

**COMMONWEALTH OF MASSACHUSETTS**

**OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION**

**DIVISION OF INSURANCE**

***REPORT OF EXAMINATION OF***

**BLUE CROSS AND BLUE SHIELD OF MASSACHUSETTS HMO BLUE, INC.**

**Boston, Massachusetts**

**As of December 31, 2012**

**NAIC COMPANY CODE 12219**

**NAIC GROUP CODE 3637**

**EMPLOYER ID NUMBER 04-3362283**

## Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

### TABLE OF CONTENTS

	<u>Page</u>
Salutation	1
Scope of Examination	2
Summary of Significant Findings	2
Subsequent Events	3
Company History	3
General	3
Corporate Records	4
Board of Directors Minutes	4
Articles of Organization and Bylaws	4
Conflict of Interest Procedures	4
Disaster Recovery and Business Continuity	4
Management and Control	4
Members and Membership	4
Board of Directors	5
Committees of the Board of Directors	5
Officers	5
Affiliated Companies	6
Organization Chart	6
Transactions and Agreements with Subsidiaries and Affiliates	7
Fidelity Bonds and Other Insurance	8
Pension, Stock Ownership, and Insurance Plans	8
Defined Contribution Plan	9
Territory and Plan of Operation	9
Policy Forms and Underwriting Practices	9
Growth of Company	10
Loss Experience	10
Provider Contracts	10
Unpaid Claims, Reserves	10
Income Taxes	11
Accounts and Records	11
Statutory Deposits	12
Financial Statements	13
Statement of Assets, Liabilities, Surplus and Other Funds	14
Statement of Assets, Liabilities, Surplus and Other Funds (continued)	15
Statement of Income	16
Statement of Capital & Surplus	17
Reconciliation of Capital & Surplus	18
Acknowledgement	19



**COMMONWEALTH OF MASSACHUSETTS**  
**Office of Consumer Affairs and Business Regulation**  
**DIVISION OF INSURANCE**

1000 Washington Street • Suite 810 • Boston, MA 02118-6200  
(617) 521-7794 • Toll Free (877) 563-4467  
<http://www.mass.gov/doi>

**DEVAL L. PATRICK**  
GOVERNOR

**GREGORY BIALECKI**  
SECRETARY OF HOUSING AND  
ECONOMIC DEVELOPMENT

**BARBARA ANTHONY**  
UNDERSECRETARY OF CONSUMER AFFAIRS  
AND BUSINESS REGULATION

**JOSEPH G. MURPHY**  
COMMISSIONER OF INSURANCE

May 20, 2014

Honorable Joseph G. Murphy  
Commissioner of Insurance  
Commonwealth of Massachusetts  
Division of Insurance  
1000 Washington Street, Suite 810  
Boston, MA 02118-6200

Honorable Commissioner:

Pursuant to your instructions and in accordance with Massachusetts General Laws ("M.G.L."), Chapter 176G, Section 10 and 211 CMR 43, an examination has been made of the financial condition and affairs of

**BLUE CROSS AND BLUE SHIELD OF MASSACHUSETTS HMO BLUE, INC.**

at its home office located at Landmark Center, 410 Park Drive, Boston, MA 02215-3326. The following report thereon is respectfully submitted.

## **SCOPE OF EXAMINATION**

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. ("Company" or "HMO Blue") was last examined as of December 31, 2009 by the Massachusetts Division of Insurance (the "Division"). The current examination was also conducted by the Division and covers the three-year period from January 1, 2010 through December 31, 2012, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners ("NAIC") Financial Condition (E) Committee and prescribed by the current NAIC *Financial Condition Examiners Handbook*. 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.

In addition to a review of the financial condition of the Company, the examination included a review of the Company's business policies and practices, corporate records, reinsurance treaties, conflict of interest disclosure statements, fidelity bond and other insurance, employees' benefits plans, disaster recovery plan, treatment of policyholders and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk and examination efforts were directed accordingly.

