

COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION OF
BLUE CROSS and BLUE SHIELD OF MASSACHUSETTS, INC.

Boston, Massachusetts

As of December 31, 2012

NAIC COMPANY CODE 53228

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EMPLOYER ID NUMBER 04-1045815

Blue Cross and Blue Shield of Massachusetts, Inc.

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COMMONWEALTH OF MASSACHUSETTS
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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 175, Section 4, Chapter 176A, Section 6, and Chapter 176B, Section 9, an examination has been made of the financial condition and affairs of

BLUE CROSS AND BLUE SHIELD OF MASSACHUSETTS, 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, Inc. (“Company,” or “BCBSMA”) 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 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 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. The two separate 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 1992, BCBSMA launched an insured Health Maintenance Organization (“HMO”) line of business branded as HMO Blue. The product reflected a change that was in line with the interests of the emerging market and represented a transition from traditional health insurance to managed care.

The Blue Cross Blue Shield of Massachusetts Foundation (“BCBSF”) was founded in 2001. The Foundation is committed to expanding high quality care access to the underserved in Massachusetts consistent with its original charter.

In January 2005, BCBSMA transferred its insured HMO business to a separately incorporated, not-for-profit subsidiary, Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue”). HMO Blue provides hospitalization, medical and other health benefits as a licensed health maintenance organization. HMO Blue and BCBSMA operate under common management and Board of Directors control. 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 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.

In August 2007, BCBSMA and Blue Cross and Blue Shield Plans from Arkansas, Florida and North Carolina formed B.P. Informatics, LLC (“BPI”), which makes strategic investments in companies developing informatics technology to promote transparency in health care costs and quality. Health Care Services Corporation became a member of BPI in December 2007 and Highmark, Inc. became a member in October 2008.

Blue Cross and Blue Shield of Massachusetts, Inc.

BCBSMA created Indigo Insurance Services, LLC (“Indigo”), a wholly-owned, for-profit subsidiary, on December 13, 2007. Indigo acts as an insurance agency and allows BCBSMA to offer ancillary products including disability insurance, death and dismemberment insurance and life insurance.

In February 2008, BCBSMA purchased a 27% interest in Life and Specialty Ventures, LLC (“LSV”). LSV is an insurance holding company that is a joint venture between the Blue Cross and Blue Shield Plans of Massachusetts, Arkansas, Florida, Hawaii and Tennessee, and was created to expand the ability of Blue’s Plans to offer broader ranges of insurance products and services.

In July 2008, BCBSMA and HMO Blue became investors in BlueCross BlueShield Ventures, Inc. (the “General Partnership”) and BlueCross Blue Shield Venture Partners, L.P. (the “Limited Partnership”), collectively, “BCBS Venture.” BCBS Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield Plans to invest in emerging companies developing services and technologies focusing on health care innovation, efficiency, transparency and consumer focus.

On June 1, 2009, BCBSMA and HMO Blue each formed a wholly-owned limited liability company subsidiary, Core Administrative I, LLC (“CASI”) and Core Administrative II, LLC (“CASII”), respectively. The purpose of these entities is to serve as an acquisition and holding company for the BlueCore IT system assets involved in a sale-leaseback transaction the Companies executed with Bank of America.

On December 31, 2009, BCBSMA entered into a Joint Ownership Agreement with Blue Cross Blue Shield of Vermont (“BCBSVT”), under which BCBSMA and BCBSVT jointly own a new entity, Cobalt Benefits Group, LLC (“Cobalt”), which provides third-party administration services. BCBSVT had established Cobalt as a limited-liability company owned by Comprehensive Benefits Administrator, Inc. (“CBA”), which is a wholly-owned indirect subsidiary of BCBSVT. Under the agreement, CBA transferred some of its assets and liabilities to Cobalt, including an ownership interest in Employee Benefit Plan Administration, LLC (a wholly-owned subsidiary of CBA). Following the transaction, BCBSMA and BCBSVT each own a 50% share of Cobalt. In conjunction with the transaction, BCBSMA created a new wholly-owned subsidiary, Massachusetts Benefit Administrators, LLC (“MBA”) to market and sell third-party employee benefit administration services.

