REPORT ON EXAMINATION

OF

EMPIRE HEALTHCHOICE HMO, INC.

AS OF

DECEMBER 31, 2006

DATE OF REPORT **JUNE 29, 2009**

EXAMINER **MATT PERKINS, CFE**

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

David A. Paterson
Governor

Eric R. Dinallo
Superintendent

June 29, 2009

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

Sir:

Pursuant to the requirements of the New York Insurance Law and acting in accordance with the instructions contained in Appointment Number 22488, dated December 22, 2006, attached hereto, I have made an examination into the condition and affairs of Empire HealthChoice HMO, Inc., a health maintenance organization (HMO) licensed pursuant to the provisions of Article 44 of the New York Public Health Law, as of December 31, 2006, and submit the following report thereon.

The examination was conducted at the HMO's office located at 15 MetroTech Center, Brooklyn, New York 11201.

Wherever the designations "EHC" or "the HMO" appear herein, without qualification, they should be understood to mean Empire HealthChoice HMO, Inc.

A concurrent examination was made of Empire HealthChoice Assurance, Inc. (EHCA), an accident and health insurer licensed pursuant to the provisions of Article 42 of the New York Insurance Law, and the direct parent (Parent) of the HMO.

A separate examination into the manner in which the HMO and its Parent, EHCA, conduct their business practices and fulfill their contractual obligations to policyholders and claimants was conducted as of December 31, 2006. A separate report thereon has been submitted.

1. SCOPE OF EXAMINATON

Empire HealthChoice HMO, Inc. was previously examined as of December 31, 1999. This examination covers the seven-year period from January 1, 2000 through December 31, 2006. Transactions subsequent to this period were reviewed where deemed appropriate.

The examination was conducted in accordance with the 2007 *NAIC Financial Condition Examiners Handbook* (the Handbook). The Handbook requires that the examiner plan and perform the examination to evaluate the financial condition and identify prospective risks of EHC by obtaining information about EHC, including corporate governance, identifying and assessing inherent risks within EHC, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with statutory accounting principles and annual statement instructions and statutes and regulations.

All accounts and activities of EHC were considered in accordance with the NAIC Risk Surveillance approach as defined in the Handbook and the examination was conducted using a risk-focused examination approach. This examination approach was included in the Handbook for the first time in 2007, thus this was the first such type of examination for the HMO.

A review or audit was also made of the following items:

History of the HMO
Management and controls
Corporate records
Territory and plan of operation
Growth of the HMO
Fidelity bonds and other insurance
Pensions and employee benefits
Loss experience
Accounts and records

A review was also made to ascertain what actions were taken by the HMO with regard to comments and recommendations made in the prior report on examination.

2. EXECUTIVE SUMMARY

The results of this examination revealed certain operational deficiencies that directly impacted the HMO's compliance with New York Insurance Laws and Regulations of the New York State Departments of Insurance and Health. Significant findings relative to this examination are as follows:

- It was determined that EHC was in violation of Part 98-1.10(c) of the Administrative Rules and Regulations of the Health Department (10 NYCRR 98-1.10(c)) when it failed to obtain the Superintendent's approval prior to enacting an agreement with its affiliates.

- It was noted that EHC needs to improve upon its procedures necessary to facilitate examinations.

3. DESCRIPTION OF THE HMO

Empire HealthChoice HMO, Inc. (EHC), formerly known as Empire HealthChoice, Inc. and originally formed in 1996 as Family HealthChoice, Inc., is a for-profit HMO licensed under Article 44 of the New York Public Health Law. EHC is a

direct, wholly-owned subsidiary of Empire HealthChoice Assurance, Inc. (EHCA). EHC became a direct subsidiary of EHCA as part of the conversion of EHCA's predecessor corporation, Empire HealthChoice, Inc. (doing business at that time in New York State as Empire Blue Cross Blue Shield) from an Insurance Law Article 43 non-profit health service corporation to an Insurance Law Article 42 for-profit accident and health insurer on November 7, 2002. As a result of the conversion, WellChoice, Inc. (WC) was established in addition to its wholly-owned subsidiary named WellChoice Holdings of New York, Inc. (Holdings). Holdings became the parent of the new Article 42 entity, which at that time changed its name to Empire HealthChoice Assurance, Inc. (EHCA), which in turn became the parent of EHC.

