc. (PA)** 23-2456130 95102
- **FH Assurance Company (Cayman Islands)** 98-0150604
- **Health Net Vision, Inc. (CA)** 77-0067022
- **Health Net Dental, Inc. (CA)** 94-2197624
- **FH-Arizona Surgery Centers, Inc. (AZ)** 86-0836312
- **FH Surgery Limited, Inc. (CA)** 68-0390434
- **FH Surgery Centers, Inc. (CA)** 68-0390435
- **Foundation Health Facilities, Inc. (CA)** 68-0390438
- **Foundation Health Warehouse Company (CA)** 68-0357852
- **Greater Sacramento Surgery Center Limited Partnership (CA)** 2 **68-0343818**
- **Managed Alternative Care, Inc. (CA)** 95-4205929
  - **American VitalCare, Inc. (CA)** 22-2646452
  - **Health Net Pharmaceutical Services (CA)** 68-0295375
  - **Intercare, Inc. (AZ)** 86-0660443
  - **Health Net of Arizona, Inc. (AZ)** 36-3097810 95206
  - **Health Net Federal Services, Inc. (DE)** 68-0214809
    - **Health Net Federal Services of Hawaii, Inc. (HI)** 99-0240224
  - **Gem Holding Corporation (UT)** 87-0445881
    - **Gem Insurance Company (UT)** 87-0451573 81698
- **Managed Health Network, Inc. (DE)** 95-4117722
  - **Health Management Center, Inc. (MA) 04-2742159**
  - **Health Management Center, Inc. of Wisconsin (WI)** 39-1528989
  - **Managed Health Network (CA)** 95-3817988
  - **MHN Reinsurance Company of Arizona (AZ)** 95-4361727 89429
  - **MHN Services (CA)** 95-4146179
    - > **MHN Services IPA, Inc. (NY)** 13-4027559
- **East Los Angeles Doctors Hospital, Inc. (CA)** 95-3275451
  - **Memorial Hospital of Gardena, Inc. (CA)** 33-0466850
  - **Health Net Employer Services, Inc. (CA)** 33-0854987
    - **Health Net Plus Managed Care Services, Inc. (CA)** 68-0303353
    - **Health Net Services, Inc. (DE)** 94-3037822
    - **Health Net CompAmerica, Inc. (DE)** 52-2355612

1- National Pharmacy Services, Inc. owns approximately 90% of the outstanding common stock.

2- FH Surgery Centers, Inc. and FH Surgery Limited, Inc. own general and limited partnership units, respectively, representing slightly over 50% of the total equity of Greater Sacramento Surgery Center Limited Partnership (which specific percentage fluctuates from time to time)

D. Administrative Service Agreement

During the period under examination, HNINY operated under three different Administrative Service Agreements, only one of which was approved by the Department. During the period January 1, 1999 to December 31 2000, the Company utilized an agreement with an effective date of January 1, 1996 referred to as "the 1996 Agreement." An examination review of this agreement indicated that it was approved by the Insurance Department on February 5, 1996.

During the period January 1, 2001 to December 31 2002, the Company utilized an agreement that was entered into with Health Net of Northeast, Inc. (HNNE), its immediate parent, effective January 1, 2001. HNINY did not seek or obtain the prior approval of the Department for this agreement.

Since January 1, 2003 to present, the Company has been operating under a second agreement that was entered into with HNNE. This agreement was submitted to the Department in December 2003.

The Department's initial review of the Administrative Service Agreement as submitted in December 2003 indicated that the proposed method of allocating selling, general and administrative expenses was not fair and equitable to the Company in accordance with the provisions of Section 1505(a) of the New York Insurance Law. The agreement originally submitted and put into use by the Company, employed *"cost drivers"* as the basis for allocating actual costs. These costs were accumulated in separate cost centers maintained by Health Net, Inc. (the Ultimate Parent), and each region or business unit (Health Net of the Northeast, Inc.).

The corporate cost centers consisted of all corporate expenses, information technology, organizational effectiveness, facilities, finance, health plan operations, pharmacy, facilities distribution services, and business consolidation. The corporate overhead was then allocated to each region or business unit on a pro rata basis with further allocation to each legal entity. Health Net of the Northeast, Inc. maintained approximately 150 such cost centers.

