Examination Warrant Number 11-00001-13735-A1

Report of Examination of

Aetna Better Health Inc. (a Pennsylvania corporation)
Blue Bell, Pennsylvania

As of December 31, 2011

Aetna Better Health Inc. (a Pennsylvania corporation)

TABLE OF CONTENTS

Harrisburg, Pennsylvania
April 17, 2013

Honorable Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 11-00001-13735-A1, dated, February 25, 2011, an examination was made of

Aetna Better Health Inc. (a Pennsylvania corporation), NAIC Code: 13735

a Pennsylvania domiciled stock Health Maintenance Organization ("HMO"), hereinafter referred to as the "Company." The examination was conducted at the Company's home office, located at 980 Jolly Road, Blue Bell, Pennsylvania 19422.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The previous examination was made as of January 12, 2010 to determine compliance with 15 P.S. § 21207, for the granting of a Certificate of Authority by the Pennsylvania Insurance Department ("Department"). This single-state examination of the Company covers the two-year period from January 13, 2010 through December 31, 2011. Material subsequent events through the date of this report were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Department and the National Association of Insurance Commissioners ("NAIC").

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a factual disclosure of other significant regulatory information.

The following Pennsylvania domestic affiliated insurance companies were also examined concurrently with this examination:

Company	NAIC Code
Aetna Health Inc. (a Pennsylvania corporation)	95109
Aetna Health Insurance Company	72052

In addition to the examinations noted above, other affiliated insurance companies examined as of December 31, 2011 by the states of New Jersey, Texas, and Missouri included the following:

Company	NAIC Code
Aetna Health Inc. (a New Jersey corporation)	95287
Aetna Dental Inc. (a New Jersey corporation)	11183
Aetna Health Inc. (a Texas corporation)	95490
Aetna Dental Inc. (a Texas corporation)	95910
Missouri Care, Incorporated	12913

<u>**Use of Others Work**</u>

The Connecticut Insurance Department ("CID") performed an examination of its domestic insurance companies that are part of the Aetna Insurance Group ("Aetna Group") as of December 31, 2010. Many of the areas and the related processes reviewed during that examination are common to all the companies in the Aetna Group, including the Pennsylvania companies examined as part of this examination. Those areas included shared information technology ("IT") systems, enterprise risk management, internal audit functions, premiums and claims systems. In an effort to increase efficiency and avoid duplication of work, this examination utilized some of the work performed by the CID in its 2010 examination.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of KPMG LLP provided an unqualified opinion on the financial statements based on statutory accounting principles. Relevant work performed by the CPA firm, during its annual audit of the Company, was also reviewed during the examination and incorporated into the examination working papers.

HISTORY

The Company was incorporated in the Commonwealth of Pennsylvania on June 28, 2005 as the Aetna Family Plans of Pennsylvania Inc. The Company changed its name to Aetna Better Health Inc. on February 29, 2008. The Company is owned by Aetna Inc.

In 2010, the Company sought and obtained a Certificate of Authority in the Commonwealth of Pennsylvania to transact business as a stock Health Maintenance Organization ("HMO"). Prior to commencing business on April 1, 2010, the Company had no operating activities.

The Company is currently authorized to transact business under 40 P.S. § 1554.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of the examination date, the Company's total capitalization was $35,732,646 consisting of 10,000 shares of issued and outstanding common stock with a par value of $0.01 per share amounting to common capital stock of $100, gross paid in and contributed surplus of $43,999,900, and $(8,267,354) of unassigned funds ("surplus").

The Company did not have any preferred stock outstanding at December 31, 2011.

Pursuant to 31 Pa. Code § 301.121(b)(2), an HMO not offering a point-of-service product is required to maintain a minimum net worth equal to the greater of $ 1,000,000 or three (3) months uncovered health care expenditures of Pennsylvania enrollees as reported on the most recent financial statement filed with the Commissioner. At December 31, 2011, the minimum net worth was $4,121,226, which represented three (3) months of uncovered health care expenditures of Pennsylvania enrollees. The Company has met all governing net worth requirements throughout the examination period.

STOCKHOLDER

The Company is 100% owned by its immediate holding company, Aetna Health Holdings, LLC which is a wholly-owned subsidiary of the ultimate controlling entity, Aetna Inc., a Pennsylvania domiciled holding company.

