

EXAMINATION REPORT
of
OPTIMA HEALTH INSURANCE COMPANY
Norfolk, Virginia
as of
December 31, 2007

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

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Richmond, Virginia
May 15, 2008

Honorable Alfred W. Gross
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by authority of Section 38.2-1317 of the Code of Virginia, an examination of the financial condition, records and affairs of

OPTIMA HEALTH INSURANCE COMPANY
Norfolk, Virginia

hereinafter referred to as the Company, has been completed. The report thereon is hereby submitted for your consideration.

DESCRIPTION

The Company is a stock accident and sickness insurance company licensed under and subject to the general insurance laws contained in Title 38.2 of the Code of Virginia. The Company was last examined by representatives of the State Corporation Commission's ("Commission") Bureau of Insurance (the "Bureau") as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2007.

HISTORY

The Company was issued a certificate of incorporation on January 29, 1992, by the Commission. According to the Articles of Incorporation, the Company's purpose is as follows:

The Corporation shall have the power to act as an insurance company issuing life insurance, variable life insurance, annuities, variable annuities, credit life insurance, credit accident and sickness insurance, and accident and sickness insurance and to transact any business related or incidental to the insurance business.

The Company was formerly known as Sentara Health Insurance Company prior to its name change which was effective on May 22, 1998.

MANAGEMENT AND CONTROL

The amended and restated bylaws of the Company provide that the business and affairs of the Company shall be managed by a Board of Directors (the "Board") consisting of no less than three and no more than sixteen individuals who shall serve staggered three-year terms. Directors shall be elected at each annual meeting of shareholders. A majority of the Board shall constitute a quorum for the transaction of business.

The officers of the Company shall consist of a Chairman, a President, a Secretary, a Treasurer and such other officers as the Board of Directors may from time to time deem necessary. The Chairman shall be selected from among the directors of the Company.

At December 31, 2007, the Board and Officers were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
Darleen S. Anderson	Senior Vice President, Operations Sentara Health Plans, Inc. Virginia Beach, Virginia
David L. Bernd	Chief Executive Officer Sentara Healthcare Norfolk, Virginia
Robert A. Broermann	System Vice President Sentara Healthcare Norfolk, Virginia
Michael M. Dudley	System Vice President Sentara Healthcare Virginia Beach, Virginia
Vicky G. Gray	Vice President, System Development Sentara Healthcare Norfolk, Virginia

DirectorsPrincipal Occupation

James E. Haden

President and Chief Executive Officer
Martha Jefferson Health Services
Charlottesville, Virginia

Wilkes Hubbard, MD

Physician
Norfolk Surgical Group
Norfolk, Virginia

John F. Kalafsky, M.D.

Physician
Ear, Nose and Throat, Ltd.
Norfolk, Virginia

Howard P. Kern

President and Chief Operating Officer
Sentara Healthcare
Norfolk, Virginia

Charles F. Lovell, M.D.

Physician
Norfolk, Virginia

E. George Middleton, Jr.

Chairman of the Board
E. G. Middleton, Inc.
Norfolk, Virginia

David M. Pariser, M.D.

Physician
Pariser Dermatology Specialists, Ltd.
Norfolk, Virginia

Meredith B. Rose, M.D.

Physician
Providence Road Family Practice
Virginia Beach, Virginia

Theodore M. Willie, Jr.

Retired
Virginia Beach, Virginia

Gary R. Yates, M.D.

