

REPORT OF EXAMINATION
OF THE
SIERRA HEALTH AND LIFE
INSURANCE COMPANY, INC.

AS OF
DECEMBER 31, 2007

Participating State
and Zone:

California

Filed September 26, 2008

TABLE OF CONTENTS

| | <u>PAGE</u> |
|--|-------------|
| SCOPE OF EXAMINATION..... | 1 |
| SUBSEQUENT EVENTS | 2 |
| COMPANY HISTORY | 2 |
| MANAGEMENT AND CONTROL: | 3 |
| Management Agreements | 4 |
| TERRITORY AND PLAN OF OPERATION | 5 |
| LOSS EXPERIENCE | 6 |
| REINSURANCE: | 6 |
| Assumed..... | 6 |
| Ceded | 7 |
| FINANCIAL STATEMENTS:..... | 7 |
| Statement of Financial Condition as of December 31, 2007 | 8 |
| Summary of Operations and Capital and Surplus Account for the Year Ended December 31, 2007..... | 10 |
| Reconciliation of Capital and Surplus from December 31, 2004 through December 31, 2007..... | 11 |
| COMMENTS ON FINANCIAL STATEMENT ITEMS:..... | 12 |
| Bonds | 12 |
| Cash and Short-term Investments | 12 |
| Accrued Retrospective Premiums..... | 12 |
| Receivable from CMS..... | 12 |
| Pharmaceutical Rebate Receivables | 14 |
| Aggregate Reserve for Accident and Health Contracts | 15 |
| Contract Claims – Life..... | 15 |
| Contract Claims – Accident and Health | 15 |
| Cash Flow Issues | 15 |
| SUMMARY OF COMMENTS AND RECOMMENDATIONS:..... | 16 |
| Current Report of Examination..... | 16 |
| Previous Report of Examination..... | 16 |
| ACKNOWLEDGEMENT | 17 |

Los Angeles, California
August 15, 2008

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Insurance Division
Santa Fe, New Mexico

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

SIERRA HEALTH AND LIFE INSURANCE COMPANY, INC.

(hereinafter also referred to as the Company) at its home office located at 2720 North Tenaya Way, Las Vegas, Nevada, 89128. The Company's statutory office is located at 300 South Grand, Suite 2200, Los Angeles, California, 90071.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2007. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2007, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

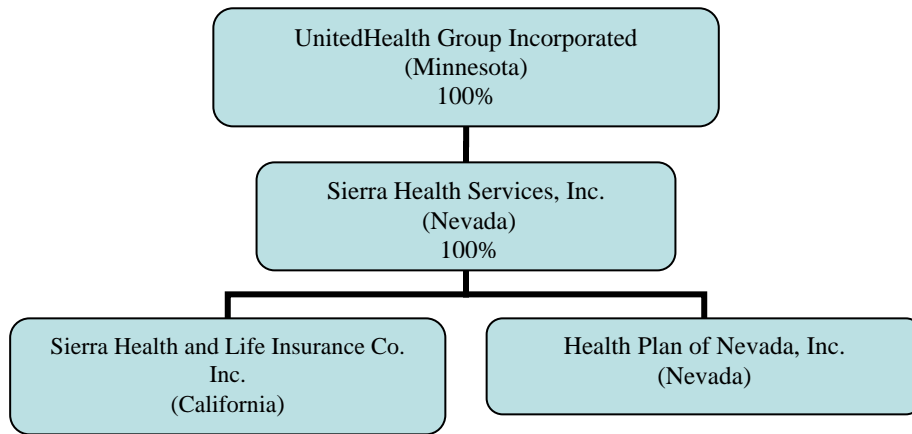
On February 25, 2008, an indirect subsidiary of UnitedHealth Group Incorporated (UnitedHealth Group) merged with and into Sierra Health Services, Inc. (the Company's parent organization) with Sierra Health Services, Inc. continuing after the merger as a wholly-owned subsidiary of UnitedHealth Group.