The Company has never paid stockholder dividends since its inception in 2010.

CAPITAL CONTRIBUTIONS

The following is a summary of capital contributions received by the Company from its parent during the period of this examination through December, 2012:

Year	Capital Contributions
2010	$ 4,000,000
2011	30,000,000
2012	17,000,000
Totals	$ 51,000,000

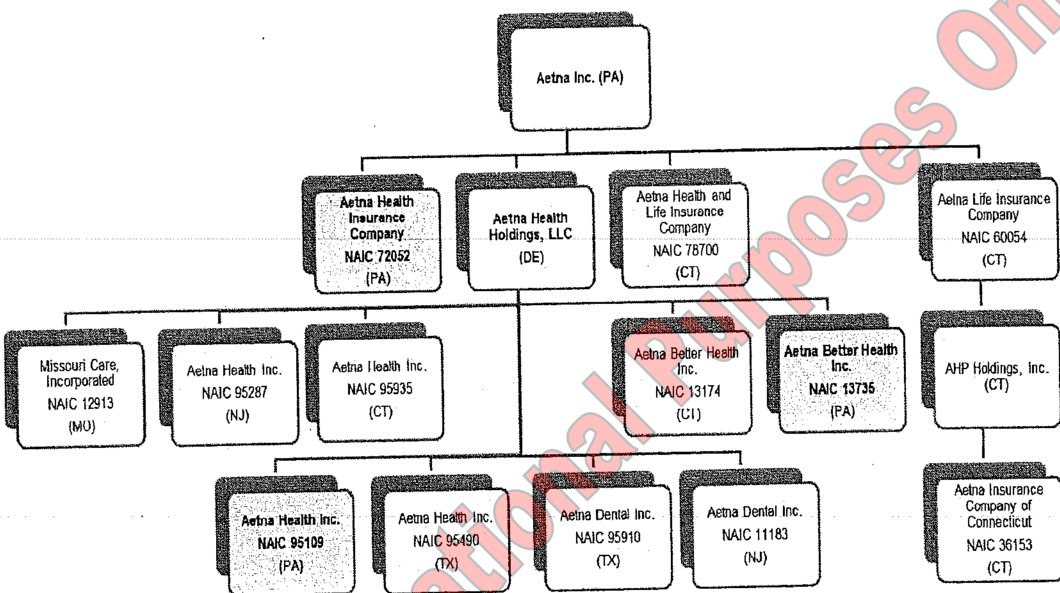
INSURANCE HOLDING COMPANY SYSTEM

The Company became a member of an insurance holding company system through its ultimate 100% ownership by Aetna Inc., in June 2005. Pursuant to the requirements of 40 P.S. §§ 991.1401-991.1413, an Insurance Holding Company System Registration Statement and various amendments thereto, has been timely filed with the Pennsylvania Insurance Department during the examination period.

The Company reported no investments in subsidiaries during the examination period.

ORGANIZATIONAL CHART

The following is an abridged organizational chart depicting the Company and selected other companies within the holding company system as of December 31, 2011[1].



BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of December 31, 2011:

Name and Address	Principal Occupation
Frederick Richard Hatfield (*) Chandler, AZ	Chief Operations Officer Aetna Life Insurance Company

1 All holdings are 100%

Thomas Laurence Kelly (*)	Chief Executive Officer and President
Phoenix, AZ	Aetna Better Health Inc. (Pennsylvania)
Coleen Hines Kivlahan, M.D. (*)	Chief Medical Officer
Reston, VA	Schaller Anderson
Gregory Stephen Martino	Vice President
Hummelstown, PA	Aetna Better Health Inc. (Pennsylvania)

(*) Paul Don Fawson, Head of Medicaid Informatics, Aetna, replaced Coleen Hines Kivlahan, effective February 15, 2012. Pamela Sue Sedmak, Head of Medicaid, Aetna, replaced Frederick Richard Hatfield and Thomas Laurence Kelly, effective December 20, 2012.

The members of the Board are elected annually to serve a term of one year.

The Company has a conflict of interest policy, which appears to adequately address any conflict of interest concerns. The policy is updated and signed annually. There were no conflicts of interest reported by the members of the Board.