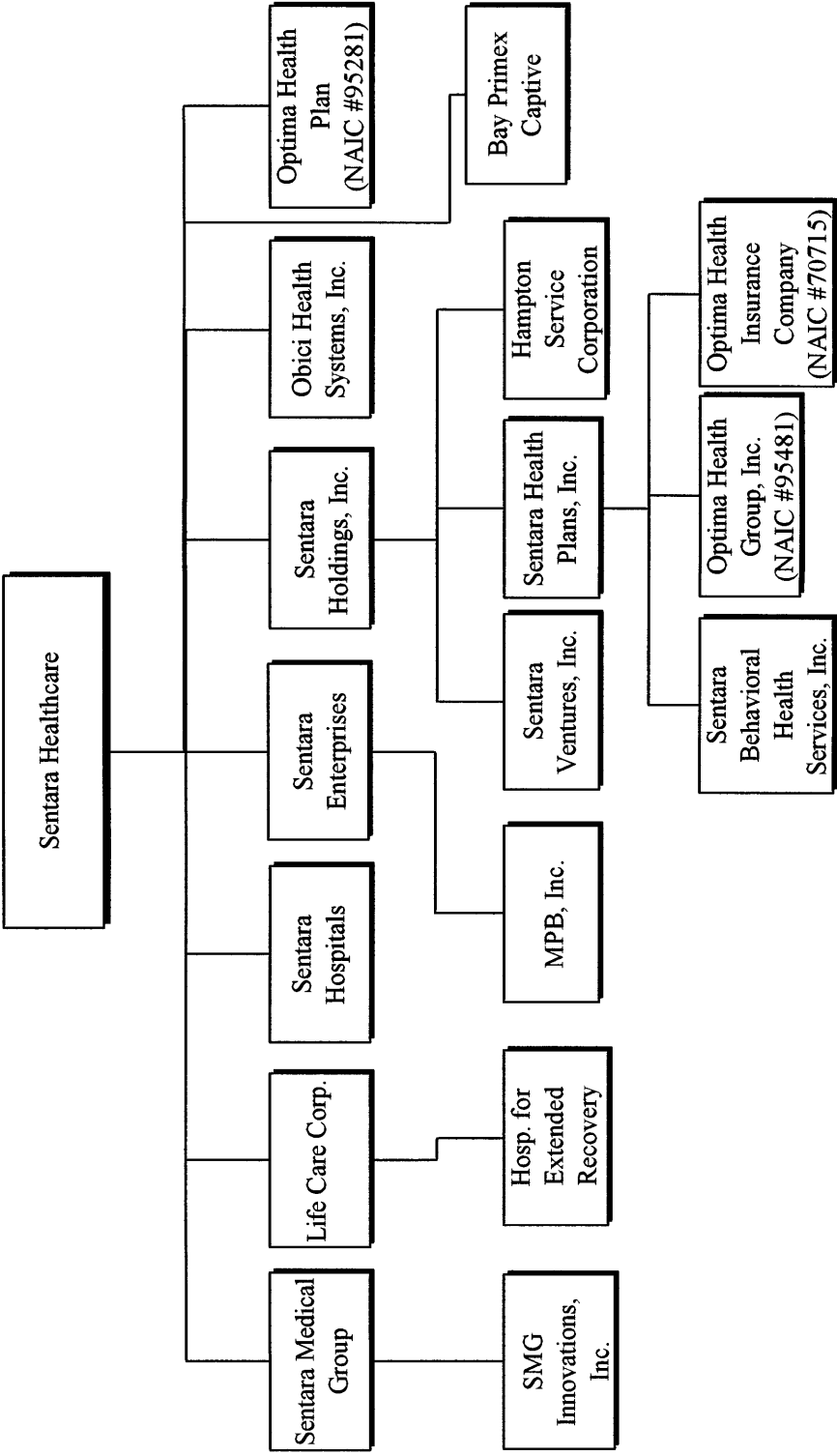
Chief Medical Officer
Sentara Healthcare
Norfolk, Virginia

