Examination Warrant Number 13-01270-54747-R1

Report of Examination of

Hospital Service Association of Northeastern Pennsylvania
Wilkes-Barre, Pennsylvania

As of December 31, 2013

Hospital Service Association of Northeastern Pennsylvania

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Harrisburg, Pennsylvania
January 6, 2015

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 13-01270-54747-R1 dated March 1, 2013, an examination was made of:

Hospital Service Association of Northeastern Pennsylvania, NAIC Code: 54747

a Pennsylvania domiciled non-stock, non-profit hospital plan corporation, hereinafter referred to as "Company" or "HSA." The examination was conducted at the Company's home office, located at 19 North Main Street, Wilkes-Barre, Pennsylvania 18711.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2008.

This examination covered the five-year period from January 1, 2009 through December 31, 2013, and consisted of a general survey of the Company's business practices and management, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department ("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.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of PricewaterhouseCoopers, LLP ("PwC") of Philadelphia, Pennsylvania has provided an unmodified opinion based on statutory accounting principles. Relevant work performed by PwC, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

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

Company	NAIC #
First Priority Life Insurance Company, Inc.	60147
HMO of Northeastern Pennsylvania, Inc.	96601

HISTORY

The Company was incorporated on September 7, 1938, under a decree of the Court of Common Pleas of Luzerne County, Pennsylvania pursuant to provisions of the non-profit Corporation Law of the Commonwealth of Pennsylvania. The Company was subsequently licensed by the Pennsylvania Insurance Commissioner on November 23, 1938 and commenced business on December 1, 1938.

The Company is authorized to transact business as a hospital plan corporation in Pennsylvania as described in 40 Pa. C.S.A. §§ 6101 – 6127.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of the examination date, December 31, 2013, the Company's total capitalization was $341,443,319, consisting entirely of unassigned funds (surplus). The Company is a non-profit, non-stock corporation. There is no minimum statutory capitalization requirement in the Pennsylvania law for hospital plan corporations.

MEMBERSHIP

Membership of the Company consists of no less than thirty-five (35), nor more than one hundred (100) persons who are either subscribers to the Company's insurance plan or subscribers to any program offered by a Blue Cross Blue Shield Association licensed subsidiary of the Company or a member of the Board of Directors of the Company who is either a subscriber to a program licensed by the Blue Cross Blue Shield Association or to a program offered by any subsidiary which is wholly-owned, directly or indirectly, by the Company.

Members elected at the annual meeting of the membership shall continue to be members until the end of the next annual meeting of the membership. Members elected by the Board of Directors shall continue to be members until the end of the next annual meeting of the Board of Directors.

The powers vested in the members shall be to set the number and elect the members of the Company, set the number and elect the members of the Board of Directors, amend the By-laws and perform any other act permitted by statute and not inconsistent with the By-laws. As of the examination date, membership was set at thirty-six (36) members.

INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement as required by 40 P.S. §§ 991.1401-991.1413. An annual Insurance Holding Company System Registration Statement and various amendments on its behalf as well as on behalf of the other insurance companies ultimately controlled by the Company, were filed timely with the Department for the period under examination. The Company is named as the ultimate controlling person. Members of the Holding Company System include the following entities briefly described below:

First Priority Life Insurance Company, Inc. (NAIC Code 60147)

First Priority Life Insurance Company, Inc. is doing business as First Priority Life ("FPL"). FPL is a licensed life, accident and health insurance company authorized to issue non-gatekeeper Preferred Provider Organization ("PPO") and traditional indemnity health insurance products. This is a for-profit corporation licensed as a controlled affiliate of HSA and Highmark Inc. ("Highmark") in thirteen counties in northeastern and northcentral Pennsylvania. HSA owns 59.9% and Highmark owns the remaining 40.1% of FPL.

HMO of Northeastern Pennsylvania, Inc. (NAIC Code 96601)

HMO of Northeastern Pennsylvania, Inc. is doing business as First Priority Health ("FPH"). FPH is a licensed Pennsylvania non-profit Health Maintenance Organization ("HMO") operating as a licensed controlled affiliate of HSA and Highmark in thirteen counties in northeastern and northcentral Pennsylvania. HSA owns 59.9% and Highmark owns the remaining 40.1% of FPH.

Hospital Service Association of Northeastern Pennsylvania Foundation

Hospital Service Association of Northeastern Pennsylvania Foundation is doing business as The Blue Ribbon Foundation of Blue Cross of Northeastern Pennsylvania. It is a 501(c)(3) organization formed to receive and maintain funds exclusively for charitable, religious, scientific, literary or educational purposes either directly or by contributions to organizations that qualify as exempt organizations. The Blue Ribbon Foundation is located in Pennsylvania.

AllOne Health Group, Inc.

AllOne Health Group, Inc. was formed as a for-profit corporation in Pennsylvania to provide utilization review and discharge planning services under the name of Universal Managed Care, Inc. in 1985. Universal Managed Care, Inc. changed its name to AllOne Health Group, Inc. in 2007 and has changed its focus to business diversification activities.

AmeriHealth Northeast, LLC

AmeriHealth Northeast, LLC

HSA has a 50% membership interest in AmeriHealth Northeast, LLC ("AHN"), which was formed in December 2012. AHN's purpose is to provide operational support services in the Medical Assistance managed care business in the Pennsylvania Department of Human Services' ("DHS") New East Service Area under an Integrated Delivery System Agreement with Vista Health Plan, Inc. that began March 1, 2013 and was terminated effective March 31, 2014.

AllOne Health Management Solutions, Inc.

AllOne Health Management Solutions, Inc. is a for-profit corporation formed in 2006 as a Pennsylvania domestic corporation that offers wellness, utilization management, disease management and other services.

