Report of Examination of

CareSource
Dayton, Ohio

As of December 31, 2009

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Columbus, Ohio
February 9, 2011

Honorable Mary Taylor
Lieutenant Governor/Director
State of Ohio
Department of Insurance
50 West Town Street
3rd Floor – Suite 300
Columbus, Ohio 43215

Dear Madam:

In accordance with Section 3901.07 of the Ohio Revised Code ("ORC"), an examination was made of

CareSource

an Ohio domiciled, health insuring corporation, hereinafter referred to as the "Company." The examination was conducted at the Company's home office, located at 230 North Main Street, Dayton, Ohio.

A report of this examination is hereby respectfully submitted.

The Company was last examined as of December 31, 2005, by the Ohio Department of Insurance ("Department"). Representatives of the Department conducted the current examination covering the intervening period to and including December 31, 2009.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

Name	Principal Occupation
Morris Brown, MD	Physician Dayton Primary and Urgent Care
Michael E. Ervin, MD	Chief Executive Officer Wright Health Associates
Ellen Leffak	Director of Insurance & Risk Management DPL, Inc.

William F. Marsteller, DC	Physician Centerville Chiropractic
David T. Miller	Vice President of Finance & Chief Financial Officer The Children's Medical Center of Dayton
Pamela B. Morris	President & Chief Executive Officer The Company
Miriam J. Paramore	Senior Vice President of Corporate Strategy Emdeon Business Strategy
R. Daniel Sadlier	Retired Chairman of the Board Fifth Third Bank (Western Ohio

Officers

As of the examination date, the following officers were elected and serving in accordance with the Company's Bylaws:

Name	Title
Pamela B. Morris	President & Chief Executive Officer
Bobby Jones	Chief Operating Officer
Craig Thiele, MD	Chief Medical Officer

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The following displays the chain of ownership of the insurance companies as of December 31, 2009:

CareSource Management Group Company
- CareSource
  - CareSource Foundation
- CareSource Michigan
- CareSource Management Services, Inc.
- CareSource Indiana
- CareSource Insurance, LLC

Reinsurance

Ceded

As of the examination date, the Company had a specific excess of loss reinsurance agreement that provided coverage for claims and expenses paid on all Medicare covered persons and Medicaid covered persons in the following plans: Aid to Families with Dependent Children ("AFDC"), Aged, Blind and Disabled ("ABD") and "Special Needs Plans ("SNP"). Coverage was provided up to 85% of the maximum payable per covered person of $2,500,000 in excess of the following specific deductibles: Medicaid AFDC, $525,000; Medicaid ABD, $325,000; and Medicare and Medicaid SNP, $200,000.

The contract contained clauses that meet the guidelines prescribed by the National Association of Insurance Commissioners ("NAIC").

Assumed

The Company does not assume any business.

Territory and Plan of Operations

The Company was licensed to transact business in the State of Ohio.

Scope of Examination

One of the purposes of the examination was to make an assessment of the financial condition of the Company as of December 31, 2009. To substantiate the various items, tests were made either by complete audits of accounts or by sampling methods prescribed by the NAIC Examiner's Handbook. In selecting the examination procedures used, due consideration was given to the importance of each account to overall solvency. Transactions occurring subsequent to the date of the examination were reviewed to the extent deemed necessary.

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

The Department's property and casualty actuary reviewed the relevant work performed by the opining actuary, to report on the adequacy of the carried reserves, and to comment on any other statutory matters relating to reserves.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers', employees', and agents' welfare and pension plans;
4. growth of Company;
5. loss experience;
6. pending litigation; and
7. Articles of Incorporation and Bylaws.

Financial Statements

The financial condition and the results of its operations for the four-year period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors, are reflected in the following:

Statement of Assets, Liabilities, Surplus and Other Funds
Statement of Operations
Statement of Changes in the Capital and Surplus Account

Statement of Assets, Liabilities, Surplus and Other Funds

	December 31, 2009
Admitted assets	
Cash and invested assets:	
Bonds	$209,296,048
Common Stocks	18,958,989
Properties occupied by the company	2,100,000
Cash	361,224,376
Aggregate write-ins for invested assets	25,296
Total cash and invested assets	591,604,709
Accrued investment income	2,140,654
Uncollected premiums and agents' balances	24,911,230
Amounts recoverable from reinsurers	6,361,914
Amounts receivable relating to uninsured plans	9,031
Health care and other amounts receivable	48,403,619
Total admitted assets	$673,431,157
Liabilities, capital and surplus	
Liabilities:	
Claims unpaid	$225,363,742
Accrued medical incentive pool and bonus amounts	1,174,825
Unpaid claims adjustment expenses	5,417,642
Premiums received in advance	239,469,394
General expenses due or accrued	14,549,558
Amounts due to parent, subsidiaries and affiliates	6,635,719
Aggregate write-ins for liabilities	23,693
Total liabilities	492,634,573
Capital and surplus:	
Gross paid in and contributed surplus	17,200,000
Aggregate write-ins for other than surplus funds	2,100,000
Unassigned funds (surplus)	161,496,584
Total capital and surplus	180,796,584
Total liabilities, capital and surplus	$673,431,157