On October 18, 2005, Wellpoint, Inc. (WellPoint) an Indiana corporation, and WellPoint Holding Corp., a Delaware corporation and a direct wholly-owned subsidiary of WellPoint, submitted an application for approval of the acquisition of control of WC. The application was submitted pursuant to Section 1506 of the New York Insurance Law and Part 80-1.6 of Department Regulation 52 (11 NYCRR 80). Concurrent with this submission was the request for the approval of the Commissioner of Health pursuant to Part 98-1.9 of the Administrative Rules and Regulations of the Health Department (10 NYCRR 98) for the acquisition of control of EHC, a wholly-owned subsidiary of EHCA. These transactions were approved by the Departments of Insurance and Health, respectively, on December 28, 2005, and WC, the ultimate parent of EHCA and EHC, merged with and into WellPoint Holding Corp.

EHC does business in downstate New York as Empire Blue Cross Blue Shield HMO and in upstate New York as Empire Blue Cross HMO.

As of the examination date, EHC was also licensed as a health maintenance organization in the State of New Jersey, where it did business as WellChoice HMO of New Jersey.

Subsequent to the examination date, July 7, 2008, the HMO surrendered its New Jersey certificate of authority.

EHC issued dividends of $40 million and $50 million in 2005 and 2006, respectively. EHC's gross paid-in and contributed surplus totaled $71,999,998 as of December 31, 2006.

A. Management and Controls

The following individuals were members of the board of directors of the HMO as of December 31, 2006:

Name and Residence	**Principal Business Affiliation**
Angela Braly Indianapolis, IN	Executive VP, General Counsel and Chief Public Affairs Officer, WellPoint, Inc.
David Colby Lake Sherwood, CA	Executive VP and CFO, WellPoint, Inc.
Grace H. McCabe New York, NY	Member, Senior Plan, Empire HealthChoice HMO, Inc.
Chrystal Veazey-Watson West Caldwell, NJ	Associate General Counsel, NY Market, WellPoint, Inc.
Mark Wagar New York, NY	President, Chairman and General Manager, WellPoint, Inc.

The board of directors' minutes and member attendance were reviewed for the period under examination for EHC. As a result of the merger with WellPoint, there was some turnover of board members during the examination period. A review was performed to determine whether members serving on the board attended at least 50% of the meetings they were eligible to attend and that proper recordkeeping was maintained. EHC maintained a list of board member attendance, through an attendance sheet recorded at each board meeting, however, it was unclear from the review of the minutes as to when a member had been elected, or if and when they were resigned or replaced.

It is recommended that better recordkeeping be prepared in regard to recording changes to the board's members.

The principal officers of EHC as of December 31, 2006 were as follows:

Name	**Title**
Mark L. Wagar	President, Chairman and CEO
David Colby*	Chief Financial Officer
Nancy L. Purcell	Secretary
Robert D. Kretschmer	Treasurer
Chrystal L. Veazey-Watson	Assistant Secretary

*David Colby resigned as Chief Financial Officer in 2007.

B. Territory and Plan of Operation

EHC is a licensee of the Blue Cross and Blue Shield Association (BCBSA) and markets its products under the Blue Cross Blue Shield trade name. EHC has been in operation for over ten years and offers HMO, Point-of-Service, Medicare Advantage and

state sponsored products to individuals and group accounts in the Greater New York metropolitan region, select upstate counties and thirteen counties within New Jersey. As was previously noted, on July 7, 2008, the HMO surrendered its New Jersey certificate of authority.