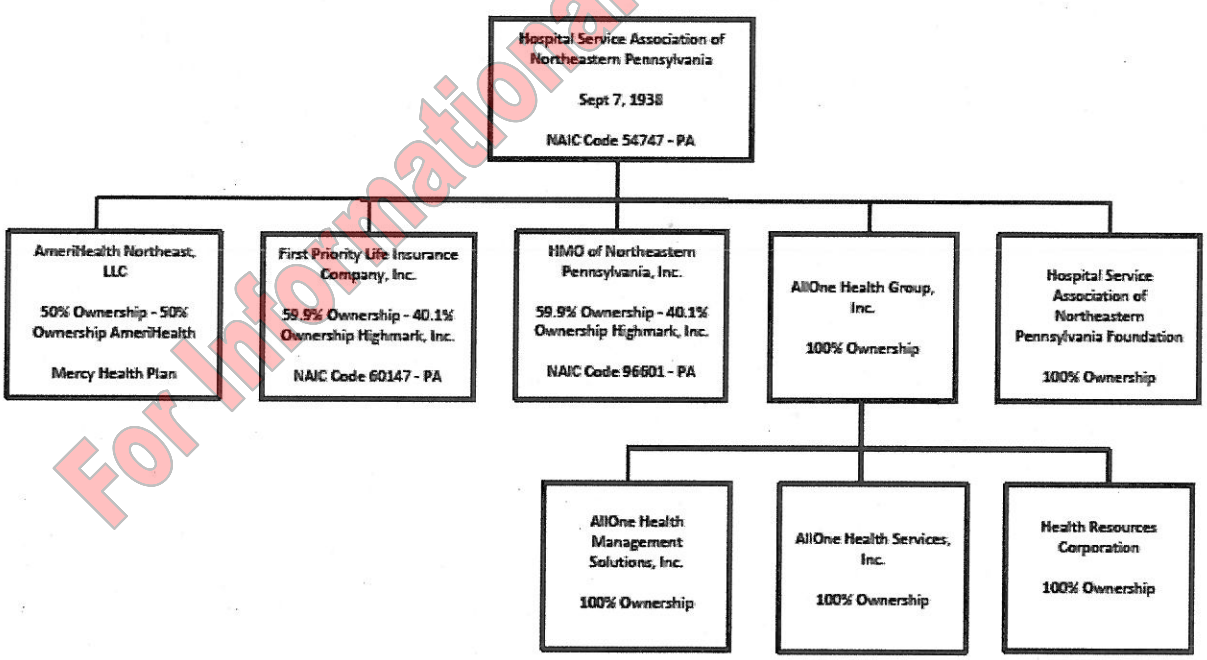
AllOne Health Services, Inc.

AllOne Health Services, Inc. was formed as a for-profit corporation in Pennsylvania to provide business marketing services under the name of AllOne Health, Inc. in November 2008. AllOne Health Inc. changed its focus to business entity producer in July 2011 and changed its name to AllOne Health Services, Inc. in August 2013.

Health Resources Corporation

Health Resources Corporation is a for-profit corporation acquired in 2006. Health Resources Corporation ("Health Resources") is domiciled in Massachusetts. Health Resources is a provider of occupational health, work/life, and medical management services in the United States. It implements and manages high quality programs for business, industry, government agencies, and commercial insurance carriers worldwide.

The following organizational chart depicts the Company's relationship within the holding company system at December 31, 2013:



BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2013:

Name and Address	Principal Occupation
Frank E. Apostolico Clarks Summit, Pennsylvania	President American Assets, Inc.
Paul J. Canevari Kunkletown, Pennsylvania	Community Development Director PPL Services Corporation
Denise S. Cesare Moosic, Pennsylvania	President and Chief Executive Officer Hospital Service Association of Northeastern Pennsylvania
Peter J. Danchak Dunmore, Pennsylvania	President Northeast Pennsylvania Region PNC Bank
Louis A. DeNaples Moscow, Pennsylvania	President DeNaples Auto Parts
Bart E. Ecker, Esquire Sugarloaf, Pennsylvania	Managing Director Laputka, Bayless, Ecker & Cohn, P.C.
John H. Graham Shavertown, Pennsylvania	Private Investor
Allen S. Hollander, Esquire Kingston, Pennsylvania	Partner and Attorney Rosenn, Jenkins, and Greenwall
Gary F. Lamont Sugarloaf, Pennsylvania	Principal The Conyngham Pass Co.
Richard K. Mangan Clarks Summit, Pennsylvania	Retired Chairman Craft Oil Company
John D. McCarthy, Jr. Trucksville, Pennsylvania	President McCarthy Tire Service
John J. Menapace Clarks Summit, Pennsylvania	President Menapace Business Consulting, Inc.
John P. Moses, Esquire Wilkes-Barre, Pennsylvania	Chairman of the Board of Directors Hospital Service Association of Northeastern Pennsylvania
Paul H. Rooney, Jr. Williamsport, Pennsylvania	Retired Senior Vice President Sovereign Bank
Rhea P. Sims Shavertown, Pennsylvania	Chief Executive Officer Lewith & Freeman Real Estate, Inc.
David J. Williams Clarks Green, Pennsylvania	Retired Chief Executive Officer Sanofi Pasteur

The Board of Directors shall contain no less than eight (8), nor more than twenty-seven (27) Directors. At the Annual Meeting of the Members held on April 28, 2011, the number of Directors was set at sixteen (16).

The individuals on the Board of Directors are elected at the annual meeting of the Company's Members. The initial term of a newly elected director is one year. Thereafter, the term of each director who is reelected shall be three years. The directors are divided into three classes, and the term of directors to be elected at the annual meeting of the Members of the Company shall be staggered so that, as nearly as possible, an equal number of directors shall be elected in each successive year.

The Company maintains a conflict of interest policy that requires all Officers and the Board of Directors to annually disclose any conflict of interest. A review of the signed conflicts of interest disclosed that the Company maintained support for this process for the period under examination.

COMMITTEES

The Company's By-laws provide for the following standing committees: Executive Committee, Audit and Risk Committee, By-laws and Legal Committee, Finance and Property Committee, Investment Committee, Nominating Committee, and the Human Resources Committee. All committee members are Directors and with the exception of the Executive Committee, are appointed by the Chairperson of the Board.