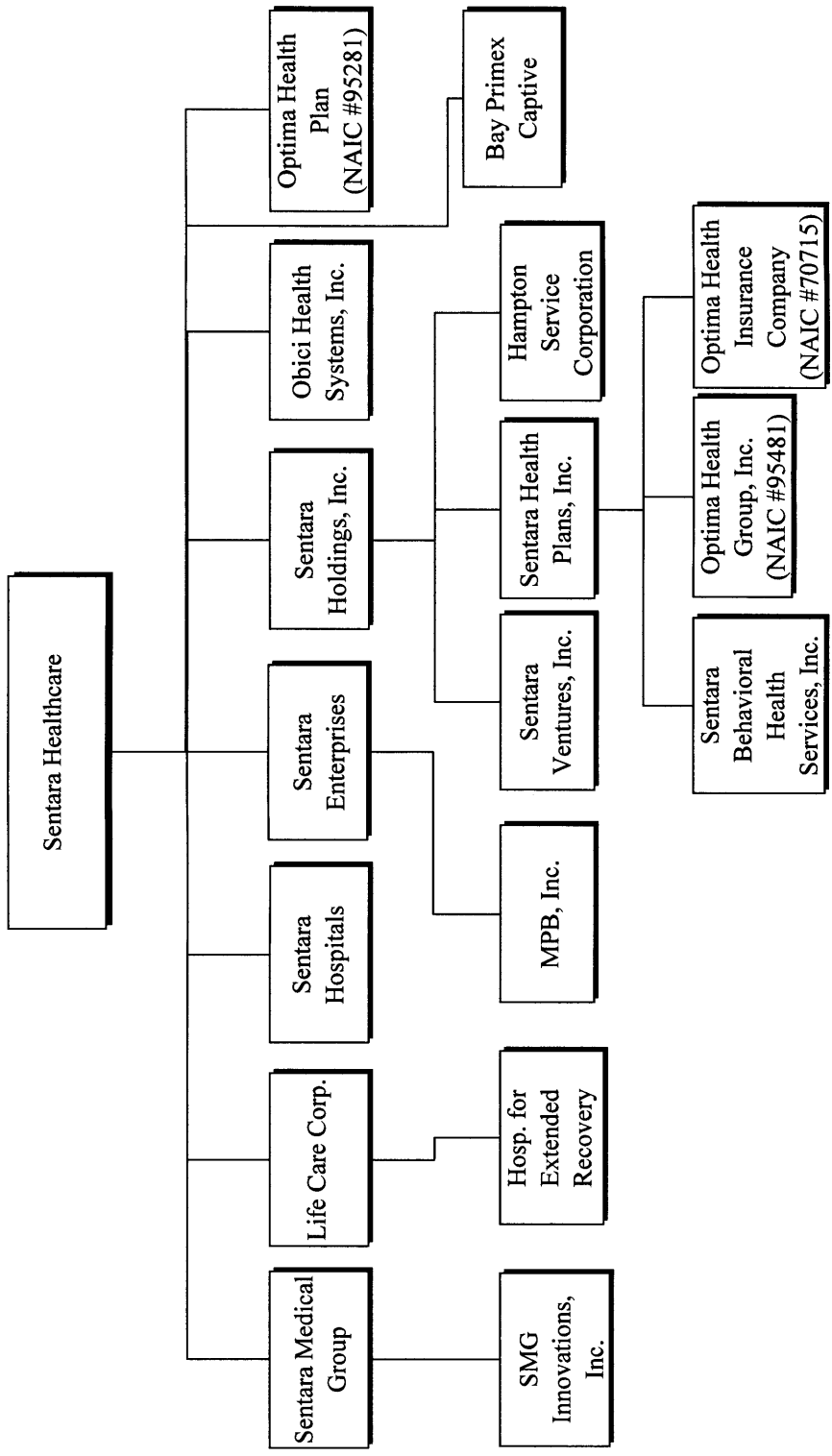
Officers

David L. Bernd	Chairman of the Board
Michael M. Dudley	President
Howard P. Kern	Secretary/Treasurer
John E. DeGruttolla	Senior Vice President – Marketing and Sales
Darlene A. Anderson	Senior Vice President – Operations
Robert A. Broermann	Assistant Treasurer
Gail P. Heagen	Assistant Secretary

The Company's authorized capital is 5,000 shares of common stock with a par value of \$1,000 per share. At December 31, 2007, there were 1,040 shares issued and outstanding.

The Company is a wholly owned subsidiary of Sentara Health Plans, Inc. ("SHP") (formerly Sentara Health Management). The ultimate controlling person is Sentara Healthcare ("Sentara"), a non-stock, not-for-profit, tax-exempt Virginia corporation. By virtue of this ownership, the Company is a member of an insurance holding company system as defined in Section 38.2-1322 of the Code of Virginia. The following chart summarizes the Company's relationship within the holding company system:





TRANSACTIONS WITH AFFILIATES

Administrative Services Agreement

At December 31, 2007 the Company has an Administrative Services Agreement with SHP. According to the provisions of the agreement, SHP shall perform, or arrange for the performance of the administrative services necessary with respect to the Company's policies. The services include but are not limited to the following:

- Underwriting Services
- Enrollment Services
- Claims Administrative Services
- Information Systems Services
- Premium Billing and Collecting
- Inquiries and Requests
- Administrative Material
- Investment Services
- Medical Care Management
- Provider Relations
- Marketing Services

As compensation for these services, the Company shall pay SHP a monthly administrative fee. The administrative fee shall equal the actual costs incurred by SHP in providing the services and shall include the direct costs as well as the allocable portion of costs incurred by SHP in connection with providing such services. SHP will develop and periodically revise a cost allocation model to allocate appropriate administrative costs among the SHP companies. The Company paid SHP \$15,034,615 in 2007, \$13,679,671 in 2006 and \$12,008,953 in 2005 for services pursuant to this agreement.