The *"cost drivers"* utilized by HNINY included premium revenue, claims volume, health care costs and membership. The proposed cost allocation method also provided for the weighting of these *"drivers"* by splitting cost centers and/or by applying a unique combination of factors arrayed by entity, segment, product, funding, and State, if necessary. Section 1505(a) of the New York Insurance Law states:

> *"Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:*
>
> *(1) the terms shall be fair and equitable;*
> *(2) charges or fees for services performed shall be reasonable; and*
> *(3) expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied."*

The Company was notified of the Department's concerns that the allocation methodology set forth in the Administrative Services Agreement did not comply with the provisions of Section 1505(a) of the New York Insurance Law. In addition, the Company's use of premium revenue, claims volume, and health care costs as the basis for allocating expenses was not fair and equitable. In addition, the Department stated that the provisions of the agreement should explicitly delineate the services that Health Net, Inc. and Health Net of the Northeast would provide each New York Company. The Department further stated that the agreement should indicate that each company will directly reimburse Health Net, Inc. and HNNE for services

provided.

Over the course of the twenty months since the agreement was first submitted to the Department, the Company provided several modifications and clarifications of its terms and conditions. As of the date of this report, the agreement has not been approved by the Department.

Notwithstanding the fact that the Company submitted the Administrative Services Agreement in December 2003, it has continued to employ this agreement in violation of Sections 1505(c) and (d) of the New York Insurance Law. Section 1505(c) states:

> *"The superintendent's prior approval shall be required for the following transactions between a domestic controlled insurer and any person in its holding company system: sales, purchases, exchanges, loans or extensions of credit, or investments, involving five percent or more of the insurer's admitted assets at last year-end.*

In addition, Section 1505(d) states:

> *"The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period:*
>
> *(1) sales, purchases, exchanges, loans or extensions of credit, or investments, involving more than one-half of one percent but less than five percent of the insurer's admitted assets at last year-end;*
> *(2) reinsurance treaties or agreements;*
> *(3) rendering of services on a regular or systematic basis; or*
> *(4) any material transaction, specified by regulation, which the superintendent determines may adversely affect the interests of the insurer's policyholders or shareholders."*

It was noted that except for 1999, the rendering of administrative services in the aggregate exceeded the five percent threshold of the Company's admitted assets at the prior year-ends as detailed in the table shown below:

1999	2000	2001	2002	9/30/03

Administrative Expenses	$ 0	$ 7,932,205	$ 15,661,899	$ 22,668,462	$ 15,923,016
Admitted Assets	21,331,257	45,892,593	54,719,518	67,220,391	85,813,976
5% of Admitted Assets	1,066,563	2,294,630	2,735,976	3,361,020	4,290,699

It is recommended that HNINY comply with the provisions of Section 1505(a) of the New York Insurance Law by ensuring that the terms of the financial transactions of its Administrative Service Agreement are fair and equitable at the time of the transactions, charges or fees for services performed are reasonable, and expenses incurred and payments received are allocated on an equitable basis in conformity with customary accounting practices consistently applied.

It is also recommended that the Company comply with the provisions of Sections 1505(c) and (d) of the New York Insurance Law by notifying, and/or seeking and obtaining the Superintendent's prior approval for the Administrative Service Agreement entered into with Health Net of the Northeast, Inc.

E. Reinsurance

The Company did not have a reinsurance agreement to provide excess of loss coverage for the period under examination. The Company stated that based on its historical data, Health Net Insurance of New York, Inc. had sufficient resources to absorb any catastrophic loss.

F. Conflict of Interest Policy

The examination review indicated that the Company included a conflict of interest statement policy in its employment manual. The Company answered "yes" to the general interrogatories in the annual statement that asked whether the Company has an established procedure for annual disclosure to its board of directors of any material interest and affiliation on the part of any of its officers and directors. However, the Company did not maintain signed conflict of interest statements from its directors, officers and responsible employees for the years of the examination. The Company has a fiduciary responsibility to its policyholders to ensure that these individuals do not use their official positions to promote an interest which is in conflict with that of the Company.

It is recommended that all officers, directors and responsible employees submit signed conflict of interest statements during each calendar year and that the Company establish a procedure for enforcing such policy.

It is also recommended the board of directors adhere to its fiduciary responsibility by properly overseeing and handling any conflicts disclosed.