COMPANY HISTORY

Sierra Health Services, Inc. made a \$4.5million surplus contribution to the Company on May 9, 2007 due to the Company's adverse first quarter 2007 operating results. Please refer to the "Loss Experience" section of this report. In accordance with the provisions of Statements of Statutory Accounting Principles (SSAP) No. 72, paragraph 8, the surplus contribution was recorded as a Type I subsequent event effective March 31, 2007. The Company received prior approval from the California Department of Insurance for this transaction.

MANAGEMENT AND CONTROL

Ultimate control of the Company is maintained by UnitedHealth Group. The following abbreviated organizational chart depicts the Company’s relationship within the holding company system:



Management of the Company is vested in an eight-member board of directors. A listing of the members of the board and principal officers serving as of December 31, 2007 follows:

Directors

Name and Residence

Principal Business Affiliation

Marc R. Briggs
Henderson, Nevada

Senior Vice President and Chief Operating
Officer
UnitedHealth Group - Nevada Market

Jonathon W. Bunker
Las Vegas, Nevada

President and Chief Executive Officer
UnitedHealth Group - Nevada Market

Frank E. Collins
Las Vegas, Nevada

Vice President
UnitedHealth Group - Nevada Market

Donald J. Giancursio
Las Vegas, Nevada

Senior Vice President
UnitedHealth Group - Nevada Market

Laurence S. Howard
Las Vegas, Nevada

Retired Insurance Executive

Name and Residence

Principal Business Affiliation

Lloyd W. Isom*
Las Vegas, Nevada

Retired Insurance Executive

Wayne R. Nippe
Las Vegas, Nevada

Associate General Counsel
UnitedHealth Group - Nevada Market

Darren G. Sivertsen*
Las Vegas, Nevada

Vice President
UnitedHealth Group - Nevada Market*

Principal Officers

Name

Title

Jonathon W. Bunker

Chief Executive Officer

Wayne R. Nippe

Secretary

John F. Okita

Chief Financial Officer

Hau T. Doan

Actuary

Management Agreements

Effective February 28, 2007, the California Department of Insurance approved a new service agreement between the Company and its immediate parent, Sierra Health Services, Inc. (SHS). Under the terms of the agreement, SHS agrees to perform such services as deemed reasonably necessary by the Company in the conduct of its operations. Services will include, but are not limited to, accounting, tax and auditing, investment and cash management, actuarial, telecommunications, electronic data processing, legal, governmental relations, regulatory compliance, purchasing, payroll, and employee relations. Reimbursement for services provided is on an actual cost basis. In 2007, the Company incurred \$2,441,512 in fees on the service agreement.

*During 2008, Messrs Isom and Sivertsen resigned from the board of directors. On June 1, 2008, Scott G. Cassano, Senior Vice President, Provider Relations, UnitedHealthcare – Nevada Market, Joseph A. Kaufman, M.D., Senior Vice President, Medical Affairs and Chief Medical Officer, UnitedHealthcare – Nevada Market, and Robert L. Schaich, Senior Vice President, Information Systems and Chief Information Officer, UnitedHealthcare – Nevada Market, were elected to the board of directors.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2007, the Company was licensed to transact health and life insurance business in the following 43 states and the District of Columbia:

| | | | |
|-------------|---------------|----------------|----------------|
| Alabama | Illinois | Montana | Rhode Island |
| Alaska | Indiana | Nebraska | South Carolina |
| Arizona | Iowa | Nevada | South Dakota |
| Arkansas | Kansas | New Jersey | Tennessee |
| California | Kentucky | New Mexico | Texas |
| Colorado | Louisiana | North Carolina | Utah |
| Connecticut | Maine | North Dakota | Virginia |
| Delaware | Maryland | Ohio | Washington |
| Georgia | Massachusetts | Oklahoma | West Virginia |
| Hawaii | Mississippi | Oregon | Wyoming |
| Idaho | Missouri | Pennsylvania | |

The Company's primary business is the participation in the Medicare Part D Prescription Drug Program (PDP). In addition, the Company provides managed indemnity plans including a managed indemnity Preferred Provider Organization (PPO) plan, Medicare Advantage PPO plans, a Medicare Advantage Private Fee-For-Service plan, a Health Savings Account plan, and Medicare Select products.