As set forth in its certificate of authority, EHC is permitted to serve the following twenty-eight counties of the State of New York:

New York Region

Bronx	Kings	Dutchess	New York
Nassau	Putnam	Queens	Richmond
Rockland	Suffolk	Westchester	

Albany Region

Albany	Clinton	Columbia	Delaware
Essex	Fulton	Greene	Montgomery
Orange	Rensselaer	Saratoga	Schenectady
Schoharie	Sullivan	Ulster	Warren
Washington			

The following table displays EHC's assets, capital and surplus, premium income and net income during the period under examination:

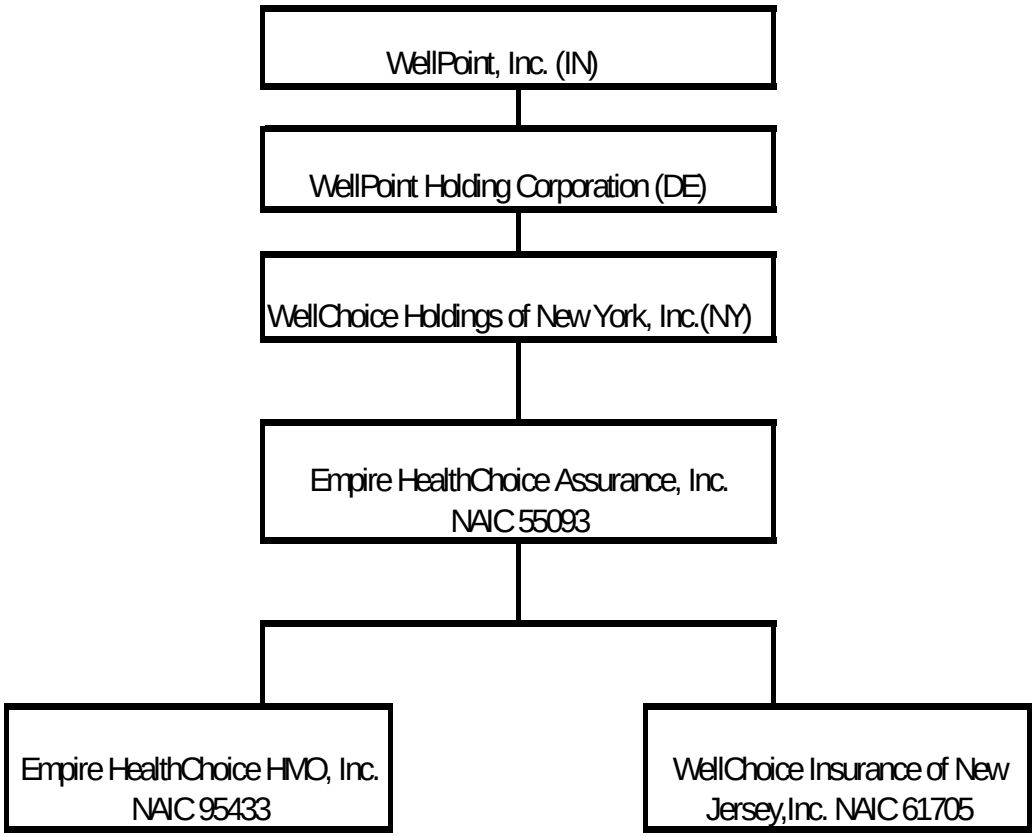
(in thousands)				
	Net Admitted Assets	Capital and Surplus	Net Premium Income	Net Income
2006	$1,037,277	$380,498	$2,548,106	$127,773
2005	608,977	293,133	2,153,820	90,283
2004	550,708	242,851	1,791,186	75,806
2003	405,845	165,879	1,479,231	77,440
2002	295,049	95,746	626,469	31,960
2001	21,301	14,882	29,610	(1,369)
2000	18,358	14,269	13,629	(4,114)

C. Holding Company System

EHC is a wholly-owned subsidiary of Empire HealthChoice Assurance, Inc. (EHCA). As of the examination date, EHCA was a wholly-owned subsidiary of WellChoice Holdings of New York, which was a wholly-owned subsidiary of WellPoint Holding Corp. (WHC). WHC is a wholly-owned subsidiary of WellPoint, Inc. (WellPoint), a publicly traded company.