COMMITTEES

The Company did not have any established committees during the examination period. However, as a result of the adoption of the Model Audit Rule ("MAR") in 2010, an audit committee was formed by the Company's Parent to cover legal entities subject to MAR. Although the Company is not currently subject to the MAR requirements, its immediate parent, Aetna Health Holdings, LLC ("AHH"), formed one common audit committee that serves as the Company's audit committee. The following are the members of the AHH Audit Committee:

Michael W. Fedyna (Chairperson)
Jerry Bellizzi
Alfred P. Quirk, Jr.

OFFICERS

The following officers were appointed and serving in accordance with the Company's by-laws as of December 31, 2011:

Name	Title
Thomas Laurence Kelly (*)	Chief Executive Officer and President
Robert Mark Kessler	Vice President and Secretary
Jennifer Anne Palma	Principal Financial Officer and Controller
Elaine Rose Cofrancesco	Treasurer
Gregory Stephen Martino	Vice President
Kevin James Casey	Senior Investment Officer
Dawn Marie Schoen	Assistant Controller

(*) Removed on December 20, 2012; Pamela Sue Sedmak was elected as CEO and President, effective December 20, 2012.

CORPORATE RECORDS

MINUTES

The Company's stockholder meetings and board of directors meetings all appear to have been held within the confines of the Company's Articles of Incorporation and By-laws. The annual meetings held by the sole stockholder were all held by Written Consent of the Sole Stockholder in Lieu of an Annual Meeting and this was the procedure used to elect the members of the Board.

ARTICLES OF INCORPORATION

In 2008, the Company's Articles of Incorporation were amended to change the Company's name to Aetna Better Health Inc. (a Pennsylvania corporation).

BY-LAWS

No changes or amendments were made to the Company's By-laws during the period under examination.

SERVICE AND OPERATING AGREEMENTS

As of December 31, 2011, the Company had the following agreements in force:

ADMINISTRATIVE SERVICES AGREEMENT WITH SCHALLER ANDERSON, LLC.

Effective January 1, 2009, the Company and Schaller Anderson of Arizona, LLC, who changed its name to Schaller Anderson, LLC on January 1, 2010 and then to Aetna Medicaid Administrators LLC ("AMA") on May 31, 2013, indirectly a wholly-owned subsidiary of Aetna, are parties to an administrative services agreement, under which AMA provides certain administrative services, including accounting and processing of premiums and claims.

Under this agreement, the Company remits 9% percentage of its earned premium revenue, as applicable, to AMA as a fee. For these services, the Company was charged $23,265,114 in 2011 and $8,644,903 in 2010.

The agreement also provides for interest on all intercompany balances. There was no interest earned ("incurred") on amounts due from/ to affiliates in 2011 or 2010.

At December 31, 2011, the Company reported $2,818,395 as amounts due to AMA related to this agreement. The Company did not report any amounts due to AMA at December 31, 2010. The terms of settlement require that these amounts be settled within forty-five ("45") days after the end of the calendar quarter.

TAX SHARING AGREEMENT

The Company participates in a tax sharing agreement, effective January 1, 2006, with its ultimate parent Aetna Inc. ("Aetna") and Aetna's other subsidiaries. The Company became a party to this agreement in 2010. This agreement provides that the subsidiaries of Aetna shall share in and settle state and federal income taxes where a consolidated return is filed. The basis of each subsidiary's liability to Aetna is generally computed as if the subsidiary were filing a separate, standalone federal and state income tax return. The agreement is continuous and can be terminated by written agreement by both parties, withdrawal from Aetna's affiliated group by the Company and the discontinuance of filing consolidated tax returns. All Federal income tax receivables/payables are due from/due to Aetna.

LITIGATION EXPOSURES COVERAGE

The Company has coverage for certain litigation exposure ($10,000,000 per claim in the aggregate including defense costs) through an affiliated captive insurance company.