In 2011, Blue Core IT system assets were transferred back to BCBSMA and HMO Blue. BCBSMA and HMO Blue performed an extensive review of the software architecture, processes, and plan for future use. As of December 31, 2011, CASI and CASII discontinued operations and became inactive.

BCBSMA has 16.7% ownership of National Account Service Company, LLC (“NASCO”). NASCO provides a single-system claims processing solution for the Blue Cross and Blue Shield plans. BCBSMA currently processes 25% of its claims through the NASCO platform. In 2011, BCBSMA started to migrate the Company’s core administrative processes of claims and enrollment from their current technology platforms to NASCO. The migration is based on NASCO’s ability to improve efficiencies and take full advantage of IT investments through a shared investor model.

Blue Cross and Blue Shield of Massachusetts, Inc.

In 2011, BCBSMA and HMO Blue each committed to invest \$10,000,000 in BlueCross BlueShield Ventures II, Inc. (the “General Partnership II”) and BlueCross BlueShield Venture Partners II, L.P. (the “Limited Partnership II”).

In August 2012, BCBSMA contributed to a newly created limited liability company named Healthbox Boston I, LLC (“Healthbox Boston”). Healthbox Boston was a 12-week healthcare business accelerator program which provided funding to ten healthcare technology start-ups and entrepreneurs in 2012.

In August 2012, a Massachusetts healthcare cost-containment bill entitled “An Act improving the quality of healthcare and reducing cost through increased transparency, efficiency and innovation” resulted in a one-time surcharge assessment upon BCBSMA.

In October 2012, BCBSMA filed a limited liability company certificate of organization with the Commonwealth of Massachusetts to establish a new wholly-owned subsidiary named Zaffre Affiliated Services, LLC (“Zaffre”). Zaffre will act as a holding company for certain strategic investments of BCBSMA as its sole member, engage in providing services to businesses in the healthcare industry, and perform any acts in connection with healthcare. Zaffre was not funded until January 2013.

CORPORATE RECORDS

Board of Directors Minutes

The minutes of the Board of Directors (“Board”) and its Committees for the period under statutory 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 various 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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:

In accordance with the Company's bylaws, the Annual Meeting of the members of the Company is to be held on the third Wednesday of March or on such other day in March as shall be fixed each year by the directors, the chair of the board or the chief executive officer and stated in the notice of the meeting. The members also serve as the Board of the Company, which consists of no less than eleven and no more than 31 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 bylaws.

Board of Directors

BCBSMA and HMO Blue 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 Rules of the Directors, in accordance with the bylaws, specify that the directors are to hold an Annual Meeting after the Annual Meeting of the members on the third Wednesday of March. 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

<u>Director</u>	<u>Position</u>
Andrew C. Dreyfus	President and CEO, Blue Cross and Blue Shield of Massachusetts
George R. Alcott III	President, Local 1301 Communication Workers of America
Brian M. Barefoot	President Emeritus, Babson College
Helen G. Drinan	President, Simmons College
Richard C. Garrison	President, Bink, Inc.
Paul Guzzi	President and CEO, Greater Boston Chamber of Commerce
Bruce H. Hamory, MD, FACP	EVP and Managing Partner, Geisinger Consulting Services
Philip W. Johnston	President, Philip W. Johnston Associates
Gloria C. Larson	President, Bentley University
Ralph C. Martin II	Senior Vice President, Northeastern University
Robert F. Meenan, M.D.	Dean, Boston University School of Public Health
Dorothy E. Puhly	COO, Dana-Farber Cancer Institute
Paul F. Toner	President, Massachusetts Teachers Association
William C. Van Faasen	Chairman, Blue Cross and Blue Shield of Massachusetts
Benaree P. Wiley	Principal, The Wiley Group
Timothy M. Sweeney	President, Liberty Mutual Group
Phyllis R. Yale	Senior Advisor, Bain & Company

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.