G. Accounts and Records

Investments

A review of the Company's investment transactions and the minutes of meetings of its board of directors indicated that there was no supporting evidentiary material to indicate that actions taken by the Company's management were authorized or approved by the board of directors. In addition, the Company answered "yes" to General Interrogatories in all its filed Annual Statements for the period under examination as to whether the Company's purchase and

sale of all investments are passed upon by either its board of directors or a subordinate committee thereof. It was noted that, the Company in its response to the comments and recommendations of the prior report on examination indicated that, it has *"formally adopted FHS' investment policy."* Section 1411(a) of the New York Insurance Law states in part:

> *"No domestic insurer shall make any loan or investment... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting."*

When this matter was brought to management's attention, the examiners were informed that the investments were approved in accordance with the ultimate parent's (Health Net Inc.) guidelines by its Investment Oversight Committee every quarter. Notwithstanding that the Company's investments are reviewed and approved by the ultimate parent, it is incumbent on the Company's board of directors to comply with the provisions of Section 1411(a) of the New York Insurance Law.

It is recommended that the board of directors authorize and approve the Company's investment transactions in accordance with the provisions of Section 1411(a) of the New York Insurance Law and that documentation supporting their actions be appended to the minutes of their meetings. A similar recommendation was made in the prior report on examination.

The Company maintains several custodial accounts with Fleet Bank. A review of the custodial agreements revealed that the agreements lacked certain safeguards and controls as set forth in the Department's Rules, and in the guidelines of the Financial Condition Examiners Handbook of the *National Association of Insurance Commissioners*. The rules and guidelines state in part:

- *That the national bank, state bank, or trust company, as custodian is obligated to indemnify the insurance company for any insurance company's loss of securities in the custodian's custody, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard the bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian;*

- *That in the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced;*

- *That if the custodial agreement has been terminated or if 100 percent of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner;*

- *That during regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company;*

It is recommended that the Company amend its custodial agreements with Fleet Bank to include the requisite safeguards and controls as set forth in the Department's Rules, and in the guidelines of the Financial Condition Examiners Handbook of the *National Association of Insurance Commissioners*.

H. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law requires that certain unclaimed insurance proceeds which are unclaimed for three (3) years be reported to the Office of the State Comptroller of the State of New York by April 1 of each year. Such reports comprise all abandoned property held by the Company at the close of business on January 1, of each year.

Section 1315 of the New York Abandoned Property Law requires that certain unclaimed vendor payments, outstanding checks and escrow amounts, or gift certificates which are

unclaimed for more than five (5) years be reported to the Office of the State Comptroller of the State of New York by March 10 of each year. Such reports comprise all abandoned property held by the Company at the close of business on December 31, each year.

The Company is also required pursuant to Section 1316 of the Abandoned Property Law to annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned property and to file proof of such publication with the Office of the State Comptroller.

An examination review of the Company's filed Abandoned Property Reports indicated that certain claim payments were incorrectly classified as unclaimed property pursuant to Section 1315 of the Abandoned Property Law. Such payments should have been properly reported as unclaimed property pursuant to Section 1316 of the Abandoned Property Law. When this matter was brought to Management's attention, the examiners were informed by Management that Section 1316 of the Abandoned Property Law was not applicable to HNINY. It appears that HNINY did not properly segregate unclaimed claim payments and miscellaneous unclaimed property to comply with the provisions of Sections 1315 and 1316 of the New York Abandoned Property Law respectively. The Department determined that unclaimed claim payments pertaining to HNINY come within the purview of Section 1316 of the Abandoned Property Law because they were payments made on, or because of a policy of insurance.

It should be noted that the Company was also unable to provide the Reports of Abandoned Property for the Years Ended December 31, 1999 and December 31, 2000. Furthermore, the Company failed to provide documentation that it annually published a list of

names and last known addresses of persons appearing to be entitled to abandoned cash amounts or provide proof that an affidavit of such publication was filed with the Office of the State Comptroller.

It is recommended that the Company properly segregate unclaimed claim payments and miscellaneous unclaimed property to comply with the provisions of Sections 1315 and 1316 of the New York Abandoned Property Law respectively.

It is also recommended that the Company file the required annual Reports of Abandoned Property with the Office of the State Comptroller to comply with the provisions of Sections 1315 and 1316 of the New York Abandoned Property Law.

It is further recommended that the Company annually publish a list of names and last known addresses of persons appearing to be entitled to abandoned property and to file proof of such publication with the Office of the State Comptroller.

I. Location of Books and Records

During the period under examination, a review of the Company's operations by the Department revealed that certain books of account were removed from its principal offices in the State of New York during 1999 through October 2002 without the Superintendent's prior approval.