Tax Allocation Agreement

At December 31, 2007, the Company participates in a tax allocation agreement with its affiliates. Pursuant to this agreement a consolidated federal income tax return is filed. The provisions from the tax allocation agreement met the requirements from the NAIC Examiners Handbook, including, but not limited to a) having a written agreement approved by the board of directors, b) balances are settled within a reasonable time and c) the agreement complies with IRS regulations.

Mental Health Services Agreement

At December 31, 2007 the Company contracts with Sentara Behavioral Health Services ("SBHS"), a subsidiary of SHP, to provide mental health services to its subscribers. Pursuant to the terms of the capitated agreement, the Company pays SBHS a fixed rate per member per month to cover the costs of these services. The Company paid SBHS \$1,351,899 in 2007, \$1,197,000 in 2006 and \$914,000 in 2005 in capitation expenses pursuant to this agreement.

Provider Agreements

The Company contracts with several subsidiaries of Sentara Healthcare to provide hospital, physician services and other medical services to its members.

HMO Excess Risk Policy

Effective October 1, 2001, the Company entered into a HMO Excess Risk Policy with Optima Health Plan ("OHP") and Optima Health Group ("OHG"). According to the terms of the policy, the Company will reimburse OHP and OHG 100% of the eligible services incurred in excess of the \$500,000 deductible per member per catastrophic event up to a maximum of \$1,000,000 per member per year. Eligible services are defined as those approved acute care hospital services rendered to a member who is registered as a bed patient at a licensed acute care hospital. Covered services also include hospital services for members approved for transplants, except transplants performed at Sentara Norfolk General Hospital which are specifically excluded under the policy. The Company receives a per member per month fee from OHP and OHG as set forth in the policy to cover all excess risk claims.

Capital Contribution

On January 28, 2005, the Company submitted a Form D filing with the Bureau requesting approval of a capital contribution of \$6,000,000 from its parent, SHP. On February 3, 2005, the Bureau approved this transaction and on February 16, 2005, the funds were infused into the Company.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2007 the Company maintained fidelity coverage of \$4,000,000, subject to a \$100,000 deductible, to insure against losses arising from the dishonest acts of its officers and employees. Additionally, the Company was listed as a named insured on a professional/commercial general liability policy, a commercial property insurance policy, a directors and officers liability policy, a workers compensation and employers liability policy and other coverages usual and customary to the nature of its business.

TERRITORY AND PLAN OF OPERATION

On October 26, 1992, the Company was issued a license to transact the business of accident and sickness insurance in the Commonwealth of Virginia. It is not licensed to do business in any other state. The Company was formed to provide the insurance component of existing and proposed group health coverage products of SHP. The Company has no immediate plans to offer life insurance.

Sentara owns or operates a significant number of health facilities. Optimum utilization of these facilities is a prime factor in cost containment. The Company's strategy is to offer products which will encourage utilization of Sentara facilities.

At December 31, 2007, the Company administers three commercial products and a Medicare Advantage PPO (preferred provider organization) product. The commercial products are identified as a PPO product, a point of service (POS) product, and an out-of-area (OOA) product. The Company does not currently sell the POS product. The PPO product strives to manage costs by encouraging the insured to utilize Sentara facilities, providers and contracted providers with resultant lower co-payments, deductibles and coinsurance. The use of non-participating providers is offered at higher out-of-pocket costs to the insured. The OOA product is an indemnity product designed primarily as an offering to area employers who have members who work out of the local area and use non-network facilities. For each of the commercial products, if out-of-network providers are utilized, the insureds are subject to higher deductibles, co-payments, and payment of charges which exceed the Company's allowable limits. The Medicare Advantage PPO product is a managed Medicare product. This program is not a Medicare Supplemental plan but serves as a replacement for traditional fee-for-service Medicare, parts A, B and D, with similar benefits to Medicare and greater savings in premium than can be found with fee for service Medicare and most Medicare Supplemental plans.

Marketing of these products is directed toward employers or organizations in the area having populations large enough to qualify for group insurance. The marketing effort is accomplished through the SHP marketing division and selected brokers.