The current standing committees of the Board are as follows:

- *Audit Committee* – The Audit Committee provides assistance to the Board in fulfilling its oversight responsibilities with regard to the audit of the Company’s financial statements and the financial reporting process, the system of internal accounting and financial controls, the internal audit function, the annual independent audit of the Company’s financial statements, and the legal compliance and ethics programs of the Company. The Committee sets the overall “tone” for quality in financial reporting and control and management of risks, and deals with all matters affecting the auditing of the Company by internal and external auditors. The Audit Committee should be comprised of at least five independent directors. At least one member should have depth of experience in financial work, and all members should have some degree of finance or accounting literacy. The Chief Audit Executive and the independent auditor report directly to the Committee and administratively to the Chief Financial Officer.
- *Finance and Business Performance Committee* – The Finance and Business Performance Committee assists the Board in its oversight responsibility for the financial and business

Blue Cross and Blue Shield of Massachusetts, Inc.

performance of the Company. It reviews key elements of the financial and business plan and also has oversight of the Company's investment activity. The Finance and Business Performance Committee should have not less than five members. The Chair of the Board and Chief Executive Officer shall be an *ex officio* member without vote. The Chief Financial Officer shall be a regular, nonvoting participant. At least two-thirds must be independent directors.

- *Human Resources Committee* – The Human Resources Committee provides assistance to the Board of Directors in its oversight responsibilities of the human assets of the Company. The Committee helps the Company in its efforts to produce sufficient leadership talent now and in the future, as well as sound practices for all associates. The Human Resources Committee shall be comprised exclusively of independent directors.
- *Governance Committee* – The Governance Committee makes sure that skilled directors are elected to the Board, that Board Committees have the necessary mix of content expertise and leadership, and that the Committees are addressing the appropriate strategic issues. With oversight of Board policy, the Governance Committee aligns the Board to its business purpose and defines the relationship between the Board, senior officers of the Company, the Company's customers, and the community. The Governance Committee shall be comprised of not less than five or more than seven members, all of whom shall be independent directors.
- *Health Care Quality and Affordability Committee* – The Health Care Quality and Affordability Committee provides assistance to the Board in its oversight responsibility for service to BCBSMA's members and coordinating the quality of health care delivery with providers. The Committee shall have a majority of independent directors. The Chair of the Committee shall preferably be a physician or someone with a strong healthcare background.

Officers

According to the Company's bylaws, the Board shall elect the officers of the Company. The officers of the Company shall be the president, one or more executive vice presidents, one or more senior vice presidents, a chief financial officer, a chief actuary, a chief legal officer, a treasurer, one or more assistant treasurers, a secretary and one or more assistant secretaries.

The directors may elect or appoint from time to time such other officers with such powers and duties and for such terms, not exceeding three years, as the Directors may determine. The directors have the authority to fix and determine the salaries and compensation of all officers.

All officers elected by the Board or members may be removed at any time for cause by vote of a majority of the directors then in office, provided that an officer may be removed for cause only after a reasonable notice and opportunity to be heard before the Board. All officers elected by the Board may be removed at any time without cause by vote of a majority of the directors then in office. Vacancies in any office, however occurring, may be filled by the directors.

The powers granted by the bylaws to any officer or officers of the Company shall be in addition to and not in limitation of any authority granted by vote of the directors.

Blue Cross and Blue Shield of Massachusetts, Inc.

The elected officers and their respective titles at December 31, 2012 were as follows:

<u>Name of Officer</u>	<u>Elected Position</u>
Andrew C. Dreyfus	President, Chief Executive Officer
William C. Van Faäsen	Chair
Gloria C. Larson	Vice Chair
Paul Guzzi	Vice Chair
Bruce M. Bullen	Executive Vice President, Chief Operating Officer
Allen P. Maltz ¹	Executive Vice President, Chief Financial Officer and Treasurer
Stephanie S. Lovell ^{2, 3, 4}	Senior Vice President, General Counsel, Secretary
Andreana Shanley	Senior Vice President, Chief Actuary
Keith Renaldi	Senior Vice President, Assistant Treasurer
William T. Cushing, Jr.	Senior Vice President, Chief Audit Executive
Alona Albalos	Vice President, Assistant Secretary

¹ – Keith Renaldi was named Treasurer at the March 2013 meeting

² – Sandra Jesse resigned her position of Executive Vice President, Chief Legal Counsel as of July 2011.