During 2007, the Company wrote \$424.5 million of direct business. Of the direct business written, \$129.6 million (30.4%) was written in California and \$134.4 million (31.6 %) was written in Nevada. Approximately 90% of the business written in California during 2007 pertained to Medicare Part D PDP coverage. Individual and group managed care products are marketed through an established sales channel that includes independent brokers, agents, and consultants.

LOSS EXPERIENCE

Between 2005 and 2007, premium income increased from \$109.8 million to \$424.5 million. The increase stems primarily from the Company offering Medicare beneficiaries a stand-alone basic Medicare Part D Prescription Drug Plan (PDP) in 2006 and an enhanced PDP benefit plan in 2007. The enhanced PDP benefit plan provided gap coverage for both brand name and generic prescription drugs.

During the first quarter of 2007, the Company recorded a \$42.8 million net loss, which was primarily attributable to the enhanced benefit PDP product results. For the entire year 2007, the Company sustained an \$11.1 million net loss, which reflects the \$31.7 million cumulative net income recorded during the second through fourth quarters. The Company engaged independent actuarial consultants in developing the enhanced plan. The premium structure for the enhanced plan was predicated on a projected level of utilization per member. However, the utilization per member turned out to be significantly higher than projected resulting in a \$67.9 million pre-tax loss on this new product. The Company did not submit a bid to the Centers for Medicare and Medicaid Services for an enhanced plan offering in 2008; hence the plan was not offered in 2008. For the period ending March 31, 2008, the Company reported a \$1.8 million net income.

REINSURANCE

Assumed

Since 2002, the Company has been party to an assumption agreement with an affiliate, Health Plan of Nevada (HPN) whereby the Company assumes the risk for HPN's inpatient hospitalization claims in excess of \$200,000 up to \$350,000 per individual per contract year. Assumed reinsurance premiums totaled \$236,059, \$256,605, and \$267,840 for the years 2005, 2006, and 2007, respectively. Under the terms of this agreement, the Company was not contractually liable for any reinsurance payable during the period covered by this examination.

Ceded

The Company retains 100 % of all non-hospital expenses. Through June 30, 2007, Allianz Life Insurance Company of North America provided coverage for 70% to 90% of hospital costs, depending on the facility, in excess of \$200,000 per case, up to a lifetime maximum benefit of \$2,000,000. Effective July 1, 2007, General Reinsurance Corporation provided coverage for 70 % to 90% of hospital costs, depending on the facility, in excess of \$350,000 per case, up to a maximum of \$2,000,000 per member per lifetime with an average daily maximum of approximately \$1,700. Ceded reinsurance premium totaled \$676,551, \$759,226, and \$581,252 for the years 2005, 2006, and 2007, respectively. Reinsurance recoverable totaled \$187,632, \$42,110 and \$46,138 for the years 2005, 2006 and 2007, respectively.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2007

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2007

Reconciliation of Capital and Surplus
from December 31, 2004 through December 31, 2007

