REPORT ON EXAMINATION

OF

EXCELLUS HEALTH PLAN, INC.

AS OF

DECEMBER 31, 2003

DATE OF REPORT	**MARCH 21, 2005**
EXAMINER	**BRUCE BOROFSKY**

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

George E. Pataki
Governor

Howard Mills
Superintendent

Honorable Howard Mills
Superintendent of Insurance
Albany, NY 12257

Date: March 21, 2005

Sir:

Pursuant to the provisions of the New York Insurance Law and in accordance with the instructions contained in Appointment Number 22094 dated October 2, 2003, attached hereto, I have made an examination into the condition and affairs of Excellus Health Plan, Inc., as of December 31, 2003 and submit the following report thereon.

The examination was conducted at the Plan's home office located at 165 Court St., Rochester, NY.

Wherever the designations "the Plan," "EHP," or "Excellus" appear herein, without qualification, they should be understood to indicate Excellus Health Plan, Inc., a wholly-owned subsidiary of Lifetime Healthcare, Inc.

Wherever the designation "the Parent" appears herein, without qualification, it should be understood to indicate Lifetime Healthcare, Inc., a not-for-profit Holding Company.

1. SCOPE OF EXAMINATION

The previous financial examination was conducted as of December 31, 1997. The Plan's name, on that date, was Finger Lakes Health Insurance Company, Inc. A market conduct examination was made as of October 10, 2003 and was filed on August 30, 2004. This financial examination covers the six-year period from January 1, 1998 through December 31, 2003. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

It is noted that additional previous examinations of the various entities that were merged into Excellus Health Plan, Inc. during the examination period also exist. These examinations consist of the following:

	Examination period	
Name	Start	End
Blue Cross and Blue Shield of Utica-Watertown, Inc.	July 1, 1989	December 31, 1994
Blue Cross and Blue Shield of Central NY, Inc.	January 1, 1989	December 31, 1993
HMO-CNY, Inc.	January 1, 1990	December 31, 1993
The Health Care Plan, Inc.	January 1, 1993	December 31, 1996
Health Service Medical Corp of Central New York, Inc.	January 1, 1992	September 30, 1996

However, since the management of the Finger Lakes Health Insurance Company, Inc. is the core surviving management of those entities, this report refers to the comments and recommendations of that entity. Where comments from the other previous reports are relevant to the findings of this report, they will be noted here within the applicable sections.

The examination comprised a verification of assets and liabilities as of December 31, 2003 in accordance with Statutory Accounting Principles, as adopted by the

Department, a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Plan's independent certified public accountants. A review was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

History of the Plan
Management and control
Corporate records
Fidelity bonds and other insurance
Territory and plan of operation
Growth of the Plan
Business in force
Loss experience
Reinsurance
Accounts and records
Financial statements

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

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

A concurrent examination was made of the Plan's three line of business health maintenance organizations. The HMO lines of business for the Plan are Fingerlakes HMO, Upstate HMO and Univera Healthcare HMO. The results of such examination are included in Appendix A to this report.

During this examination, an information systems review was made of the Plan's computer systems and operations with the assistance of Ernst & Young, LLP. The results of such review are included in Appendix B to this report.

2. DESCRIPTION OF PLAN

Excellus Health Plan, Inc. is a not-for-profit health service corporation organized and licensed under Article 43 of the New York Insurance Law. The Plan also holds a Certificate of Authority under Article 44 of the New York Public Health Law as a health maintenance organization. The Plan operates using two assumed names, Excellus Blue Cross and Blue Shield and Univera HealthCare.

At the examination date, Excellus, Inc. was the sole member of Excellus Health Plan, Inc. Excellus Inc. changed its name on January 23, 2004 to Lifetime Healthcare, Inc. d/b/a The Lifetime Healthcare Companies. Excellus Health Plan, Inc. is the surviving entity resulting from the mergers of the Blue Cross/Blue Shield Plans in the Rochester, Central New York, and Utica-Watertown regions and HMOs in Central and Western New York including HMO-CNY and Univera Healthcare of Central and Western New York.

A. Management

Pursuant to the Plan's charter and by-laws, management of the Plan is vested in a board of directors consisting of twenty-three members. As of the examination date, the board of directors was comprised of 21 members. The board met six times during each calendar year of the examination period. The directors as of December 31, 2003 were as follows:

Name and Residence	Principal Business Affiliation
Mary A. Bellardini Homer, NY	Retired
Randall L. Clark Buffalo, NY	Chairman, Dunn Tire, LLC
Thomas S. Coughlin Binghamton, NY	President and CEO, McFarland-Johnson, Inc.
Daniel S. Fuleihan, M.D. Syracuse, NY	Physician

Name and Residence	Principal Business Affiliation
David T. Griffith New Hartford, CT	President, M. Griffith, Inc.
Kirk B. Hinman Rome, NY	President, Rome Strip Steel, Inc.
Honorable William A. Johnson, Jr. Rochester, NY	Mayor, City of Rochester, NY
David H. Klein Rochester, NY	President and CEO, MedAmerica of New York, Inc.
Joseph F. Kurnath, M.D. Rochester, NY	Physician and Chairman of the Board, MedAmerica of New York, Inc.
James L. Magavern, Esq. Buffalo, NY	Attorney, Magavern, Magavern & Grimm LLP
Thomas L. Mahoney, M.D. Henrietta, NY	Physician
Geraldine C. Ochocinska Amherst, NY	Director, United Auto Workers, Region 9
Sandra A. Parker Rochester, NY	President and COO, Rochester Business Alliance, Inc.
Carol Raphael New York, NY	President and CEO, Visiting Nurse Services of New York
David D. Reh Fishers, NY	President, The Raytec Group
E. Phillips. Saunders Rochester, NY	President, Saunders Management Co., Inc.
Casper F. Sedgwick Fayetteville, NY	Retired
Mary A. Shaw Syracuse, NY	Associate of the Chancellor, Syracuse University
Albert J. Simone Rochester, NY	President, Rochester Institute of Technology

Name and Residence	Principal Business Affiliation
William F. Streck, M.D. Cooperstown, NY	Physician and President and CEO, Bassett Healthcare
William E. Whitehill, Jr. Clayville, NY	Retired

A review of the minutes of the attendance records at the Plan's board of directors' meetings held during the period under examination revealed that the meetings were generally well attended.

It is noted that, while the by-laws call for the board to consist of twenty-three members, at December 31, 2003 there were only twenty-one members on the board.

It is recommended that the Plan maintain the required number of members on its board of directors in compliance with Article III, Section 1 of its by-laws.

It is noted that as of the report date, the Plan had filled one of the vacancies on its board.

During both March 2003 and October 2004, over a period of several days, meetings of the boards of directors of the Parent, the Plan, and the subsidiary MedAmerica, Inc., were held in New York City. Attendees included directors, officers, certain employees, as well as spouses/partners. The total expenses for these meetings was, in each case, greater than $200,000, although a small portion of those expenses were allocated to the Plan's parent and subsidiary. The meeting expenses included lodging, airfare, local transportation, dinners, room service and social events such as receptions, Broadway shows and a dinner cruise.

The Plan's mission, as cited in its internal website, and as ratified by the board of directors at its October 1, 2004 meeting, is quoted in part as follows:

"Being responsible stewards of our communities' health care premiums and health care resources."

Within its strategy statement, also cited within the internal website, the Plan notes the following as a value:

"Reducing unnecessary, wasteful expense is essential."

While the Plan has provided extensive information from various authorities on not-for-profit corporate governance that advocate the value of off-site meetings, spousal attendance and social events, the Department is concerned about the location, number of participants, extent of the activities described herein and resulting expenses. While it is noted that the Plan's overall administrative expenses as a percentage of premium income are within statutory limitations, the board meeting expenses described above appear to be inconsistent with the Plan's mission and strategy statements.

It is recommended that the members of the board act to control expenditures for off-site Board of Directors' meetings and retreats in accordance with its mission and strategy statements and consistent with the provisions of the New York State Not-For-Profit Corporation Law.

It is noted that a current member of the board of directors was also a member of the board of directors for Blue Cross and Blue Shield of Utica-Watertown, Inc., an entity that was subsequently absorbed into the Plan. The most recent Report on Examination for that entity, dated November 5, 1997, included similar recommendations and comments.

The Plan has a policy that under certain circumstances, it will pay the travel and entertainment expenses for spouses/partners when accompanying officers and board members to off-site meetings. Pursuant to federal and state income tax laws, such benefits are directly taxable as income to those individuals and as such, the Plan is required to report such expenses as income for the board members. The Plan contends that although it is its policy to report such amounts, it did not do so because of a clerical

error.

It is recommended that the Plan report all amounts considered to be income to board members and officers as required pursuant to federal and state income tax laws.

The officers of the Plan as of December 31, 2003 were as follows:

Name	Title
Kevin N. Hill	President and COO
William Whitehill	Secretary
Emil D. Duda	Chief Financial Officer
Edward Wardrup	Treasurer

It should be noted that members of the board of directors and senior management of EHP are also members of the board of directors and senior management of the parent, as well as other affiliated companies.