³ – Fredi Shonkoff resigned as the Senior Vice President and Secretary July 2012.

⁴ – Stephanie Lovell was elected Senior Vice President, General Counsel, and Assistant Secretary in December 2011. S. Lovell became Secretary as of June 2012.

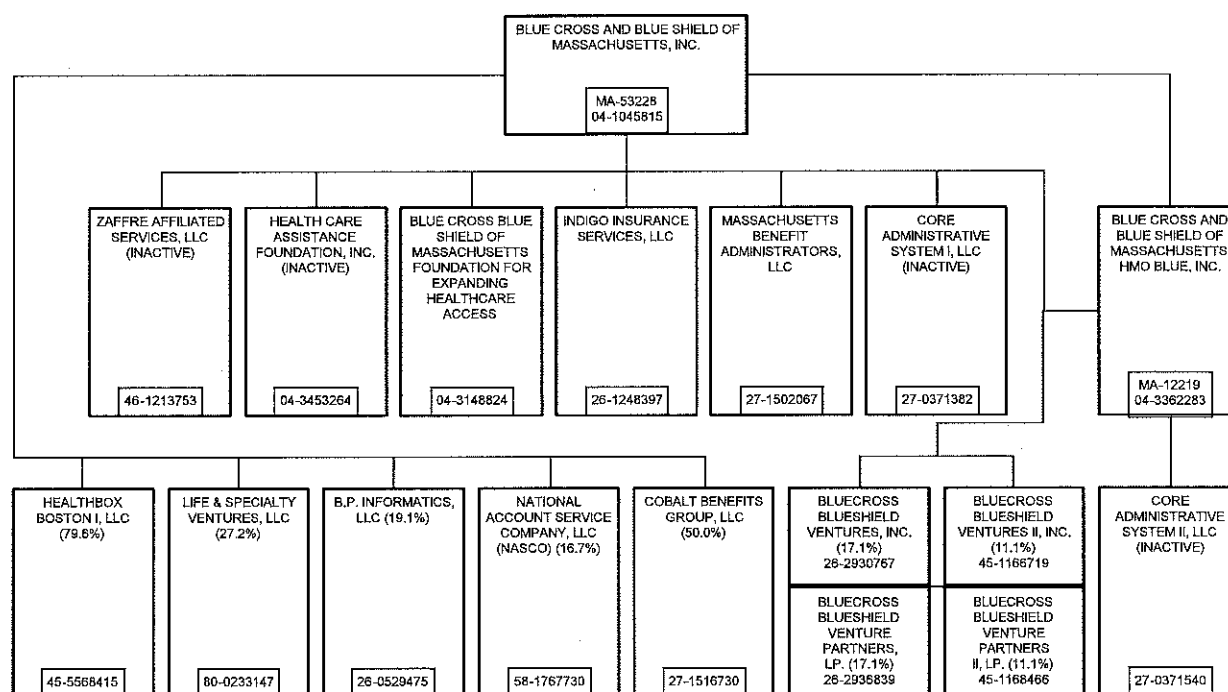
Affiliated Companies

BCBSMA has five subsidiaries and seven affiliated companies. Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue”) is a wholly-controlled subsidiary. Indigo Insurance Services, LLC (“Indigo”), Core Administrative Systems I, LLC (“CAST”), Massachusetts Benefit Administrators, LLC (“MBA”) and Zaffre Affiliated Services, LLC (“Zaffre”) are the wholly-owned limited liability company subsidiaries.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

BCBSMA and HMO Blue operate under common Board management and control. The Company participates in a bilateral intercompany agreement with HMO Blue 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 were 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 set up for payroll and payroll related benefits. An agency arrangement has been established for

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payment of claims and operating expenses and receipt of funds.

The Companies' pension and post-retirement plans ("Benefit 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.