Executive Committee

The Executive Committee shall consist of the Officers of the Corporation who are members of the Board of Directors, the Chairpersons of the Audit and Risk, By-laws and Legal, Finance and Property, Investment, Nominating, and Human Resources Committees, and up to two Directors appointed by the Chairperson of the Board. Between meetings of the Board of Directors and subject to its authority, the Executive Committee shall act upon matters of an emergency nature or which may be specially assigned to it by the Board. As of the examination date, the following members were serving on the Executive Committee: John P. Moses, Esquire, Chairperson; Frank E. Apostolico; Denise S. Cesare; Louis A. DeNaples; John H. Graham; Alan S. Hollander, Esquire; Gary F. Lamont; and John J. Menapace.

Audit and Risk Committee

The Audit and Risk Committee shall consist of no less than five (5) Directors, except that no Director who is also a paid employee of the Company may be a member of the Audit and Risk Committee. The Audit and Risk Committee shall recommend an independent auditor for selection by the Board of Directors, review the scope of the audit, giving attention to the adequacy of accounting, financial and operational controls, the auditor's report, and any other written communication received from the Company's auditor. As of the examination date, the following members were serving on the Audit and Risk Committee: Louis A. DeNaples, Chairperson; Paul J. Canevari, Vice Chairperson; Frank E. Apostolico; Peter J. Danchak; Bart E. Ecker, Esquire; Richard K. Mangan; John D. McCarthy, Jr.; John J. Menapace; Paul H. Rooney, Jr.; and David J. Williams.

By-laws and Legal Committee

The By-laws and Legal Committee shall consist of no less than five (5) Directors. The By-laws and Legal Committee shall review the By-laws of the Corporation annually and recommend to the Board of Directors or members of the Company any changes, modifications or amendments to the By-laws. The By-laws and Legal Committee shall review and make recommendations to the Board of Directors regarding significant legal issues affecting the Corporation. As of the examination date, the following members were serving on the Bylaws and Legal Committee: Alan S. Hollander, Esquire, Chairperson; Bart E. Ecker, Esquire, Vice Chairperson; John P. Moses, Esquire, Ex Officio; Louis A. DeNaples; John H. Graham; John J. Menapace; and Rhea P. Simms.

Finance and Property Committee

The Finance and Property Committee shall consist of no less than five (5) Directors. The Finance and Property Committee shall be responsible for reviewing the annual budget, capital expenditures, rate filings, operating results, establish policy and provide oversight of the Company's marketing activities and such other financial matters as directed by the Board of Directors. As of the examination date, the following members were serving on the Finance and Property Committee: Frank E. Apostolico, Chairperson; Rhea P. Simms, Vice Chairperson; John P. Moses, Esquire, Ex Officio; Louis DeNaples; John H. Graham; Alan S. Hollander, Esquire; Gary F. Lamont; Richard K. Mangan; John D. McCarthy, Jr.; David Williams and John J. Menapace.

Investment Committee

The Investment Committee shall consist of no less than five (5) Directors. The Investment Committee shall be responsible for reviewing and recommending to the Board of Directors changes to the Statement of Investment Policy and shall also be responsible for monitoring investment performance and for such other matters as the Board of Directors may direct. As of the examination date, the following members were serving on the Investment Committee: John H. Graham, Chairperson; Richard K. Mangan, Vice Chairperson; John P. Moses, Esquire, Ex Officio; Frank E. Apostolico; Paul J. Canevari; Alan S. Hollander, Esquire; Gary F. Lamont; John D. McCarthy, Jr.; and Rhea P. Simms.

Nominating Committee

The Nominating Committee shall consist of no less than five (5) Directors, except that no Director who is also a paid employee of the Company may be a member of the Nominating Committee. The Nominating Committee shall select and nominate candidates for membership in the Company, the Board of Directors, the Chairperson of the Board, President and Chief Executive Officer, Secretary and Treasurer of the Corporation. As of the examination date, the following members were serving on the Nominating Committee: Gary F. Lamont, Chairperson; Alan S. Hollander, Esquire, Vice Chairperson; Peter J. Danchak; Louis A. DeNaples; John H. Graham; John D. McCarthy, Jr.; and Paul H. Rooney, Jr.

Human Resources Committee

The Human Resources Committee shall consist of no less than five (5) Directors, except that no Director who is also a paid employee of the Corporation may be a member of the Human Resources Committee. The Human Resources Committee shall review and recommend to the Board of Directors salaries of the Officers of the Corporation; compensation, retirement and benefit programs for all employees; as well as review the Corporation's human resources policies and practices. As of the examination date, the following members were serving on the Human Resources Committee: John J. Menapace, Chairperson; Paul H. Rooney, Jr., Vice Chairperson; Frank E. Apostolico; Paul J. Canevari; Peter J. Danchak; Bart E. Ecker, Esquire; John H. Graham; Alan S. Hollander, Esquire; Gary F. Lamont; Richard K. Mangan; and David J. Williams.

40 P.S.§ 991.1405 (c) (3) Standards of management of an insurer within a holding company system, states: "not less than one-third of the directors of a domestic insurer and not less than one-third of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of such insurer or of any entity controlling, controlled by or under common control with such insurer and who are not beneficial owners of a controlling interest in the voting stock of such insurer of any such entity. At least one such person must be included in any quorum for the transaction of business of business at any meeting of the board of directors or any committee thereof.

40 P.S. § 991.1405 (c) (4), Standards of management of an insurer within a holding company system states: "The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have the responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating committees for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers.

40 P.S. § 991.1405 (c)(4.1) Standards and management of an insurer within a holding company system, states that "the board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer. The committee or committees shall have responsibility for recommending candidates to be nominated by the board of directors, in addition to any other nominations by voting shareholders or policyholders, for election as directors by voting shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers."

The Company has board and committee membership that meets the necessary independence to comply with paragraph (3) as cited above. The Company's independent board committees comply with paragraphs (4) and (4.1) as cited above.