The Company is audited annually by Ernst & Young LLP ("E&Y"), an independent Certified Public Accounting firm. The firm expressed unqualified opinions about the Company's financial statements for the calendar years 2009 through 2012. A review and use of the Certified Public Accountants' work papers were made to the extent deemed appropriate and effective. Representatives from the firm of KPMG LLP ("KPMG") were retained by the Division to assist in the examination by performing certain examination procedures at the direction and under the overall management of the Division's examination staff. This assistance included a review of accounting records, information systems, taxes, investments, and actuarially determined loss and loss adjustment expense reserves.

## **SUMMARY OF SIGNIFICANT FINDINGS**

The prior report of examination did not have any findings. This report of examination has no findings.

## **SUBSEQUENT EVENTS**

There are no material subsequent events to report.

## **COMPANY HISTORY**

### **General**

Blue Cross and Blue Shield of Massachusetts (“BCBSMA”) began as the Associated Hospital Service Corporation of Massachusetts in 1937. The Corporation aimed to spread the cost of hospital treatment among a large group of employed persons and, upon its opening, was the twenty-sixth plan of its kind in the United States, differing from others in its offering of statewide coverage. In 1939, the name Blue Cross was officially adopted by the American Hospital Association as the national symbol for the Hospital Service movement and in 1941, Blue Shield of Massachusetts was established as a result of physician interest in the prepayment concept of financing health care.

Over the years, Blue Cross and Blue Shield of Massachusetts continued to grow and adapt to the needs of consumers, offering ever-increasing comprehensive coverage. In 1988, the two separate Blue organizations merged to become Blue Cross and Blue Shield of Massachusetts, Inc. and continued as part of a national network of affiliated plans, the Blue Cross and Blue Shield Association.

In January 2005, BCBSMA transferred its insured HMO business to a separately incorporated, wholly-controlled subsidiary, Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue”). HMO Blue is a Massachusetts corporation organized under Chapter 180 of the Massachusetts General Laws and holds a health maintenance organization (“HMO”) license pursuant to Massachusetts General Laws Chapter 176G. HMO Blue and BCBSMA operate under common management and Board of Directors control. HMO Blue provides hospitalization, medical and other health benefits to members through contracts with hospitals, participating physicians, skilled nursing facilities, nursing homes, and other health care providers and organizations. It offers a variety of HMO and other supplementary programs for the benefit of its members.

HMO Blue was licensed by the Division effective January 1, 2005. As a condition of granting an HMO license to HMO Blue, the Division required BCBSMA and HMO Blue to enter into an agreement with the Division granting the Division discretionary authority to require either company to issue a surplus note to the other company if either entity’s health risk based capital (“RBC”) falls outside a specified range. BCBSMA also entered into a unilateral agreement with HMO Blue to guarantee all of HMO Blue’s current and future financial obligations. HMO Blue and BCBSMA continue to operate under common management and Board of Directors’ control.

## **CORPORATE RECORDS**

### **Board of Directors Minutes**

The minutes of the Board of Directors ("Board") and its Committees for the period under examination were read and they indicated that all meetings were held in accordance with the Company's bylaws and the laws of the Commonwealth of Massachusetts. Activities of the committees were reported and ratified at meetings of the Board.

### **Articles of Organization and Bylaws**

The name and purposes of the Company are set forth in the Articles of Organization ("Articles"). The Company bylaws, the powers of the Company and its members, directors and officers, and all matters concerning the conduct and regulation of the affairs of the Company are subject to the Articles. In September 2013, the Governance Committee recommended certain proposed amendments to the bylaws to facilitate the Board's ability to govern the Company effectively in accordance with modern corporate governance best practices. The amendments are pending approval from the Board. The Articles and the bylaws were read and reviewed.

### **Conflict of Interest Procedures**

The Company has a policy pertaining to conflict of interest. In support of its answer to Question 18 in Part 1 Common Interrogatories of the annual statement, the Company has an established procedure for the disclosure to the Board of any material interest or affiliation on the part of any officer or director or responsible employee which is in or is likely to conflict with his/her official duties. Annually, each officer or director or responsible employee completes a questionnaire disclosing any material conflicts of interest. The completed questionnaires were reviewed for 2010, 2011 and 2012 and no discrepancies were noted.

### **Disaster Recovery and Business Continuity**

The Company provides for the continuity of management and operations in the event of a catastrophe or national emergency in accordance with Massachusetts General Laws, Chapter 175 Section 180M-180Q.

