



Protecting, maintaining and improving the health of all Minnesotans

June 5, 2013

Jon Carlson, Director of Accounting
PreferredOne Community Health Plan
6105 Golden Hills Drive
Golden Valley, MN 55416

Dear Mr. Carlson:

Enclosed please find a copy of original Examination Report for PreferredOne Community Health Plan as of December 31, 2011, as prepared by the Minnesota Department of Commerce.

In accordance with Minnesota Statutes, § 62D.14, a copy of the Examination Report is also to be delivered to each member of the Board of Directors and executed affidavits should be forwarded to us for each Director.

A copy of an illustrated affidavit is enclosed for your information. Please return affidavits no later than 60 days.

If you have any questions or wish to discuss the Examination Report further, please feel free to contact Peter T. Foley II at 651-296-8541.

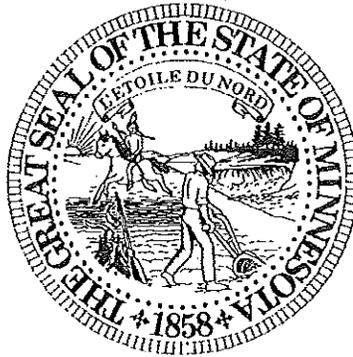
Sincerely,

A handwritten signature in black ink, appearing to read "Edward P. Ehlinger for".

Edward P. Ehlinger, MD, MSPH
Commissioner

Enc.

cc: Margie Pinedo, Minnesota Department of Commerce



STATE OF MINNESOTA
DEPARTMENT OF HEALTH
SAINT PAUL, MINNESOTA
REPORT OF EXAMINATION
OF
PREFERREDONE COMMUNITY HEALTH PLAN
GOLDEN VALLEY, MINNESOTA
NAIC # 95724
AS OF
DECEMBER 31, 2011



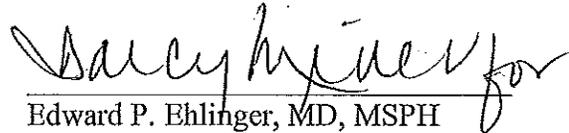
Protecting, maintaining and improving the health of all Minnesotans

The attached report of examination made of the condition and affairs as of December 31, 2011 of:

PREFERREDONE COMMUNITY HEALTH PLAN
Golden Valley, Minnesota

was recently completed by duly qualified examiners of the State of Minnesota.

Due consideration has been given to the comments of the examiners regarding the operations of PreferredOne Community Health Plan and its financial condition, as reflected in this report. This report is hereby, as of this date, approved, adopted, filed and made an official record of this Department.


Edward P. Ehlinger, MD, MSPH
Commissioner

Dated: 6/12/13



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St. Paul, Minnesota 55101-2198
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651.296.4026 FAX 651.297.1959
An equal opportunity employer

Pursuant to the authority vested in the Commissioner of Commerce of the State of Minnesota, Mike Rothman, being first duly sworn, upon his oath, deposes and says that a comprehensive examination was made of the affairs and financial condition of

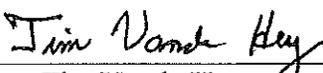
**PREFERREDONE COMMUNITY HEALTH PLAN
GOLDEN VALLEY, MINNESOTA**

an insurance company authorized under the laws of the State of Minnesota. That, to the best of his information, knowledge and belief, the attached report of examination describes the affairs and financial condition of the above named company as of December 31, 2011 as determined by a comprehensive examination made in accordance with Minnesota Statutes Section 60D.14. The examination was completed by duly qualified examiners of the State of Minnesota representing the Midwestern Zone (III) of the National Association of Insurance Commissioners.

Due consideration has been given to the comments of the examiners regarding the operations of the above named company and its financial condition, as reflected in this report.

This report is hereby, as of this date, approved, adopted, filed and made an official record of this Department.

MIKE ROTHMAN
Commissioner


By: Tim Vande Hey
Deputy Commissioner

Dated: June 6, 2013

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Protecting, maintaining and improving the health of all Minnesotans

June 5, 2013

The Honorable Edward Ehlinger, MD, MPH
Commissioner of Health
State of Minnesota
Department of Health
85 7th Place East, Suite 400
St. Paul, Minnesota 55101

The Honorable Mike Rothman
Commissioner of Commerce
State of Minnesota
Department of Commerce
85 7th Place East, Suite 500
St. Paul, Minnesota 55101

Dear Honorable Commissioners:

Pursuant to your instructions and the statutory requirements of the State of Minnesota, a comprehensive examination has been made of the books, records, business affairs and financial condition of:

PREFERREDONE COMMUNITY HEALTH PLAN

NAIC #95724

6105 Golden Hills Drive
Golden Valley, Minnesota, 55416

The following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

The examination was a comprehensive examination, conducted, on behalf of the Minnesota Department of Health, by the Minnesota Department of Commerce, observing the guidelines and procedures in the NAIC Financial Examiners' Handbook ("Handbook"). The Department of Commerce Examination Order 12-013 directed the examination to include a determination of the financial condition of the Plan and a general review of its corporate affairs and insurance operations to determine compliance with Minnesota statutes.