OFFICERS

As of the examination date, December 31, 2013, the following officers were appointed and serving in accordance with the Company's By-laws:

Name	Title
John P. Moses, Esquire	Chairperson of the Board
Denise S. Cesare	President and Chief Executive Officer
William J. Farrell	Treasurer and Chief Financial Officer
Gertrude C. McGowan, Esquire	Secretary and Chief Legal Officer
Bruce Sickel	Assistant Treasurer

CORPORATE RECORDS

MINUTES

A review of the minutes of the annual organizational meetings of the Company's Board of Directors held during the period under examination indicates that meetings were held in April or May of each year and regular meetings of the Board of Directors were held not less than four (4) times a year in compliance with the Company's By-laws. Directors were elected at the annual meeting of the members and Officers were appointed at the annual organizational meeting of the Board. Quorums were established at all meetings. The Board routinely approves the Company's investment transactions and is apprised of all material business transactions. The members ratified the actions of the Board and Officers at its annual meeting. These minutes revealed adequate attendance and active participatory oversight of the Company's operations and compliance with governing By-laws.

ARTICLES OF INCORPORATION

There were no changes or amendments made to the Company's Articles of Incorporation during the examination period.

BY-LAWS

There were numerous changes made to the Company's By-laws during the period under examination. The following summarizes the significant changes:

> Section 1.4 was amended changing the date of the Annual Meeting of the Members from "the last Thursday of April" to "no later than five months after the end of the Corporation's fiscal year".
>
> Section 2.2 was amended reducing the threshold for approving a merger, consolidation or sale or disposal of the assets of the Corporation from 50% to 30% and further any acquisition of the stock, assets or other equity interest in a business for a purchase price that exceeds ten percent (10%) of the Corporation's Statutory Surplus as of the thirty-first day of December immediately preceding the effective date of such acquisition would require the affirmative vote of at least

two thirds (⅔) of the Directors of the Corporation present at a duly convened meeting called for that purpose.

Section 2.4 (a) was amended raising the upper limit on age eligibility for Directors from 72 to 77 years of age.

Sections 5.2, 5.3, 5.4, 5.5, 5.6, 5.7, 5.8, and 5.9 were amended removing the cap of eight (8) on the number of Committee Members for all Committees.

Section 8.2 was amended to allow the Company to pay the expenses incurred by any current or former Director or Officer in defending any action, suit or proceeding in advance versus the discretionary language.

SERVICE AND OPERATING AGREEMENTS

The Company provides the majority of the facilities and equipment, staffing, bookkeeping and administrative services at the enterprise level to all or a majority of its subsidiaries and affiliates. As a result, the Company is party to several written, executed intercompany service and operating agreements. These agreements outline the items and services provided, as well as the responsibilities, terms and conditions of each party. The agreements and subsequent amendments have been approved by the Board of Directors and submitted to the Pennsylvania Insurance Department for approval and the examination team for review.

Administrative Service Agreements

The Company provides the operational and administrative services to the following subsidiaries and affiliates: First Priority Life Insurance Company, Inc., HMO of Northeastern Pennsylvania, Inc., AllOne Health Group, Inc., AllOne Health Management Solutions, Inc., Health Resources Corporation, and The Blue Ribbon Foundation of Blue Cross of Northeastern Pennsylvania. Costs are billed based on actual cost and amounts are paid on a monthly basis.

AllOne Health Management Solutions, Inc. provides health management services to the Company. Costs are billed based on actual cost and amounts are paid on a monthly basis.

Health Resources Corporation provides employee assistance services to the Company. Costs are billed based on actual cost and amounts are paid on a monthly basis.

Tax Allocation Agreements

The Company has tax allocation agreements with the following subsidiaries and affiliates: AllOne Health Group, Inc., AllOne Health Management Solutions, Inc., AllOne Health Services, Inc., and Health Resources Corporation. The Company has a written election, approved by the Board of Directors, setting forth the manner in which the total combined federal income tax is allocated to each entity which is party to the consolidation.

All intercompany agreements were determined to be fair and reasonable and met the requirements of 40 P.S. § 991.1405 (a)(1).

Data Center Infrastructure Agreement

Effective November 7, 2011 the Company entered into a Data Center Infrastructure Agreement with Highmark. The agreement is in effect for a term of five (5) years. Under terms of the agreement, Highmark provides the Company with the use of its Provider Data Center and Computer Equipment as well as the personnel used to service the Company's business as well as the business of its subsidiaries and affiliates. The Company pays Highmark a monthly service fee plus a 'billable electric amount" based on their percentage of electrical usage per month.

REINSURANCE

ASSUMED

The following summarizes the reinsurance contract in effect during the period under examination, through which the Company assumed a significant block of its business from another insurer:

Reinsured	Vista Health Plan, Inc.
Type of contract:	Quota share
Effective date:	December 3, 2012
Termination date:	None
Territory	New East Service Area
Business covered:	Medical Assistance Managed Care
Company's retention:	50%
Reinsurance limits:	50%

This reinsurance agreement was terminated effective March 31, 2014.

The above contract contains satisfactory insolvency and arbitration clauses.

CEDED

The Company did not cede any significant business to another insurer during the period under examination.

TERRITORY AND PLAN OF OPERATIONS

The Company was incorporated as a Pennsylvania single state hospital plan corporation. It is an independent licensee of Blue Cross Blue Shield Association primarily operating in thirteen (13) counties in Northeastern and North Central regions of Pennsylvania. The counties include Bradford, Carbon, Clinton, Lackawanna, Luzerne, Lycoming, Monroe, Pike, Sullivan, Susquehanna, Tioga, Wayne, and Wyoming.

The Company writes premiums classified as Comprehensive, Medicare Supplement and Federal Employees Health Benefit Plans. Marketing is primarily performed through the use of in-house sales staff. The Company offers plans categorized as full risk and employer-funded insurance plans. Under the full risk plans, the Company assumes all or a majority of health care cost utilization or other risk. Under employer-funded plans, the plan sponsor, under an administrative services contract ("ASC"), assumes all or the majority of risk. The Company retains credit risk with the plan sponsors with an ASC.

The Company also has a 50% membership interest in AmeriHealth Northeast, LLC ("AHN"), which was formed in December 2012. AHN's purpose is to provide health benefits through a medical assistance managed care program in the Pennsylvania Department of Human Services' ("DHS") New East Service Area under an agreement that began March 1, 2013 and was terminated effective March 31, 2014. AHN has an integrated delivery service agreement with Vista Health Plan, Inc. ("Vista") in which Vista is the contractor with the DHS under a managed care contract and AHN assumes, on a fully delegated risk basis, the risk undertaken by Vista. In conjunction with these agreements, the Company entered into a 50% quota share reinsurance agreement with Vista for the New East Service Area.