B. Territory and Plan of Operation

At December 31, 2003, Excellus Health Plan, Inc., a not-for-profit health service corporation organized and licensed under Article 43 of the New York Insurance Law was authorized to transact business in all counties of New York State. Excellus Health Plan, Inc. either directly or through one of its subsidiaries, conducts business in all counties of New York State. The Plan also held a Certificate of Authority under Article 44 of the New York Public Health Law as a health maintenance organization that was authorized to transact business only in the following counties in the State of New York:

Allegany	Erie	Madison	St. Lawrence
Broome	Essex	Monroe	Schuyler
Cattaraugus	Franklin	Montgomery	Seneca
Cayuga	Fulton	Niagara	Steuben
Chattaqua	Genesee	Oneida	Tioga
Chemung	Hamilton	Onandaga	Tompkins
Chenango	Herkimer	Ontario	Wayne
Clinton	Jefferson	Orleans	Wyoming

Cortland	Lewis	Otsego	Yates
Delaware	Livingston	Oswego	

Excellus participates in the Blue Card program. This program allows Excellus members to receive treatment from providers participating in other Blue Cross Blue Shield Plans when they travel outside of Excellus' territory. In return, members of other Blue Cross and Blue Shield plans are permitted to obtain treatment from providers in Excellus' territory on a participating basis.

The following schedule shows direct premiums written in the State of New York during the six-year examination period:

Year	Premiums
1998	$2,237,654,602
1999	2,491,125,752
2000	3,938,931,134
2001	3,221,401,247
2002	3,260,135,355
2003	3,769,775,179

As of December 31, 2003 health care services were provided to 1,890,430 members. The following chart shows annual membership changes by number and percentage:

	1998	1999	2000	2001	2002	2003
Members	1,909,220	1,858,024	2,293,291	1,893,224	2,001,806	1,890,430
Change %		-2.7%	+23.4%	-17.5%	+5.7%	-5.6%

It is noted that the increase during calendar year 2000 was due, in large part, to a restatement of membership associated with the 2001 merger with Univera, Inc. The subsequent decrease during 2001 was the result of a change in treatment of the Plan's minimum premium/premium credit business.

C. Reinsurance

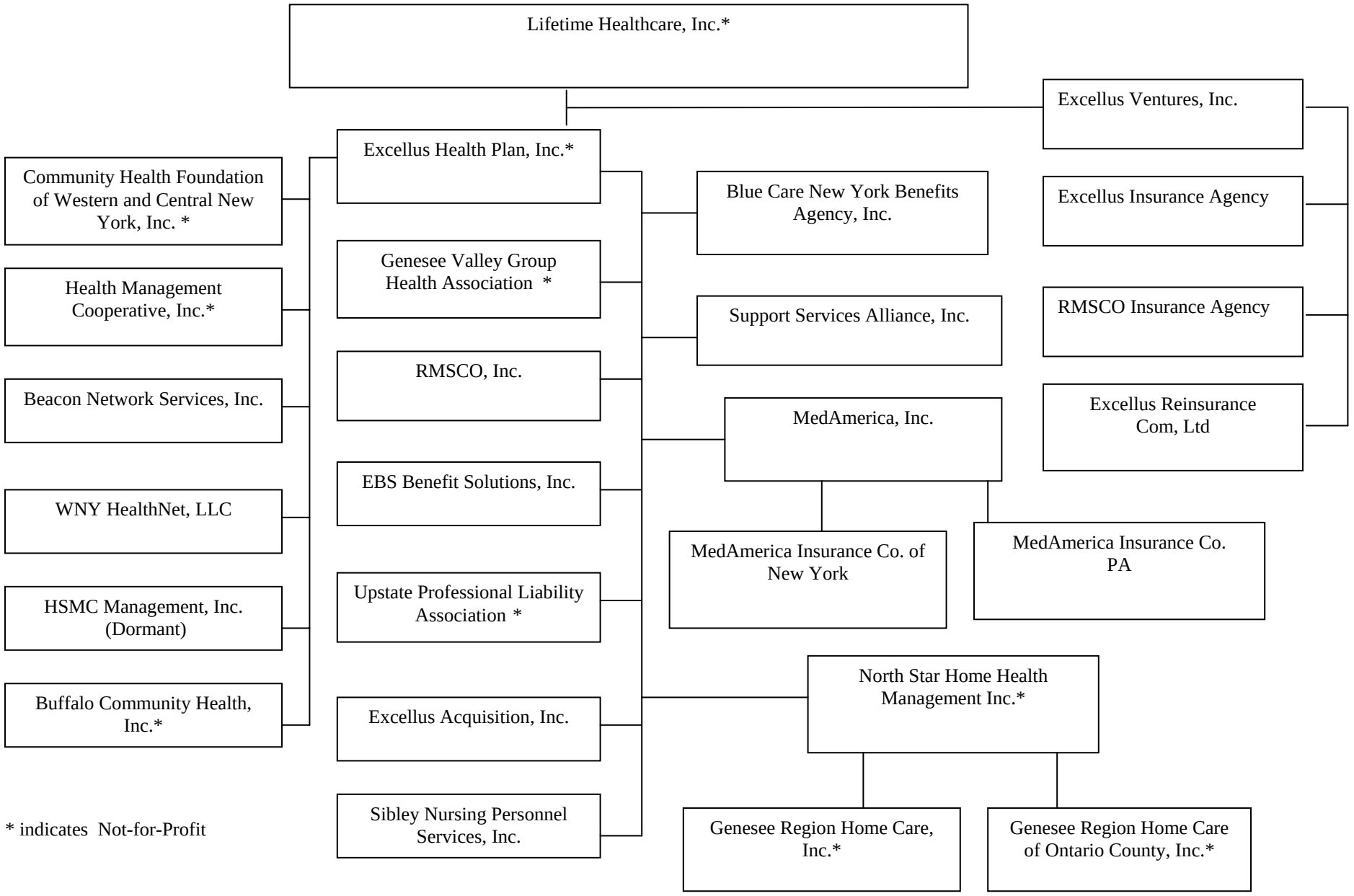
The Plan's Utica/Watertown line of business HMO maintains a 50% Bone Marrow and Organ Transplant reinsurance treaty with the BCS Insurance Company, an authorized reinsurer. This coverage consists of two separate reinsurance pools that are settled annually. At the inception of the coverage year, each reinsurance participant is billed 70% of the estimated claims cost. The remaining 30% is payable to the extent that, at annual settlement, total experience is greater than the amount billed plus administrative expenses.

The reinsurance treaty includes an insolvency clause that meets the requirements of Section 1308 of the New York Insurance Law.

D. Holding Company System

As a member of a holding company system, the Plan is required to file registration statements pursuant to Article 15 of the New York Insurance Law and Department Regulation 52 (11NYCRR 80). All pertinent filings made, regarding the aforementioned statute and regulation, during the examination period were reviewed. No problem areas were encountered.

The following is the organizational chart of the Plan's holding company system as of December 31, 2003:


Lifetime Healthcare, Inc.*
Excellus Ventures, Inc.
Excellus Health Plan, Inc.*
Community Health Foundation of Western and Central New York, Inc. *
Health Management Cooperative, Inc.*
Beacon Network Services, Inc.
WNY HealthNet, LLC
HSMC Management, Inc. (Dormant)
Buffalo Community Health, Inc.*
Genesee Valley Group Health Association *
RMSCO, Inc.
EBS Benefit Solutions, Inc.
Upstate Professional Liability Association *
Excellus Acquisition, Inc.
Sibley Nursing Personnel Services, Inc.
Blue Care New York Benefits Agency, Inc.
Support Services Alliance, Inc.
MedAmerica, Inc.
MedAmerica Insurance Co. of New York
MedAmerica Insurance Co. PA
North Star Home Health Management Inc.*
Genesee Region Home Care, Inc.*
Genesee Region Home Care of Ontario County, Inc.*
Excellus Insurance Agency
RMSCO Insurance Agency
Excellus Reinsurance Com, Ltd
* indicates Not-for-Profit

The Plan maintains administrative services agreements with the following affiliated entities:

- Genesee Valley Group Health Association (GVGHA): This subsidiary provides disease management, telemarketing and call center services to Excellus. Reimbursement is made to GVGHA for exact costs. The agreement is dated March 28, 2002.
- Buffalo Community Health, Inc. (BCH): Univera HMO, a d/b/a for Excellus in Western New York manages a separate prepaid health services plan on behalf of the members of BCH. The members of BCH are Excellus Health Plan and two hospital networks located in Erie County. The agreement is dated March 28, 2002.
- EBS Benefit Services, Inc.: This affiliated entity provides pension and related services to the Plan. The agreement is dated March 28, 2002.
- MedAmerica Insurance Co. of NY: Excellus provides personnel, office space and related management services to this subsidiary. The agreement is dated January 1, 2002 and was renewed on March 1, 2004.
- Greater Regional Home Care Association, Inc.: This subsidiary organization provides various marketing and quality assurance services to the Plan in return for exact costs. The agreement is dated April 1, 2003.
- RMSCO, Inc.: This Excellus subsidiary administers the Plan's self-funded worker's compensation program. The agreement was submitted to the Department for approval on February 20, 2004.

It is noted that there is also an approved Management Services Agreement between the Plan and UNYS, Upstate Holding Company, and Utica-Watertown Health Insurance Company. This agreement, however, has not been updated to reflect the new corporate names.

It is recommended that, where applicable, administrative service agreements should be updated to reflect the current names of the signatories.