Subsequent to the examination date, on December 31, 2008, WellChoice Holdings of New York, Inc. merged with and became WellPoint Holding Corporation.

The following chart depicts the HMO's holding company system as of December 31, 2006:



Part 98-1.10(c) of the Administrative Rules and Regulations of the Health Department (10 NYCRR 98-1.10(c)) states in part:

> "…Thirty days prior notice to the commissioner and... the superintendent, is required before entering into the following transactions between a controlled MCO and any person in its holding company system: a reinsurance agreement or an agreement for rendering services on a regular or systematic basis…"

In November 2002, EHC enacted and implemented a services agreement with its affiliates, which received the requisite approval from the Superintendent. In 2005, as a result of the merger with WellPoint, such agreement was amended and, in December 2005, such amendment was likewise approved by the Superintendent. On April 3, 2006, the agreement was again amended and approval was once again sought from the Superintendent.

The approval of this amended agreement was made by the superintendent on July 3, 2008, subsequent to this examination.

Prior to the most recent amended agreement being approved in 2008, it was implemented by the HMO, which action, technically, was not in compliance with Part 98-1.10(c) of the Administrative Rules and Regulations of the Health Department. While such agreement was implemented without formal approval by the Superintendent of Insurance and the Commissioner of Health, personnel from both Departments were aware of the implementation of the agreement and due to the complexity and nature of the agreement understood that, to be approved, implementation on a trial basis was necessary to determine whether such agreement was acceptable to the Departments and whether certain methodology could be examined and audited by Department examiners. The HMO sent reports to the Insurance Department in this regard. Nevertheless, the agreement did not receive formal approval by the superintendent prior to implementation.

It is recommended that EHC complies with Part 98-1.10(c) of the Administrative Rules and Regulations of the Health Department and refrain from enacting agreements requiring the Superintendent’s approval until such approval has been obtained.

During the examination it was noted that EHC did not prepare certain management reports communicating the type and nature of inter-company allocations that transpired during a given month. Such reports are mandatory if management is to be cognizant of the reasonableness of the charges attached to EHC. These reports should be of interest to both management and the board of directors.

It should be noted that subsequent to the examination date, such management reports were designed and put in place.

It is recommended that EHC continues to provide its management with summary reports of inter-company expense allocations and that the reports be used to verify that the expenses allocated to EHC are fair and equitable.

The examiners reviewed several inter-company transactions from various months covering the examination period to test the support, propriety and existence of the monetary transactions involved. During the review, it was noted that some accounting errors had occurred. These errors included invoices being charged to the wrong entity and charges being allocated based on incorrect or inappropriate methodologies. In each case, the errors had been detected by the HMO's own internal systems. Regardless, the initial recording of an error can lead to a misinterpretation of financial results and to incorrect decisions being made about aspects of EHC's operations.

It is recommended that EHC continues to ensure that all inter-company accounting transactions are correct and verified in all aspects prior to being recorded.

EHC does not maintain a separate cash disbursements (electronic) journal; instead, it consolidates its journal with its affiliates, then differentiates transactions through the application of a separate company number.

Part 98-1.11(a) of the Administrative Rules and Regulations of the Health Department (10 NYCRR 98-1.11(a)) states in part:

> "The functions, activities and services undertaken and performed pursuant to the MCO's Article 44 certificate of authority shall be clearly distinguished from any other function, activity or service through the maintenance of separate records, reports and accounts for each such MCO function, activity or service. The records, reports and accounts of each MCO shall be maintained separately from those of other persons or MCOs in a holding company system…"

EHC's failure to maintain a separate cash disbursements journal may constitute a violation of the cited statutory requirements.