## **MANAGEMENT AND CONTROL**

### **Members and Membership**

The Company's bylaws indicate the following regarding its corporate membership:

The sole Member of the Corporation is Blue Cross Blue Shield of Massachusetts, Inc., acting through its Board of Directors. In accordance with the Company's bylaws, the Annual Meeting of the Member shall be held on such day and at such time and place as the Member may from time to time determine. There shall be such further meetings as may be called by the Board of Directors or the Member. The Board of the Company consists of no less than five and no more than 21 members. The purpose of the Annual Meeting is the election of directors and the transaction of such other business as may come before the meeting. The members shall also include persons having the qualifications required by any applicable law governing the

composition of the Board. Members and directors of the Company shall be elected in accordance with Section 2 of Article II (directors) of the Corporate bylaws.

#### Board of Directors

HMO Blue and BCBSMA operate under common Board management and control. The bylaws specify that the business and affairs of the Company are controlled by a Board, the size of which is determined at each Annual Meeting of the members. Each director must be a member of the Company. Directors are elected at the Annual Meeting and serve for three years or until a successor is duly elected and qualified.

The Board of Directors shall meet annually immediately following the Annual Meeting of the Member. Regular meetings shall be at such place and time as the Board of Directors may from time to time determine. The Annual Meeting of the directors is for the purpose of organization, election of the officers of the Company not elected by the members, establishment of committees of the directors and the transaction of such other business as may properly come before the meeting. Special meetings of the Board may be called on notice by the Secretary upon request by the Chair of the Board, the Chief Executive Officer or two or more directors.

At December 31, 2012, the Board was comprised of five directors, which was in compliance with Company bylaws. Directors duly elected and serving at December 31, 2012 are as follows:

<u>Name of Director</u>	<u>Position</u>
William C. Van Faasen	Chairman
Bruce M. Bullen	Chief Operating Officer
Stephanie S. Lovell	Clerk
Andrew C. Dreyfus	President and Chief Executive Officer
Allen P. Maltz	Executive Vice President and Treasurer

#### Committees of the Board of Directors

The Board may delegate such of its powers as it considers advisable, except those powers which by law, the Articles of Organization, or the bylaws may not be so delegated, to such committees as the Board or the bylaws may from time to time establish. All committees shall serve at the pleasure of the Board. There are no current standing committees of the Board.

#### Officers

According to the Company's bylaws, the Board shall elect the officers of the Company. The officers of the Company are the chairman of the board of directors, the president and chief executive officer, chief operating officer, clerk, assistant clerk, executive vice president and treasurer, assistant treasurer, and chief actuary.

# Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Officers of the Company at December 31, 2012 were as follows, in addition to those directors above are as follows:

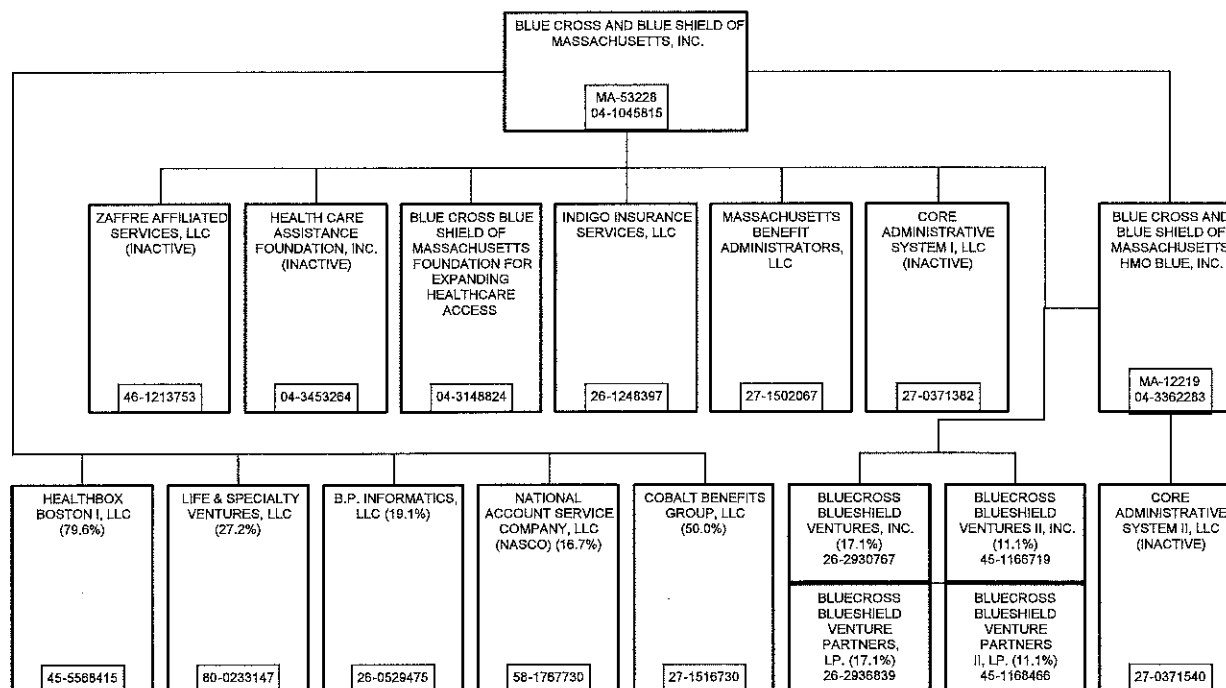
<u>Name of Officer</u>	<u>Elected Position</u>
Andrew C. Dreyfus	President and Chief Executive Officer
Bruce M. Bullen	Chief Operating Officer
Stephanie S. Lovell	Clerk
Alona G. Abalos	Assistant Clerk
Allen P. Maltz	Executive Vice President & Treasurer
Keith R. Renaldi	Assistant Treasurer
Andreana Shanley	Chief Actuary
William C. Van Faasen	Chairman

## Affiliated Companies

HMO Blue has one subsidiary and two affiliated companies. The Company participates in providing financial support to Blue Cross Blue Shield of Massachusetts Foundation, Inc. ("BCBSF"). The Company provided support of \$2,500,000 to BCBSF in 2012 and 2011. The Company did not provide support to BCBSF in 2010.

## Organization Chart

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2012 is illustrated below:





Transactions and Agreements with Subsidiaries and Affiliates

HMO Blue and BCBSMA operate under a common Board management and control. HMO Blue participates in a bilateral inter-company agreement with BCBSMA to settle any claims, fees, administrative cost expense allocation and pass-through cash and expenses paid by one company on behalf of the other company.

Both BCBSMA and HMO Blue have an undivided interest in the Companies' property and equipment. The initial basis of the property and equipment was systematically allocated to each Company. Ongoing depreciation expenses are charged to each company based on utilization. Existing employees of the Companies ("Associates") are either concurrently employed by both BCBSMA and HMO Blue or solely employed by BCBSMA. Those individuals solely employed by BCBSMA include senior level management. The compensation, benefits and administrative expenses of the concurrently employed Associates are charged to BCBSMA and HMO Blue in accordance with their provision of services to each company.

With respect to individuals solely employed by BCBSMA, the pro rata portion of compensation, benefits and administrative expenses attributable to services provided to HMO Blue is charged to HMO Blue on an arm's length basis, including a mark-up. A common paymaster arrangement has been established for payroll and payroll related benefits. An agency arrangement has been established for payment of claims and operating expenses and receipt of funds.

The Companies' pension and post-retirement benefits plans ("Benefits Plans") continue to be sponsored by BCBSMA and BCBSMA will continue to be liable for the Benefit Plans. BCBSMA charges HMO Blue, as a participating employer of the Benefit Plans, a fee based on HMO Blue's allocated share of the Benefit Plans' expenses.

The Company had a payable to BCBSMA of \$25,020,000 as of December 31, 2012. The Company had a receivable from BCBSMA of \$12,797,000 as of December 31, 2011. The Company had a payable to BCBSMA of \$1,110,000 as of December 31, 2010.