The Plan files its taxes on a consolidated basis with its parent and affiliates. Statutory Accounting Principle No. 10 requires that income tax transactions between affiliated parties will only be recognized if the transactions are pursuant to a tax allocation agreement. Although the Plan has entered into a tax allocation agreement, such agreement has not been approved by the Department.

The agreement being utilized by the Plan is not in compliance with Circular Letter No. 33 (1979), which established the requirement that the Plan establish an escrow account or "… a method… to help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses."

It is recommended that the Plan comply with Circular Letter No. 33 (1979) and establish an escrow account or "… a method… to help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses." It is further recommended that the Plan submit its tax allocation agreement to the Department.

The Plan engaged in regular transactions with two of its subsidiaries, SSA and Beacon Network, without prior notification to the Superintendent. Such transactions were entered into in the Plan's role as the provider of administrative services to the two subsidiaries, though such arrangement was made without a formal document. This is a violation of Section 1505(d) of the New York Insurance Law, which states the following:

> "The following transactions between a domestic controlled insurer and any person in its holding Plan 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:
>
> ... (3) rendering of services on a regular or systematic basis;"

It is recommended that the Plan comply with Section 1505(d) of the New York Insurance Law and ensure that it has filed administrative service agreements with the

Department for each affiliate which it engages in transactions with on a regular or systematic basis.

It is noted that as of the report date, the Plan has submitted these agreements to the Department.

E. Significant Operating Ratios

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

	Amounts	Ratios
Total hospital and medical	$16,504,799,554	90.1%
Claim adjustment expenses	553,767,427	3.0%
General administrative expenses	865,931,623	4.7%
Net underwriting gain	394,470,854	2.1%
Net premium income	18,318,969,458	100.0%

F. Investment Activities

During the examination period, the Plan contracted with nine investment managers for their diverse investment approaches and for specialized expertise. The activities of these nine investment managers were overseen by a consultant, Prime, Buchholz & Associates until October 1. 2004. Effective at that date, Cardinal Investment Advisors became the new investment consultant. The custodian for the Plan's investments was M&T Bank until February 2004, at which time; HSBC Bank became the new custodian.

The board of directors approved the Plan's investment strategy annually and at any time a change in the strategy was made.

In March 2003, Excellus raised the target investment in equities to 20% of the long-term investment portfolio. Multiple investment managers continue to be utilized for diversification purposes.

As of December 31, 2003 Excellus' investment yield was 1.2%, in which the majority of the investments were in convertible bonds.

Section 1409(a) of the New York Insurance Law states:

> "Except as more specifically provided in this chapter, no domestic insurer shall have more than ten percent of its admitted assets as shown by its last statement on file with the Superintendent invested in, or loaned upon, the securities (including for this purpose certificates of deposit, partnership interests and other equity interests) of any one institution."

Excellus was not in compliance with this restriction as it had more than 10% of its admitted assets invested in the securities of Asset Management Funds Adjustable Rate Mortgage Portfolio.

It is recommended that the Plan comply with New York Insurance Law §1409(a) and not invest more that 10% of its admitted assets in the securities of any one institution.

Paragraph 6 of Statement of Statutory Accounting Principle (SSAP) No. 26 states that the amortization of bond premiums and/or discounts shall be calculated using the scientific (constant yield) method and that bonds containing call provisions shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).

The Plan did not calculate its amortization utilizing this methodology. As a result, it overstated its amortization. Additionally, this led to a reporting error in Schedule D of its filed Annual Statement, as noted elsewhere in this report.

It is recommended that the Plan comply with SSAP No. 26, paragraph 6, and report investments at the proper value.

It is noted that the Plan has instituted procedures to ensure it complies with this recommendation.

Investment managers for the Plan are provided with a set amount of funds and are free to select brokers/dealers who execute trades in order to achieve the specific goals set for the managers. The brokers/dealers select the securities to be traded and determine the frequency of such trades.

The Plan relies on its independent investment consultant to monitor the investment managers, which is accomplished by the review of monthly investment reports from the custodian bank. The result of this process is that there are multiple layers between the brokers/dealers who execute the buy/sell orders and the Plan, which is responsible for the investment of its funds. There is, however, no documented audit process or controls in place at the Plan to review the investment manager's oversight of the investment function. Such an arrangement increases the risk associated with the investment of the Plan's funds. It is critical that adequate controls are in place to ensure the integrity of the process.

It is recommended that the Plan establish appropriate controls to monitor the functions of its investment consultant, managers, and the broker/dealers who execute the buy/sell orders on behalf of the Plan.

At the time of the examination, the Plan was not performing a proper reconciliation of its investments. Instead, the Plan used the custodian bank statements as its sole source of information, and recorded the holdings and transactions indicated in such statements as its investment inventory and annual statement valuation. There is no other reference used by the Plan to compare or check the custodian statements. This practice may impact the accuracy of the Plan's filed Schedule D.

It is recommended that the Plan require a monthly statement from its investment managers listing all holdings and transactions initiated during the preceding month, highlighting any discrepancies with the custodian bank statement. It is also recommended that the Plan reconcile such statements to its investment inventory.

During the course of the examination, the Plan's investment policies and procedures were also reviewed by the Department's Capital Markets Bureau. Conclusions

from that review include the following:

- The Plan increased the fee it paid to its investment consultant without formalizing such change in an addendum to its written investment agreement.

  It is recommended that the Plan formalize all changes, including modifications to compensation arrangements, to existing and future investment management agreements through an addendum or amendment.

- It was noted that the investment strategy is presented to the Audit and Finance Committee of the board of directors annually. This committee, which is comprised of members of the board, is charged with monitoring the finances of the Plan. When there are recommended changes to the strategy on an interim basis, only the recommended changes are presented to the committee. This may be insufficient to ensure that there is a full understanding of the relevant issues and their potential impact at the time a decision is required.

  It is recommended that the entire investment strategy be presented to the board of directors whenever a change in strategy is proposed or advised.

- As noted earlier within this report section, Excellus retains several investment managers that are overseen by an independent investment management consultant. The new consultant, Cardinal Investment Advisors, LLC (Cardinal), which was established in 2001, entered into a contract effective October 16, 2004 with the Parent. As Cardinal is new to the oversight of the Parent's investment guidelines, objectives and managers, proposed changes in investment initiatives and managers put forward by Cardinal and approved by the board, along with the governing agreements, provide important details about investment philosophy, standards and methodologies.

  It is recommended that any change in a provision and/or condition of the October 16, 2004 agreement between Cardinal Investment Advisors, LLC and

Lifetime Healthcare, Inc. be reflected in a written amendment or modification to the existing agreement.

It is recommended that after Cardinal's review of Excellus' current investment strategy, any approved revisions to strategic and implementation approaches and newly approved investment directives be provided in writing to the Capital Markets Bureau.

It is recommended that when the Audit and Finance Committee approves a new investment manager, the governing agreement be submitted to the Capital Markets Bureau for its review.

- Excellus indicated that it has not historically retained the quarterly performance reports of its investment managers. These reports provide pertinent information regarding the effectiveness of certain aspects of the investment strategy during varying economic cycles.

  It is recommended that the Plan retain the fourth quarter report incorporating year-to-date performance measures from each investment manager with which it has an agreement.

It is noted that the Plan has taken steps to review internal and external controls within all investment functions while this examiner was on site.

During the examination, internal controls within the Plan's Treasury Department (Treasury) were tested to ensure appropriate care was applied to the functions being performed. During that testing, the following was noted:

The Plan has a requirement that electronic fund transfers and special checks requested of Treasury contain the approval of an authorized individual, but the requirement does not limit that approval to an individual from the department requesting the fund transfer. Instead, the Plan allows authorized personnel from any department to

sign for the payment. This requirement may not be sufficient to ensure that the transfer of funds is appropriate.

It is recommended that the Plan limit the signing authority for checks to a specified number of individuals from the issuing departments.

As of the report date the Plan has complied with this recommendation.

It is noted also that special checks for amounts greater than an established limit are required to contain the signature of the Treasurer; but that signature may be electronic. This control may not be sufficient to ensure that approvals for such checks are subject to proper review.

It is recommended that the Plan require a personal signature of the Treasurer on special checks issued for an amount greater than an established limit.

G. Provider and Third Party Administration Arrangements

The Plan maintains two third party administration (TPA) agreements. The first is with Vision Service Plan, Inc. (VSP) in which VSP provides vision care to Plan members on a pre-paid capitation basis. The second agreement is with Landmark Chiropractic Services, which provides utilization review services to Univera HMO members on a capitated basis.

At the examination date, the Plan's agreement with VSP was not in compliance with Section 243.2(b)(4) of New York State Insurance Department Regulation 152 (11 NYCRR 243) which mandates that claim files be maintained for a period of six years. The agreement with VSP stated that books and records were to be maintained for “at least three years”.

It is recommended that the Plan ensure that its third party agreements be consistent in their terms to assure compliance with New York State Insurance Department Regulation 152 (11 NYCRR 243).

Subsequent to the examination date, the Plan submitted a new agreement to the Department for approval. Such agreement complies with the record retention requirements of New York State Insurance Department Regulation 152 (11 NYCRR 243).

H. Accounts and Records

The Plan has an administrative services agreement with its parent, Lifetime Healthcare Inc. In certain instances, revenues and expenses that were received or paid by the parent or an affiliate were allocated to the Plan. Such revenues and expenses are then allocated by the Plan to the appropriate line of business.