REINSURANCE

CEDED

The Company had a reinsurance agreement with ReliaStar Life Insurance Company ("ReliaStar"), which became effective April 1, 2010 for a two-year period, and was intended to reduce the Company's risk of catastrophic loss. Under this agreement, ReliaStar was liable for 90% of the Company's incurred claims during the contract year once the deductible amount of $400,000 per member had been met. In 2011 and 2010, the Company paid reinsurance premiums of $477,666 and $805,337, respectively. The Company realized net reinsurance recoveries of $756,980 in 2011. The Company had no realized net reinsurance recoveries in 2010. The Company did not renew this agreement in 2011.

During the 3rd quarter of 2012, the Company began reporting premiums and recoveries related to the Pennsylvania High Risk Pool ("HRP") as reinsurance in accordance with the requirements of Statements of Statutory Principals ("SSAP") No. 63 – Underwriting Pools and Associations Including Intercompany Pools. Therefore, premiums payable to HRP were included as ceded reinsurance premiums payable in the Statutory Statement of Liabilities at December 31, 2012, which were previously included as claims unpaid in the Statutory Statement of Liabilities in prior periods. The Company's 2012 realized net reinsurance recoveries were recorded as net reinsurance recoveries in the December 31, 2012 Statutory Statements of Revenue and Expenses, previously recorded as a reduction of hospital and medical expenses in the Statutory Statements of Revenue and Expenses in prior periods. Additionally, the Company's amounts recoverable from HRP at December 30, 2012 were included as amounts recoverable from reinsurers in the Statutory Statements of Assets, previously included as healthcare receivables in the Statutory Statements of Assets in prior periods. Also, in accordance with SSAP No. 3 – Accounting Changes and Correction of Errors, the Company disclosed this accounting change in its 2012 filed statutory financial statements.

ASSUMED

The Company did not assume any reinsurance during the period under examination.

TERRITORY AND PLAN OF OPERATIONS

The Company commenced operations on April 1, 2010 and in that month it was awarded a contract by the Pennsylvania Department of Public Welfare ("DPW"), The Office of Medical Assistance Programs ("OMAP"). OMAP administers the joint state/federal Medical Assistance (also known as Medicaid) program that purchases health care for Pennsylvania residents. The Company's contract with the DPW accounts for 100% of its current total revenues. The Company insures Medicaid membership through its HealthChoices contract with the DPW. The contract period is April 1, 2010 through December 31, 2015.

The Company only writes Medicaid business and is only licensed in Pennsylvania and writes exclusively in that state (in the Southeast and Lehigh/Capital zones). The Lehigh/Capital zone consists of the following counties: Adams, Cumberland, Perry, Dauphin, York, Lancaster, Lebanon, Berks, Lehigh and Northampton. The Southeast zone consists of the following counties: Philadelphia, Montgomery, Delaware, Chester and Bucks.

In July 2012, the Company expanded its operations to the following three additional counties: Franklin, Fulton and Huntingdon.

Lines of Business / Operations

As shown below, all of the Company's 2011 net premiums were from the Medicaid line. All of the reinsurance ceded premiums were to ReliaStar Life Insurance Company.

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Premium	Percentage of total
December 31, 2011				
Title XIX - Medicaid	$ 251,329,744	$ 477,666	$ 250,852,078	100.0%
Totals	$ 251,329,744	$ 477,666	$ 250,852,078	100.0%

MEMBERSHIP

As noted in the following schedule, the Company's total members and member month's enrollment increased from 2010 to 2011.

Description	2-Year Change	2011	2010
Total members at end of period (enrollment)	15,804	54,776	38,972
% Change from Prior Year-end & 2-Year	40.6%	40.6%	
Total member months (enrollment)	361,526	577,721	216,195
% Change from Prior Year-end & 2-Year	167.2%	167.2%	

SIGNIFICANT OPERATING TRENDS

The Company reported the following key financial statement balances during the period under examination:

	2011	2010
Admitted Assets	$ 98,043,030	$ 50,486,923
Liabilities	$ 62,310,384	$ 40,242,796
Capital and Surplus Funds	$ 35,732,646	$ 10,244,127
Net Premium Income	$ 250,852,078	$ 98,995,534
Underwriting Gain (Loss)	$ (6,757,474)	$ (4,170,036)
Investment Gain (Loss)	$ 713,169	$ (38,930)
Net Income (Loss)	$ (4,120,767)	$ (3,585,840)

ACCOUNTS AND RECORDS

The Company maintains its accounts and records at its home office in Blue Bell, Pennsylvania, as well as in its affiliate's home office in Hartford, Connecticut through an administrative services agreement with AMA. The Company, as a purchaser of the services, has its accounting, premium, and claim processing records kept on an automated and integrated accounting system with respect to the general ledger, trial balance, receivables, and payables. The receipt of premium and payment of claims are handled by AMA with cash due to and due from the Company settled through an inter-company receivable and payable system.