Statement of Financial Condition
as of December 31, 2007

| <u>Assets</u> | <u>Ledger and Nonledger Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|--|--|--------------------------------|--------------------------------|--------------|
| Bonds | \$ 22,995,523 | \$ | \$ 22,995,523 | (1) |
| Real estate - property occupied by the company | 4,266,976 | | 4,266,976 | |
| Cash and short-term investments | 4,005,262 | | 4,005,262 | (2) |
| Investment income due and accrued | 566,586 | | 566,586 | |
| Uncollected premiums and agents' balances in course of collection | 2,687,343 | | 2,687,343 | |
| Accrued retrospective premiums | 11,748,737 | | 11,748,737 | (3) |
| Amounts recoverable from reinsurers | 46,138 | | 46,138 | |
| Current federal and foreign income tax recoverable and interest thereon | 3,944,814 | | 3,944,814 | |
| Net deferred tax asset | 2,613,140 | | 2,613,140 | |
| Electronic data processing equipment and software | 1,304,191 | 663,749 | 640,442 | |
| Furniture and equipment | 31,583 | 31,583 | | |
| Receivables from parent, subsidiaries and affiliates | 133,723 | 8,999 | 124,724 | |
| Receivable from CMS | 56,746,216 | | 56,746,216 | (3) |
| Interest maintenance reserve | 197,922 | 197,922 | | |
| Pharmaceutical rebates receivable | 24,200,622 | 1,183,538 | 23,017,084 | (4) |
| Miscellaneous other receivables | <u>445,480</u> | <u>354,071</u> | <u>91,409</u> | |
| Total assets | <u>\$135,934,256</u> | <u>\$2,439,862</u> | <u>\$133,494,394</u> | |

Statement of Financial Condition
as of December 31, 2007
(Continued)

Liabilities, Capital and Surplus

| | | |
|--|--------------------------|-----|
| Aggregate reserve for accident and health contracts | \$ 1,294,689 | (5) |
| Contract claims - Life | 213,086 | (5) |
| Contract claims - Accident and health | 55,933,504 | (5) |
| Premiums and annuity considerations received in advance | 2,078,085 | |
| Commissions to agents due or accrued | 455,887 | |
| General expenses due or accrued | 5,817,589 | |
| Taxes, licenses and fees due or accrued | 1,087,314 | |
| Amounts withheld or retained by company as agent or trustee | 4,403 | |
| Liability for benefits for employees and agents | 676,600 | |
| Asset valuation reserve | 435,698 | |
| Payable to parent, subsidiaries and affiliates | 2,429,018 | |
| Aggregate write-ins for liabilities | <u>7,446</u> | |
| Total liabilities | 70,433,319 | |
| Common capital stock | \$ 3,600,000 | |
| Gross paid-in and contributed surplus | 11,624,960 | |
| Unassigned funds | <u>47,836,111</u> | |
| Capital and surplus | <u>63,061,071</u> | |
| Total liabilities, capital and surplus | <u>\$133,494,394</u> | |

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2007

Statement of Income

| | | |
|--|------------------|----------------------------------|
| Premium and annuity considerations | \$424,512,404 | |
| Net investment income | 5,210,414 | |
| Amortization of interest maintenance reserve (IMR) | 36,307 | |
| Aggregate write-ins for miscellaneous income | <u>1,402,195</u> | |
| Total | | \$431,161,320 |
| Death benefits | 714,851 | |
| Disability benefits and benefits under accident and health contracts | 393,783,312 | |
| Increase in aggregate reserves for life and accident and health contracts | 34,446 | |
| Commissions on premiums, annuity considerations and deposits | 9,131,769 | |
| General insurance expenses | 36,221,685 | |
| Insurance taxes, licenses and fees | 5,544,174 | |
| Aggregate write-ins for deductions | <u>1,249,797</u> | |
| Total | | <u>446,680,034</u> |
| Net loss from operations before federal income taxes and realized capital gains | | (15,518,714) |
| Federal income taxes incurred | | 4,347,355 |
| Net realized capital gains | | <u>67,942</u> |
| Net loss | | <u><u>\$(11,103,417)</u></u> |

Capital and Surplus Account

| | | |
|--|--------------------|--------------------------|
| Capital and Surplus, December 31, 2006 | | \$ 63,752,444 |
| Net loss | \$(11,103,417) | |
| Change in net deferred income tax | 1,312,122 | |
| Change in nonadmitted assets and related items | 4,582,857 | |
| Change in asset valuation reserve | 17,065 | |
| Surplus adjustment – Paid in | <u>4,500,000</u> | |
| Net change in capital and surplus for the year | | <u>(691,373)</u> |
| Capital and surplus, December 31, 2007 | | <u>\$ 63,061,071</u> |