Core Administrative Systems I, LLC ("CASI") is a wholly-owned subsidiary of BCBSMA. Core Administrative Systems II, LLC ("CASII") is a wholly-owned subsidiary of HMO Blue. Both were formed in 2009 for the purpose of acquiring and holding certain assets associated with a software system for billing and enrollment ("Blue Core"), and to enter into a hosted services agreement to provide access to and use of Blue Core to its parent corporation pursuant to such agreement.

In 2011, BCBSMA and HMO Blue ("Companies") underwent an extensive review of the software architecture, processes and plan for future use given the plan to replace this existing functionality with a more automated, integrated, NASCO based solution. As a result of the review, Blue Core assets were transferred back to BCBSMA and HMO Blue and fully impaired by recording an impairment charge of \$58,463,000 and \$51,844,000 respectively. In January 2012, CASI and CASII had returned the remaining contributed capital of \$1,397,000 and \$1,505,000 in cash back to BCBSMA and HMO Blue, respectively, discontinued their operations and became inactive.

In 2008, HMO Blue and BCBSMA each committed to invest \$10,000,000 in BlueCross BlueShield Ventures, Inc. ("General Partner") and BlueCross BlueShield Venture Partners, L.P. ("Partnership"), in the form of the purchase of 20 Class A shares of the General Partner and 17.1% limited interest in the Limited Partnership. BlueCross BlueShield Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield plans to invest in emerging companies that will bring greater innovation, efficiency, consumer-focus and transparency to healthcare. As of December 31, 2012, BCBSMA contributed \$8,463,000 to BlueCross BlueShield Venture. As of December 31, 2012, the Company had an outstanding contingent commitment for additional funding of \$1,537,000 related to the future equity contributions in the Partnership.

In 2011, HMO Blue and BCBSMA each committed to invest \$10,000,000 in BlueCross BlueShield Ventures II, Inc. ("General Partner II") and BlueCross BlueShield Venture Partners II, L.P. ("Partnership II"), in the form of the purchase of 200 Class A shares of the General Partner II and 11.1% limited interest in the Partnership II. BlueCross BlueShield Venture II is a strategic corporate venture fund formed by twenty Blue Cross and Blue Shield plans to primarily make equity investments in emerging companies of strategic interest to Blue Plans while pursuing positive financial returns. As of December 31, 2012, BCBSMA contributed \$1,899,000 to BlueCross Blue Shield Venture II.

#### **FIDELITY BONDS AND OTHER INSURANCE**

The Company maintains fidelity coverage with an authorized Massachusetts insurer. The aggregate limit of liability exceeds the NAIC suggested minimum.

The Company has further protected its interests and properties by policies of insurance covering other insurable risks. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts and was in force as of December 31, 2012.

#### **PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS**

The pension and other post-retirement benefit plans are sponsored by BCBSMA and the associated costs are shared by the Companies. All employees who have completed twelve months of employment are eligible to participate in BCBSMA's Retirement Income Trust Plan ("RIT"), which grants benefits to retired employees at various levels based on age and years of service. BCBSMA also participates in two noncontributory retirement plans for eligible employees. BCBSMA uses a December 31 measurement date for all of its plans. HMO Blue is an active participating employer of the Plans. The Company's share of the net expense for the pension plan was \$12,770,000; \$9,025,000; and \$10,156,000 for 2012, 2011 and 2010, respectively and for other post-retirement benefit plans was \$3,410,000; \$3,324,000; \$3,632,000 for 2012, 2011 and 2010, respectively.

BCBSMA also sponsors a defined benefit plan covering medical, life and dental benefits. The 401(h) account was instituted by BCBSMA in December 2003. The Companies made a 401(h) contribution of \$6,000,000 in 2012 and 2011, and a contribution of \$3,300,000 in 2010.

### Defined Contribution Plan

BCBSMA also has a 401(k) savings plan for eligible employees. Under the employee savings plan, BCBSMA contributes an amount equal to 100% of employee contributions, up to a maximum of 4% of each employee's compensation, subject to pretax Internal Revenue Service limits. The Company's allocated costs for the 401(k) plan were \$3,128,000; \$3,083,000; and \$3,096,000 in 2012, 2011 and 2010, respectively.