The Plan does not allocate any expenses to investments in its Annual Statement Underwriting and Expense Exhibit, Part 3, Analysis of Expenses, other than those fees paid specifically to investment consultants/managers/brokers/custodians. This is contrary to SSAP No. 70, Allocation of Expenses, which states the following:

> "Investment expenses - Expenses incurred in the investing of funds and pursuit of investment income. Such expenses, include those specifically identifiable and allocated costs related to activities such as ... support personnel, postage and supplies, office overhead, management and executive duties and all other functions reasonable associated with the investment of funds."

It is recommended that the Plan comply with SSAP No. 70 and properly allocate investment expenses within its Annual Statement, Underwriting and Expense Exhibit, Part 3, Analysis of Expenses.

The following reporting errors were noted within the Annual Statement:

a.) The Plan failed to note the name of the Corporate Secretary on the Jurat page. The Jurat page also failed to contain the signature of that individual.

b.) The properties acquired as a result of the merger of Univera have been properly classified as "Properties held for sale". Schedule A correctly lists their cost, and the amounts of the mortgages left on the properties are correctly categorized as encumbrances. There was, however, a failure to show the encumbrances (mortgages) on Page 2, Line 4.3; instead the line indicates $0 for encumbrances.

c.) Certain securities that the Plan reported as containing option call dates did not, in fact, contain any call options.

d.) As noted elsewhere in this report, the Plan's improper calculation of amortization on certain bonds resulted in the filing of an inaccurate Schedule D.

e.) The Plan failed to complete its Schedule Y- Part 2 properly in that it failed to summarize the non-routine transactions of two subsidiaries with which it was doing business. The subsidiaries in question are Excellus Ventures, with a net transaction total of $37,541 and Telemon, with a net transaction total of $17,219. Additionally, Schedule Y – Part 1 lists the entity EBS Benefit Solutions, Inc. by its former name, Excellus Benefit Services, Inc.

f.) The Plan incorrectly completed its originally filed Balance Sheet in that the Plan failed to record the gross amount of its deferred tax asset. This was later corrected through a resubmission.

g.) The Plan disclosed its pharmaceutical rebate receivables in the Annual Statement Notes to Financial Statements, item 27 by stating that "...receivables are accounted for in accordance with SSAP No. 84." This statement is incorrect in that SSAP No. 84, paragraph 24, states the following:

> "The financial statements shall disclose the method used by the reporting entity to estimate pharmaceutical rebate receivables. Furthermore, for the most recent three years and for each quarter therein, the reporting entity shall also disclose the following:
>
> a. Estimated balance of pharmacy rebate receivable as reported on the financial statements;
> b. Pharmacy rebates as invoiced or confirmed in writing; and
> c. Pharmacy rebates collected."

Instead of reporting the data for three years as required by the aforementioned paragraph, the Plan only reported amounts for the year 2003. Additionally, this

methodology fails to comply with the annual statement instructions which require that there be a six column grid outlining health care receivables.

It is recommended that the Plan properly record information within their filed financial statements.

I. Information Systems

An examination of the Plan's Information Systems was performed by the independent consulting firm Ernst and Young. A separate report of findings and recommendations is attached as Appendix B. In addition to the independent review, the following was noted by this examiner:

The Plan does not utilize software that locks desktop computers after a given period of disuse. As a result, if an employee leaves their workstation for a period of time, access to their computer is available to anyone nearby.

It is recommended that the Plan install software to automatically lock desktop computers after a given period of disuse.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities, and total capital and surplus as determined by this examination and as reported by the Plan in its December 31, 2003 filed annual statement.

Assets	PLAN			EXAMINATION	
	Total Assets	Not Admitted Assets	Admitted Assets	Examination Assets	Surplus Increase/ (Decrease)
Bonds	$ 838,246,057	$	$ 838,246,057	$ 833,668,768	$ (4,577,289)
Stocks	234,355,028		234,355,028	234,355,028	
Real estate occupied by the company	70,449,994		70,449,994	70,449,994	
Real estate held for sale	843,744		843,744	843,744	
Cash and short term investments	202,011,875		202,011,875	202,011,875	
Investment income due and accrued	4,229,358		4,229,358	4,229,358	
Uncollected premiums in the course of collection	100,319,712		100,319,712	100,319,712	
Accrued retrospective premiums	1,904,313		1,904,313	1,904,313	
Amounts recoverable from reinsurers	94,882		94,882	94,882	
Amounts receivable relating to uninsured plans	38,387,962		38,387,962	38,387,962	
Net deferred tax asset	17,238,000		17,238,000	17,238,000	
Guaranty funds receivable or on deposit	1,157,516		1,157,516	1,157,516	
Electronic data processing equipment and software	1,391,166	1,391,166	0	0	
Furniture and equipment	14,952,658	12,230,678	2,721,980	2,721,980	
Receivables from parent, subsidiaries and affiliates	15,759,730	13,463,911	2,295,819	2,295,819	
Health Care and other amounts receivable	119,816,323	34,963,937	84,852,386	84,852,386	
Other assets nonadmitted	44,537,739	44,537,739	0	0	
Goodwill	3,325,955	3,325,955	0	0	
Miscellaneous accounts receivable	3,287,704		3,287,704	3,287,704	
Other	169,421	169,421	0	0	
Total assets	$ 1,712,479,137	$ 110,082,807	$ 1,602,396,330	$ 1,597,819,041	$ (4,577,289)

Total Liabilities	Plan	Examination	Surplus Increase / (Decrease)
Claims unpaid	$ 589,522,945	$ 464,855,945	$ 124,667,000
Unpaid claims adjustment expenses	21,563,985	17,003,202	4,560,783
Aggregate health policy reserves	10,914,733	10,914,733	
Premiums received in advance	74,761,351	74,761,351	
General expenses due or accrued	50,739,199	50,739,199	
Amounts withheld or retained for the account of others	93,061,234	93,061,234	
Borrowed money	41,783,784	41,783,784	
Liability for amounts held under uninsured accident and health plans	21,986,146	21,986,146	
Capitalized lease obligation	3,533,797	3,533,797	
Post retirement and pension	57,477,714	57,477,714	
NYIL Section 4308(h) dividend/credit payable	7,502,172	7,502,172	
Other liabilities	538,528	538,528	
Total liabilities	$ 973,385,588	$ 844,157,805	$ 129,227,783
Reserves and unassigned funds			
Statutory reserve requirement	$ 443,702,469	$ 443,702,469	$
Unassigned funds (surplus)	185,308,273	309,958,767	124,650,494
Total capital and surplus	$629,010,742	$ 753,661,236	$ 124,650,494
Total liabilities, capital and surplus	$1,602,396,330	$ 1,597,819,041	

The Internal Revenue Service has completed its audits of the consolidated tax returns filed on behalf of the Plan through 2001. All material adjustments, if any, made subsequent to the date of 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 Plan to any further tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Revenue and Expenses

Capital and Surplus increased $368,872,268 during the six-year examination period, (January 1, 1998 through December 31, 2003) detailed as follows:

Underwriting Income		
Net premium income		$ 18,318,969,458
Hospital and Medical:		
Hospital/medical benefits	$ 14,293,047,446	
Other professional services	497,973,561	
Outside referrals	277,711,878	
Emergency room and out-of-area	238,982,382	
Prescription drugs	1,184,920,219	
Other medical expense	13,584,336	
Subtotal	$ 16,506,219,822	
Less:		
Net reinsurance recoveries	1,420,268	
Total hospital and medical	$ 16,504,799,554	
Claims adjustment expenses	553,767,427	
General administrative expenses	865,931,623	
Total underwriting deductions		17,924,498,604
Net underwriting gain or (loss)		$ 394,470,854
Investment Income		
Net investment income earned	125,468,086	
Net realized capital gains or (losses)	39,598,730	
Net investment gains or (losses)		$ 165,066,816
Other income		
Fee-for-service	47,182,494	
Miscellaneous	407,881	
Total other income		47,590,375
Aggregate write-ins for other income or expenses		(2,403,495)
Contribution to Community Health Foundation, Inc.		(19,373,407)
Net income or (loss) before federal income taxes		$ 585,351,143
Federal income taxes incurred		88,651,967
Net income (loss)		$ 496,699,176

Capital and surplus as of December 31, 1997				$ 320,561,185
	Gains		Losses	
Net income	$ 496,699,176	$		
Adjustments due to mergers/consolidations			8,185,412	
Change in net deferred income tax	17,238,000			
Change in nonadmitted assets			60,661,002	
Cumulative effect of changes in accounting principles			31,433,215	
Unrealized capital gains and losses	21,549,013			
Other changes			2,106,509	
Net change in capital and surplus				433,100,051
Capital and surplus per examination as of December 31, 2003				$ 753,661,236

4. BONDS

The examination admitted asset of $833,668,768 is $4,577,289 less than the amount reported by the Plan as of December 31, 2003.

As noted within the Investment Activities Section (2.G) of this report, at the examination date, the Plan was in violation of New York Insurance Law 1409(a). As of the report date, the Plan held an excess of $4,040,426 in the investments of the Asset Management Funds Adjustable Rate Mortgage Portfolio. As a result, this amount was not admitted from the Plan's assets.