Total net premiums written were $215,646,283 for 2013 as compared to $112,978,651 the prior year. The increase in premiums is mainly due to the quota share reinsurance agreement with Vista as the Company assumed $99,623,569 of premiums from Vista during 2013. Excluding the assumed premiums from Vista in 2013, the Company's net premiums written remained relatively stable since the prior examination.

The Company's primary method of selling its products is through employed sales representatives. Direct mail is used in small and community business segments until an interest is shown by a prospective insured at which point contact is made by a sales representative. The following chart indicates the distribution of the Company's lines of business by percentage of total net written premium for the year ended December 31, 2013:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
Comprehensive (hospital and medical)	$ 15,413,070	$ 0	$ 15,413,070	7.1 %
Medicare Supplement	36,350,756	0	36,350,756	16.9 %
Federal Employees Health Benefits Plan	59,761,204	0	59,761,204	27.7 %
Title XIX - Medicaid	99,623,569	0	99,623,569	46.2 %
Other Health	4,708,741	211,057	4,497,684	2.1 %
Totals	$ 215,857,340	$ 211,057	$ 215,646,283	100.0 %

SIGNIFICANT OPERATING RATIOS AND TRENDS

The following indicates the growth of the Company during the period covered by this examination:

	2013	2012	2011	2010	2009
Admitted assets	$ 497,703,433	$ 496,555,972	$ 485,833,226	$ 520,440,106	$ 542,161,331
Liabilities	$ 156,260,114	$ 238,334,965	$ 276,368,523	$ 258,918,882	$ 291,416,640
Surplus as regards policyholders	$ 341,443,319	$ 258,221,007	$ 209,464,703	$ 261,521,224	$ 250,744,691
Gross premium written	$ 215,857,340	$ 113,192,386	$ 142,112,342	$ 129,035,191	$ 122,769,624
Net premium written	$ 215,646,283	$ 112,978,651	$ 141,908,856	$ 128,666,513	$ 122,565,349
Underwriting gain/(loss)	$ 17,056,752	$ 13,803,976	$ (51,267,768)	$ (36,025,546)	$ (84,599,812)
Investment gain/(loss)	$ 33,981,903	$ 22,758,905	$ 26,592,029	$ 23,947,830	$ 22,702,009
Other gain/(loss)	$ 3,130,505	$ 2,586,383	$ (1,099,951)	$ 4,598,392	$ 3,075,767
Net income	$ 50,580,160	$ 32,382,264	$ (25,786,690)	$ (7,138,324)	$ (59,535,036)

ACCOUNTS AND RECORDS

The Company's home office and primary location of its books and records is 19 North Main Street, Wilkes-Barre, Pennsylvania 18711. The Company's accounting, investment, policy and claim records are available at the home office and are primarily maintained off site at Highmark's data center in Harrisburg, Pennsylvania or at other outsourced vendor locations. The Company's IT department is centralized in Wilkes-Barre, Pennsylvania; its IT processes and controls are uniform across the Company's applications and are planned and executed centrally by the Company's IT leadership team and their supporting managers. As much of the Company's back-end hardware is hosted at Highmark's data center, Highmark is responsible for executing the computer operation functions on behalf of the Company.

The Company also uses a number of outside service organizations to provide information, process electronic medical related transactions and perform custodial, investment management advisory services, processing and accounting.

The Company's key applications were identified based on its significance in a key business process. The Department engaged Cerebres, LLC to conduct an evaluation of the Company's IT general controls environment supporting the key applications that were identified. The evaluation included the testing and determination of whether the Company's IT controls, including those over change management, access control, computer operations and disaster recovery, were designed and operating effectively throughout the review period. No significant deficiencies were noted and no recommendations were made as the result of the review.

PENDING LITIGATION

Legal representation letters from the Company's General Counsel and outside legal counsel, indicate that the Company is not involved in any material litigation whose outcome could have a material effect on its financial condition as of the date of this examination report.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2013, and the results of its operations for the five-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,

	2013	2012	2011	2010	2009
Bonds	$ 202,357,845	$ 203,365,983	$ 198,400,817	$ 196,875,959	$ 180,891,345
Preferred stocks	112,894	0	63,600	298,750	377,940
Common stocks	220,320,808	235,928,421	220,443,100	266,745,912	280,795,648
Real estate					
Properties occupied by Company	13,237,374	13,919,783	16,746,521	17,591,959	18,347,019
Properties held for sale	2,034,334	2,034,334	0	0	0
Cash, cash equivalents and short-term investments	7,768,468	5,408,425	10,542,274	7,083,252	10,035,388
Other invested assets	15,273,328	8,436,667	2,449,262	1,362,080	20,147,041
Receivable for securities	27,652	10,855	112,395	0	0
Subtotals, cash and invested assets	461,132,703	469,104,468	448,757,969	489,957,912	510,594,381
Investment income due and accrued	1,582,668	1,663,320	1,733,796	1,851,356	1,631,015
Premiums and considerations	238,194	337,397	317,226	268,663	150,263
Amounts recoverable from reinsurers	0	0	0	117,725	0
Amounts receivable relating to uninsured plans	1,143,864	3,323,230	4,680,660	3,204,035	1,217,769
Current federal income tax recoverable and interest thereon	218,160	0	78,212	376,097	12,699,034
Net deferred tax asset	12,382,000	0	0	0	0
Electronic data processing equipment	1,496,901	1,673,859	1,579,611	2,286,987	2,180,218
Receivable from parent, subsidiaries and affiliates	1,722,961	1,869,734	1,579,258	2,160,884	1,594,999
Health care and other amounts receivable	17,785,982	18,583,964	27,106,494	18,755,816	12,093,652
Aggregate write-ins for other than invested assets	0	0	0	1,460,631	0
Totals	$ 497,703,433	$ 496,555,972	$ 485,833,226	$ 520,440,106	$ 542,161,331