## **TERRITORY AND PLAN OF OPERATION**

The Company is licensed to transact business in the Commonwealth of Massachusetts. Blue Cross Blue Shield of Massachusetts HMO Blue, Inc. is headquartered in Boston, MA. As of December 31, 2012, HMO Blue's service area included all of Massachusetts with a focus on the greater metropolitan Boston area.

### Policy Forms and Underwriting Practices

The Company receives premium revenue from insured business. Member premiums are billed in advance of their prospective coverage periods. Premium receivables are recorded when due. Premium earned is recorded during the coverage period. Aggregate policy reserves are established to cover the unexpired portion of premiums written and are computed by pro rata methods for direct business. Expenses incurred in connection with acquiring new insurance business, including acquisition costs such as sales commissions, are charged to administrative expenses as incurred. The premium paid by subscribers prior to the effective date is recorded in the balance sheets as premiums received in advance and subsequently credited to income as earned during the coverage period.

Effective in 2011, commercial health plans with medical loss ratios on fully insured products, as calculated under the definitions of the Patient Protection and Affordable Care Act ("PPACA") and implementing regulations, that fall below certain targets are required to rebate ratable portions of their premiums annually. At December 31, 2011, the Company's estimated medical loss ratios are above the targets and accordingly, the Company has not recorded a liability pursuant to PPACA.

For uncollected premium, after the calculation of non-admitted amounts, an evaluation is made of the remaining admitted assets in accordance with SSAP No. 5, *Liabilities, Contingencies, and Impairment of Assets*, to determine if there is a collectability issue. If it is probable that the balance is uncollectible, any uncollectible amount is written off and charged to income in the period the determination is made.

**GROWTH OF COMPANY**

Capital and Surplus consists of capital contributed to the Company and the excess of revenues over expenses since inception. The total admitted assets, total liabilities, capital and surplus and net premium income of the Company for the years ended 2010 through 2012 are shown in the following schedule, which was prepared from the Company's annual statements:

<b><u>Year</u></b>	<b><u>Admitted Assets</u></b>	<b><u>Liabilities</u></b>	<b><u>Capital and Surplus</u></b>	<b><u>Net Premium Income</u></b>
2010	\$1,363,200,507	\$604,582,707	\$ 758,617,800	\$4,018,072,861
2011	1,539,912,047	624,774,082	915,137,965	3,981,202,727
2012	1,780,731,130	703,593,129	1,077,138,001	3,892,728,634

**LOSS EXPERIENCE****Provider Contracts**

The Company arranges for the provision of health care services to its subscribers and eligible dependents thereof through contracts with physician providers and other health care providers. Physician providers and such other organizations or individuals are and shall be deemed to be, for all purposes, independent contractors with the Company, and shall not be characterized as officers, employees or agents of the Company.

For the HMO product, the Company, participating hospitals and physicians are generally parties to risk incentive agreements (including pay-for-performance agreements) whereby favorable and unfavorable claims experience is shared. Payments to participating physicians for medical claims are generally subject to retention by the Company. Distribution of such retention is contingent upon the results of the risk incentive arrangements. The agreements are in compliance with Massachusetts statutes and regulation 211 CMR section 52.

**Unpaid Claims, Reserves**

The Company uses estimates for determining its claims incurred but not yet reported, which are based on historical claim payment patterns, healthcare trends and membership and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

KPMG Health Actuaries prepared independent estimates of the Unpaid Claim Liabilities ("UCL") as of December 31, 2012 and prior periods. For December 31, 2012, completion factors for the projection of ultimate claims were developed using historical payment patterns and actuarial judgment. "Low" and "High" estimates were developed by subtracting the claims paid-to-date from the actuarial range of incurred estimates. As the HMO Blue business pays fairly quickly, the range of estimates for the December 31, 2012 UCL is narrow and the actuarial estimates are similar to HMO Blue's estimates with hindsight through June 30, 2013.

The Company's premium deficiency reserve calculation was reviewed and found to be reasonable. The calculation indicated that no premium deficiency reserves were required as of December 31, 2012.

### **INCOME TAXES**

The Company is reporting as an organization exempt from federal income taxes under Internal Revenue Code Section 501(c) (4), and is exempt from Massachusetts state income taxes. The Company is subject to tax on any income unrelated to its operations as a tax-exempt health maintenance organization. The amount of unrelated business income tax for the Company for both 2012 and 2011 was immaterial.