Reconciliation of Capital and Surplus
from December 31, 2004 through December 31, 2007

| | | | |
|--|----------------------------|----------------------------|---------------------|
| Capital and surplus, December 31, 2004, per Examination | | | \$38,389,012 |
| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> | |
| Net income | \$19,656,641 | \$ | |
| Change in net deferred income tax | 2,161,816 | | |
| Change in nonadmitted assets and related items | | 1,653,832 | |
| Change in asset valuation reserve | 7,434 | | |
| Surplus adjustment - paid in | <u>4,500,000</u> | _____ | |
| Total gains and losses in surplus | <u>\$26,325,891</u> | <u>\$1,653,832</u> | |
| Increase in capital and surplus | | | <u>24,672,059</u> |
| Capital and surplus, December 31, 2007 per Examination | | | <u>\$63,061,071</u> |

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

During the period covered by this examination, the Company's securities were held under a custodial agreement which was not approved by the California Department of Insurance (CDI). Effective July 31, 2008, a new custodial agreement was executed which complies with California Insurance Code Section 1104.9.

(2) Cash and Short-term Investments

For the purpose of complying with California Insurance Code Section 1104.1, it is recommended that cash funds held outside of California be transferred to a California depository. Management has apprised the examiners that the transfer of such funds will be effectuated prior to year-end 2008.

(3) Accrued Retrospective Premiums Receivable from CMS

As previously referenced, the Company is a sponsor in the Medicare Part D Prescription Drug Program (PDP). The Center for Medicare & Medicaid Services (CMS) makes monthly prospective subsidy payments to sponsors for providing prescription drug coverage to Medicare beneficiaries. In addition to a direct subsidy, which together with beneficiary premiums is designed to cover the sponsor's cost of providing the benefit, prospective subsidy payments are made pertaining to reinsurance and low income cost sharing provisions. After the close of the plan year, CMS reconciles these prospective payments with sponsors' actual costs incurred by the sponsors. CMS calculates a reconciliation amount for the reinsurance subsidy and for the low income cost sharing subsidy. As a last step, CMS uses the finalized direct subsidy payments to determine if risk sharing payments are required.

Reinsurance and Low-income Cost-sharing Subsidies

The reinsurance subsidy covers the federal government's share of drug costs for beneficiaries who have reached catastrophic coverage. CMS makes monthly prospective payments to sponsors based on the reinsurance estimate in the sponsor's bid, multiplied by the total number of beneficiaries enrolled in the plan. The low-income cost-sharing subsidy covers the federal government's portion of the cost sharing payments for certain low income beneficiaries. CMS makes monthly prospective payments to sponsors based on the low-income estimate in the sponsor's bid, multiplied by the total number of low-income beneficiaries enrolled in the plan.

Despite the engagement of a consulting actuarial firm, the results of the 2006 PDP bid formulation process significantly underestimated the amount of low income beneficiaries that the Company would cover. As a result of the necessity to submit the 2007 plan year bid by May 2006, this inaccuracy carried over to the 2007 plan year bid. To account for these subsidy underpayments, the Company established receivables from CMS in the amounts of \$63.2 million and \$56.7 million for the years 2006 and 2007, respectively. As the result of a petition filed with CMS for interim payment relief, the Company received an interim payment of \$32.5 million in December 2006 and \$16.2 million in January 2007. Upon completion of the reconciliation process in November 2007, CMS rendered the final subsidy payment for the 2006 plan year.

In conformity with the provisions of Statements of Statutory Accounting Principles (SSAP) No. 47 Uninsured Plan, the Company established a receivable from CMS to reflect the excess expenditure for drug payments relating to the above mentioned subsidies over and above the amount received from CMS during the year. Although documentation that was reviewed and tested provides support for the reported \$56.7 million receivable, the actual amount due the Company will not be known with certainty until the CMS reconciliation process has been finalized. It has been noted, however, that in response to a filed petition, CMS provided the Company with a \$36.5 million interim subsidy payment in June 2007. Management has indicated that the 2007 reconciliation process should be completed during the final quarter of 2008.

