

EXAMINATION REPORT
of
SOUTHERN HEALTH SERVICES, INC.
Richmond, Virginia
as of
December 31, 2010

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

JACQUELINE K. CUNNINGHAM
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



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I, Jacqueline K. Cunningham, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Southern Health Services, Inc. as of December 31, 2010, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 27th day of January, 2012

Jacqueline K. Cunningham
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
November 10, 2011

Honorable Jacqueline K. Cunningham
Commissioner of Insurance
Richmond, Virginia

Dear Madam:

Pursuant to your instructions and by the authority of Section 38.2-4315 of the Code of Virginia, an examination of the records and affairs of

SOUTHERN HEALTH SERVICES, INC.

Richmond, Virginia

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

DESCRIPTION

The Corporation became licensed in Virginia as a health maintenance organization ("HMO") pursuant to Chapter 43 of Title 38.2 of the Code of Virginia on April 1, 1991. The Corporation was last examined by representatives from the State Corporation Commission's (the "Commission") Bureau of Insurance (the "Bureau") as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2010.

HISTORY

Southern Health Services, L.P. (the "Partnership") was organized on November 21, 1983 and became licensed as an HMO on March 15, 1985. The Partnership's general partner was Southern Health Management Corporation (the "General Partner"), a Subchapter S corporation formed on November 23, 1983.

Effective April 1, 1991, the Partnership and the General Partner were reorganized and merged into Southern Health Management Corporation ("SHMC"). Southern Health Services, Inc. (the "Corporation") succeeded the Partnership when the Partnership transferred its assets and liabilities to SHMC and SHMC simultaneously transferred certain assets and liabilities to the Corporation. The Corporation became a federally qualified HMO on June 1, 1991.

On September 14, 1994, SHMC, Coventry Corporation and Coventry Acquisition Sub, Inc., a wholly owned subsidiary of Coventry Corporation, entered into an Agreement and Plan of Reorganization. In accordance with terms of the Agreement, Coventry Acquisition Sub, Inc. would merge with and into SHMC, with SHMC becoming the surviving entity. The merger was approved by the Bureau on November 8, 1994. On December 1, 1994, the Plan of Merger was closed and the Certificate of Merger was filed with the Commonwealth of Virginia. At the time of the merger, Coventry Corporation became the sole shareholder of SHMC by converting the outstanding shares of SHMC's common stock into approximately \$75,000,000 worth of Coventry Corporation's common stock. During 1996, SHMC changed its name to Coventry HealthCare Management Corporation ("CHMC").

On January 27, 1998, the Bureau approved a change in control of the Corporation. Principal Health Care, Inc. merged with Coventry Corporation, forming a new company, Coventry Health Care, Inc. ("Coventry"). CHMC continued to be the immediate parent company of the Corporation and Coventry became the immediate parent company of CHMC.

On July 27, 2001, Coventry entered into a Stock Acquisition Agreement with the Rector and Visitors of the University of Virginia ("UVA"), the University of Virginia Health Services Foundation and Blue Ridge Health Alliance, Inc. ("BRHA") to purchase 100% of the issued and outstanding capital stock of BRHA, including its wholly owned subsidiary QualChoice of Virginia Health Plan, Inc. ("QualChoice"), a Virginia domiciled HMO that was initially licensed in Virginia on January 4, 1995. Upon acquisition of BRHA's capital stock, BRHA, QualChoice and the Corporation merged, with the Corporation remaining as the surviving entity. The Bureau approved the transaction on August 28, 2001 and the acquisition and merger was completed on September 1, 2001.

Effective September 30, 2002, the Corporation merged with and into CHMC with the Corporation remaining as the surviving entity. Prior to the merger the Corporation was a wholly owned subsidiary of CHMC and, as a result of the merger, all outstanding shares of the Corporation were transferred to Coventry. At December 31, 2010, all of the outstanding shares of the common stock of the Corporation are held by Coventry.

CAPITAL AND SURPLUS

At December 31, 2010, the Corporation's capital and surplus was \$60,048,012. According to the amended and restated Articles of Incorporation, the Corporation has the authority to issue 1,000 shares of common capital stock with a par value of \$.01 per share. As of December 31, 2010, 1,000 shares were issued and outstanding, with gross paid in and contributed surplus of \$106,211,202 and unassigned funds of (\$46,163,200).