On January 1, 2005, BCBSMA transferred the operations of its health maintenance organization to HMO Blue in exchange for the assumption of the liabilities of the HMO. Prior to this restructuring, BCBSMA received opinion letters from outside counsel covering three issues; (1) that BCBSMA should not recognize taxable income or gain upon the transfer of assets to HMO Blue; (2) that the transfer would not constitute a material change of BCBSMA's business and BCBSMA would continue to qualify as an existing Blue Cross Blue Shield organization under Internal Revenue Code Section 833(c) (2); and (3) HMO Blue should be a tax exempt organization.

As noted in the opinion letter, the Internal Revenue Service ("IRS") had stopped issuing ruling regarding Section 501(m) and the definition of "commercial-type" insurance as it relates to HMO's. Because of the lack of authoritative guidance by the IRS regarding the treatment of HMO's, it is difficult to conclude whether or not HMO Blue would be successful in sustaining their tax-exempt position upon examination by the IRS.

Effective for the period beginning on January 1, 2011, BCBSMA and HMO Blue made a change from the methodology used for determining the premiums related to Preferred Provider Arrangements subject to Massachusetts annual assessment under M.G.L. Chapter 176I, Section 11, which provides for a PPO tax to be paid on the gross premiums received during the preceding calendar year for coverage of covered persons residing in the Commonwealth of Massachusetts. Specifically, the Companies' change in methodology excludes premiums received for coverage of non-Massachusetts residents from the assessment. Prior to this change, the Companies determined the assessment using all premiums associated with the Preferred Provider Arrangement product.

### **ACCOUNTS AND RECORDS**

The Company's internal control structure was discussed with management through questionnaires and through a review of the work performed by the Company's independent Certified Public Accountants. No material deficiencies were noted.

As part of its engagement for the Division, KPMG performed a review and evaluation of the control environment of the Company's IT systems. The NAIC's Information Systems Questionnaire completed by the Company was reviewed and interviews with Company management and IT staff were conducted to gather supplemental information and corroborate the Company's responses to the Questionnaire. Included was a review of the documentation supporting Management and Organization Controls, Application Systems Development and Maintenance Controls, Operating and Processing Controls, Logical and Physical Security Controls, Contingency Planning Controls, Personal Computers, Local Area Network ("LAN"), Wide Area Network ("WAN") and Internet Controls. The control environment of the Company's information systems was found to have in place sufficient internal controls.

No material internal control weaknesses were noted in connection with the examination, nor were any such matters reported in the Company's filings with the Division. The Company uses an automated general ledger system. Trial balances were traced from the general ledger and supporting documents to the 2012 Annual Statement. No material exceptions were noted.

The books and records of the Company are audited annually by Ernst & Young LLP, independent Certified Public Accountants in accordance with 211 CMR Section 26.00

### **STATUTORY DEPOSITS**

The statutory deposits of the Company at December 31, 2012 are as follows:

<u>Jurisdiction</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Massachusetts	U.S. Treasury Note	<u>\$1,000,000</u>	<u>\$1,023,165</u>	<u>\$1,194,771</u>
		<u>\$1,000,000</u>	<u>\$1,023,165</u>	<u>\$1,194,771</u>

**FINANCIAL STATEMENTS**

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance and by the NAIC as of December 31, 2012:

Statement of Assets, Liabilities, Surplus and Other Funds as of December 31, 2012

Statement of Income for the Year Ended December 31, 2012

Statement of Capital & Surplus for the Year Ended December 31, 2012

Reconciliation of Capital and Surplus for Each Year in the Three-Year Period Ended December 31, 2012

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.  
Statement of Assets, Liabilities, Surplus and Other Funds (continued)  
As of December 31, 2012