CONFLICT OF INTEREST

The Company has adopted a conflict of interest policy. The objective of this policy is to ensure that each director, officer, and employee faithfully serves the Company and refrains from doing anything which is adverse or prejudicial to the Company's interest. To ensure compliance with the policy, the Company has established procedures which require directors, officers and members of a committee with Board designated powers to sign a conflict of interest disclosure form annually.

GROWTH OF THE COMPANY

The following data represents the growth of the Company for the ten-year period ending December 31, 2007. The data is compiled from the Company's filed Annual Statements, previous examination reports, and the current examination report.

	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>	<u>Unassigned Funds</u>	<u>Premiums</u>	<u>Net Income/ (Loss)</u>
1998	\$17,379,602	8,873,394	10,400,000	(1,893,792)	43,350,001	(399,048)
1999	19,789,324	11,788,223	14,000,000	(5,998,899)	80,066,647	(4,084,259)
2000	18,121,749	10,767,188	24,000,000	(16,645,439)	69,711,631	(10,674,544)
2001	13,727,287	9,167,235	27,000,000	(22,439,948)	63,476,893	(1,910,291)
2002	18,695,812	8,969,089	27,000,000	(17,273,277)	59,585,619	1,799,230
2003	22,799,883	8,657,781	27,000,000	(12,857,898)	58,581,920	11,243,046
2004	25,162,854	10,876,267	27,000,000	(12,713,413)	59,220,570	3,145,950
2005	29,907,926	10,090,913	27,000,000	(7,182,987)	50,574,003	280,905
2006	33,866,521	11,808,717	27,000,000	(4,942,197)	75,778,449	(260,668)
2007	37,930,667	13,466,546	27,000,000	(2,535,879)	89,830,090	2,751,489

EXCESS LOSS INSURANCE

Effective April 1, 2007, the Company entered into an Excess Risk Insurance Agreement with HCC Life Insurance Company ("HCC"). For eligible expenses, the deductible is \$1,000,000 per member for each contract year except for the largest claim in a contract year in which the deductible is \$1,300,000. Once the deductible has been reached in a contract year, HCC will reimburse the Company 90% of all eligible expenses up to a maximum of \$5,000,000 per member per contract year. The agreement includes a continuation of coverage endorsement in the event of the Company's insolvency.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period January 1, 2005 through December 31, 2007. Assets were verified and liabilities were established at December 31, 2007. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the NAIC Examiners Handbook. Analytical review procedures were applied for non-SRA items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in the report.

History
Corporate records
Management and control
Transactions with affiliates
Fidelity bond and other insurance
Territory and plan of operations
Growth of the company
Accounts and records
Financial statements

FINANCIAL STATEMENTS

There follows a statement of financial condition of the Company at December 31, 2007, a statement of revenue and expenses for the year ending December 31, 2007, a reconciliation of capital and surplus for the period under review, and a statement of cash flows for the year ending December 31, 2007. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$10,846,800		\$10,846,800
Cash and short-term investments	<u>25,909,094</u>		<u>25,909,094</u>
Subtotals, cash and invested assets	\$36,755,894	\$0	\$36,755,894
Investment income due and accrued	118,710		118,710
Uncollected premiums and agents' balances in the course of collection	319,307	289,556	29,751
Net deferred tax asset	735,000	44,000	691,000
Electronic data processing equipment and software	115,787		115,787
Furniture and equipment, including health care delivery assets	50,197	50,197	0
Health care and other amounts receivable	451,099	231,574	219,525
Other assets nonadmitted	<u>39,703</u>	<u>39,703</u>	<u>0</u>
Total assets	<u><u>\$38,585,697</u></u>	<u><u>\$655,030</u></u>	<u><u>\$37,930,667</u></u>