NET WORTH REQUIREMENT

Section 38.2-4302 of the Code of Virginia states that an HMO licensed in Virginia shall maintain a minimum net worth in an amount at least equal to the sum of uncovered expenses, but not less than \$600,000, up to a maximum of \$4,000,000. 14 VAC 5-210-60 A requires that an HMO report the sum of its uncovered expenses for each three-month period ending December 31, March 31, June 30 or September 30. Because the sum of the Corporation's uncovered expenses for the three-month period ending December 31, 2010 was \$6,571,884, the Corporation's minimum net worth requirement at December 31, 2010 was \$4,000,000.

MANAGEMENT AND CONTROL

The bylaws of the Corporation provide that the business and affairs of the Corporation shall be managed by the Board of Directors (the "Board"). The minimum number of Directors shall be three with the actual number fixed by the affirmative vote of a majority of the entire Board. Each director shall be elected for one year or until the next annual meeting of the Corporation's shareholders. A majority of the directors elected to hold office shall constitute a quorum for the transaction of business.

The officers of the Corporation shall consist of a President, a Treasurer and a Secretary. Additional officers, including a Chairman of the Board and assistant officers, may be elected or appointed by the Board. Any two or more offices may be held by the same person.

At December 31, 2010, the Board and Officers were as follows:

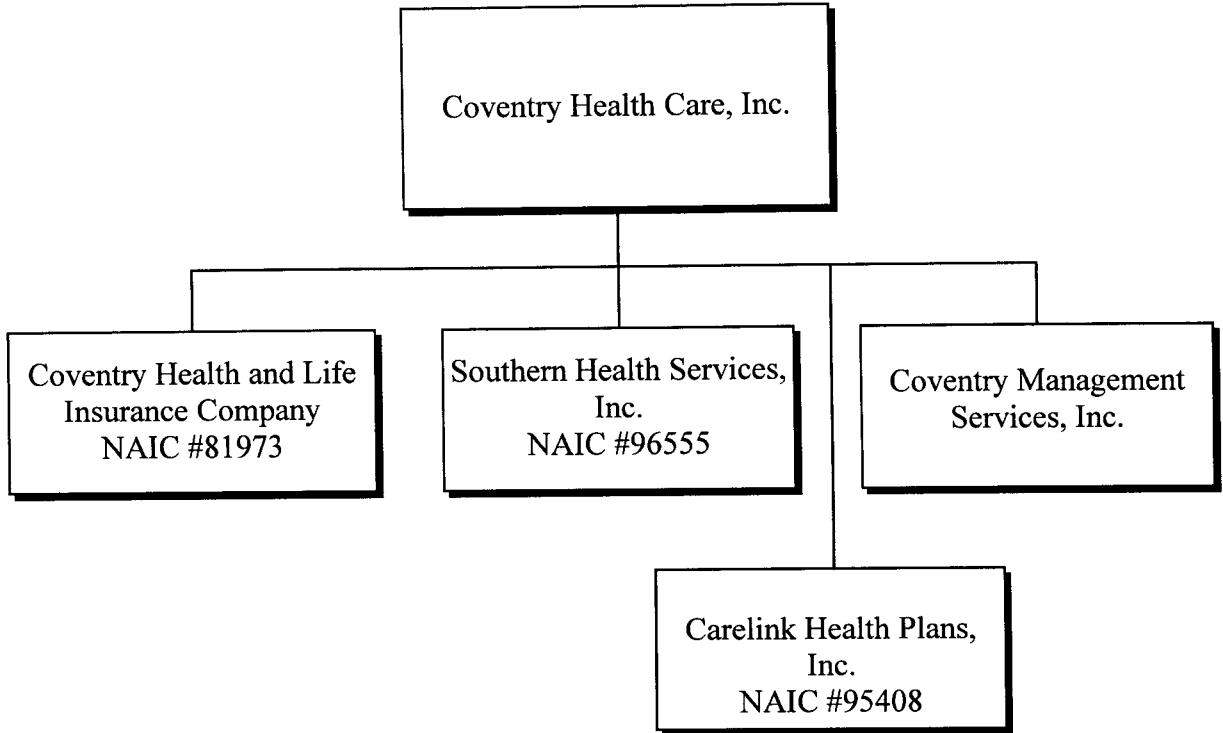
<u>Directors</u>	<u>Principal Occupation</u>
Michael D. Bahr	Executive Vice President Coventry Health Care, Inc. Bethesda, Maryland
Tracy H. Baker	President and Chief Executive Officer Southern Health Services, Inc. Richmond, Virginia
Charles R. Stark	President and Chief Executive Officer Coventry Health Care of Nebraska, Inc. Omaha, Nebraska