	As Reported by the Company	Examination Changes	Per Statutory Examination
<b>Liabilities</b>			
Claims unpaid	\$ 359,955,441	\$ 0	\$359,955,441
Unpaid medical incentive pool and bonus amounts	115,440,750		115,440,750
Unpaid claims adjustment expenses	3,353,482		3,353,482
Aggregate health policy reserves	17,327,944		17,327,944
Premiums received in advance	97,182,536		97,182,536
General expenses due or accrued	39,961,577		39,961,577
Current federal and foreign income tax payable and interest thereon	1,267		1,267
Amounts due to parent, subsidiaries and affiliates	25,019,858		25,019,858
Payable for securities	23,585,451		23,585,451
Other liabilities	21,764,823		21,764,823
Total Liabilities	<u>703,593,129</u>	<u>0</u>	<u>703,593,129</u>
Capital and surplus:			
Unassigned funds (surplus)	<u>1,077,138,001</u>		<u>1,077,138,001</u>
Total capital and surplus	<u>1,077,138,001</u>		<u>1,077,138,001</u>
Total liabilities, surplus, and Other funds	<u><u>\$1,780,731,130</u></u>	<u><u>\$ 0</u></u>	<u><u>\$1,780,731,130</u></u>



Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.  
Statement of Income  
For the Year Ended December 31, 2012

	As Reported by the Company	Examination Changes	Per Statutory Examination
Premiums Earned	\$ 3,892,728,634	0	\$ 3,892,728,634
Change in unearned premium reserves and reserve for rate credits	2,422,702		2,422,702
Total revenues	3,895,151,336	0	3,895,151,336
Hospital and Medical:			
Hospital/medical benefits	2,635,262,044		2,635,262,044
Other professional services	116,431,316		116,431,316
Emergency room and out-of-area	70,434,235		70,434,235
Prescription drugs	448,584,381		448,584,381
Incentive pool and bonus amounts	148,348,143		148,348,143
Total hospital and medical	3,419,060,119	0	3,419,060,119
Claims adjustment expenses	166,297,407		166,297,407
General administrative expenses	250,873,175		250,873,175
Total underwriting deductions	3,836,230,701	0	3,836,230,701
Net underwriting gain	58,920,635	0	58,920,635
Net investment income earned	39,109,672		39,109,672
Net realized capital losses	19,027,693		19,027,693
Net investment gain	58,137,365	0	58,137,365
Other income	712,456		712,456
Net income after capital gains tax and before all other federal income taxes	117,770,456		117,770,456
Net Income	\$ 117,770,456	\$ 0	\$ 117,770,456

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.  
Statement of Capital & Surplus  
For the Year Ended December 31, 2012

	As Reported by the Company	Examination Changes	Per Statutory Examination
Capital and Surplus, December 31, prior year	\$ 915,137,965	\$ 0	\$ 915,137,965
Net income	117,770,456		117,770,456
Change in net unrealized capital gains	47,375,489		47,375,489
Change in nonadmitted assets	(3,145,909)		(3,145,909)
Net change in capital and surplus	162,000,036	0	162,000,036
Capital and Surplus, December 31, current year	<u>\$1,077,138,001</u>	<u>\$ 0</u>	<u>\$1,077,138,001</u>

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.  
Reconciliation of Capital & Surplus  
For each Year in the Three-Year Period Ended December 31, 2012

	<u>2010</u>	<u>2011</u>	<u>2012</u>
Capital and Surplus, December 31, prior year	\$705,830,049	\$758,617,800	\$915,137,965
Net income	7,938,555	119,537,908	117,770,456
Change in net unrealized capital gains	43,217,320	35,613,765	47,375,489
Change in nonadmitted assets and related items	<u>1,631,876</u>	<u>1,368,492</u>	<u>(3,145,909)</u>
Net change in capital and surplus for the year	<u>52,787,751</u>	<u>156,520,165</u>	<u>162,000,036</u>
Capital and Surplus, December 31, current year	<u><u>\$758,617,800</u></u>	<u><u>\$915,137,965</u></u>	<u><u>\$1,077,138,001</u></u>

**ACKNOWLEDGEMENT**

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by KPMG and the following Division examiner who participated in this examination is hereby acknowledged:

John Coyne, Examiner II

A handwritten signature in dark ink, appearing to read "R.J. Ciaramella, Jr.", written over a horizontal line.

Raffaele J. Ciaramella, Jr., CFE  
Supervising Examiner and Examiner-in-Charge  
Commonwealth of Massachusetts  
Division of Insurance