This examination included a review of the Plan's systems and internal control environment and an assessment of its risk exposure level and the adequacy of its current and planned surplus to support future operations.

The examination covered the period January 1, 2009 through December 31, 2011, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. The work papers of the Plan's designated certified public accountant, for the audit year 2011, were reviewed and copies included as part of the examination files where utilized.

The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

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

Status of Prior Examination Findings

The examination included a review to determine the current status of any recommendations noted in the previous Report of Examination as of December 31, 2008. There were no recommendations contained in that report.

FINDINGS AND RECOMMENDATIONS

The examination did not result in any reportable findings or recommendations.

SUBSEQUENT EVENTS/CONTINGENT LIABILITIES

The examination found no indication of any subsequent events or contingent liabilities at or after December 31, 2011, to the date of this examination report that were considered to have a material effect either on the Plan's operations, financial stability or management oversight.

PLAN HISTORY

The Plan was organized in December 1994 as a nonprofit Community Integrated Service Network under Minnesota Statute Chapter 62N and licensed by the State of Minnesota to provide comprehensive prepaid health care services per the provisions of the Minnesota Integrated Service Network Act.

On December 20, 1999, the Minnesota Department of Health (hereinafter referred to as "MDH") issued the Plan a certificate of authority to operate as a not-for-profit health maintenance organization, under Minnesota Statute Chapter 62D.

The Plan was formed by and through the contributions of two Minnesota nonprofit health service providers.

MANAGEMENT AND CONTROL

Plan Governance

The Plan consists of two classes of membership, contributing members and non-contributing members.

Contributing members contribute capital to the Plan, have one vote per member, exercise approval over various financial matters and may be admitted upon the affirmative vote of two-thirds of the existing contributing members of the Plan. There are currently two contributing members.

Non-contributing members are entitled to one vote per member, except for approval of certain financial matters. There is currently one non-contributing member.

Plan governance is provided by the Plan's Board of Directors, and is carried out by Plan management.

Board of Directors

The Board consists of enrollee directors and non-enrollee directors.

Enrollee directors are individuals who have coverage with the Plan. Enrollee directors make up 40% of the Board. Each enrollee director is appointed for a term of two years and is limited to three terms.

Non-enrollee directors make up 60% of the Board two-thirds of whom are appointed by the contributing members and one-third of whom are appointed by the non-contributing members.

The Plan is in compliance with the Minnesota Statutes, section 62D.06 limitations on enrollee directors.

At December 31, 2011, the Board of Directors of the Plan consisted of the following individuals:

<u>Director</u>	<u>First Elected</u>	<u>Principal Business Affiliation</u>
Patrick J. Boran	2005	VP, Finance & CFO-Contributing Member
George T. Chresand	2005	Senior VP & General Counsel-Contributing Member
Deborah M. Gephart-Chair	2008	Associate Senior VP-Enrollee Group
Mark E. Hansberry	2008	Planning & Marketing VP- Contributing Member
Lyle J. Swenson, M.D.	2008	Physician-Non Contributing Member
Ramin R. Mahabadi	2010	CFO-Enrollee Group
Steven E. Prawer, M.D.	2010	Physician-Non Contributing Member
James K. Croston, M.D.	2011	Chief Medical Officer-Contributing Member
Todd F. Jeffers	2011	Finance/Operations Director-Enrollee Group
Debra M. Sylvester	2011	Human Resources Administrator-Enrollee Group

Principal Officers

Officers of the Plan are elected by the Board of Directors, at its annual meeting, for terms of one year and serve at the discretion of the Board. At December 31, 2011, the principal operating officers of the Plan and their positions were as follows:

<u>Name</u>	<u>Position</u>
Marcus A. Merz	President
Debra J. R. Shoemaker	Secretary
Michael S. Umland	Treasurer

Enterprise-Wide Risk Management

Risk management activities are coordinated with the corporate-wide strategic planning and budgeting process.