Officers

Tracy H. Baker	President and Chief Executive Officer
John K. Maruca	Vice President
W. Dewey Brown, Jr.	Chief Financial Officer
Peter W. Chauncey	Chief Operations Officer
John J. Ruhlman	Corporate Controller
Denise W. Bartlett	Assistant Corporate Controller
Melinda L. Tuozzo	Assistant Treasurer
Shirley A. Roquermore-Smith	Secretary
Jonathan D. Weinberg	Assistant Secretary
Lee J. Nicholson	Actuary

AFFILIATED COMPANIES

The Corporation is a wholly owned subsidiary of Coventry. The following chart shows the organizational structure of Coventry and selected subsidiaries at December 31, 2010:



TRANSACTIONS WITH AFFILIATES

Management Services Agreements

Effective January 1, 2003, the Corporation entered into a Management Services Agreement with Coventry. Under the terms of the agreement, Coventry shall perform certain administrative services including, but not limited to, senior management, advertising, actuarial services, marketing and public relations, purchasing, pharmacy services, corporate and legal services, regulatory compliance and governmental affairs, accounting services, tax compliance and consulting, facilities management, risk management, human resources consulting and payroll services. As compensation, the Corporation pays Coventry \$5.26 per member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation incurred \$8,329,552 in fees related to the agreement in 2010.

Effective January 1, 2003, the Corporation entered into a Management Services Agreement with Coventry Management Services, Inc. ("CMS"). Under the terms of the agreement, CMS shall perform the following services:

- a. **Information System Services.** Provide all services relating to information system equipment and services, including, but not limited to, desktop support, application development, data center support, telecommunications support and network support.
- b. **Service Center Services.** Provide claims processing services, data integrity services, fraud and recovery support, premium billing and collection services, enrollment and eligibility services, member services and benefit and contract administration.

As compensation, the Corporation pays CMS \$5.44 and \$5.27 per member per month for information system services and service center services, respectively. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation incurred \$9,048,141 in information system fees and \$8,657,166 in service center fees related to the agreement in 2010.

Administrative Services Agreement

Effective January 1, 2002, the Corporation entered into an Administrative Services Agreement with Coventry Health and Life Insurance Company ("CHLIC"). Pursuant to the agreement, the Corporation shall perform certain administrative services for CHLIC including management and general administrative services, sales and marketing, financial services, medical management, provider relations and contracting, and facilities and support. For these services, the Corporation is reimbursed \$14 per CHLIC member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation charged \$4,840,738 in fees related to this agreement during 2010.

Management Services Agreement

Effective April 1, 2006, the Corporation entered into a Management Services Agreement with Carelink Health Plans, Inc. ("Carelink"). Pursuant to the agreement, the Corporation shall provide senior management services, medical management services, regulatory compliance and governmental affairs, financial and accounting services and human resources consulting. For these services, the Corporation is reimbursed \$4 per Carelink member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation charged \$4,466,832 in fees related to this agreement during 2010.

Excess Risk Insurance Agreement

Effective April 1, 2010, the Corporation entered into an amended Excess Risk Insurance Agreement with CHLIC. The deductible pursuant to the agreement is \$300,000 per HMO and Point-of-Service member per year and \$225,000 per Medicaid member per year. Once the deductible has been reached, CHLIC will reimburse the Corporation for eligible charges in the following manner:

- a. 90% as to each HMO and Point-of-Service plan member.
- b. 80% as to each Medicaid member.

The maximum insurance payable under this agreement for any one member is \$1,000,000. In 2010, the Corporation incurred \$2,798,988 in premiums and recovered \$1,409,847 in claims pursuant to the agreement.