EHC defends its use of a single journal for multiple entities by stating that the use of individualized company numbers is sufficient to permit the transactions to be segregated by entity when desired.

D. Accounts and Records

During the course of the examination, it was noted that the HMO's treatment of certain items was not in accordance with Statutory Accounting Principles. A description of such items is as follows:

1. Under Article 14 of the New York Insurance Law, EHC has limitations on the types of investments that are permitted. When asked how EHC ensures that it maintains its investments within the permitted limits, EHC noted that, "EHC's investment portfolio is reviewed quarterly to ensure compliance with all relevant New York investment limitation guidelines."

While this process may ensure compliance on the date it is tested, it does not ensure compliance is maintained consistently throughout the quarter.

It is recommended that EHC reviews its investment portfolio more frequently than quarterly, at least monthly, to ensure compliance with all applicable New York investment limitation statutes and internal guidelines.

2. Two of the controls used by EHC to ensure compliance with Department Regulation 152 (11 NYCRR 243.2) - Standards of Records Retention by Insurance Companies, were insufficient to ensure compliance with the Regulation. EHC's record retention policy, which was accessed online, included a link to a retention schedule that was not working at the time of the examination. While the policy notes the length of time records are required to be retained, this information was not listed within the schedule. The HMO agreed that the link was inactive at the time of the examination, and it was repaired while the examiner was on site. In addition, the word "years" was added to the HMO's retention schedule, as suggested by the examiner, to clarify the length of time records are required to be retained.

It is recommended that EHC continues to ensure compliance with Department Regulation 152 by ensuring that its record retention schedules available for reference are clear and complete.

E. Internal Controls

The basis for the newly adopted NAIC Risk Surveillance approach to financial examinations relies on the review of mitigating controls applicable to the inherent risks of the companies being examined. In the case of EHC, the mitigating controls are housed in "Paisley Risk Navigator" (Risk Navigator). These controls related to the WellPoint Sarbanes-Oxley (SOX) process are mandated and regulated by the SEC. Within Wellpoint's SOX records, the internal controls applicable to EHC were identified by its management. The examiner only reviewed the controls applicable to the HMO. It was noted that during 2006, there were no specific regulations around SOX stipulated by the NAIC. A thorough review of these controls was an important component of the examination process. Although there were no material weaknesses or significant deficiencies in internal controls over financial reporting detected during the examination, there were some issues noted during the review of EHC's internal controls contained in Risk Navigator that warrant attention. These are as follows:

The descriptions of certain primary financial controls were not clear, others were not adequately described, and/or did not appear to be a "control", by EHC's definition in Risk Navigator. EHC's management and associates must be able to understand how a control operates in order to effectively implement, monitor and sign-off on its

effectiveness. In addition, if the control is not understandable, it would not appear to be effective in mitigating risks.

The following is an example of a primary financial control that appears unclear:

- Control 997 - "Provide Process Testing, by reviewing implementation plans and confirming implementation tasks on select implementations. Audits done quarterly to ensure that all companies are tested annually."

  The control is not clear as stated. It is hard to determine exactly what control function is taking place and what risk it is mitigating.

The following is an example of a primary financial control that was not adequately described:

- Control 4216 - "The Accounting Billing Unit representative enters the administrative fee methodology and rate."

  The control does not specify where or what the fee methodology and rate is being entered into, or for what reason. Therefore, the control is not adequately described or is incomplete by its current description.

The following is an example of a primary financial control that does not appear to be a "control", by EHC's definition in Risk Navigator:

- Control 963 - "Corporate Finance policies are published and maintained on EHC's WorkNet."

  The control appears to be a statement about a corporate process, rather than meeting the criteria of a control as defined in Risk Navigator.

Subsequent to the examination date EHC discontinued its use of Risk Navigator.