Strategic Planning

The Plan has a formal corporate wide strategic planning process in place that incorporates strategies and objectives that includes both the current and prospective operating environment. The planning process includes procedures for monitoring and amending the plan on an on-going basis.

Conflict of Interest

The corporate group has a conflict of interest policy in place which requires completion of conflict of interest statements annually by all directors and officers. The Plan's Board of Directors reviews all potential conflict situations. The conflict of interest statements, for the period under examination, were reviewed and no material conflicts were noted.

CORPORATE RECORDS

Articles of Incorporation and By-laws

The Articles of Incorporation and By-laws of the Plan were not amended during the period under examination.

Board of Directors Minutes

The minutes of the Plan's Board of Directors' and Audit and Investment Committee meetings, covering the period of this examination, were reviewed and found to be in proper order. All significant actions taken by the Plan during the examination period, including those mandated by statute, were addressed in the meeting minutes.

Policies, Procedures and Internal Controls

The Plan has no formal internal audit departmental function. The Plan's external auditors perform certain reviews of the corporate system of internal controls as part of the annual audits. Accountability for managing the Plan's risks resides with its Board of Directors and senior management.

AFFILIATED COMPANIES

Affiliated Companies

Members of the Plan are Fairview Health Services, North Memorial Health Care and PreferredOne Physician Associates. The Plan has provider agreements with the Members.

PreferredOne Administrative Services, Inc. (PAS) is a third party administrator providing management services to the Plan. The Plan Members are the controlling parties of PAS.

PreferredOne Insurance Company (PIC) is a Minnesota domiciled health insurance company wholly owned by PAS.

Affiliated Agreements & Transactions

Administrative Services Agreement

The Plan and PAS entered into an Amended and Restated Management Agreement, effective January 1, 1998 as amended in 2008. Per the terms of the agreement, PAS provides the Plan with all managerial services, including human resources, accounting, actuarial, claims, enrollment administration, customer service, information systems, marketing, provider contracting and other miscellaneous administrative services. As compensation, the Plan pays PAS a fee on a percentage of gross premium revenue on a large group and small group basis. These fees were \$5,139,743 for 2011, \$8,932,307 for 2010 and \$9,284,086 for 2009.

Repayment of Paid-in Surplus

The Plan received permission from MDH in 2005 to return up to \$6 million of contributed surplus to the contributing members. During 2006, the Plan returned \$2 million of contributed surplus. An additional \$2 million was returned in each of the years 2009 and 2011.

FIDELITY BOND AND OTHER INSURANCE

PAS carries fidelity coverage for the corporate group of companies that provides limits of coverage that are in excess of the minimum suggested NAIC guidelines for the Plan.

PAS carries general insurance coverages for the corporate group, which management feels are sufficient to cover risk exposures in the normal course of business.

EMPLOYEE BENEFITS

The Plan has no employees. All Plan personnel are provided and paid by PAS under an intercompany management services agreement. No specific personnel costs are charged back to the Plan.

The Plan is not a party to any employment contracts, deferred compensation plans or post-retirement health plans.

STATUTORY & SPECIAL DEPOSITS

The Plan met the requirements of Minnesota Statutes, section 62D.041, as of December 31, 2011, for deposits to be held in the event of insolvency. The Plan had no other restricted admitted asset balances at December 31, 2011.

TERRITORY AND PLAN OF OPERATION

The Plan is authorized in Minnesota as a health maintenance organization. The Plan markets comprehensive large and small group hospital, medical and dental coverages primarily through independent brokerage firms/agents.

The Plan contracts out to an affiliated third-party administrator the pharmacy and dental portions of its health insurance programs. Included in this contracted administration is the processing and payment of claims.

REINSURANCE

The Plan is a reinsured party to an excess of loss reinsurance agreement with a Minnesota authorized reinsurer, covering the Plan's commercial members. The 2011 retention was \$425,000 plus 10% of the excess over the retention per member per year. There is also an aggregate retention based on membership. The reinsurer's annual limit of liability per member coincides with the limits of the benefit plans. The reinsurer's lifetime per member liability is unlimited. The reinsurance agreement passes risk. The agreement has an experience refund provision.

ACCOUNTS AND RECORDS

Systems/Operations Databases & Business Continuation

The Plan's primary books and supporting records are processed and maintained by PAS. PAS subcontracts investment, dental and pharmaceutical record-keeping.

The Plan's regulatory reporting forms were reviewed for proper completion in accordance with Minnesota Rules 4685.1910, and the related NAIC Annual Statement Instructions. No material deviations were found.

The Plan has no formal internal auditing staff.