	2013	2012	2011	2010	2009
Claims unpaid	$ 13,240,893	$ 13,175,453	$ 17,530,059	$ 21,653,783	$ 15,838,765
Unpaid claims adjustment expenses	40,102	49,596	89,183	90,310	142,173
Aggregate health policy reserves	1,662,552	12,658,072	13,634,468	25,340,509	16,069,214
Premiums received in advance	7,022,136	7,649,118	16,954,263	9,444,547	5,530,306
General expenses due or accrued	48,507,506	105,237,798	74,476,617	61,625,018	99,077,057
Current federal income tax payable and interest thereon	0	6,616,840	0	0	0
Ceded reinsurance premiums payable	0	0	0	17,062	0
Amounts withheld or retained for the account of others	1,016,177	925,859	928,723	470,475	99,020
Borrowed money and interest thereon	67,730,598	79,514,504	108,618,726	114,107,916	121,451,756
Amounts due to parent, subsidiaries and affiliates	4,500,147	2,657,189	1,403,285	2,750,482	6,405,000
Derivatives	0	446,142	2,029,605	3,192,396	1,966,492
Payable for securities	495,144	0	423,811	2,024,767	0
Liability for amounts held under uninsured plans	4,227,236	5,253,480	5,966,309	653,829	3,060,265
Aggregate write-ins for other liabilities	7,817,623	4,150,914	34,313,474	17,547,788	21,776,592
Total liabilities	156,260,114	238,334,965	276,368,523	258,918,882	291,416,640
Unassigned funds (surplus)	341,443,319	258,221,007	209,464,703	261,521,224	250,744,691
Surplus as regards policyholders	341,443,319	258,221,007	209,464,703	261,521,224	250,744,691
Totals	$ 497,703,433	$ 496,555,972	$ 485,833,226	$ 520,440,106	$ 542,161,331

Comparative Statement of Income
For the Year Ended December 31,

	2013	2012	2011	2010	2009
Net premium income	$ 215,646,283	$ 112,978,651	$ 141,908,856	$ 128,666,513	$ 122,565,349
Total revenues	215,646,283	112,978,651	141,908,856	128,666,513	122,565,349
Hospital/medical benefits	98,622,688	97,688,442	125,988,060	115,938,848	117,905,652
Prescription drugs	5,901,002	6,628,858	9,426,771	9,545,829	3,747,145
Aggregate write-ins for other hospital and medical	251,686	269,268	226,328	250,327	17,150
Incentive pool, withhold adjustments and bonus amounts	0	0	0	0	(34,552)
Subtotal (hospital and medical)	104,775,376	104,586,568	135,641,159	125,735,004	121,635,395
Net reinsurance recoveries	(99,371,883)	269,268	345,627	459,682	17,150
Total hospital and medical	204,147,259	104,317,300	135,295,532	125,275,322	121,618,245
Claims adjustment expenses	1,808,849	(1,677,600)	3,222,317	9,137,034	11,122,228
General administrative expenses	3,628,943	(2,488,629)	66,364,816	21,008,910	67,835,584
Increase in reserves for life accident and health contracts	(10,995,520)	(976,396)	(11,706,041)	9,270,793	6,589,104
Total underwriting deductions	198,589,531	99,174,675	193,176,624	164,692,059	207,165,161
Net underwriting gain or (loss)	17,056,752	13,803,976	(51,267,768)	(36,025,546)	(84,599,812)
Net investment income earned	8,717,348	8,934,201	8,725,661	7,311,211	12,090,187
Net realized capital gains or (losses)	25,264,555	13,824,704	17,866,368	16,636,619	10,611,822
Net investment gains or (losses)	33,981,903	22,758,905	26,592,029	23,947,830	22,702,009
Aggregate write-ins for other income or expenses	3,130,505	2,586,383	(1,099,951)	4,598,392	3,075,767
Net income or (loss) before federal income taxes	54,169,160	39,149,264	(25,775,690)	(7,479,324)	(58,822,036)
Federal income taxes incurred	3,589,000	6,767,000	11,000	(341,000)	713,000
Net income	$ 50,580,160	$ 32,382,264	$ (25,786,690)	$ (7,138,324)	$ (59,535,036)

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

	2013	2012	2011	2010	2009
Surplus as regards policyholders, December 31, previous year	$ 258,221,007	$ 209,464,703	$ 261,521,224	$ 250,744,691	$ 338,687,233
Net income	50,580,160	32,382,264	(25,786,690)	(7,138,324)	(59,535,036)
Change in net unrealized capital gains or (losses)	(4,787,145)	20,238,957	(16,529,366)	(2,636,012)	(17,649,867)
Change in net deferred income tax	11,311,512	287,505	(10,993,580)	(8,509,900)	2,184,318
Change in non-admitted assets	3,469,510	7,370,746	16,113,555	24,551,018	(13,284,844)
Aggregate write-ins for gains or (losses) in surplus	22,648,275	(11,523,168)	(14,860,440)	4,509,751	342,887
Change in surplus as regards policyholder for the year	83,222,312	48,756,304	(52,056,521)	10,776,533	(87,942,542)
Surplus as regards policyholders, December 31, current year	$ 341,443,319	$ 258,221,007	$ 209,464,703	$ 261,521,224	$ 250,744,691

