

Report of Examination of

McKinley Life Insurance Company
Canton, Ohio

As of December 31, 2010

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Columbus, Ohio
September 16, 2011

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

Dear Lt. Governor/Director:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

McKinley Life Insurance Company

an Ohio domiciled, stock, life and accident and health insurance company, hereinafter referred to as the “Company”.

Scope of Examination

The Department last examined the Company as of December 31, 2005. The Department’s current examination covers the period of January 1, 2006 through December 31, 2010.

The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks and evaluate 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.

For all years under examination, the Certified Public Accounting firm of Bruner-Cox LLP provided an unqualified opinion on the Company’s financial statements based on Statutory Accounting Principles. The audited financial reports were reviewed during the examination.

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
Darryl J. Dillenback	President and Owner, DNS Insurance, Inc.
Michael R. Gallina	Superintendent, North Canton City Schools
Gregory A. Haban, M.D.	Physician, Family Physicians, Inc.
Timothy L. Hagen, D.O.	Physician, Neurocare Center, Inc.
Rick L. Haines	Chief Executive Officer, AultCare Corporation
John B. Humphrey Jr., M.D.	Physician, North Canton Medical Foundation
Christopher E. Remark	Senior Vice President and Chief Operating Officer, Aultman Health Foundation
Michael A. Rich, M.D.	Physician, Michael A. Rich, M.D. and Associates
Edward J. Roth III	President and Chief Executive Officer, Aultman Health Foundation
Allen Rovner, M.D.	Senior Attending Staff, Aultman Hospital Department of Radiology
William Wallace, M.D.	Physician, Radiology Associates of Canton
Mark D. Wright	Vice President and Chief Financial Officer, Aultman Health Foundation

Officers

As of the examination date, the following officers were serving in the designated position:

Name	Title
Rick L. Haines	President
William Wallace, M.D.	Secretary
Mark D. Wright	Treasurer
Edward J. Roth III	Executive Vice President

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined in ORC Section 3901.32. Aultman Health Foundation, a not-for profit integrated healthcare delivery organization, owns 100% of the outstanding stock of the Company and is the ultimate controlling entity within the holding company system.

AultCare Corporation, an affiliated not for profit corporation, provides services to the Company, including but not limited to, underwriting, claims processing, provider relations, finance and accounting, and information technology, under the terms of an Amended and Restated Management Services Agreement effective December 31, 2008.

Territory and Plan of Operations

The Company underwrites accident and health insurance to small and mid-sized groups and individuals, as well as Medicare Advantage plans, marketed under different product names. The majority of the Company's business is written in a five-county area surrounding Canton, Ohio.

The following schedule illustrates the Company's net premium written during the examination period by line of business, reported in thousands:

<u>Line of Business</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Comprehensive	\$180,231	\$196,414	\$217,202	\$230,015	\$189,151
Dental	441	0	0	0	0
Fed. Employees	10,627	13,050	12,453	12,657	13,932
Medicare	220,605	213,137	215,483	162,697	151,516
Other health	<u>5,457</u>	<u>6,873</u>	<u>7,665</u>	<u>6,549</u>	<u>7,123</u>
Total	<u>\$417,361</u>	<u>\$429,474</u>	<u>\$452,803</u>	<u>\$411,918</u>	<u>\$361,722</u>

Reinsurance

The Company maintains a reinsurance agreement with Munich Reinsurance America, Inc., effective January 1, 2010, for its commercial and individual business that provides for coverage in excess of \$300,000, to a maximum of \$700,000 per covered person per agreement year.

The Company also maintains a reinsurance agreement with ACE American Insurance Company, effective January 1, 2010, for its commercial and individual business that provides for indemnification of 100% of in-network transplant claims up to \$2 million, and for 70% of out-of-network transplant claims up to \$1 million, per covered person per agreement year.

The Company maintains a reinsurance agreement with Zurich American Insurance Company, effective April 1, 2010, for its Medicare business that provides coverage for indemnification of 90% of claims per covered person in excess of \$250,000, to a maximum of \$2 million per covered person per agreement year.

Significant Operating Results

The Company reported the following underwriting results during the examination period by line of business, reported in thousands:

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Comprehensive	\$(556)	\$(10,783)	\$(19,671)	\$(21,027)	\$(6,561)
Dental	51	0	0	0	0
Fed. Employees	(2,755)	2,046	2,751	2,988	1,656
Medicare	9,663	12,633	26,808	(1,112)	7,548
Other health	<u>(2,778)</u>	<u>(1,100)</u>	<u>(3,597)</u>	<u>(1,012)</u>	<u>(1,511)</u>
Total gain (loss)	<u>\$3,625</u>	<u>\$2,796</u>	<u>\$6291</u>	<u>\$(20,163)</u>	<u>\$1,132</u>

Financial Statements

The financial condition and the results of its operations for the 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, Capital and Surplus

Statement of Revenue and Expenses

Statement of Changes in the Capital and Surplus Account

**Statement of Assets, Liabilities, Capital and Surplus
December 31, 2010**

Bonds	\$ 55,531,759
Common stock	15,537,644
Cash, cash equivalents, and short term investments	21,616,225
Other invested assets	<u>15,630,026</u>
Subtotal, cash and invested assets	108,315,654
Investment income due and accrued	531,153
Uncollected premiums in course of collection	2,236,506
Amounts recoverable from reinsurers	20,058
Current federal and foreign income tax recoverable	187,478
Net deferred tax asset	3,501,869
Health care and other amounts receivable	<u>3,991,065</u>
Total assets	<u>\$ 118,783,783</u>
Claims unpaid	\$ 34,766,056
Accrued medical incentive pool and bonus amounts	2,783,155
Unpaid claims adjustment expenses	1,200,700
Aggregate health policy reserves	10,729,631
Premiums received in advance	3,953,161
General expenses due or accrued	4,209,137
Ceded reinsurance premiums payable	1,166,890
Liability for amounts held under uninsured plans	<u>400,487</u>
Total liabilities	<u>59,209,217</u>
Common capital stock	1,000,000
Gross paid in and contributed surplus	48,875,734
Unassigned funds	<u>9,698,832</u>
Total capital and surplus	<u>59,574,566</u>
Total liabilities, capital and surplus	<u>\$ 118,783,783</u>