It is recommended that EHC continues to improve and enhance its internal control environment by ensuring that control descriptions are clear, adequately described and meet the criteria of a control.

F. Facilitation of Examination

As previously described in the scope paragraph of this report, the examination was conducted in accordance with the *2007 NAIC Financial Condition Examiners Handbook* (Handbook) as a risk-focused examination. This examination approach differs from the traditional examination in that it places greater emphasis on understanding a company's risks and exposures and methods of mitigating such risks. Specifically, the Handbook requires that the examiner plans and performs the examination to evaluate the financial condition of the company and identify its current and prospective risks by obtaining information regarding corporate governance, identifying and assessing inherent risks within the company, and evaluating system controls and procedures used to mitigate those risks.

This was the first such type of examination for the HMO, and as such, certain challenges arose for both EHC and the Department during the examination process. Further, concurrent with undergoing the examination, EHC and its affiliated entities were being integrated within WellPoint's corporate structure and underlying organizational and regulatory framework, this integration complicated the transition to the new examination process.

While the Department recognizes certain difficulties encountered by the HMO in facilitating the examination, the following was noted:

- Due to the timing of the examination (shortly after the merger with WellPoint, Inc.), a significant number of WellPoint's SOX records deemed applicable to the HMO, were not maintained in the state of New York. For example, Sarbanes-Oxley (SOX) scoping and conversion documentation were located in California and SOX risk and control matrices were located in Indiana as they were applicable to the overall WellPoint SOX process for SEC reporting.

  In addition, the individuals with a comprehensive and thorough knowledge of the WellPoint SOX process were located in different states, creating logistical issues. This made it difficult to determine the "owner" of various business processes from a separate legal entity perspective and to acquire pertinent and timely explanations and walk-throughs of said process.

- Some examination requests in regard to SOX documentation and the examination planning questionnaire that are key components of the planning phase of the examination were not received in a timely manner.

- Responses to the examiner's requests for the independent certified public accountants' (CPA's) audit workpapers and related internal control test work were not provided in the format or timeframe that the CPAs had agreed to.

It is recommended that EHC improves its procedures for facilitating examinations. These comments are also directed at the HMO's independent certified public accountant in regard to the requirements of Section 307(b) of the New York Insurance Law and Department Regulation 118 (11 NYCRR 89).

4. FINANCIAL STATEMENTS

A. Balance Sheet

The following compares the assets, liabilities and capital and surplus as determined by this examination with those reported by EHC in its filed annual statement as of December 31, 2006:

Assets	Examination	HMO	Surplus Increase/ (Decrease)
Bonds	$ 941,985,534	$ 941,985,534	
Preferred stocks	11,692,142	11,692,142	
Cash	(62,937,142)	(62,937,142)	
Short-term investments	31,913,748	31,913,748	
Receivables for securities	26,074,204	26,074,204	
Aggregate write-ins for invested assets	1,814,889	1,814,889	
Investment income due and Accrued	8,639,150	8,639,150	
Uncollected premiums in course of collection	25,685,813	25,685,813	
Net deferred tax asset	9,874,424	9,874,424	
Receivable from parent, subsidiaries and affiliates	106,110	106,110	
Health care and other amounts Receivable	10,506,764	10,506,764	
Aggregate write-ins for other than invested assets	31,921,804	31,921,804	
Total assets	$ 1,037,276,719	$ 1,037,276,719	$