PENDING LITIGATION

A review of the Company's legal representation letter indicates that there was no material current, pending, or threatened litigation, other than claim litigation, which is considered in the normal course of business.

FINANCIAL STATEMENTS

The financial condition of the Company as of December 31, 2011 and the results of its operations for the two-year period under examination are reflected in the following statements:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
Comparative Statement of Income;
Comparative Statement of Capital and Surplus; and
Comparative Statement of Cash Flow

Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,

	2011	2010
Bonds	$ 46,012,604	$ 4,858,820
Cash, cash equivalents and short-term investments	12,113,101	12,785,273
Investment income due and accrued	247,508	99,412
Premiums and considerations:		
Uncollected premiums and agents' balances in course of collection	34,890,480	32,725,336
Net deferred tax asset	0	0
Health care and other amounts receivable	4,779,285	0
Aggregate write-ins for other than invested assets	52	18,082
Total	$ 98,043,030	$ 50,486,923
Claims unpaid	$ 55,755,208	$ 36,173,167
Unpaid claims adjustment expenses	731,382	446,936
General expenses due or accrued	4,655	0
Current federal and foreign income tax payable and interest thereon	527,997	292,165
Amounts due to parent, subsidiaries and affiliates	4,748,451	2,333,820
Aggregate write-ins for other liabilities	542,691	996,708
Total liabilities	62,310,384	40,242,796
Common capital stock	100	100
Gross paid in and contributed surplus	43,999,900	13,999,900
Unassigned funds (surplus)	(8,267,354)	(3,755,873)
Total capital and surplus	35,732,646	10,244,127
Totals	$ 98,043,030	$ 50,486,923

Comparative Statement of Income
For the Year Ended December 31,

Account	2011	2010
Net premium income	$ 250,852,078	$ 98,995,534
Total revenues	250,852,078	98,995,534
Hospital/medical benefits	168,081,612	78,363,822
Other professional services	7,773,627	2,753,635
Outside referrals	5,065,168	3,659,578
Emergency room and out-of-area	10,018,786	4,308,349
Prescription drugs	31,352,470	0
Subtotal (hospital and medical)	222,291,663	89,085,384
Net reinsurance recoveries	756,980	0
Total hospital and medical	221,534,683	89,085,384
Claims adjustment expenses	8,715,007	1,781,708
General administrative expenses	27,359,862	12,298,478
Total underwriting deductions	257,609,552	103,165,570
Net underwriting gain or (loss)	(6,757,474)	(4,170,036)
Net investment income earned	733,786	119,298
Net realized capital gains or (losses)	(20,617)	(158,228)
Net investment gains or (losses)	713,169	(38,930)
Net income or (loss) before federal income taxes	(6,044,305)	(4,208,966)
Federal income taxes incurred	(1,923,538)	(623,126)
Net income	$ (4,120,767)	$ (3,585,840)

Aetna Better Health Inc. (a Pennsylvania corporation)

Comparative Statement of Capital and Surplus
For the Year Ended December 31,

Account	2011	2010
Capital and surplus, December 31, previous year	$ 10,244,127	$ 10,000,405
Net income or (loss)	(4,120,767)	(3,585,840)
Change in net deferred income tax	0	882,292
Change in nonadmitted assets	(390,714)	(1,052,730)
Surplus adjustments:		
Paid in	30,000,000	4,000,000
Net change in capital and surplus	25,488,519	243,722
Capital and surplus, December 31, current year	$ 35,732,646	$ 10,244,127