Tax Sharing Agreement

Effective with the tax year ending December 31, 2004, the Corporation entered into an Amended and Restated Tax Sharing Agreement with and among Coventry and its subsidiaries. Pursuant to the agreement, the Corporation is included in the consolidated federal income tax return filed by Coventry. The Corporation's federal income tax liability or refund is determined as if it was filing its own separate federal income tax return. If the Corporation's tax benefits (i.e. losses or credits) are used to reduce the consolidated federal tax liability, Coventry will pay the Corporation the amount equal to the reduction in the consolidated federal income tax liability. If the Corporation's tax liabilities are used to increase the consolidated federal tax liability, the Corporation will pay Coventry the amount equal to the increase in the consolidated federal income tax liability. Final settlement for a tax year shall be paid to Coventry or paid by Coventry within ninety days after the filing of the consolidated federal income tax return.

Guarantor Agreement

Effective June 7, 2001, the Corporation entered into a Guarantor Agreement with Coventry. According to the agreement, Coventry will pay all expenses and claims incurred by the Corporation pursuant to its agreements with groups and subscribers in the event of the Corporation's inability to pay or its insolvency. Such expenses and claims shall include, but not be limited to, all hospital charges and any other fee-for-service charge for services or benefits for which the Corporation is liable, capitation payments to health care providers who have contracted with the Corporation and payments to health care providers not under contract with the Corporation for covered services rendered to a member.

Dividends

The Corporation paid cash dividends of \$13,650,000, \$5,000,000 and \$14,492,000 in 2008, 2009 and 2010, respectively. The 2010 dividend was considered extraordinary and was pre-approved by the Commission. The 2008 and 2009 dividends were considered ordinary and did not require prior approval of the Commission. The dividends were paid to the Corporation's sole shareholder, Coventry.

TERRITORY AND PLAN OF OPERATION

At December 31, 2010, the Corporation's service area, as reported in its 2010 Annual Statement, included the Virginia cities of Alexandria, Bedford, Bristol, Buena Vista, Charlottesville, Clifton Forge, Colonial Heights, Covington, Danville, Emporia, Fairfax, Falls Church, Fredericksburg, Galax, Harrisonburg, Hopewell, Lexington,

Lynchburg, Manassas, Manassas Park, Martinsville, Norton, Petersburg, Radford, Richmond, Roanoke, Salem, Staunton, Suffolk, Waynesboro, Williamsburg and Winchester. In addition, the service area included the Virginia counties of Albemarle, Alleghany, Amelia, Amherst, Appomattox, Arlington, Augusta, Bath, Bedford, Bland, Botetourt, Brunswick, Buckingham, Campbell, Caroline, Carroll, Charles City, Charlotte, Chesterfield, Clarke, Craig, Culpeper, Cumberland, Dinwiddie, Essex, Fairfax, Fauquier, Floyd, Fluvanna, Franklin, Frederick, Giles, Goochland, Grayson, Greene, Greensville, Halifax, Hanover, Henrico, Henry, Isle of Wight, James City, King and Queen, King George, King William, Lancaster, Loudoun, Louisa, Lunenburg, Madison, Mathews, Mecklenburg, Middlesex, Montgomery, Nelson, New Kent, Northumberland, Nottoway, Orange, Page, Patrick, Pittsylvania, Powhatan, Prince Edward, Prince George, Prince William, Pulaski, Rappahannock, Richmond, Roanoke, Rockbridge, Rockingham, Russell, Shenandoah, Smith, Spotsylvania, Stafford, Surry, Sussex, Tazewell, Warren, Washington, Westmoreland, Wise, Wythe and York. The Corporation's service area also includes the West Virginia counties of Greenbrier, Hardy, Monroe, Pendleton and Pocahontas.

Medical services are provided by physicians in independent practice within the Corporation's service area. The Corporation markets an HMO plan, an In-Network Point-of-Service (POS) plan and an Out-of-Network POS plan. Each member selects a primary care physician ("PCP") from a directory of the Corporation's primary providers. Members can go to a specialist physician without a referral, however, under the HMO and In-Network POS plans the specialist physician must be a participating provider in order for services to be covered. Members must receive prior authorization for inpatient hospital admissions and selected outpatient procedures. A member must notify the Corporation within 24 hours of an emergency room visit or emergency hospital admission.

During 2010, the Corporation contracted with the Virginia Department of Medical Assistance Services to administer coverage to Medicaid members which comprised 34% of its total premium revenue.