	Examination	HMO	Surplus Increase/ (Decrease)
Liabilities			
Claims unpaid	$ 237,934,239	$ 270,175,330	$ 32,241,091
Claims adjustment expenses	8,749,258	8,749,258	
Aggregate health policy reserves	19,002,860	19,002,860	
Aggregate health claim reserves	2,958,704	2,958,704	
Premiums received in advance	29,180,899	29,180,899	
General expenses due or accrued	8,662,802	8,662,802	
Federal and foreign income tax payable and interest thereon	26,825,814	26,825,814	
Remittance and items not allocated	84,375	84,375	
Amounts due to parent, subsidiaries and affiliates	251,986,893	251,986,893	
Aggregate write-ins for other liabilities	39,151,791	39,151,791	
Total liabilities	$ 624,537,635	$ 656,778,726	$ 32,241,091
Capital and Surplus			
Gross paid-in and contributed surplus	71,999,998	71,999,998	
Aggregate write-ins for other than special surplus	165,630,569	165,630,569	
Unassigned funds	175,108,517	142,867,426	32,241,091
Total capital and surplus	412,739,084	380,497,993	32,241,091
Total liabilities, capital and surplus	$ 1,037,276,719	$ 1,037,276,719	

Note: The Internal Revenue Service has not conducted any audits of the income tax returns filed on behalf of the HMO through tax year 2006. The examiner is unaware of any potential exposure of the HMO to any tax assessments and no liability has been established herein relative to such contingency.

B. Statement of Revenue, Expenses and Capital and Surplus

Capital and surplus increased $394,213,055 during the seven-year examination period, January 1, 2000 through December 31, 2006, detailed as follows:

Revenue		
Premium income		$ 8,642,049,867
Change in unearned premium reserves		(56,147,568)
Total revenue		8,585,902,299
Hospital and medical expenses		
Hospital/medical benefits	$ 5,336,143,096	
Other professional services	319,202,500	
Outside referrals	194,218,169	
Emergency room and out-of-area	272,770,501	
Prescription drugs	976,750,546	
Graduate medical	116,724,126	
Pool recoveries - stop loss	(127,783,213)	
Aggregate write-ins for other hospital and medical	16,584	
Total hospital and medical benefits	$ 7,088,042,309	
Administrative expenses		
Claims adjustment expenses	389,193,105	
General administrative expenses	525,186,713	
Total underwriting expenses		8,002,422,127
Net underwriting gain		$ 70,212,279
Net investment gain		583,480,172
Net income before federal and foreign income taxes		$ 653,692,451
Federal and foreign income taxes incurred		223,672,350
Net income		$ 430,020,101

Changes in Capital and Surplus

	Gains in Surplus	Losses in Surplus	
Capital and surplus per report on examination as of December 31, 1999			$ 18,526,029
Net income	$ 430,020,101		
Change in net deferred income tax	9,191,574		
Change in non-admitted assets		$ 4,093,428	
Cumulative effect of changes in accounting principles		2,905,192	
Capital change	50,000,000		
Surplus adjustment		256,245	
Dividends to stockholders		90,000,000	
Change in contingency reserve	2,256,245	0	
Net increase in capital and surplus			$ 394,213,055
Capital and surplus per report on examination as of December 31, 2006			$ 412,739,084

5. CLAIMS UNPAID

The examination liability of $237,934,239 for the above captioned account is $32,241,091 less than the $270,175,330 reported by the HMO in its filed annual statement as of December 31, 2006. The examination change resulted from an actuarial review of the claims unpaid liability as of December 31, 2006, which determined that there was favorable development of the claims reserves subsequent the examination date.

The examination analysis of the claims unpaid reserve was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the HMO's internal records and in its filed annual statements as verified by the examiner.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination, as of December 31, 1999 contained the following recommendation (page number refers to the prior report on examination):

ITEM NO.		PAGE NO.
	Management	
1.	Within one year following the date when Empire HealthChoice HMO, Inc. begins writing business in New York State the composition of its board of directors should comply with Part 98-1.11(f) of the New York Codes, Rules and Regulations.	6
	The HMO has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

Appointment No. 22488

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, ***Howard Mills***, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

INS Regulatory Insurance Services, Inc.

as a proper person to examine into the affairs of the

Empire HealthChoice HMO, INC.

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

Company

with such information as it 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 22nd day of December 2006

Howard Mills
Superintendent of Insurance