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

	2013	2012	2011	2010	2009
Cash from Operations					
Premiums collected net of reinsurance	$ 215,118,504	$ 103,653,335	$ 149,352,947	$ 132,479,416	$ 120,654,420
Net investment income	11,435,865	11,928,692	11,952,145	8,957,197	14,699,621
Miscellaneous income	3,130,505	2,586,383	(1,099,951)	4,598,392	3,075,767
Total	229,684,874	118,168,410	160,205,141	146,035,005	138,429,808
Benefit and loss related payments	204,057,793	108,502,751	131,387,786	127,657,681	124,882,133
Commissions, expenses paid and aggregate write-ins for deduc	59,998,212	(7,753,355)	58,213,286	66,836,112	12,260,544
Federal and foreign income taxes paid (recovered)	10,424,000	71,948	(286,885)	(12,663,937)	1,403,463
Total deductions	274,480,005	100,821,344	189,314,187	181,829,856	138,546,140
Net cash from operations	(44,795,131)	17,347,066	(29,109,046)	(35,794,851)	(116,332)
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	89,619,889	108,147,564	95,287,419	169,885,683	117,287,431
Stocks	62,125,364	47,847,733	43,910,401	23,852,118	19,950,707
Real estate	0	115,063	0	0	11,333
Other invested assets	1,618,494	4,532	146,612	19,447,541	4,500,000
Cash, cash equivalents and shor-term investments	88	740	68	(1,286)	(414)
Miscellaneous proceeds	478,347	0	0	2,024,767	0
Total investment proceeds	153,842,182	156,115,632	139,344,500	215,208,823	141,749,057
Cost of investments acquired (long-term only):					
Bonds	89,618,112	110,660,796	96,558,893	181,273,717	130,222,678
Stocks	24,276,162	32,896,640	5,947,777	5,067,954	32,906,450
Real estate	369,701	531,574	864,458	445,631	1,547,654
Other invested assets	10,184,160	6,175,056	1,273,841	820,983	698,045
Miscellaneous applications	0	322,271	1,713,351	0	721,370
Total investments acquired	124,448,135	150,586,337	106,358,320	187,608,285	166,096,197
Net cash from investments	29,394,047	5,529,295	32,986,180	27,600,538	(24,347,140)
Cash from Financing and Miscellaneous Sources					
Cash provided (applied):					
Borrowed funds received or (repaid)	(11,783,906)	(29,104,222)	(5,489,190)	(7,343,840)	12,464,782
Other cash provided or (applied)	29,545,033	1,094,012	5,071,078	12,586,017	5,195,394
Net cash from financing and miscellaneous sources	17,761,127	(28,010,210)	(418,112)	5,242,177	17,660,176
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	2,360,043	(5,133,849)	3,459,022	(2,952,136)	(6,803,296)
Cash and short-term investments:					
Beginning of the year	5,408,425	10,542,274	7,083,252	10,035,388	16,838,684
End of the year	$ 7,768,468	$ 5,408,425	$ 10,542,274	$ 7,083,252	$ 10,035,388

SUMMARY OF EXAMINATION CHANGES

There have been no changes made to the Company's financial statements as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2013, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	$ 202,357,845	43.9 %
Preferred stocks	112,894	0.0 %
Common stocks	220,320,808	47.8 %
Real estate: occupied by the company	13,237,374	2.9 %
Real estate: properties held for sale	2,034,334	0.4 %
Cash on hand and on deposit	(2,687,108)	(0.6)%
Short-term investments	10,455,576	2.3 %
Other invested assets	15,273,328	3.3 %
Receivable for securities	27,652	0.0 %
Totals	$ 461,132,703	100.0 %

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

NAIC Designation	Amount	Percentage
1 - highest quality	$ 169,019,667	79.4 %
2 - high quality	24,937,778	11.7 %
3 - medium quality	14,596,395	6.9 %
4 - low quality	4,259,581	2.0 %
Totals	$ 212,813,421	100.0 %

Years to Maturity	Amount	Percentage
1 year or less	$ 31,085,829	14.6 %
2 to 5 years	98,988,758	46.5 %
6 to 10 years	59,134,076	27.8 %
11 to 20 years	13,772,127	6.5 %
over 20 years	9,832,631	4.6 %
Totals	$ 212,813,421	100.0 %

As depicted above, the Company is primarily invested in bonds and common stocks, representing $433,134,229, or 93.9%, of the total invested assets. The investment portfolio also includes other invested assets of $15,273,328, or 3.3%, of the total invested assets, real estate of $15,271,708, or 3.3%, of the total invested assets. At year-end 2013, the Company had negative cash on hand of ($2,687,108), or (0.6%), of total invested assets.

Bonds consisted of $102,058,245 in Industrial and Miscellaneous, $50,071,956 in Government Securities, $49,540,306 in U.S. Special Revenue Securities, $492,519 in U.S. Political Subdivisions of States, Territories, and Possessions, and $194,819 in U.S. States, Territories, and Possessions.

The common stock portfolio includes $79,718,987 in unaffiliated industrial and miscellaneous stocks consisting of mutual funds and exchange-traded funds ("ETF's") and $140,601,821 in equities of subsidiaries and affiliates.

The unaffiliated industrial and miscellaneous stocks are comprised of $78,306,338 of ETF's and $1,412,649 in two non-publicly traded equity securities. Trading activity with these securities is generally limited to Blue Cross Blue Shield Companies with their values determined by the issuer on a net book value basis.

The subsidiaries and affiliates investments held by the Company as of December 31, 2013, are as follows: HMO of Northeastern Pennsylvania, Inc. and First Priority Life Insurance Company, Inc., both of which are insurance only operations that are 59.9% owned by the Company and AllOne Health Group, Inc., which is a non-insurance entity focused on business diversification activities that is wholly owned by the Company. The Company's investment in affiliates and subsidiaries has been valued utilizing the equity methodology, in accordance with the NAIC valuation standards, as specified in the Securities and Valuation Manual and allocated to the Company based on its ownership interest.

With the exception of the Company's common stock and other invested assets, the Company's investment securities are held with Wells Fargo Bank, N.A. in a custodial account under the terms of a written custodial agreement. The custodial agreement was reviewed and determined to be in compliance with 31 Pa. Code § 148a.3.

The Company has a written investment policy as required by 40 P.S. § 504.1 (c). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company, at December 31, 2013, was following its investment policy.

LIABILITIES

POLICYHOLDER AND CLAIM RESERVES

The Company reported reserves for unpaid claims of $13,240,893, unpaid claims adjustment expenses of $40,102 and aggregate health policy reserves of $1,662,552, on the December 31, 2013 annual statement.

For the first year under examination, 2009, the Company's appointed actuary was Jack F. Sulger, FSA, MAAA an associate with the firm of PricewaterhouseCoopers LLP. For each of the next two years, 2010 and 2011, the Company's appointed actuary was Mitch Kalish, FSA, MAAA, Vice President and Chief Actuary of HSA. For the last two years under examination, 2012 and 2013, the Company's appointed actuary was Courtney R. White, FSA, MAAA an associate with the firm of Milliman, Inc. Appointments of all actuaries were confirmed to the minutes of the Board. Also, the changes in actuaries from 2009 to 2010 and from 2011 to 2012 were reported to the Department. No disagreement letters were received from the actuary being replaced.