CONFLICT OF INTEREST

The Corporation has adopted Coventry's code of business conduct and ethics policy. The policy, as it relates to conflicts of interest, states that directors, officers, and employees should avoid situations that conflict or appear to conflict with their personal interests and the interests of the Corporation. To ensure compliance with the policy the Corporation's directors, officers and employees must complete an annual conflict of interest questionnaire that discloses any interests, affiliations, and relationships.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2010, the Corporation was listed as a named insured on a financial institution bond with a \$10,000,000 limit of liability, subject to a \$500,000 deductible, to insure against losses arising from dishonest acts of its officers and employees. Additionally, the Corporation was listed as a named insured on a property insurance policy, a commercial general liability policy, a professional liability policy, a commercial umbrella liability policy, a commercial automobile policy, and a workers compensation and employers liability policy.

PROVIDER AGREEMENTS

Medical Services

The Corporation has entered into agreements with numerous PCPs and specialist physicians to render, provide or arrange for the provision of covered health care services to members. The Corporation compensates participating physicians either on a capitated basis or a fee-for-service arrangement. The fee-for-service arrangement is the lesser of billed charges or established fee schedules minus any applicable copayments.

Hospital Care

The Corporation has entered into agreements with a number of hospitals in its service area to provide covered hospital services to members. The Corporation compensates participating hospitals on either a fee-for-service, a fixed per-diem, or a per case basis. The amounts paid to each hospital are based on terms disclosed in each individual agreement.

Other Health Care Services

The Corporation has entered into various ancillary service agreements. These agreements provide mental health services, pharmacy services, laboratory services, home health care, physical therapy, durable medical equipment and other related covered health care services. Compensation is based on arrangements set forth in each contract.

CONTRACT FORMS**Group Contracts**

The group contract agreement generally covers the following services provided by PCPs, participating specialists and other participating providers:

1. Physician Services
2. Inpatient Hospital Care
3. Preventive Care
4. Maternity Services
5. Skilled Nursing Facility Confinement
6. Home Health Care Services
7. Ambulance Services
8. Emergency Benefits
9. Durable Medical Equipment
10. Short-Term Rehabilitative Therapy

Exclusions generally include any service or supply that is not medically necessary or any service or supply that is not a covered service; private duty nursing; cosmetic surgery; prescription drugs unless covered by a prescription drug rider; and experimental medical, surgical or other health care procedures, services or supplies. Other exclusions include routine eye exams and visual augmentation devices; contraceptive devices; routine footcare and foot orthotics; and programs for weight reduction or smoking cessation.

The above are abbreviated descriptions of the coverages and exclusions and each individual contract may vary.

GROWTH OF THE CORPORATION

The following data is representative of the growth of the Corporation for the ten-year period ending December 31, 2010. The data is compiled from the Corporation's filed Annual Statements, previous examination reports and the current examination report.

<u>Year</u>	Total Admitted <u>Assets</u>	Total <u>Liabilities</u>	Total Capital & <u>Surplus</u>
2001	\$69,138,537	\$48,519,126	\$20,619,411
2002	70,455,422	37,671,506	32,783,916
2003	76,026,998	43,578,489	32,448,509
2004	86,977,731	45,024,220	41,953,511
2005	92,640,930	46,422,914	46,218,016
2006	102,839,842	41,487,041	61,352,801
2007	106,789,201	49,564,358	57,224,843
2008	102,867,409	42,264,452	60,602,957
2009	98,074,324	37,542,166	60,532,158
2010	95,730,259	35,682,247	60,048,012

<u>Year</u>	Total <u>Revenue</u>	Net Investment <u>Gain</u>	Medical & Hospital <u>Expenses</u>	Administrative <u>Expenses</u>	Pre-Tax Income <u>(Loss)</u>
2001	\$245,295,898	\$2,095,363	\$228,760,419	\$45,029,985	(\$26,399,143)
2002	233,641,847	1,938,671	196,378,248	32,344,819	6,857,451
2003	268,420,669	2,320,160	227,908,168	34,464,011	8,368,650
2004	310,664,732	2,499,228	256,177,136	29,962,630	27,024,194
2005	338,032,322	2,719,626	285,249,190	30,240,954	25,261,804
2006	362,886,208	3,682,867	291,610,867	29,978,418	44,979,790
2007	387,993,182	4,779,452	319,778,352	33,911,764	39,082,518
2008	337,833,926	3,712,223	291,310,348	26,226,435	24,009,366
2009	276,042,474	2,622,121	245,886,919	27,311,198	5,466,478
2010	242,733,601	2,411,026	199,742,561	25,945,012	19,457,054