As noted within the Investments section of this report, as of the Examination Date, the Plan was not in compliance with Paragraph 26 of Standard Accounting Procedure No. 26**.** This accounting procedure establishes the requirement that the amortization of bond premiums and/or discounts be calculated using the scientific (constant yield) method and that bonds containing call provisions be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).

The Plan did not calculate its amortization utilizing this methodology. As a result, it overstated the value of its amortization of discount in the amount of $547,863.

5. CLAIMS UNPAID

The examination liability of $464,855,945 is $124,667,000 less than the amount reported by the Plan as of December 31, 2003.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and utilized statistical information contained in the Plan's internal records and in its filed annual and quarterly statements, as well as additional information provided by the Plan.

The following exhibit illustrates a pattern of material over-reserving by the Plan beyond a reasonable range:

Runoff of Total Claims Unpaid by Calendar Year ($000 omitted)

Year	Annual Statement Claims Reserve	One Year Development	Two Year Development	Three Year Development	As of 12/31/2004	Percentage as of 12/31/2004
2001	$483,710	$418,527	$371,651	$403,734	$79,976	16.5%
2002	530,642	426,063	376,052		154,590	29.1%
2003	589,523	446,755			142,768	24.2%

The jurat to the 2003 Annual Statement as sworn to by officers of Excellus Health Plan, Inc. states in part:

> "...this statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to, is a full and true statement of all the assets and liabilities of the condition and affairs of the said reporting entity as of the reporting period stated above, and of its income and deductions therefrom for the period ended, and have been completed in accordance with the NAIC Annual Statement Instructions and Accounting Practices and Procedures manual except to the extent that: (1) state law may differ; or, (2) that state rules or regulations require differences in reporting not related to accounting practices and procedures, according to the best of their information, knowledge and belief..."

Health insurance is considered a "short tail" line as a result of the comparatively rapid pay-out of any given year's claims. Because of this nature, it is the Department's

finding that enough information was available at the time of the preparation of the Annual Statement to more reasonably estimate the reserve for unpaid claims. The effect of the Plan's consistent overstatement of these reserves as depicted above was to understate total capital and surplus, and to present a less accurate picture of the true nature of the Plan's financial strength which was greater than reported.

It is recommended that the Plan set its unpaid claim reserves at levels within a reasonable range and cease its practice of overstating such reserves. It is further recommended that the Plan demonstrate to the Department what proactive checks and measures it will institute to ensure that its unpaid claim reserving methodology will be adequate, but not excessive.

On a quarterly basis, the Plan is required to submit Loss Ratio reports. These reports indicate the Medical Loss Ratios for the Plan’s various lines of business. If the claims liability is recorded incorrectly, the Loss Ratio reports will also be incorrect.

It is recommended that the Plan re-submit its Loss Ratio reports for calendar years 2000 through 2003 using claims experience through December 31, 2004.

6. UNPAID CLAIMS ADJUSTMENT EXPENSE

The examination liability of $17,003,202 is $4,560,783 less than the amount reported by the Plan as of December 31, 2003.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and utilized statistical information contained in the Plan’s internal records and in its filed annual and quarterly statements, as well as additional information provided by the Plan.

7. TREATMENT OF POLICYHOLDERS AND CLAIMANTS

A Market Conduct Report on Examination, as of October 10, 2003, which detailed a review of the manner in which Excellus conducted its business practices and fulfilled its contractual obligations to its policyholders and claimants was filed August 30, 2004.

Subsequent to the issuance of the above referenced Market Conduct Examination, the following was determined:

A. Member Benefits

The Plan operates a program entitled "Member Benefits," under which Plan enrollees are entitled to discounts for selected services and memberships at participating facilities. Generally, such services as gym memberships and healthy cooking classes are included and are charged to incurred claims in the Plan's community-rated lines of business.

The Plan's approved subscriber contracts do not include these services as benefits. Corresponding rates calculated by the Plan do not take these expenses into account. Rather, these "member benefits" are funded by the Plan from its retained surplus. Therefore, these expenses cannot be construed as contractual health benefits. Instead, such expenses appear to be enrollment inducements. Section 4224(c) of the New York State Insurance Law states:

> "No …insurer doing in this state the business of accident and health insurance … shall pay allow or give, or offer to pay, allow or give, directly or indirectly, as an inducement to any person to insure… any valuable consideration or inducement whatever which is not specified in such policy or contract."

It is recommended that the Plan limit its funded member welfare programs to those which directly affect the general health of its members.

It is further recommended that in order for the cost of such programs to be included as part of claims cost, such programs should be established as policy riders so that Plan members have a choice as to whether or not they wish to have such options available.

Finally, it is recommended that the Plan comply with Section 4224(c) of the New York State Insurance Law and not utilize Plan funded "member benefit" programs as an inducement to enroll Members.

B. Claim Processing

During the course of the exam, the Plan was unable to support the date of service for a number of electronically submitted claims. The Plan explained that this was because the data needed to be restored from backup tapes, a process that is cumbersome and labor intensive. The Plan indicated that the information could have been obtained had more time been available. Such delays, however, impede the ability of the Plan to obtain data that could be needed for appeals or for other internal uses.

It is recommended that the Plan maintain its stored data for six years within a current database or data warehouse from which such data may be obtained in a timely and efficient manner.

In certain circumstances, the Plan allows its claim processing system to automatically adjudicate claims. The system that the Plan uses contains edits to ensure in-patient claims over a certain dollar threshold are suspended for review prior to processing. This procedure reduces the risk of fraud associated with high value in-patient claims. It is noted, however, that no such system exists for out-patient claims. As a result, there may be a vulnerability that could allow fraudulent out-patient claims to be processed.

It is recommended that the Plan establish an internal control to ensure that all claims over a certain threshold are reviewed prior to processing.

8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

ITEM		PAGE NO.
A.	It is recommended that the Plan amend its by-laws to require that the number of board members shall be no less than thirteen. It is noted that the Plan has complied with this recommendation.	3
B.	It is recommended that the Plan amend its by-laws to provide for a minimum number of times the board will meet each year. It is noted that the Plan has complied with this recommendation.	4
C.	It is recommended that the Plan comply with the expense limitations set forth in Section 4309(a)(2) of the New York Insurance Law. It is noted that the Plan has complied with this recommendation.	10
D.	It is recommended that the Plan maintain accurate and complete workpapers supporting amounts reported in its filed annual statements. It is noted that the Plan has complied with this recommendation.	10
E.	It is recommended that the Plan comply with the provisions of Section 215.17(a) of Department Regulation 34. It is noted that the Plan has complied with this recommendation.	17
F.	It is recommended that the Plan comply with the provisions of Section 215.9(c) of Department Regulation 34. It is noted that the Plan has complied with this recommendation.	17

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Management	
i.	It is recommended that the Plan maintain the required number of members on its board of directors in compliance with Article III, Section 1 of its by-laws.	6
ii.	It is recommended that the members of the board act to control expenditures for off-site Board of Directors' meetings and retreats in accordance with its mission and strategy statements and consistent with the provisions of the New York State Not-For-Profit Corporation Law.	7
iii.	It is recommended that the Plan report all amounts considered to be income to board members and officers as required pursuant to federal and state income tax laws.	8
B.	Holding Company System	
i.	It is recommended that, where applicable, administrative service agreements should be updated to reflect the current names of the signatories.	12
ii.	It is recommended that the Plan comply with Circular Letter No. 33 (1979) and establish an escrow account or "… a method… to help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses." It is further recommended that the Plan submit its tax allocation agreement to the Department.	13
iii.	It is recommended that the Plan comply with Section 1505(d) of the New York Insurance Law and ensure that it has filed administrative service agreements with the Department for each affiliate which it engages in transactions with on a regular or systematic basis.	13
C.	Investment Activities	
i.	It is recommended that the Plan comply with New York Insurance Law §1409(a) and not invest more that 10% of its admitted assets in the securities of any one institution.	15

APPENDIX A

HMO OPERATIONS

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1. SCOPE OF EXAMINATION

The HMO lines of business for the Plan are Fingerlakes HMO, Upstate HMO and Univera Healthcare HMO. Wherever the term "HMO" appears in this report, it shall refer to the aggregate HMO operations of Excellus Health Plan, Inc.

The previous examination of Excellus Health Plan, Inc.'s HMO operation was conducted as of December 31, 1997. This examination covered the six-year period from January 1, 1998 through December 31, 2003 and was done in conjunction with the examination of Excellus Health Plan, Inc. Transactions subsequent to the date of examination were reviewed where deemed appropriate by the examiner.

It is noted that additional previous examinations of the various entities that were merged into Excellus Health Plan, Inc. during the examination period also exist. These examinations consist of the following:

	Examination Period	
Name	Start	End
Blue Care Plus	July 1, 1989	December 31, 1994
HMO-CNY, Inc.	January 1, 1990	December 31, 1993
The Health Care Plan, Inc.	January 1, 1993	December 31, 1996

However, since the management of the Finger Lakes Health Insurance Company is the core surviving management of those entities, this report refers to the comments and recommendations of that entity. Where comments from the other previous reports are relevant to the findings of this report, they will be noted here within the applicable sections.

2. DESCRIPTION OF HMO LINES OF BUSINESS

Finger Lakes HMO

Effective January 1, 1985, Finger Lakes HMO was authorized by the New York State Department of Health to operate as a health maintenance organization (HMO) pursuant to Article 44 of the New York Public Health Law. Finger Lakes HMO operates as a non-profit individual practice association (IPA) model HMO and is operated as a line of business of Excellus Health Plan, Inc.