The provisions of Section 325 of the New York Insurance Law states in part:

> "*(a) Every domestic insurer and every licensed United States branch of an alien insurer entered through this state shall, except as hereinafter provided, keep and maintain at its principal office in this state its charter and by-laws…and its books of account, and if a domestic stock corporation a record containing the names and addresses of its shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof, and if a domestic corporation the minutes of any meetings of its shareholders, policyholders, board of directors and committees thereof…"*
>
> *(b) A domestic insurer…may keep and maintain its books of account without this state if, in accordance with a plan adopted by its board of directors and approved by the superintendent, it maintains in this state suitable records in lieu thereof; provided, however, that the superintendent may after notice and hearing direct such insurer to return all or any of its books of account to this state if such return is reasonably necessary to protect the interests of the people of this state or to permit their inspection in this state by a director, a shareholder, or, in the case of a mutual insurer, a policyholder, who has shown to the satisfaction of the superintendent that he has made an application to such insurer for inspection of such books in good faith and for a necessary and legitimate purpose, and that such insurer has either declined to permit such inspection without this state or to agree to pay any additional expenses reasonably to be incurred by the applicant or his agent or attorney in connection with the inspection of such books as a result of their maintenance without this state. If in the judgment of the superintendent delay in the return of any or all books of account of such insurer may be hazardous, or may cause irreparable injury, to the people of this state or to the policyholders of such insurer he may direct the return thereof without notice and hearing.*

Health Net Insurance in its response to a request from the Department for an itemization of the books of accounts that are kept and maintained at the pertinent locations of White Plains, New York; Shelton, Connecticut; and Woodland Hills, California stated that commencing in 2004 workpapers supporting the Statutory financial statements for calendar years 1999 through 2003 for the Company were moved to Woodland Hills, California. Health Net Insurance stated that prior to 2004 these workpapers were retained in Shelton, Connecticut. The Company also stated that copies of its financial statements are kept in White Plains, New York; Shelton, Connecticut; and Woodland Hills, California. The Company further stated that GAAP accounting functions were transferred to Woodland Hills, California in October 2002.

The Company indicated that the "keeping and maintenance of books of accounts has been

kept outside New York since 1999 (in Shelton, Connecticut) with suitable records retained in White Plains, New York with the Department's knowledge." The Company also indicated that it "remains committed to providing any and all personnel and materials to the Department at its Shelton, Connecticut offices for purposes of financial audits, as it has in past years."

Notwithstanding the fact that the Department may have had knowledge of the Company's transfer of its books of account in 1999 from White Plains, New York to Shelton, Connecticut, Health Net has neither sought nor received approval to such transfer from the Superintendent. In addition, an examination review of the minutes indicated that Health Net Insurance's board of directors had not adopted a plan to maintain suitable records at its principal office in New York. Furthermore, HNINY has not responded to a Department request for "a detailed plan of how its books and records that are located in Woodland Hills, California can be readily made available to Department employees engaged in field examinations of Health Net at either its White Plains, New York or Shelton, Connecticut office."

It is recommended that the Health Net Insurance's board of directors comply with the provisions of Section 325 of the New York Insurance Law by adopting a plan to maintain suitable records at its principal office in New York and to submit such plan to the Superintendent for approval.

J. Significant Operating Ratios

The following ratios were computed as of September 30, 2003, based upon the results of this examination:

Net premiums written to Capital and surplus	3.09 to 1

Liabilities to Liquid Assets	60.20%
Uncollected premiums and agents balances in course of collection to Capital and surplus	9.01%

The underwriting ratios presented below are on an earned-incurred basis and encompass the period covered by this examination:

	Amounts	Percentage
Claims incurred	$ 480,537,055	78.1%
Claims adjustment expenses incurred	1,006,201	0.2%
Other underwriting expenses incurred	754,339	0.1%
Net underwriting gain (loss)	132,749,782	21.6%
Premiums earned	$ 615,047,377	100.0%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as determined by this examination as of September 30, 2003. This statement differs from the one filed by the Company.