The Corporation's enrollment data at year-end is illustrated as follows:

<u>Year</u>	<u>Number of Members</u>
2001	122,012
2002	97,836
2003	103,386
2004	112,040
2005	112,185
2006	106,368
2007	117,565
2008	92,166
2009	70,998
2010	57,769

EXCESS RISK INSURANCE

At December 31, 2010, the Corporation has an Excess Risk Insurance Agreement with CHLIC. The specific terms of the contract are discussed in the Transactions with Affiliates section of the examination report

SPECIAL RESERVES AND DEPOSITS

At December 31, 2010, the Bureau required the Corporation to maintain a minimum deposit of \$3,380,000 with the Treasurer of Virginia.

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, 2008 through December 31, 2010. Assets were verified and liabilities were established at December 31, 2010.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook. The Handbook requires that the Bureau plan and perform the examination to evaluate the financial condition and identify prospective risks of the Corporation, assess corporate governance, identify and assess inherent risks within the Corporation, and evaluate system controls and procedures used to mitigate those risks. An 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 when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2010; a statement of revenue and expenses for the year ending December 31, 2010; a reconciliation of capital and surplus for the period under review; and a statement of cash flow for the year ending December 31, 2010. 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	\$77,355,349		\$77,355,349
Properties occupied by the company	2,183,490		2,183,490
Cash and short-term investments	<u>5,157,337</u>		<u>5,157,337</u>
Subtotals, cash and invested assets	\$84,696,176	\$0	\$84,696,176
Investment income due and accrued	1,030,298		1,030,298
Uncollected premiums and agents' balances in the course of collection	7,611,092		7,611,092
Amounts recoverable from reinsurers	1,255,898	1,255,898	0
Amounts receivable relating to uninsured plans	565,836		565,836
Current federal income tax recoverable and interest thereon	182,831		182,831
Net deferred tax asset	1,223,289	128,479	1,094,810
Furniture and equipment	156,813	156,813	0
Health care and other amounts receivable	564,244	15,028	549,216
Aggregate write-in for other than invested assets	<u>243,532</u>	<u>243,532</u>	<u>0</u>
Total assets	<u><u>\$97,530,009</u></u>	<u><u>\$1,799,750</u></u>	<u><u>\$95,730,259</u></u>

LIABILITIES, CAPITAL AND SURPLUS

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims unpaid	\$15,911,116	\$615,431	\$16,526,547
Unpaid claims adjustment expenses	329,000		329,000
Premiums received in advance	2,156,845		2,156,845
General expenses due or accrued	3,076,308		3,076,308
Current federal income tax payable and interest thereon	455,932		455,932
Amounts withheld or retained for the account of others	6,065		6,065
Remittance and items not allocated	391,882		391,882
Amounts due to parent, subsidiaries and affiliates	8,947,002		8,947,002
Liability for amounts held under uninsured plans	<u>3,792,666</u>		<u>3,792,666</u>
 Total liabilities	 <u>\$35,066,816</u>	 <u>\$615,431</u>	 <u>\$35,682,247</u>
 Common capital stock			\$10
Gross paid in and contributed surplus			106,211,202
Unassigned funds (surplus)			<u>(46,163,200)</u>
 Total capital and surplus			 <u>\$60,048,012</u>
 Total liabilities, capital and surplus			 <u><u>\$95,730,259</u></u>