Finger Lakes HMO is authorized to operate in the following counties of New York State:

Genesee	Ontario	Yates
Livingston	Orleans	Wayne
Monroe	Seneca	Wyoming

In October of 1996, the Finger Lakes HMO entered into an agreement with Greater Rochester Independent Practice Association, Inc. (“GRIPA”) whereby GRIPA participating providers would deliver services required by the HMO's Commercial subscribers in return for capitation payments on a per member per month basis.

Finger Lakes HMO also entered into an agreement with Genesee Valley Group Health Association (“GVGHA”) whereby GVGHA participating providers would deliver services required by the HMO's Commercial, Senior, Medicaid and Family Health Plus subscribers in return for capitation payments on a per member per month basis.

Effective January 1, 1997, Finger Lakes HMO renewed its agreement with Monroe Plan for Medical Care, Inc. ("MP") whereby MP participating providers would deliver services required by the HMO's Medicaid, Family Health Plus and Child Health Plus subscribers in return for capitation payments on a per member per month basis.

Finally, Finger Lakes HMO also maintained a capitated agreement with Rochester Individual Practice Association ("RIPA"), which is a network of providers who deliver

services required by Finger Lakes HMO subscribers in return for capitation payments on a per member per month basis.

Upstate HMO

Effective January 2, 2001, HMO-CNY, Inc. merged with Excellus Health Plan, Inc. HMO-CNY, which was originally certified to conduct business by the State of New York on May 16, 1982, and HMO Blue, which was originally certified by the State of New York to conduct business on November 12, 1986, combined to form Upstate HMO, effective January 1, 2002. Upstate HMO was authorized by the New York State Department of Health to operate as an HMO pursuant to Article 44 of the New York Public Health Law. Upstate HMO operates as a non-profit IPA model HMO and is operated as a line of business of Excellus Health Plan, Inc.

Upstate HMO is authorized to operate in the following counties of New York State:

Broome	Essex	Madison	Schoharie
Cayuga	Franklin	Montgomery	Schuyler
Chemung	Fulton	Oneida	St. Lawrence
Chenango	Hamilton	Onondaga	Steuben
Clinton	Herkimer	Oswego	Tioga
Cortland	Jefferson	Otsego	Tompkins
Delaware	Lewis		

Univera Healthcare HMO

Effective September 8, 1978, Univera Healthcare HMO was authorized by the New York State Department of Health to operate as an HMO pursuant to Article 44 of the New York Public Health Law. Univera Healthcare HMO operates as a non-profit IPA model HMO and is operated as a line of business of Excellus Health Plan, Inc.

Univera Healthcare HMO is authorized to operate in the following counties of New York State:

Allegany	Genesee	Orleans

Cattaraugus	Erie	Wyoming
Chautauqua	Niagara	

Univera, which was originally formed as The Health Care Plan, Inc. (HCP), was started as a staff model HMO and, accordingly, owned its health centers, which grew to eight in number. Subsequently, HCP developed a network model as well, and continued to offer the health centers as a provider option under its network. Univera HMO continues to provide primary and certain specialty care in the health centers within a staff model format.

The HMOs are each managed from the Plan's office, located at 165 Court St., Rochester, NY 14615.

A. Management

Management is comprised of the board of directors and officers of Excellus Health Plan, Inc.

B. Territory and Plan of Operation

The Plan holds one Certificate of Authority that covers all three of the HMOs. The Certificate was updated on January 1, 2003.

Subscribers of each HMO select a participating physician, who acts as their primary care physician. This physician refers subscribers to other participating physicians when particular medical specialties are required. When authorized by a physician, benefits to the subscriber for inpatient benefits are provided by hospitals in the operating area of the HMO. Subscriber contracts provide for coverage of emergency treatment and/or hospitalization without authorization from the primary care physician when the subscriber's medical condition requires such treatment. The HMO reserves the right to determine if such treatment was required on an emergency basis. Emergency treatment might be required within or without the HMO's operating area.

In addition to those discussed earlier, at the examination date, the Plan maintained capitation arrangements with Landmark Chiropractic, which provides Utilization Review services to members of the Univera HMO line of business.

C. Significant Operating Ratios

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

	Claims	Ratios
Claims	8,553,575,833	91.5%
General administrative expenses	721,090,973	7.7%
Net underwriting gain (loss)	69,969,304	.8%
Total premium	9,344,636,110	100.0%

D. Accounts and Records

Separate general ledger accounts are maintained for specified HMO liabilities, revenues and expenses. However, as the Plan's operations are reported as a line of business, no balance sheet relative to HMO operations is maintained.

3. FINANCIAL STATEMENTS

A. Balance Sheet

As noted above, since the Plan's HMO operations are reported as a line of business, no balance sheet is included in this report relative to its operations.

B. Statement of Revenue and Expenses

The following shows the revenue and expenses of the Plan's HMO operations for the six-year examination period (January 1, 1998 through December 31, 2003) detailed as follows:

Revenues		
Premium	$9,289,961,673	
Changes in reserves	3,465,316	
Fee for service	47,182,495	
Aggregate write-ins for other health care related receivables	4,026,626	
Total Revenue		$9,344,636,110
Expenses		
Hospital/medical benefits	$5,029,891,346	
Other professional services	162,766,237	
Outside referrals	317,237,312	
Emergency room, Out-of-area, Other	579,035,806	
Inpatient	1,182,397,148	
Aggregate write-ins for other medical Expenses	900,949,357	
Demographic Pool expense (recovery)	(166,905)	
SMC Pool expense (recovery)	220,160	
Drug expense	182,902,018	
Rider expense	217,084,162	
Incentive pool and withhold adjustments	602,217	
Subtotal	$8,572,918,858	

Less:		
Net reinsurance payments	$ (365,335)	
Stop loss fund recoveries	8,163,962	
COB and subrogation	11,544,158	
	$ 19,342,785	
Total medical and hospital		$8,553,576,073
Revenue less medical and hospital		$ 791,060,037
Administration:		
Claim adjustment expenses	$ 247,273,023	
General administration expenses	473,817,950	
Total administration		721,090,973
Net underwriting gain/(loss)		$69,969,064
Net investment income earned		1,893,587
Less: Provision for income taxes		(773,731)
Net income		$72,636,382

4. ENROLLMENT

Enrollment changed during the period under examination as follows:

Finger Lakes HMO

	Contracts	Members
1998	301,430	594,831
1999	313,058	604,680
2000	320,856	607,665
2001	315,667	591,836
2002	283,285	514,480
2003	272,024	482,349

Upstate HMO

	Contracts	Members
1998	73,058	138,406
1999	89,774	162,445
2000	90,976	161,845
2001	93,336	167,626
2002	70,488	121,584
2003	47,446	69,617

Univera WNY

	Contracts	Members
2001	89,581	160,249
2002	89,251	158,690
2003	72,765	122,660

APPENDIX B

INFORMATION SYSTEMS REVIEW

Examination Date: April 30, 2004

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1. SCOPE AND OBJECTIVES OF THE EXAMINATION

Information Technology ("IT") at Excellus Blue Cross Blue Shield of New York (Excellus) is used to support the delivery of services and products and to provide support for all management processes. The objective of the IT control evaluation is to assist the Examiner-In-Charge ("EIC") in developing a risk-based strategy for setting the examination scope and objectives and in identifying the appropriate procedures necessary to support the overall examination strategy. In order to accomplish this objective, the examiners reviewed the general controls regarding Excellus' processing environment and reviewed certain controls over the applications that were determined to be financially significant by the EIC.

Examination Limitations

The general controls as examined were identified through discussions with IT management and a review of control documentation. This is not an attest report in conjunction with American Institute of Certified Public Accountants standards. This report provides information about the condition of risks and internal controls at a single point in time. Future changes in environmental factors and actions by personnel may significantly and adversely impact these risks and controls in ways that this report did not and cannot anticipate.

2. AREAS EXAMINED

The general controls reviewed during this examination are promulgated by the New York State Insurance Department ("NYSID") and consist of 14 categories. Those 14 categories can be further grouped into the following risk areas: management risks (associated with supporting IT management processes), transaction risks (associated with service or product delivery), or infrastructure risks (associated with the IT hardware and software supporting business processes). The general control categories, grouped by risk area, are described on the following page.

Management Risks:

- **Management Controls over the IT Department –** Delivery of services and products and support for IT management processes.
- **Organizational Controls over the IT Department –** Adequacy of resources and separation of duties between application development and maintenance, computer operations, and data entry.
- **Documentation Controls over Applications –** Appropriate documentation exists for new applications and changes.
- **Contingency Planning Controls –** The data center has a valid disaster recovery plan which covers the applications identified by the Chief Examiner as critical. The disaster recovery plan is tested and is integrated with an overall business resumption plan. Also, critical data is backed up and these backup files are stored in a secure manner.
- **Personal Computers –** Personal computers are utilized in an appropriate manner without exposing the Plan to unnecessary financial risk.
- **Service Agreements** – Service agreements with outside vendors cover provisions for loss of data and processing ability that could affect output of financial data.

Transaction Risks:

- **Processing Controls over Critical Applications -** Data is transmitted completely and accurately, input edits are working as intended and detected errors are corrected.
- **Converted Systems** – Transactions processed on newly developed or converted systems do not work as intended and errors can occur.