Assets	Company	Examination	Surplus Increase (Decrease)
Bonds	$ 20,208,412	$ 20,208,412	
Cash and Short-term investments	49,138,396	49,138,396	
Investment income due and accrued	120,891	120,891	
Uncollected premiums and agents balances in course of collection	4,602,733	4,602,733	
Amounts recoverable from reinsurers	41,819	41,819	
Net Deferred tax asset	271,610	271,610	
Receivable from parent, subsidiaries and affiliates	6,891,304	6,891,304	
Premium taxes recoverable	534,702	534,702	
Total Assets	$ 81,809,867	$ 81,809,867	

Liabilities	Company	Examination	Capital and Surplus Increase/ (Decrease)
Claims unpaid	$ 21,785,670	$ 25,985,670	$ (4,200,000)
Aggregate health policy reserves	0	0	
Unpaid claims adjustment expenses	389,556	389,556	
Premiums received in advance	310,564	310,564	
General expenses, due or accrued	1,559,701	1,559,701	
Remittances and items not allocated	2,328	2,328	
Amounts due to parent, subsidiaries and affiliates	2,426,093	2,426,093	
Payable to reinsurer	49,255	49,255	
Other liabilities	22,857	22,857	
Total Liabilities	26,546,024	30,746,024	(4,200,000)
Capital and Surplus			
Common capital stock	1,000,000	1,000,000	
Gross paid in and contributed surplus	2,800,623	2,800,623	
Contingency reserve	499,030	499,030	
Unassigned Funds Surplus/(Deficit)	50,964,190	46,764,190	(4,200,000)
Total Capital and Surplus	55,263,843	51,063,843	(4,200,000)
Total Liabilities, Capital and Surplus	$ 81,809,867	$ 81,809,867	

The Internal Revenue Service completed its audits of the consolidated income tax returns filed on behalf of the Company through tax years 1998 - 2002. All material adjustments, if any, made subsequent to the date of the examination and arising from said audits, are reflected in the financial statements included in this report. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Revenue, Expenses and Capital and surplus

Surplus and capital increased $46,959,898 during the examination period, encompassing January 1, 1999 to September 30, 2003, detailed as follows:

Revenues:		
Net premium income	$ 615,046,427	
Net investment income	4,989,174	
Other revenues	950	
Total revenues		$ 620,036,551
Expenses		
Medical and hospital	$ 481,977,991	
Reinsurance expenses net of recoveries	(686,597)	
Administrative	63,191,783	
Total expenses		$ 544,483,177
Net income before federal and foreign income taxes		75,553,374
Federal and foreign income taxes incurred		(26,802,962)
Net income		$ 48,750,412

Capital and surplus

	Gains in Surplus	Loss in Surplus	
Capital and surplus, per report on examination as of December 31, 1998			$ 4,103,943
Net income	$ 48,750,412		
Change in net deferred income tax		$ 703,833	
Change in non-admitted assets		3,022,187	
Cumulative effect of changes in accounting principles	2,622,322		
Adjustment for prior year taxes	359,115		
Cumulative differences between end of year capital and surplus for 1999 and 2000 and, beginning of year capital and surplus for 2000and 2001		1,045,931	
	$ 51,731,849	$ 4,771,951	
Net increase in capital and surplus			46,959,898
Capital and surplus, per report on examination as of September 30, 2003			$ 51,063,841

4. CLAIMS UNPAID

The examination liability of $25,985,670 was $4,200,000 more than the $21,785,670 reported by the Company in its filed September 30, 2003 quarterly statement. A Department actuarial analysis of claims payable was performed in accordance with generally accepted actuarial principles and practices.

The Department's claim reserves were determined based on statistical data relevant to claims experience for medical care benefits accumulated over an extended period of time. This is reflected in the Company's internal records and in its filed and sworn annual and quarterly statements. The Department's actuaries employed an actuarial methodology referred to as the *"Paid Loss Developmental Method"* (PLDM) that is commonly used by actuaries in the derivation of claim reserves for medical care services. It determined completion factors from past claims experience on months with complete run out data and applied such completion factors to incomplete paid claims on months of incurred claims with less than complete data. The completion factors represented estimates of the percentages of incurred claims paid after periods of one month, two months and beyond.

5. MARKET CONDUCT

In the course of this examination, a review was made of the manner in which the Company conducted its business practices and fulfilled its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more

precise scope of a market conduct investigation. The review was directed at the practices of HNINY in the following major areas:

A. Claims processing
B. Agents and brokers
C. Frauds prevention

A. Claims processing

A review of HNINY's claims practices and procedures was performed by using a statistical sampling methodology covering claims adjudicated during the period January 1, 1999 to September 30, 2003, in order to evaluate the overall financial accuracy and compliance environment of its claims processing. In addition, the Examiners placed emphasis on the accuracy and completeness of the Company's paid loss development schedules. In order to achieve the goals of this review, the Company's claims were segregated into separate hospital (institutional) and medical claims segments. A random statistical sample one hundred sixty seven (167) claims was drawn from each of these segments.