Statement of Operations

	For the Year Ended December 31, 2009
Net premium income	$2,440,658,793
Total revenues	2,440,658,793
Hospital and Medical:	
Hospital/medical benefits	1,623,941,216
Other professional services	18,594,900
Outside referrals	
Emergency room and out-of-area	139,823,095
Prescription drugs	379,636,166
Incentive pool, withhold adjustments and bonus amounts	1,990,188
Subtotal	2,163,985,565
Less:	
Net reinsurance recoveries	8,172,384
Total hospital and medical	2,155,813,181
Claims adjustment expenses	39,339,741
General administrative expenses	221,217,339
Total underwriting deductions	2,416,370,261
Net underwriting gain	24,288,532
Net investment income earned	11,314,425
Net realized capital losses less capital gains tax	(690,207)
Net investment gains	10,624,218
Net income	$34,912,750

Statement of Changes in the Capital and Surplus Account
(In thousands)

	2006	2007	2008	2009
Capital and surplus December 31, previous year	$76,774	$125,205	$126,368	$132,409
Net income (loss)	43,693	21,335	(819)	34,913
Net unrealized capital gains (losses)	461	(1,335)	(8,713)	4,801
Change in nonadmitted assets	5,210	(2,837)	6,173	162
Surplus paid in			9,900	7,300
Surplus transferred from capital		(16,000)	(500)	(888)
Dividends to stockholders	(4,500)			
Aggregate write-ins	3,567			2,100
Net change in capital and surplus	48,431	1,163	6,041	48,388
Capital and surplus December 31, current year	$125,205	$126,368	$132,409	$180,797

Notes to Financial Statements

Investments

The Company's investments were in compliance with Section 3925.08 of the ORC.

Loss and Loss Adjustment Expense Reserves

The Company had an outside actuary, Darrell D. Knapp, FSA, MAAA of Ernst & Young LLP certify the total reserves for the last three years covered by the examination. The Company had another outside actuary, Roger Schacht, FSA, MAAA, also of Ernst & Young LLP, certify the total reserves for the first year covered by the examination. The Department's actuary, Mary Miller, FSA, MAAA, reviewed the detailed calculations for the reserves of the major lines of business as of December 31, 2009.

On the basis of the above-mentioned analysis, it was determined that the reserves established and recorded in the December 31, 2009 financial statements were actuarially sound at the time they were established. Starting in January 2010, the Company's reserves began to indicate adverse development, particularly as related to high dollar claims. As of September 30, 2010, the Company's December 31, 2009 reserves had developed out to be inadequate by approximately $10.0 million. The Company has indicated that they have implemented additional tracking and treatment of high dollar claims, and continued to strengthen their reserves in 2010.

Subsequent Event

On February 1, 2011, the Company agreed to pay $26 million to settle a federal lawsuit alleging, among other things, that it violated Medicaid provider agreements by failing to conduct assessments of large numbers of special-needs children. The complaint, filed by the U.S. government in November 2006 and unsealed late Monday, also alleges "bogus"

data were submitted to the Ohio Department of Job and Family Services, which administers the state's Medicaid program. That data was "used to create a false appearance of compliance," the complaint alleges.

The Company strongly denied the allegations.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2009, and is summarized as follows:

Total Admitted Assets	$673,431,157
Liabilities	$492,634,573
Surplus as Regards Policyholders	180,796,584
Total Liabilities and Surplus as Regards Policyholders	$673,431,157

Acknowledgement

Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

In addition to the aforementioned and the undersigned, the following representatives of the Department participated in this examination: Mohammad A. Arif, AES, CFE, CIDM, CISA, CISSP; Aaron R. Hibbs, CPA, FLMI, ChFC; James H. Luke, CFE, CPA: Floyd D. Meeks, AES, CFE, CIDM, CISA, CPA, MBA; and Larry G. Rice, CFE, CPA.

Respectfully,

Kevin J. Rupp, CFE
Examiner-In-Charge
Ohio Department of Insurance

David A. Cook, CFE
Assistant Chief Examiner
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2009.

Examiner-In-Charge — Date 3/4/11 — Assistant Chief Examiner — Date 3/4/11

State of Ohio

County of Franklin

Personally appeared before me the above named Kevin J. Rupp, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 4 day of March, 2010.

Elizabeth Chase
(Notary Public)

ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2012

My Commission Expires

State of Ohio

County of Franklin

Personally appeared before me the above named David A. Cook, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 4 day of March, 2010.

Elizabeth Chase
(Notary Public)

ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2012

My Commission Expires