Infrastructure Risks:

- **Controls over Changes to Applications –** Users and IT department personnel approve modifications before they are implemented into the production environment.
- **Controls over System and Application Programming and Development –** Application programming and development/ modifications are performed in a

controlled manner and are adequately tested before they are moved into production.

- **Operations Controls –** Performance and problem resolution are monitored and the data center processes Plan information in a controlled manner. Also, the procedures for handling critical data and scheduling critical computer programs are monitored and controls are in place to maintain an environmentally secure data center.
- **Logical and Physical Security –** Employees are granted access to *only* the information they need to perform their assigned job duties and computing resources are adequately protected so that access is restricted to appropriate personnel.
- **Local Area Networks (LANs) –** Changes to the LAN are documented and implemented in a controlled manner and LAN access is granted for business purposes only.
- **Wide Area Networks (WANs)** – Changes to the WAN are documented and sensitive financial data transmitted on the WAN is adequately protected.

3. SUMMARY OF SIGNFICANT FINDINGS

The audit testing resulted in the following findings and recommendations to company management. Certain areas that could impact the examination scope may have resulted in increased substantive procedures. These areas include the following:

A. Logical Security Controls (UNIX)

Description and Risk

Through analysis of a script that was run on both the primary UNIX servers for Facets and Lawson, it was noted that password “shadowing” is not being performed to protect the passwords in the /etc/passwd file. Upon further inspection, it was noted that the etc/password file was world readable. As a result, any user on the UNIX system could gain access to sensitive passwords of authorized users, such as system and database

administrators. Excellus has taken the precaution of using encryption to store the passwords in the /etc/passwd file. However, these passwords were reviewed and it was determined that many of them could be easily decrypted. It is noted that the risk of users being able to find and decrypt passwords for sensitive accounts is limited to internal users (since the WAN appears to be appropriately controlled). Nevertheless, an internal user with limited knowledge of UNIX could gain inappropriate access to sensitive UNIX accounts and data.

In addition, it is noted that FACETS and LAWSON application source files and directories are also worldly accessible. As a result, users could directly modify production files without signing-in through the application.

Recommendation

It is recommended that Management use the Shadow option for all UNIX servers that house critical applications, such as Lawson and Facets. This feature would allow the company to store passwords for the system in an undisclosed location – where a user with basic knowledge of UNIX would not be able to locate it. It is also recommended that Management make this Shadow file readable and writeable only by individuals with access to the Root account. It is recommended that, at a minimum, management remove world readable permissions from the /etc/passwd file and grant permission to this file only to system administrators. Lastly, it is recommended that management review access to all application source, object and data files to ensure proper permissions have been set for access.

B. <u>Logical Security Controls (UNIX)</u>

Description, Risk and Recommendation

The examination noted several security risks through review of the UNIX operating systems security parameters.

i. No password standards are currently being enforced

Risk: If system password standards are not being enforced, then there is no way to ensure that the password guidelines stated by management are actually being followed.

Weak passwords lead to the possibility of a system being compromised if the password is guessed.

Recommendation: It is recommended that a minimal standard be set as follows: MinLength = 6, MaxAge = 60, MaxTry = 5, MinAge = 7, complexity set to alpha and numeric.

ii. Root access is not locked to the console

Risk: If root is not locked to console, a user may obtain root access from any remote terminal. This increases the risk of root access being obtained by someone who is restricted to the data center otherwise.

Recommendation: It is recommended that the root login be locked to the console.

iii. Audit logs are not currently utilized

Risk: If audit logs are not turned on or reviewed, security events may not be recorded or noticed leading to the inability to track a user's actions in the event of a security breach.

Recommendation: It is recommended that auditing be turned on for security changes and user logons (success and failure).

iv. Developers have ability to SU to root on FACETS

Risk: The ability of developers to access the root is a violation of segregation of duties. It s recommended that developers not have root access.

v. Inappropriate user with ability to SU to root on Lawson

Risk: The examiners noted an account, "user1" had used the SU command to gain root access. This account, according to Steve Tucker, is an old Corporate Publishing application account that is in the process of being eliminated. The Unix administrator is in the process of eliminating SU privileges from this account.

Recommendation: It is recommended that only a select few valid accounts have the ability to SU to root as necessary.

vi. No session timeout for users on LAWSON

Risk: If a user's session does not timeout, access may be obtained by an unauthorized user through an open session.

Recommendation: It is recommended that a user timeout be set to a reasonable level (5-20 minutes).

C. FACETS Application Logical Security Controls

Description and Risk

Application passwords for FACETS are assigned to the users by the system through a batch process, which randomly generates passwords. This e-mail however, is sent to the security administrators to distribute and is never changed by the user. Additionally, the database administrators have access to this job and user passwords as well.

Security administrators and database administrators have access to all account passwords and have complete access to the entire application through any user's account. This inhibits the application from creating an accurate audit trail of actions, if a system administrator were to conduct an action under another user's account.

Recommendation

It is recommended that Management require emails with login and password information be sent directly to its users. Additionally, it is recommended that the security and database administrators not be given access to users' passwords.

D. Lawson Application Logical Security Controls

Description and Risk

Per discussion with management, there is no prompt to enforce users to create or change their passwords, and password expirations are not set up for the front end of

Lawson. If passwords are chosen by users, implemented by administrators, and are never changed by the users, then the security of a users account may be compromised. Security and Lawson System Administrators should not have knowledge of any other user's passwords as this opens up a users account to be improperly accessed and utilized.

The examiners noted that re-certification of Lawson user IDs is not being performed, as there are several active generic IDs. The examiners also noted that new Security Classes were created from implementation, but the documentation which indicates what permissions or module access these security class permits is not maintained, and as such not provided. If generics IDs are active, this increases the risk that an unauthorized person can log onto to the Lawson application with these IDs and perform transactions without an audit trail or accountability.

Recommendation

It is recommended that users be prompted to change their password upon login, as well as on a quarterly basis to ensure that systems security is reinforced.

It is recommended that the system administrators review the Lawson access control listing periodically to ensure that inappropriate user IDs do not have the capability of accessing sensitive data on Lawson.

E. FACETS Application Change Management Controls

Description and Risk

When a change has been authorized, developed, and tested, a Peer Review ticket is created in a Lotus Notes Database. The Peer Review creation requests discussion of the change that is ready for implementation by all peer developers, model office, the Peer Review Chairman, and the system administrators responsible for migrating the change. This discussion consists of stepping through the code that will be modified line by line. The examiners noted that upon this review, there is no required sign off on the peer review ticket that ensures that the change request was discussed at the meeting. Per discussion with management, only certain changes with high criticality or modifications

require a “reviewer sign off.” The examiners noted that database objects chp_update, SP_CLMS_INV_ROLLUP, and P14330 do not have a reviewer sign off.

Without a required reviewer sign off, there is a potential risk that the Peer Review Chairman, who is responsible for the final approval for implementation, can create a peer review ticket in the Lotus Notes Database and push the change to the system administrators indicating that the change was discussed at Peer Review and approved, although no reviewer sign off is noted. This can result in an implemented production change that was not authorized or tested.

No supporting documentation was found or provided by the FACETS AD Manager on the change sp_FNAC_NYSHCRA_SCHG_050701.

If no Peer Review ticket was created for these database object changes, then the changes being implemented into production can potentially circumvent the Peer Review control that required approvals from a team of developers, model office personnel, and system administrator approval for migration.

Recommendation

It is recommended that the Peer Review sign off be required on all Peer Review Tickets before database administrators or Data Center Ops personnel migrate changes into production.

It is recommended that a standard Change Management Procedure be adhered to across all divisions of the firm.

F. Logical Security Controls (Mainframe)

Description and Risk

The examiners noted certain security risks through review of the Mainframe operating systems security controls.

Security Parameters

The examiners noted that inactive user IDs are not being automatically revoked. This creates an opportunity for a hacker or unauthorized employee to target an inactive, authorized, ID for manipulation. If this ID were used, it would not necessarily be traceable to any individual.

Segregation of Duties

There are 8 programmers/system engineers that belong to the Mainframe (RACF) group that grants "Update" access to a TOPPS production source library "SYS2.RHS.PROD.LIBR.MASTER". The examiners also noted 10 programmers/system engineers who have "Control" access to two TOPS/FLRx/LRSP production source libraries: "TBS.RHS.PROD.LIBR.MASTER" and "DPO.RHS.PROD.MFS.LIBR. MASTER".

Per discussions with management from Corporate Security, "Update" access grants permissions to Read, Write, and Execute mainframe objects and "Control" access grants permissions to Read, Write, and Execute mainframe objects.

While access controls around these datasets are restricted by Librarian/CCF, the examiners also noted that mainframe applications in Rochester are being migrated to different environments using the Roscoe RPF system. As a result, it appears that programmers have inappropriate access to production source libraries. However, changes made by these programmers need to adhere to the company's normal change control processes. Therefore, the risk of unauthorized changes being promoted into production by these individuals is greatly reduced.

If programmers have access to the production libraries, there is a risk that they could modify a module and implement that change into the production environment without proper authorization/ testing.

Recommendation

Security Parameters

It is recommended that this mainframe user setting be improved upon to tighten up controls around the system.

Segregation of Duties

It is recommended that Programmers be removed from Mainframe (RACF) groups that have Update, Control, or Alter access to the production source libraries.