**Statement of Revenues and Expenses
As of December 31, 2010**

Net premium income	<u>\$ 417,360,736</u>
Hospital/medical benefits	259,716,271
Outside referrals	32,811,603
Emergency and out-of-area	7,062,983
Prescription drugs	61,805,949
Reinsurance claims	9,077,684
Incentive pool, withhold adjustments and bonus amounts	<u>4,500,000</u>
Subtotal	374,974,490
Less:	
Net reinsurance recoveries	<u>3,428,362</u>
Total hospital and medical	371,546,128
Claims adjustment expenses	6,317,250
General administrative expenses	<u>35,872,539</u>
Total underwriting expenses	<u>413,735,917</u>
Net underwriting gain	<u>3,624,819</u>
Net investment income earned	2,369,219
Net realized capital gains (losses)	<u>(2,032)</u>
Net investment gains	<u>2,367,187</u>
Net income before federal income taxes	5,992,006
Federal income taxes incurred	<u>3,497,644</u>
Net income	<u>\$ 2,494,362</u>

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

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital and surplus, beginning of year	\$49,239	\$42,555	\$36,396	\$32,957	\$29,712
Net income (loss)	2,494	3,976	4,171	(12,937)	3,000
Net unrealized gains	1,052	1,469	0	0	0
Change in net deferred income tax	1,727	(509)	0	0	0
Change in non-admitted assets	(77)	1,748	1,988	(3,102)	1,401
Change in accounting principles	0	0	0	1,776	0
Surplus adjustments	5,140	0	0	16,130	416
Other	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,572</u>	<u>(1,572)</u>
Net change during the year	<u>10,336</u>	<u>6,684</u>	<u>6,159</u>	<u>3,439</u>	<u>3,245</u>
Capital and surplus, end of year	<u>\$59,575</u>	<u>\$49,239</u>	<u>\$42,555</u>	<u>\$36,396</u>	<u>\$32,957</u>

Notes to Financial Statements

Investments

The Company's investments were in compliance with ORC Section 3907.14 and valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Claims Unpaid

The Company's Board of Directors appointed Duane P. Lee, FSA, MAAA, associated with the firm of Buck Consultants, to render the Company's Statement of Actuarial Opinion in connection with the preparation of the Company's December 31, 2010 Annual Statement.

Mary Miller, FCAS, MAAA, Assistant Director, Product Regulation and Actuarial Services with the Department, reviewed the Actuarial Opinion prepared by Mr. Lee. In addition, Ms. Miller performed an independent analysis on the combined inpatient, outpatient and medical lags that accounted for over 90% of the Company's total claim reserves. Based on her analysis, Ms. Miller determined the claims reserves presented in the Company's 2010 Annual Statement appear to make a slightly inadequate provision for the Company's required reserves due to billing and processing errors at an affiliated hospital. The Company is implementing procedures to prevent this from occurring again. The deficiency is less than 5% of surplus. While these estimates have some potential for variability, there is little risk to the Company's financial position from further potential adverse development.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2010, and is summarized as follows:

Total Assets	<u>\$ 118,783,783</u>
Liabilities	\$ 59,209,217
Capital and Surplus	<u>59,574,566</u>
Total Liabilities, Capital and Surplus	<u>\$ 118,783,783</u>

Subsequent Events

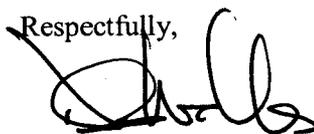
There have been no events subsequent to the examination date which would have a material effect on the financial condition of the Company.

Acknowledgement

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

In addition to the undersigned, Jeffrey Ferris, AES, CFE; Vicky Hugo, AES, CPA; Floyd Meeks, AES, CPA; Mary Miller, FCAS, MAAA; Jyotika Patel, CPA; Brad Schroer; and Patricia Severs, CPA; of the Department, participated in this examination.

Respectfully,



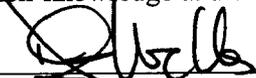
Donnie G. Wells, CFE
Examiner in Charge
Office of Risk Assessment
Ohio Department of Insurance



Jeffrey K. Ebert, CFE
Assistant Chief Examiner
Office of Risk Assessment
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, 2010.

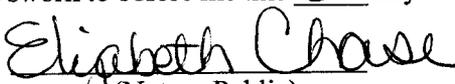

Examiner in Charge

9/20/11
Date

State of Ohio
County of Franklin

Personally appeared before me the above named Donnie G. Wells 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/her knowledge and belief.

Subscribed and sworn to before me this 20 day of September, 2011.


(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
~~MY COMMISSION EXPIRES MAY 22, 2012~~
My Commission Expires

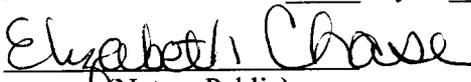

Assistant Chief Examiner

9/20/11
Date

State of Ohio
County of Franklin

Personally appeared before me the above named Jeffrey K. Ebert 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/her knowledge and belief.

Subscribed and sworn to before me this 20 day of September, 2011.


(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
~~MY COMMISSION EXPIRES MAY 22, 2012~~
My Commission Expires