The Plan is part of the corporate group's formal comprehensive business continuation/disaster recovery program. The elements of the program are tested on a periodic basis.

Safekeeping of Assets and Investment Policy

The Plan's securities investments are held, under a custodial agreement, in book entry form with a national banking association.

The Plan was not involved in any securities lending activities during the period under examination.

The Plan has an investment policy that is in compliance with the provisions of Minnesota Statutes, section 62D.045 and 60A.112. The Plan's investment policy is reviewed and re-affirmed annually by the Board of Directors.

The Plan is a party to investment management agreements by which it gives the investment advisors sole discretionary investment authority, as limited by any written directions or guidelines from the Plan, over the investment of Plan assets under the advisor's management. Controls are in place that reasonably mitigate risk exposure inherent in these agreements.

Designated Independent Public Accountants

The books and records of the Plan are audited annually by independent public accountants in accordance with Minnesota Statutes, section 62D.08. During the period under examination, the designated independent public accounting firm was McGladrey & Pullen, LLP. The Plan received unqualified audit opinions in all examination years.

Loss Liabilities

The Minnesota Department of Commerce developed claim liability projections and compared them to values carried by the Plan at December 31, 2011. The examination consisted of review of the underlying data using procedures prescribed by the NAIC Financial Condition Examiners' Handbook and other procedures as determined necessary by the Department actuary to provide adequate validation of the data. Based on the procedures applied, the claim liabilities appear to be reasonably stated and have been accepted for the purposes of this report.

Federal and State Taxes

The Plan is exempt from Federal income taxation under IRC section 501(c)(4) and is exempt from State income taxation under Minnesota Statutes, section 290.05. The Plan is subject to taxation on premium and income from unrelated business activities. The Plan's premium tax returns and related documentation for the period under examination were found to have been properly completed and filed.

Risk Based Capital Ratio

The Plan's year end 2011 total adjusted capital was 252% of its authorized control level. The RBC ratios for year ends 2010 and 2009 were 223% and 213 respectively.

FINANCIAL STATEMENTS

The following are the Plan's reported statutory statements of admitted assets, liabilities and unassigned funds as of December 31, for the years 2009 through 2011, and the related statutory statements of operations and cash flows for the years then ended, as reported by the Plan. The examiners have incorporated these statements into this report without adjustments.

PreferredOne Community Health Plan
 Statements of Assets, Liabilities, Surplus and Other Funds
 As of December 31,

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<u>Admitted Assets</u>			
Bonds	\$ 15,260,478	\$ 17,972,095	\$ 18,905,599
Common Stocks	4,854,494	7,088,821	3,604,712
Cash and Short-term Investments	1,375,245	4,288,578	3,707,766
	<hr/>	<hr/>	<hr/>
	\$ 21,490,217	\$ 29,349,494	\$ 26,218,077
Investment Income Due and Accrued	131,898	130,928	187,685
Uncollected Premiums	127,050	158,357	950,382
Recoverable from Reinsurers	0	283,337	0
Other Reinsurance Amounts Receivable	67,335	0	0
Healthcare Receivables	594,088	489,100	577,100
Total Admitted Assets	<hr/> \$ 22,410,588	<hr/> \$ 30,411,216	<hr/> \$ 27,933,244
 <u>Liabilities</u>			
Claims Unpaid	\$ 8,971,267	\$ 13,487,152	\$ 11,958,605
Premiums Received in Advance	1,458,043	3,152,626	2,797,153
General Expenses Due or Accrued	1,362,135	1,686,583	1,561,225
Payable to Affiliates	68,194	135,767	196,076
Total Liabilities	<hr/> \$ 11,859,639	<hr/> \$ 18,462,128	<hr/> \$ 16,513,059
 <u>Surplus</u>			
Gross Paid-in and Contributed Surplus	\$ 656,095	\$ 2,656,095	\$ 2,656,095
Unassigned Funds	9,894,854	9,292,993	8,764,090
Total Surplus	<hr/> \$ 10,550,949	<hr/> \$ 11,949,088	<hr/> \$ 11,420,185
Total Liabilities and Surplus	<hr/> \$ 22,410,588	<hr/> \$ 30,411,216	<hr/> \$ 27,933,244

PreferredOne Community Health Plan
Statements of Income and Reconciliation of Surplus
Years ended December 31,