LIABILITIES, CAPITAL AND SURPLUS

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims unpaid	\$8,704,610	\$628,605	\$9,333,215
Accrued medical incentive pool and bonus amounts	694,678		694,678
Unpaid claim adjustment expenses		155,909	155,909
Aggregate health policy reserves	12,596		12,596
Aggregate health claim reserves	129,662	9,364	139,026
Premiums received in advance	1,053,203		1,053,203
Amounts due to parent, subsidiaries and affiliates	568,179	860,725	1,428,904
Aggregate write-ins for other liabilities	<u>649,015</u>		<u>649,015</u>
Total liabilities	<u>\$11,811,943</u>	<u>\$1,654,603</u>	<u>\$13,466,546</u>
Common capital stock			\$ 1,040,000
Gross paid in and contributed surplus			25,960,000
Aggregate write-ins for other than special surplus funds			(335,085)
Unassigned funds (surplus)			<u>(2,200,794)</u>
Total capital and surplus			<u>\$24,464,121</u>
Total liabilities, capital and surplus			<u><u>\$37,930,667</u></u>

STATEMENT OF REVENUE AND EXPENSES

	<u>Uncovered</u>	<u>Total</u>
Net premium income	XXX	\$89,830,090
Change in unearned premium reserves and reserve for rate credits	XXX	1,766
Total revenues	XXX	\$89,831,856
Hospital and Medical:		
Hospital/medical benefits	\$4,649,423	\$57,337,707
Emergency room and out-of-area	180,431	2,410,251
Prescription drugs		10,689,961
Aggregate write-ins for other hospital and medical		343,314
Incentive pool, withhold adjustments and bonus amounts		930,000
Total hospital and medical	\$4,829,854	\$71,711,233
Claims adjustment expenses	1,341,674	1,341,674
General administrative expenses	13,919,326	13,998,068
Total underwriting deductions	\$20,090,854	\$87,050,975
Net underwriting gain	XXX	\$2,780,881
Net investment income earned		\$1,562,957
Net realized capital gains		78,692
Net investment gains		\$1,641,649
Net income before federal income taxes	XXX	\$4,422,530
Federal income taxes incurred	XXX	1,671,041
Net income	XXX	\$2,751,489

RECONCILIATION OF CAPITAL AND SURPLUS

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Capital and surplus prior reporting year	<u>\$14,286,587</u>	<u>\$19,817,013</u>	<u>\$22,057,804</u>
GAINS AND LOSSES TO CAPITAL AND SURPLUS			
Net income or (loss)	280,905	(260,668)	2,751,489
Change in net deferred income tax	(173,000)	319,000	134,000
Change in nonadmitted assets	(16,567)	128,223	(492,655)
Paid in	6,000,000		
Aggregate write-ins for gains or (losses) in surplus	<u>(560,912)</u>	<u>2,054,236</u>	<u>13,483</u>
Net change in capital and surplus	<u>\$5,530,426</u>	<u>\$2,240,791</u>	<u>\$2,406,317</u>
Capital and surplus end of reporting year	<u><u>\$19,817,013</u></u>	<u><u>\$22,057,804</u></u>	<u><u>\$24,464,121</u></u>

CASH FLOW**Cash from Operations**

Premiums collected net of reinsurance	\$90,876,158
Net investment income	<u>1,627,127</u>
Total	\$92,503,285
Benefit and loss related payments	\$70,423,476
Commissions, expenses paid and aggregate write-ins for deductions	15,339,742
Federal income taxes paid	<u>1,671,041</u>
Total	<u>\$87,434,259</u>
Net cash from operations	<u>\$5,069,026</u>

Cash from Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$7,856,387
Miscellaneous proceeds	<u>57,728</u>
Total investment proceeds	<u>\$7,914,115</u>
Cost of investments acquired (long-term only):	
Bonds	\$8,039,728
Miscellaneous applications	<u>82,662</u>
Total investment acquired	<u>\$8,122,390</u>
Net cash from investments	<u>(\$208,275)</u>

Cash from Financing and Miscellaneous Sources

Cash provided:	
Other cash provided	<u>\$2,521,491</u>
Net cash from financing and miscellaneous sources	<u>\$2,521,491</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

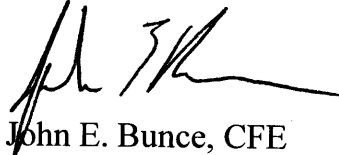
Net change in cash and short-term investments	\$7,382,242
Cash and short-term investments:	
Beginning of the year	<u>18,526,852</u>
End of the year	<u><u>\$25,909,094</u></u>

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Bryan Almond, Chris Collins, John Drean, CFE, David Fiden, Kevin Knight, AFE, Hai Nguyen and Michael Peterson participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'John E. Bunce', written over a horizontal line.

John E. Bunce, CFE
Assistant Chief Examiner
Commonwealth of Virginia