This statistical random sampling process was utilized to test various attributes deemed necessary for successful claims processing activity. The objective of this sampling process was to be able to test and reach conclusions about all predetermined attributes, individually or on a combined basis. For example, if ten (10) attributes were being tested, conclusions about each attribute individually, or on a collective basis, could be concluded for each item in the sample.

To ensure the completeness of the claims population being tested, the total dollars paid were reconciled to the financial data reported by Health Net Insurance of New York. To verify

each service that resulted in no payment, a reconciliation of transaction counts was also performed.

The examiners applied certain procedures to test the accuracy and validity of the Company's paid claims as it related to service dates, received dates, lines of business, paid dates, and paid amounts. The examiners also formatted HNINY's paid claims data into matrices aligned by date of service month and date of payment month. Although the examiners' total paid claims from the matrices agreed with the Company's total paid claims on its "lag" reports, the individual claims cells derived on the examiners' matrices did not match the Company's individual claims cells from the "lag" reports. When the Company was asked to explain the differences, management informed the examiners that such differences resulted from Health Net Insurance adopting month-end general ledger closing dates that were different from calendar month-ends. The Company also informed the examiners that its adopted month-end general ledger closing dates were applied consistently from year to year.

The following list summarizes the details of the examination review of Institutional (hospital) and Encounter (medical) claims:

- There was one (1) in-network hospital claim that was improperly denied as not having a prior authorization.

- There was one (1) hospital claim that was paid more than forty-five days from the date of receipt. However, the Company did compute and pay

interest in accordance with the provisions of Section 3224-a(a) of the New York Insurance Law.

Section 3224-a (a) states:

> "*Except in a case where the obligation of an insurer or an organization or corporation licensed or certified pursuant to article forty-three of this chapter or article forty-four of the public health law to pay a claim submitted by a policyholder or person covered under such policy or make a payment to a health care provider is not reasonably clear, or when there is a reasonable basis supported by specific information available for review by the superintendent that such claim or bill for health care services rendered was submitted fraudulently, such insurer or organization or corporation shall pay the claim to a policyholder or covered person or make a payment to a health care provider within forty-five days of receipt of a claim or bill for services rendered."*

B. Agents and Brokers

Pursuant to Article 21 of the New York Insurance Law, Health Net Insurance utilizes independent insurance agents and brokers as its primary distribution system. The Company maintains a direct sales staff of account executives and group service representatives. A review of agents and brokers licensing information revealed that the Company was generally in compliance with the licensing provisions of Article 21 of the New York Insurance Law. The examiners traced a sample of HNINY's appointed agents and brokers to information on file with the Department and found no exceptions. Section 2112(d) of the New York Insurance Law states in part:

> *"Every insurer, fraternal benefit society or health maintenance organization or insurance producer or the authorized representative of the insurer, fraternal benefit society, health maintenance organization or insurance producer doing business in this state shall, upon termination of the certificate of appointment as set forth in subsection (a) of this section of any insurance agent licensed in this state, or upon termination for cause for activities as set forth in subsection (a) of section two thousand one hundred ten of this article, of the certificate of appointment, of employment, of a contract or other insurance business relationship with any insurance producer, file with the superintendent within thirty days a statement, in such form as the superintendent may prescribe, of the facts relative to such termination for cause. The insurer, fraternal benefit society, health maintenance organization, insurance producer or the authorized representative of the insurer, fraternal benefit society, health maintenance organization or insurance producer shall provide, within fifteen days after notification has been sent to the superintendent, a copy of the statement filed with the superintendent to the insurance producer at his, or her or its last known address by certified mail, return receipt requested, postage prepaid or by overnight*

delivery using a nationally recognized carrier. Every statement made pursuant to this subsection shall be deemed a privileged communication."

The examiners traced a sample of terminated agents and brokers to statements on file with the Department. It was determined that the Department had not been notified of the termination of some agents and brokers in a timely manner. Health Net Insurance indicated that these exceptions were due to an oversight. The requisite termination statements were subsequently filed with the Department.