Comparative Statement of Cash Flow
For the Year Ended December 31,

	2011	2010
Cash from Operations		
Premiums collected net of reinsurance	$ 248,686,934	$ 66,270,198
Net investment income	623,378	25,244
Miscellaneous Income	(390,714)	(170,438)
Total	248,919,598	66,125,004
Benefit and loss related payments	206,731,927	52,912,217
Commissions, expenses paid and aggregate write-ins for deductions	35,785,768	13,633,250
Federal and foreign income taxes paid (recovered)	(2,169,884)	(1,000,272)
Total deductions	240,347,811	65,545,195
Net cash from operations	8,571,787	579,809
Cash from Investments		
Proceeds from investments sold, matured or repaid:		
Bonds	3,952,000	11,594,780
Net gain or (loss) on cash, cash equivalents and short term investments	206	(25)
Total investment proceeds	3,952,206	11,594,755
Cost of investments acquired (long-term only):		
Bonds	45,174,809	16,702,360
Total investments acquired	45,174,809	16,702,360
Net cash from investments	(41,222,603)	(5,107,605)
Cash from Financing and Miscellaneous Sources		
Cash provided (applied):		
Capital and paid in surplus, less treasury stock	30,000,000	4,000,000
Other cash provided or (applied)	1,978,644	3,312,446
Net cash from financing and miscellaneous sources	31,978,644	7,312,446
Reconciliation of cash and short-term investments:		
Net change in cash and short-term investments	(672,172)	2,784,650
Cash and short-term investments:		
Beginning of the year	12,785,273	10,000,623
End of the year	$ 12,113,101	$ 12,785,273

SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

The book value of the Company's invested assets as of December 31, 2011, as shown below, totaled $58,125,705 and consisted of bonds, cash, cash equivalents, and short-term investments.

Description	Amount	Percentage
Bonds	$ 46,012,604	79.1%
Cash	4,337,548	7.5%
Cash equivalents	4,917,538	8.5%
Short-term investments	2,858,015	4.9%
Totals	$ 58,125,705	100.0%

The Company's bond, cash equivalents, and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1-Highest quality	$ 46,493,164	86.4%
2-High quality	6,295,541	11.7%
3-Medium quality	999,452	1.9%
Totals	$ 53,788,157	100.0%

As noted above, approximately 98.1% of the Company's bond, cash equivalents, and short-term investment portfolio received a National Association of Insurance Commissioners ("NAIC") "highest" or "high quality" rating. Specifically, 86.4% of the portfolio was rated "highest quality" and 11.7% of the portfolio was rated "high quality". The remaining investments, approximately 1.9%, were classified as "medium quality".

The contractual or expected maturities of bonds, cash equivalents, and short-term investments at December 31, 2011 were as follows:

Years to Maturity	Amount	Percentage
1 Year or Less	$ 7,875,553	14.6%
2 to 5 Years	16,306,148	30.3%
6 to 10 Years	15,319,939	28.5%
Over 10 Years	14,286,517	26.6%
Totals	$ 53,788,157	100.0%

The maturity for a mortgage pass-through security, included in U.S. Government and U.S. special revenue and assessment obligations and all non-guaranteed obligations of agencies and authorities of governments and their political subdivisions, is not based on stated maturity, but instead is based on prepayment assumptions. Prepayment assumptions are calculated utilizing published repayment factors that estimate the prepayment rates on the mortgages in the Federal National Mortgage Association ("FNMA") and Government National Mortgage Association ("GNMA") pools.

The Company's bond portfolio is spread among the following categories: U.S. Special Revenue and Special Assessment 36.06%; Industrial and Miscellaneous 28.25%; Government 28.16%; and U.S. Political Subdivisions of States, Territories and Possessions 7.53%. Investments in foreign bonds accounted for 9.76% of the bond portfolio and 4.58% of total admitted assets. Cash consisted of cash and short-term investments.

On December 31, 2011, all of the Company's bonds were held under a custodian agreement with State Street Bank and Trust Company in Westwood, Massachusetts. However, the agreement did not meet all the requirements of 31 Pa. Code, Chapter 148a3. It was recommended that the custodian agreement with State Street Bank and Trust Company be amended to contain all of the requirements of 31 Pa. Code, Chapter 148a3. The Company complied with this recommendation in 2013.

The Company has a written investment policy as required by 40 P.S. § 504.1(c). The investment policy is approved by the Board on an annual basis. It appears that the Company is following its investment policy.