G. Mainframe Program Change Controls (LRSP and TOPS)

Description and Risk

LRSP

During testing, the examiners noted that certain changes to the LRSP Membership and Billing production libraries were made without systematically noting when these changes had been implemented (the LAST – Modified" field was not populated for all modules). If management cannot easily identify when production libraries have been modified, they may have difficulty investigating the causes of production problems. For example, there was no date stamp for the FNBILLIT module (however, through discussions and review of documentation, it is believed that this module was last updated on December 3, 2003).

TOPS

Testing of changes for the TOPS application may not be adequate to ensure that all changes meet user requirements before they are migrated into production. Through observation and inquiry with management, it was noted that while a test environment exists for the TOPS application, it does not fully mirror the production environment. The examiners also noted that a subset of production data was used within the test environment and that strobe testing was performed to ensure changes will not negatively impact the system. However, since the test environment only uses a subset of production data, management cannot effectively evaluate how certain changes will impact system performance before they are introduced into the production environment. While the system may perform adequately on a subset of data, it may not perform to expectations in

the production environment. In addition, spikes in daily transactions could cause the system to perform at a prohibitively slow rate.

Recommendation

LRSP

It is recommended that Management establish a systematic date stamp for the modifications of all critical production libraries.

TOPS

It is recommended that Management ensures that the test environment mirrors the production environment for all critical applications. It is also recommended that Management ensure that all changes are fully stress tested and can handle spikes and fluctuations in volume.

H. Change Management Policies and Procedures

Description and Risk

There is no link between the Service Request Database and the Production Turnover Database, which is used to monitor mainframe application changes. As a result, a programmer could potentially create and submit a production turnover ticket for a change that had not been appropriately authorized and tested.

Currently, the "Service Request Database" logs the status of all change requests indicating which changes have been requested, approved, developed and tested. When a change is ready to be promoted into production, the Application Development Manager reviews the status of the change within the "Service Request Database" and directs the developer to create a second ticket in the "Production Turnover database." The creation of this second ticket initiates an email to the Application Development Manager, the developer, and the Computer Operations Personnel responsible for migrating the change into production. The changes are then loaded by the Computer Operations/ Technical Services Group into an interim load library, which compiles the data for 5 runs before migrating the changes into production. The Computer Operations Personnel will change

the production turnover status to “Closed”, which will automatically send an email to all personnel on the ticket that the change has been implemented.

During testing, the examiners noted that there is no link between the Service Request Database and the Production Turnover Database. As a result, a programmer could create and submit a production turnover ticket for a change that was not authorized or tested. This change can be implemented because the Computer Operations/ Technical Services Group does not review the Service Request tickets to ensure the changes have been authorized and approved. Although the generation of an email message to the Application Development Manager serves as a compensating control, this control may not be effective (the Application Development Manager may be on vacation or may not diligently review all email notifications regarding changes being promoted into production).

Recommendation

It is recommended that Management establish a better link between the “Service Request Database” and the “Production Turnover Database”. This will enable monitoring and the prevention of potential threats of inappropriate changes to production.

I. Local Area Network Controls

Description and Risk

Virus Protection

Through discussions with management from the IT Infrastructure and Security group, the examiners discovered that virus protection is not currently running on the Mainframe environment. Without proper virus protection on systems that house critical data, the systems become more susceptible to external threats. Since many of the known viruses spread through email and Excellus has appropriate virus protection controls around its email servers, this risk is substantially mitigated. However, the possibility exists that a virus could get past the email system and infect the mainframe environment.

Firewall and Intrusion Detection

Through discussions with management from the IT Infrastructure and Security group, it was noted that firewall and IDS logs are reviewed 2-3 times a day. This process, however, is not formally documented and there is no sign-off/ evidence that these reviews have been performed (audit trail). Having an audit trail is a requirement for HIPAA compliance, but moreover will provide a detection control for management to help them investigate problems, should they occur.

Recommendation

Virus Protection

It is recommended that the Plan research the installation of virus protection controls on the mainframe.

Firewall and Intrusion Detection

It is recommended that a formal daily review/ sign-off process be established for the IDS and firewall. This paper trail will serve as evidence that these reviews have been conducted.

J. Wide Area Network (WAN) and Interface Controls

Description and Risk

In reviewing the PCAnywhere settings (L4.5) in conjunction with the PCAnywhere policies (L4.6), it was noted that encryption was not established in the two systems that were reviewed. In addition, the connections were not limited to a specific range of IP addresses.

Recommendation

Due to known security weaknesses associated with prior versions of PCAnywhere, it is recommended that management upgrade all versions of this software package to version 10.0 or above. In addition, it is recommended that a review be conducted to ensure that all systems with PCAnywhere installed conform to the policies stated.

K. Physical Access

Description and Risk

Certain individuals who have access to the Excellus Data Center (Rochester) may not have a business need to routinely enter the facility. This could permit them to inappropriately access critical systems, data and programs. During review, it was noted that 21 programmers who possessed access to the data center may not have a need to routinely enter the facility – since these individuals are not assigned to the Data Center Operations or Technical Services Department. If access to the data center is not appropriately restricted, critical systems could be damaged and data/ programs could be inappropriately modified or corrupted resulting in system failures and data integrity issues.

The examiners also noted that there are 3 developers with access to the Univera Data Center (Buffalo). Through follow-up discussions regarding access to this data center, management has stated that these individuals need access to the facility because it is not staffed 24 hours a day/ 7 days a week. As a result, developers cannot always be escorted through the data center when they are needed to fix production problems. The examiners also noted that a number of people in the executive group (4) have access to the data center as well.

Recommendation

It is recommended that Management review access to their data centers and consider removing access to all individuals who are not assigned to the Data Center Operations or Technical Services Department. It is further recommended that management also review this access periodically and remove individuals who do not have a business need to enter the facility. Upon reviewing the examiner's recommendation, management took certain corrective action, such as, reducing the number of non-operational staff with access to the data center.

L. Business Continuity

Description and Risk

Business Continuity Plans (BCPs) are not tested in conjunction with Disaster Recover (DR) testing. If BCPs are not included in Disaster Recovery testing, then management cannot be certain that business users will have the knowledge or ability to perform their job functions at a remote location as critical data could be inaccessible. Through observation and inquiry, it was noted that 92 BCPs exist, one for each business unit. Currently, only 10% of these plans are updated on an annual basis. It was also noted that a business impact analysis has not been performed for each business unit in an effort to prioritize the recovery of critical business processes, systems, historic data files, and programs. If a business impact analysis is not performed, systems may not be recovered on a timeline consistent with the needs and priorities of the business.

Recommendation

It is recommended that Management perform a full Business Impact Analysis to prioritize the recovery of critical business processes and fully integrate the Business Continuity Plan with the Disaster Recovery plan. This Analysis should include scheduling and performing regular tests of the Business Continuity Plans in conjunction with Disaster Recovery testing. Additionally, all plans should be updated at least annually.

It should be noted that Excellus responded to the foregoing information technology review by the immediate implementation of the recommendations or where appropriate, by developing action plans to work with their software vendors and/or their own responsible staff. These plans were initiated while the examiners were still on site.

4. SUMMARY OF COMMENTS AND RECOMMENDATIONS

prevention of potential threats of inappropriate changes to production.

I. Local Area Network Controls

i. It is recommended that the Plan research the installation of virus protection controls on the mainframe. 60

ii. It is recommended that a formal daily review/ sign-off process be established for the IDS and firewall. This paper trail will serve as evidence that these reviews have been conducted. 60

J. Wide Area Network (WAN) and Interface Controls

i. Due to known security weaknesses associated with prior versions of PCAnywhere, it is recommended that management upgrade all versions of this software package to version 10.0 or above. In addition, it is recommended that a review be conducted to ensure that all systems with PCAnywhere installed conform to the policies stated. 61

K. Physical Access

i. It is recommended that Management review access to their data centers and consider removing access to all individuals who are not assigned to the Data Center Operations or Technical Services Department. It is further recommended that management review this access periodically and remove individuals who do not have a business need to enter the facility. Upon reviewing the examiner's recommendation, management took certain corrective action, such as, reducing the number of non-operational staff with access to the data center. 62

L. Business Continuity

i. It is recommended that Management perform a full Business Impact Analysis to prioritize the recovery of critical business processes and fully integrate the Business Continuity Plan with the Disaster Recovery plan. This Analysis should include scheduling and performing regular tests of the Business Continuity Plans in conjunction with Disaster Recovery testing. Additionally, all plans should be updated at least annually. 62

Respectfully submitted,

Bruce E. Borofsky,
Associate Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF NEW YORK)

Bruce E. Borofsky, being duly sworn deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Bruce E. Borofsky

Subscribed and sworn to before me
this 19th day of September, 2005.

Charles T. Lovejoy
Notary Public, State of New York
No. 31-4718052
Qualified in New York County
Commission Expires 1-[illegible]-06

Appointment No. ***22094***

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:

Bruce Borofsky
as a proper person to examine into the affairs of the

Excellus Health Plans, 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 *2nd* day of *October* *2003*

Gregory V. Serio
Superintendent of Insurance

Appointment No. ***22118***

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:

Ernst & Young, LLP

as a proper person to examine into the affairs of the

Excellus Health Plans, 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 *8th* day of *January 2004*

Gregory V. Serio
Superintendent of Insurance