C. Frauds Prevention

A review was conducted of the organization and structure of Health Net Insurance's Fraud Division. The Company's compliance with New York Insurance Law Sections 405 and 409, and Department Regulation 95 with respect to the reporting of fraud cases to the Department was also reviewed. The examiners noted that HNINY implemented a new fraud prevention plan that was not filed with the Department. Section 409(a) of New York Insurance Law states in part:

"Every insurer writing private or commercial automobile insurance, workers' compensation insurance, or individual, group or blanket accident and health insurance policies issued or issued for delivery in this state annually,....., file with the superintendent a plan for the detection, investigation and prevention of fraudulent insurance activities in this state and those fraudulent insurance activities affecting policies issued or issued for delivery in this state."

When this matter was brought to management's attention, the Company submitted a revised fraud prevention plan in July 2004. The Department approved the revised plan on September 16, 2004 subject to the following conditions:

1. The Company confirms with the Department's Frauds Bureau that two additional investigators were hired to work exclusively on New York fraud cases.

2. The Company confirms with the Department's Frauds Bureau that fraud detection and

prevention training for all underwriting and claims staff was completed by February 15, 2005, and that such training would continue on a periodic basis.

3. The Company resubmit the Annual Fraud Report that reflected New York only information.

During the period January 1, 1999 to September 30, 2003, the Company had not sufficiently staffed its fraud division to provide assurance of its commitment to reduce fraud. The Company's frauds unit consisted of three (3) Investigators, three (3) Investigative Analysts, one (1) Administrative Assistant, and a Vice President. The fraud investigators perform work for all Health Net of Northeast companies in New York, New Jersey, and Connecticut. None of these investigators was specifically assigned to New York only cases. It was noted that there were several cases with assigned case numbers that were yet to be investigated, where the actual complaint dated back many months and years. The Company also failed to include the Department's fraud-case log number in the case files and to provide the basis of allocation of expenses for fraud investigation to the Insurance Department during the period under examination. Furthermore, the Company failed to provide documents to the Department's Frauds Bureau, such as fraud detection procedures, fraud case logs, and fraud case files for the years covered under this examination. Section 409(b)(1) of the New York Insurance Law states in part:

> *"The plan shall provide the time and manner in which such plan shall be implemented, including provisions for a full-time special investigations unit and staffing levels within such unit. Such unit shall be separate from the underwriting or claims functions of an insurer, and shall be responsible for investigating information on or cases of suspected fraudulent activity and for effectively implementing fraud prevention and reduction activities pursuant to the plan filed with the superintendent. An insurer shall include in such plan staffing levels and allocations of resources in such full-time special investigations unit as may be necessary and appropriate for the proper implementation of the plan and approval of such plan pursuant to subsection (d) of this section."*

In addition, Section 405(a) of the New York Insurance Law, states in pertinent part:

> *"Any person licensed pursuant to the provisions of this chapter, and any person engaged in the business of insurance in this state who is exempted from compliance with the licensing requirements of this chapter, including the state insurance fund of this state, who has reason to believe that an insurance transaction may be fraudulent, or has knowledge that a fraudulent insurance transaction is about to take place, or has taken place shall, within thirty days after determination by such person that the transaction appears to be fraudulent, send to the insurance frauds bureau on a form prescribed by the superintendent, the information requested by the form and such additional information relative to the factual circumstances of the transaction and the parties involved as the superintendent may require..."*

It is recommended that the Company comply with the terms and conditions of the fraud plan approval letter dated September 16, 2004.

It is also recommended that the Company add appropriate staff to its fraud investigation unit so that fraud can be investigated and prevented more effectively in accordance with the provisions of Section 409(b)(1) of the New York Insurance Law.

It is further recommended that the Company comply with the provisions of Section 405(a) of the New York Insurance Law as regards suspected fraudulent transactions by submitting to the Insurance Department Frauds Bureau on a form prescribed by the superintendent, the information requested by the form and such additional information relative to the factual circumstances of the transactions and the parties involved as the superintendent may require.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 1998 contained eleven (11) recommendations as follows (page numbers refer to the prior report):

ITEM		PAGE NO.
A. Management		
i.	It is recommended that the Company comply with New York Insurance Law Sections 1202 (a)(1) and 1201(a)(5)(B)(v), by maintaining the required number of board of director members. *The Company has not complied with this recommendation. A similar recommendation is contained in this report.*	4
ii.	It is recommended that the Company report an accurate listing of directors in its annual statements filed with the Department pursuant to Section 307 of the New York Insurance Law. *The Company has not complied with this recommendation. A similar recommendation is contained in this report.*	5
iii.	It is recommended that the Company comply with the requirements of Section 1201 (a)(5)(B)(vi) of the New York Insurance Law, by having at least three New York State residents serve on the board of directors. *The Company has complied with this recommendation.*	5
iv.	It is recommended that the Board of Directors be fully apprised of Company's investments and financial position on a regular basis by management as required by Section 1411(a) of the New York Insurance Law. *The Company has not complied with this recommendation. A similar recommendation is contained in this report.*	6

ITEM PAGE NO.