LIABILITIES

CLAIMS UNPAID AND UNPAID CLAIMS ADJUSTMENT EXPENSES

At December 31, 2011, the Company reported an unpaid claims liability of $55,755,208, which included a liability for claims reported in process of adjustment (case reported) of $5,071,774 and an incurred but unreported claim liability (IBNR) of $50,683,434. The following schedule reflects the Company's reserves for case reported and IBNR by line of business:

Description	Total	Title XIX Medicaid
Case Reported		
Direct (reported in process of adjustment)	$ 5,071,774	$ 5,071,774
Reinsurance assumed (reported in process of adjustment)	0	0
Reinsurance ceded (reported in process of adjustment)	0	0
Net (reported in process of adjustment)	**5,071,774**	**5,071,774**
Incurred but Unreported		
Direct (incurred but unreported)	50,683,434	50,683,434
Reinsurance assumed (reported in process of adjustment)	0	0
Reinsurance ceded (incurred but unreported)	0	0
Net (incurred but unreported)	**50,683,434**	**50,683,434**
Direct (totals)	55,755,208	55,755,208
Reinsurance assumed (totals)	0	0
Reinsurance ceded (totals)	0	0
Net (totals)	**$ 55,755,208**	**$ 55,755,208**

Hospital and medical costs consist principally of fee-for-service medical claims and capitation costs. Claims unpaid include the Company's estimate of payments to be made on claims reported but not yet paid and for health care services rendered to enrollees but not yet reported to the Company as of the financial statement date. Such estimates are developed using actuarial principles and assumptions, which consider, among other things, historical and projected claim submission and processing patterns, medical cost trends, historical utilization of health care services, claim inventory levels, changes in membership and product mix, seasonality and other relevant factors. Capitation costs, which are recorded in hospital and medical expenses in the statutory financial statements, represent contractual monthly fees paid to participating physicians and other medical providers for providing medical care, regardless of the medical services provided to the enrollee.

The Company uses the triangulation method to estimate reserves for IBNR. The method of triangulation makes estimates of completion factors which are then applied to the total paid claims (net of coordination of benefits) to date for each incurred month. This provides an estimate of the total projected incurred claims and total amount outstanding or claims incurred but not reported (claims unpaid). For the most current dates of service where there is insufficient paid claim data to rely solely on the triangulation method, the Company examines cost and utilization trends as well as environmental factors, plan changes, provider contracts, changes in membership and/or benefits, and historical seasonal patterns to estimate the reserve required for these months.

At December 31, 2011, the Company also reported an unpaid claims adjustment expense liability of $731,382. Claims adjustment expenses, which include cost containment expenses, represent the costs incurred related to the claim settlement process such as costs to record, process and adjust claims.

The Company's appointed actuary, Mr. Michael W. Fedyna, who is an employee of the Company, provided an unqualified actuarial opinion on all of the claims and reserve liabilities reported by the Company as of December 31, 2011 in its statutory financial statements.

This examination utilized the actuarial services of Lewis & Ellis, LLP (L&E) to assist the Department examiners in the Phase 1 and 2 activities of the risk-focused financial examination of the Company. After review of the reserving risks identified by L&E's actuary and the subsequent testing by the examiners in Phase 3 and 4 of the Company's controls to mitigate those risks, it was determined that no further substantive procedures were required to test the adequacy of the above captioned liability accounts.

It was also noted that as part of their year-end 2011 statutory audit, the Company's external auditors, KPMG LLP ("KPMG"), evaluated the adequacy of the Company's reserves. Based on the analysis, KPMG's actuaries concluded that the Company's provision for its unpaid claims liability (including the reserves for unpaid claims adjustment expenses) was reasonable.

In addition to KPMG's and the Company's appointed actuary's actuarial reserve evaluations, a review was made by the Department examiners of the development of the unpaid claims and claims adjustment expenses subsequent to the examination date. Based on the subsequent development through December 31, 2012, as reported by the Company, the year-end 2011 reserves appear to be adequate.

A review of the work performed by KPMG to test the accuracy and completeness of the claims data used in the Company's actuarial analysis noted no exceptions.