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net Premium Income	\$ 103,815,656	\$ 137,574,266	\$ 136,054,481
Other Health Care Revenue	0	500,000	0
Total Revenues:	\$ 103,815,656	\$ 138,074,266	\$ 136,054,481
Hospital/Medical Benefits	\$ 71,589,213	\$ 94,239,408	\$ 94,800,067
Other Professional Services	2,472,727	2,999,327	2,774,186
Outside Referrals	1,283,177	1,908,049	2,001,968
Emergency Room & Out of Area	3,220,619	3,981,453	3,647,413
Prescription Drugs	11,940,564	17,040,486	17,837,976
Subtotal	\$ 90,506,300	\$ 120,168,723	\$ 121,061,610
Net Reinsurance Recoveries	53,130	185,880	994,155
Total Hospital and Medical	\$ 90,453,170	\$ 119,982,843	\$ 120,067,455
Claim Adjustment Exp. including Cost Containment	3,870,968	3,021,727	3,294,752
General Administrative Expenses	9,498,190	16,242,389	16,528,124
Total Underwriting Deductions:	\$ 103,822,328	\$ 139,246,959	\$ 139,890,331
Net Underwriting Gain or (Loss)	(\$ 6,672)	(\$ 1,172,693)	(\$ 3,835,850)
Net Investment Income Earned	686,916	607,487	897,821
Net Realized Capital Gains	501,087	989,543	813,307
Net Income (Loss)	\$ 1,181,331	\$ 424,337	(\$ 2,124,722)
<u>Surplus Account</u>			
Surplus – Beginning of Year	\$ 11,949,088	\$ 11,420,185	\$ 14,715,076
Net Income (Loss)	1,181,331	424,337	(2,124,722)
Change in Net Unrealized Capital Gains (Losses)	(587,630)	6,548	875,933
Change in Non-admitted Assets	8,160	98,018	(46,102)
Paid-in Surplus Adjustments	(2,000,000)	0	(2,000,000)
Net Change in Surplus for the Year	(1,398,139)	528,903	(3,294,891)
Surplus – End of Year	\$ 10,550,949	\$ 11,949,088	\$ 11,420,185

PreferredOne Community Health Plan
 Statements of Cash Flows
 Years ended December 31,

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<u>Cash from Operations</u>			
Premiums Collected Net of Reinsurance	\$ 102,085,045	\$ 138,761,210	\$ 135,654,840
Net Investment Income	708,873	745,263	1,074,922
Miscellaneous. Income	0	500,000	0
Total	<u>102,793,918</u>	<u>140,006,473</u>	<u>136,729,762</u>
Benefit and Loss Related Payments	94,790,706	118,627,098	121,424,338
Commissions & Expenses Paid	13,589,016	19,138,758	18,396,331
Total	<u>108,379,722</u>	<u>137,765,856</u>	<u>139,820,669</u>
Net Cash from Operations	(\$ 5,585,804)	\$ 2,240,617	(\$ 3,090,907)
<u>Cash from Investments</u>			
Proceeds from Investments Sold, Matured or Repaid:			
Bonds	\$ 20,275,451	\$ 26,376,114	\$ 32,888,080
Stocks	4,148,112	3,921,877	8,444,965
Total Investment Proceeds	<u>24,423,563</u>	<u>30,297,991</u>	<u>41,333,045</u>
Cost of Investments Acquired (Long-Term Only):			
Bonds	17,580,944	25,119,791	26,703,219
Stocks	2,111,714	6,812,175	4,351,715
Total Investments Acquired	<u>19,692,658</u>	<u>31,931,966</u>	<u>31,054,934</u>
Net Cash from Investments	\$ 4,730,905	(\$ 1,633,975)	\$ 10,278,111
<u>Cash from Financing and Miscellaneous Sources</u>			
Cash Provided (Applied):			
Paid-in Surplus	(\$ 2,000,000)	\$ 0	(\$ 2,000,000)
Other Cash Provided (Applied)	(58,434)	(25,830)	(1,589,446)
Net Cash from Financing & Misc. Sources	(\$ 2,058,434)	(\$ 25,830)	(\$ 3,589,446)
<u>Reconciliation of Cash & Short-Term Investments</u>			
Net Change in Cash and Short-Term Investments	(\$ 2,913,333)	\$ 580,812	\$ 3,597,758
Cash & Short-Term Investments:			
Beginning of Year	\$ 4,288,578	\$ 3,707,766	\$ 110,008
End of Year	<u>\$ 1,375,245</u>	<u>\$ 4,288,578</u>	<u>\$ 3,707,766</u>

CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by the personnel of the Plan during the course of this examination.

Participating in the examination were James Carr and Rick Theisen (actuarial review) of the Minnesota Department of Commerce. Michael Morrissey of the Examination Resources consulting firm performed the systems review.