STATEMENT OF REVENUE AND EXPENSES

	<u>Uncovered</u>	<u>Total</u>
Net premium income	XXX	\$242,731,821
Aggregate write-ins for other health care related revenues	XXX	1,780
Total revenues	XXX	\$242,733,601
Hospital and Medical		
Hospital/medical benefits	\$4,895,664	\$142,940,098
Other professional services	1,419,754	8,059,895
Emergency room and out-of-area	395,947	18,197,067
Prescription drugs		31,955,348
Subtotal	\$6,711,365	\$201,152,408
Less:		
Net reinsurance recoveries		1,409,847
Total hospital and medical	\$6,711,365	\$199,742,561
Claims adjustment expenses	11,264,628	11,264,628
General administrative expenses	14,549,159	14,549,159
Total underwriting deductions	\$32,525,152	\$225,556,348
Net underwriting gain	XXX	\$17,177,253
Net investment income earned		\$2,418,442
Net realized capital gains		(7,416)
Net investment gains		\$2,411,026
Net (loss) from agents' or premium balances charged off		(\$131,225)
Net income before federal income taxes	XXX	\$19,457,054
Federal income taxes incurred	XXX	5,410,996
Net income	XXX	\$14,046,058

RECONCILIATION OF CAPITAL AND SURPLUS

	<u>2008</u>	<u>2009</u>	<u>2010</u>
Capital and surplus prior reporting year	<u>\$57,224,843</u>	<u>\$60,602,957</u>	<u>\$60,532,158</u>
GAINS AND LOSSES TO CAPITAL AND SURPLUS			
Net income	\$17,352,459	\$4,492,029	\$14,046,058
Prior year adjustment	6,146		
Change in net deferred income tax	167,516	25,965	448,331
Change in nonadmitted assets	(498,007)	411,207	(486,535)
Dividends to stockholders	<u>(13,650,000)</u>	<u>(5,000,000)</u>	<u>(14,492,000)</u>
Net change in capital and surplus	<u>\$3,378,114</u>	<u>(\$70,799)</u>	<u>(\$484,146)</u>
Capital and surplus end of reporting year	<u><u>\$60,602,957</u></u>	<u><u>\$60,532,158</u></u>	<u><u>\$60,048,012</u></u>

CASH FLOW**Cash from Operations**

Premiums collected net of reinsurance	\$239,356,657
Net investment income	3,434,973
Miscellaneous income	1,780
Total	<u>\$242,793,410</u>
Benefit and loss related payments	\$203,289,488
Commissions, expenses paid and aggregate write-ins for deductions	25,072,073
Federal income taxes paid	4,897,617
Total	<u>\$233,259,178</u>
Net cash from operations	<u><u>\$9,534,232</u></u>

Cash from Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$15,229,838
Total investment proceeds	<u>\$15,229,838</u>
Cost of investments acquired (long-term only):	
Bonds	\$7,551,381
Real estate	69,991
Total investments acquired	<u>\$7,621,372</u>
Net cash from investments	<u><u>\$7,608,466</u></u>

Cash from Financing and Miscellaneous Sources

Cash provided (applied):	
Dividends to stockholders	(\$14,491,999)
Other cash provided	1,802,777
Net cash from financing and miscellaneous sources	<u><u>(\$12,689,222)</u></u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

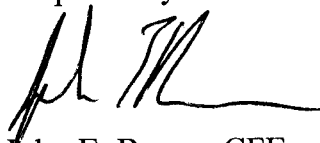
Net change in cash and short-term investments	\$4,453,476
Cash and short-term investments:	
Beginning of the year	703,861
End of the year	<u><u>\$5,157,337</u></u>

CONCLUSION

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

In addition to the undersigned, Chris Collins, AFE, Jack Drean, CFE, and Kevin Knight, AFE, participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'John E. Bunce', written in a cursive style.

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



RECEIVED
BUREAU OF INSURANCE
12 JAN 17 PM 1:45

January 12, 2012

David H. Smith, CFE, CPA, CPCU
Chief Examiner
Bureau of Insurance
P.O. Box 1157
Richmond, Virginia 23218

RE: Southern Health Services, Inc.
Examination Report as of December 31, 2010

Dear Mr. Smith:

On behalf of Southern Health Services, Inc. (Southern Health), I am confirming that Southern Health did receive your Examination Report as of December 31, 2010 in your letter dated January 5, 2012. Since the examination report does not contain any recommendations for corrective action, Southern Health would appreciate receiving two (2) final copies of the report for our records.

We appreciate the opportunity to work with you on this financial examination which covered the period of January 1, 2008 through December 31, 2010.

Sincerely,



Tracy H. Baker
Chief Executive Officer
Southern Health Services, Inc.

Cc: Denise Bartlett, Controller, Southern Health Services, Inc.