SUBSEQUENT EVENTS

Financial Results through December 31, 2012

The Company continues to report underwriting losses and net losses in 2012 (year ended December 31, 2012). The Company reported a net underwriting loss of $22.4 million for year ended December 31, 2012 which is a year-over-year increase in net underwriting losses of $15.6 million ($22.4 million underwriting loss for year ended December 31, 2012 vs. $6.8 underwriting loss for year ended December 31, 2011). The Company is reporting net losses for year ended December 31, 2012 of $13.1 million vs. $4.1 million net loss for year ended December 31, 2011, or an increase in net losses of $9.0 million. Since it commenced operations in 2010, the Company has reported net losses totaling $20.9 million.

This decrease in profitability can be attributed to, in part, a significant increase in hospital/ medical benefits and prescription drugs expenses. Total hospital and medical expenses, net of reinsurance, are up $47.4 million or 21.4% from 2011 totals. General administrative expenses are also up $9.0 million or 33.0% from 2011 totals. During the same period, premium revenues were up by $38.7 million or 15.4% from 2011 totals.

In order to maintain surplus, the Company's parent has made capital contributions totaling $51 million from 2010 through December 31, 2012. $17 million of which was contributed in 2012.

According to the Company, the results were driven by a number of factors including the fast growth of the plan from 2010 to 2012 and an increase in utilization with higher risk members. The results were also driven by the unit cost of some provider contracts. Specific operational processes related to claims payments and encounter submissions have also unfavorably impacted revenue through lower risk adjustment in the capitation payment rates paid by the Department of Public Welfare ("DPW").

In an attempt to reverse these operating results, the Company is incorporating the following actions:

- Improving submitted encounter data to the DPW so risk of member is more adequately recognized in the monthly capitation rates;
- Identification of other revenue improvement opportunities through continued reconciliations;
- Review of key provider contracts for operational and/or financial improvements through re`contracting;
- Identification of areas in medical and pharmacy management where cost savings can be identified without compromising member care; and
- Improvement of operations with respect to claims, encounters and provider relations through efficiency or cost recovery actions.

The 2013 plan is projecting a financial improvement in or about the 4th quarter of 2013.

The Company's parent indicated that it is its intention to maintain adequate level of capital to support the ongoing solvency of the Company.

Acquisitions

On December 27, 2012, the Insurance Commissioner of the Commonwealth of Pennsylvania approved the acquisition of Coventry Health Care of Pennsylvania, Inc., HealthAssurance Pennsylvania, Inc., and HealthAmerica Pennsylvania, Inc. ("Domestic Insurers") by the Company's ultimate parent, Aetna Inc. ("Aetna").

The Domestic Insurers are part of an insurance holding company system controlled by Coventry Health Care Inc. ("Coventry"). Under the terms of the acquisition, Coventry will merge with and into Aetna. As a result of the merger, Coventry and its Domestic Insurers would become wholly-owned subsidiaries of Aetna.

The acquisition of Coventry Health Care, Inc. by Aetna became effective on May 7, 2013.

RECOMMENDATIONS

PRIOR EXAMINATION

It was recommended that the Applicant (Company) be issued a Certificate of Authority to conduct the business of a Health Maintenance Organization (HMO).

The Company was issued a Certificate of Authority in 2010 to conduct the business of an HMO.

CURRENT EXAMINATION

There were no recommendations as a result of this examination.

CONCLUSION

As a result of this examination, the financial condition of Aetna Better Health Inc. (a Pennsylvania corporation), as of December 31, 2011, was determined to be as follows:

	Amount	Percentage
Admitted Assets	$ 98,043,030	100.0%
Liabilities	$ 62,310,384	63.6%
Capital and Surplus	35,732,646	36.4%
Total Liabilities, Capital and Surplus	$ 98,043,030	100.0%

Since January 12, 2010, the date of the previous examination, the Company's assets increased by $88,041,740, its liabilities increased by $62,309,933, and its surplus increased by $25,731,807.

This examination was conducted with actuarial assistance from Lewis & Ellis, LLP and examination assistance from Cerebres, LLC with Richard Stone, CFE of Cerebres, LLC in charge.

Respectively

Annette B. Szady, CPA
Director, Bureau of Financial Examinations

David R. Evans, CFE
Examination Manager

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