Risk Sharing

The purpose of risk sharing is to minimize unexpected profits or losses to sponsors. To determine whether risk sharing payments are required, CMS compares the target amount which represents the costs anticipated in the sponsor's bid to the actual allowable benefit costs. If a plan's allowable costs are at least 2.5% above or below the target amount, then a portion of these profits or losses are subject to risk sharing.

In conformity with the provisions of SSAP No. 66 Retrospectively Rated Contracts, the Company's year-end 2007 calculated risk share loss was reported in its Annual Statement under the caption "Accrued Retrospective Premiums." As noted in the supporting documentation, the reported \$11.7 million risk share loss is primarily attributable to the 2007 enhanced prescription drug plan offering. The actual amount due the Company will not be known with certainty until the CMS reconciliation process has been finalized. Management has indicated that the 2007 reconciliation process should be completed during the final quarter of 2008.

(4) Pharmaceutical Rebates Receivable

Arrangements are maintained whereby various pharmaceutical entities provide the Company with rebates predicated upon the product utilization by its enrollees. Pharmaceutical rebates are invoiced in arrears on a quarterly basis by an outside firm. Predicated upon a retrospective review of invoiced and collected rebates; and the determined compliance with the admittance criteria stipulated in paragraphs 10 (a)(b) of SSAP No. 84, Certain Health Care Receivables and Receivables Under Government Insured Plans, the reported net receivable of \$23.0 million was determined to be reasonably stated.

- (5) Aggregate Reserve for Accident and Health Contracts
- (5) Contract Claims – Life
- (5) Contract Claims – Accident and Health

For the purpose of assessing the reasonableness of the above referenced reserves, the CDI retained the services of a consulting actuary. Predicated on the consulting actuary's analysis and the review of such by a Life Actuary from the CDI, the Company's reported reserves are reasonably stated as of December 31, 2007 and have been accepted for the purpose of this examination.

(6) Cash Flow Issues

It should be noted that the aggregate balance of the accounts pertaining to accrued retrospective premiums and the receivables from CMS, and pharmaceutical rebates represented 68% of admitted assets and 145% of capital and surplus as of year-end 2007.

The combination of the losses sustained from its 2007 enhanced PDP product offering and the underpayment of subsidies provided by CMS during the year caused the Company to experience a negative cash flow from its PDP program.

In response, the Company's parent Sierra Health Services, Inc. (SHS) provided the Company with a \$4.5 million surplus contribution in May 2007. In addition, SHS established on behalf of the Company a \$30 million revolving line of credit facility which expires at the end of 2008. During 2007, and through July 31, 2008, the Company did not utilize the credit facility. Cash flow challenges were met via the reduction of the Company's cash, short-term investments and bond holdings: Between year-end 2006 and 2007, the aggregate balance of such holdings declined by \$36.5 million.

In assessing the potentiality for future cash flow issues, the following mitigating factors have been noted: (1) the highly unprofitable enhanced PDP plan was not offered in 2008; (2) a comparison of the CMS subsidy receivable balance at July 31, 2007 and July 31, 2008 shows a significant decline;

and (3) between year-end 2007 and July 31, 2008, the basic PDP membership has decreased from 136,633 members to 26,706 members.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Bonds (Page 12): During the period covered by this examination, the Company's securities were held under a custodial agreement which was not approved by the California Department of Insurance. Effective July 31, 2008, a new custodial agreement was executed which complies with California Insurance Code Section 1104.9.

Cash and short-term investments (Page 12): For the purpose of complying with California Insurance Code Section 1104.1, it was recommended that cash funds held outside of California be transferred to a California depository

Previous Report of Examination

The previous report did not reflect any comments or recommendations.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_____
David A. Fischman, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California