Courtney R. White, FSA, MAAA, an associate with the firm of Milliman, Inc. was the Company's appointed actuary for the last two years of the examination period. The Company's appointed actuary concluded that the amounts carried in the balance sheet on account of the items identified above:

A. Are in accordance with accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles;
B. Are based on actuarial assumptions relevant to contract provisions and appropriate to the purpose for which the statement was prepared;
C. Meet the requirements of the Insurance Laws and regulations of the State of Pennsylvania;
D. Make a good and sufficient provision for all unpaid claims and other actuarial liabilities of the organization under the terms of its contracts and agreements;
E. Are computed on the basis of assumptions and methods consistent with those used in computing and corresponding items in the annual statement of the preceding year-end; and
F. Include appropriate provision for all actuarial items that ought to be established.

The examination team utilized the work performed by the Company's CPA firm, PricewaterhouseCoopers, LLP ("PwC"), to augment the risks identified in Phases 1 and 2 of the Department's risk-focused examination process associated with the Claims and Reserving Key Functional Activity. After reviewing the risks identified by PwC, and performing testing in Phases 3 and 4 of the examination with regard to the Company's controls to mitigate those risks, it was determined that no further substantive procedures were required to test the adequacy of the policyholder and claim reserves.

It was also noted that as part of the year-end 2013 statutory audit, PwC evaluated the adequacy of the Company's reserves. Based on their analysis, PwC's actuaries concluded that the Company's provision for aggregate health claim reserves liability was reasonable.

The Department accepted the conclusion of the Company's appointed actuary that the Company's reserves as of December 31, 2013 make an appropriate provision for all actuarial items that ought to be established.

BORROWED MONEY

On March 27, 2013, the Company renewed its line of credit with PNC Bank, N.A. of Scranton, Pennsylvania until March 27, 2016. The maximum principal of the line of credit decreased from $150,000,000 to $125,000,000. The line of credit carries a floating interest rate based on a 7 day LIBOR plus 0.75%. On that same date, the pledged agreement was amended to decrease the collateral requirement from a minimum fair value of $150,000,000 to $125,000,000. The interest rate at December 31, 2013 was 0.92%. The Company paid interest of $733,184 related to the line of credit for the year ended December 31, 2013. The outstanding balance of the line of credit as of December 31, 2013 was $67,730,598 (including interest). At December 31, 2013, the Company had pledged as collateral for the line of credit, securities with an admitted asset value of $129,568,312.

SUBSEQUENT EVENTS

Effective January 1, 2014, the Company became subject to an annual fee under section 9010 of the Affordable Care Act ("ACA"). This annual fee is allocated to individual health insurance issuers based on the ratio of the amount of the entity's net premiums written during the preceding calendar year to the amount of health insurance for any U.S. health risk that is written during the preceding calendar year. A health insurance entity's portion of the annual fee becomes payable once the entity provides health insurance for any U.S. health risk for each calendar year beginning on or after January 1, 2014. As of September 30, 2014, the Company estimates its ACA assessment for 2015 to be $920,250. As such the Company has reclassified $920,250 from "unassigned funds" to "special surplus funds" on its Quarterly Statement as of September 30, 2014.

On February 18, 2014, the Boards of Directors of the Company and Highmark announced the signing of a definitive agreement to merge, marking a key milestone in bringing together the two not-for-profit health insurance organizations to better serve the communities of northeastern and north central Pennsylvania. Under the terms of the merger agreement, the Company will be merged with and into Highmark, with Highmark being the surviving corporation. Highmark will become the Blue Cross and Blue Shield Association affiliate for the Company's thirteen county service area. On that same date, Highmark submitted an application filing, Form A, to the Department to seek approval for the merger.

The Company is a Pennsylvania nonprofit corporation licensed to operate a nonprofit hospital plan corporation. Highmark is a nonprofit corporation licensed to operate a nonprofit hospital plan and a nonprofit professional health service plan. Pennsylvania domiciled insurers affected by the merger include: First Priority Life Insurance Company, Inc. ("FPL") (ownership interest: HSA 59.9% and Highmark 40.1%) and HMO of Northeastern Pennsylvania, Inc. d/b/a First Priority Health ("FPH") (ownership interest: HSA 59.9% and Highmark 40.1%). By virtue of the merger, FPL and FPH will become direct wholly-owned subsidiaries of Highmark.

On June 18, 2014, the Company sold its 50% ownership interest in AmeriHealth Northeast, LLC, to AmeriHealth Caritas Health Plan, making AmeriHealth Caritas Health Plan the sole owner of AmeriHealth Northeast, LLC. This sale had a retroactive effective date of March 31, 2014.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained the following recommendation:

1. It was recommended that the Company amend its custodial agreement with Mellon Bank to comply with 31 Pa. Code § 148a 3(b).

   The Company no longer contracts with Mellon Bank to provide custodial services. (See "Investments," page 19.)

CURRENT EXAMINATION

There are no recommendations being made as the result of the current examination.

CONCLUSION

As a result of this examination, the financial condition of Hospital Service Association of Northeastern Pennsylvania, as of December 31, 2013, was determined to be as follows:

	Amount	Percentage
Admitted assets	$ 497,703,433	100.0 %
Liabilities	$ 156,260,114	31.4 %
Surplus as regards policyholders	341,443,319	68.6 %
Total liabilities and surplus	$ 497,703,433	100.0 %

Since the previous examination, made as of December 31, 2008, the Company's assets decreased by $57,406,489, its liabilities decreased by $60,162,575, and its surplus increased by $2,756,086.

This examination was conducted by David Hughes, Scott Langstein, CISA, Aftab Malik, CISA, April Spevak, CFE, John Ware, CISA, and Dennis A. Mavrich, CFE, with the latter in charge.

Respectfully,

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

David R. Evans, CFE
Examination Manager

Dennis A. Mavrich, CFE
Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of performing statutory examinations of insurance companies.