B. Holding Company System

i. It is recommended that the Company comply with the provisions of Section 1505(d) of the Insurance Law by formalizing an agreement detailing all transactions covered by the statute between the two companies and filing with the Superintendent for his non-disapproval. 9

The Company has not complied with this recommendation. A similar recommendation is contained in this report.

ii. It is recommended that the Company settle balances within the holding company system in a timely manner pursuant to Sections 1505(a)(1) & (3) of the New York Insurance Law. 9

The Company has complied with this recommendation since March 2000.

C. Management Service Agreement

i. It is recommended that the Company correct inaccurate disclosures stated in its notes to financial statements. 11

The Company has complied with this recommendation.

D. Conflict of Interest Statements

i. It is recommended that all officers, directors and responsible employees submit signed conflict of interest statements during each calendar year. It is further recommended that the Company establishes a procedure for enforcing such a policy and permits the Board of Directors to properly oversee and handle any conflicts disclosed. 12

The Company has not complied with this recommendation. A similar recommendation is contained in this report.

E. Abandoned Property Law

i. It is recommended that the Company adhere to the provisions of Section 1316 of the Abandoned Property Law and submit unclaimed funds reports in a timely manner. 12

The Company has not complied with this recommendation. A similar recommendation is contained in this report.

ITEM **PAGE NO.**

F. Accounts and Records

i. It is recommended that the Company's board adopt a plan and submit it to the Superintendent so as to comply with the requirements of Section 325 of the New York Insurance Law. 13

The Company has not complied with this recommendation. A similar recommendation is contained in this report.

ii. It is recommended that the Company submit CPA reports pursuant to Section 307(b)(1) of the New York Insurance Law. 13

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A. Management		
i.	It is recommended that the Company comply with the provisions of its by-laws and the provisions of Section 1201(a)(5)(B)(v) of the New York Insurance Law by maintaining the requisite number of members of the board of directors.	6
ii.	It is also recommended that the Company exercise prudence by reporting an accurate schedule of directors in its statements filed with the Department pursuant to Section 307(a)(2) of the New York Insurance Law.	6
B. Administrative services agreement		
i.	It is recommended that HNINY comply with the provisions of Section 1505(a) of the New York Insurance Law by ensuring that the terms of the financial transactions of its Administrative Service Agreement are fair and equitable at the time of the transactions, charges or fees for services performed are reasonable, and expenses incurred and payments received are allocated on an equitable basis in conformity with customary accounting practices consistently applied.	13
ii.	It is also recommended that the Company comply with the provisions of Sections 1505(c) and (d) of the New York Insurance Law by notifying, and/or seeking and obtaining the Superintendent's prior approval for the Administrative Services Agreement entered into with Health Net of the Northeast, Inc.	13
C. Conflict of interest policy		
i.	It is recommended that all officers and directors submit signed conflict of interest statements during each calendar year and that the Company establish a procedure for enforcing such policy.	14
ii.	It is also recommended the board of directors adhere to its fiduciary responsibility by properly overseeing and handling any conflicts disclosed.	14

G. Frauds prevention

i. It is recommended that the Company comply with the terms and conditions of the fraud plan approval letter dated September 16, 2004.

ii. It is also recommended that the Company add appropriate staff to its fraud investigation unit so that fraud can be investigated and prevented more effectively in accordance with the provisions of Section 409(b)(1) of the New York Insurance Law.

iii. It is further recommended that the Company comply with the provisions of Section 405(a) of the New York Insurance Law as regards suspected fraudulent transactions by submitting to the Insurance Department Frauds Bureau on a form prescribed by the superintendent, the information requested by the form and such additional information relative to the factual circumstances of the transactions and the parties involved as the superintendent may require.

Appointment No. ***22106***

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, ***GREGORY V. SERIO***, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

Pearson Griffith

as a proper person to examine into the affairs of the

Health Net Insurance of New York, Inc.

and to make a report to me in writing of the said

Company

with such information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York.

this *6th* day of *November 2003*

Gregory V. Serio
Superintendent of Insurance