Because of the significant related-party transactions with HMO Blue, the Company's financial condition and the results of operations may not necessarily be indicative of the financial condition or results of operations that would have occurred if the Company had been operated as an unaffiliated company.

The Company is the sole corporate member of two Foundations: Blue Cross Blue Shield of Massachusetts Foundation, Inc. ("BCBSF") and Health Care Assistance Foundation ("HCAF"). The mission of BCBSF is to promote and support programs, research and policies that will help to expand access to high quality, affordable health care for Massachusetts residents. BCBSMA provided substantial support to BCBSF in the amount of \$3,850,000; \$3,498,000; and \$1,090,000 in 2012, 2011 and 2010, respectively. Since 2005, HCAF is an inactive entity.

Massachusetts Benefit Administrators, LLC ("MBA") is a wholly-owned subsidiary of BCBSMA organized under M.G.L. section 156C as a limited liability company. MBA markets and sells third-party employee benefit administration services. As required by the Blue Cross Blue Shield Controlled Affiliate License, BCBSMA guarantees, to the full extent of its assets, all of the contractual and financial obligations of MBA.

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 Company pursuant to such agreement.

During 2011, the 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, and became inactive.

The Company has 19.1% interest ownership in B.P. Informatics, LLC ("BPI") which was formed by BCBSMA and Blue Cross and Blue Shield Plans from Arkansas, Florida, and North Carolina. Health Care Services Corporation and Highmark, Inc. joined BPI later. BPI operates to address the need for greater transparency in health care cost and quality.

The Company also has 27.5% ownership interest in Life and Specialty Ventures, LLC ("LSV"), an insurance holding company. LSV is a joint venture between Blue Cross and Blue Shield plans of Massachusetts, Arkansas, Florida, Hawaii, and Tennessee, created to offer a broad range of insurance

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products and services to individuals and groups nationwide.

In 2008, BCBSMA and HMO Blue each committed to invest \$10,000,000 in BlueCross BlueShield Ventures, Inc. (“General Partnership”) and BlueCross BlueShield Venture Partners, L.P. (“Limited Partnership”), in the form of the purchase of 20 Class A shares of the General Partnership and a 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. At 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, BCBSMA and HMO Blue each committed to invest \$10,000,000 in BlueCross BlueShield Ventures II, Inc. (“General Partnership 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 an 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 BlueShield Venture II. At December 31, 2012, the Company had an outstanding contingent commitment for additional funding of \$8,101,000 related to the future equity contributions in the Partnership II.

For the purpose of administering third-party administration business BCBSMA executed a Joint Ownership Agreement with Blue Cross Blue Shield of Vermont (“BCBSVT”) whereby BCBSVT and BCBSMA jointly own and operate a new entity, Cobalt Benefits Group, LLC (“Cobalt”). BCBSMA has a 50.0% ownership interest in Cobalt. Cobalt is the third party administrator to process self-insured business benefits for MBA.

In August 2012, BCBSMA contributed \$1,365,000 in exchange for 79.6% interest in a newly created limited liability company named Healthbox Boston I, LLC (“Healthbox Boston”). Healthbox Boston is managed by Chicago-based Sandbox Industries. Healthbox is a 12-week healthcare business accelerator program which provided funding to ten healthcare technology start-ups and entrepreneurs in 2012.

As of December 31, 2012, December 31, 2011, and December 31, 2010 the BCBSMA intercompany balances with HMO Blue, BCBSF, Indigo, and MBA were as follows, (000’s):

	RECEIVABLES			PAYABLES		
	2012	2011	2010	2012	2011	2010
HMO Blue	\$25,020	-	\$1,110	-	\$12,797	-
BCBSF	-	-	968	4,083	2,135	-
Indigo	314	238	156	-	-	-
MBA	78	54	16	-	-	-
CASI			10			
Totals	\$25,412	\$292	\$2,260	\$4,083	\$14,932	-

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

All employees who have completed twelve months of employment are eligible to participate in the Retirement Income Trust Plan ("RIT"), which grants benefits to retired employees at various levels based on age and years of service. The Company also participates in two noncontributory retirement plans for eligible employees, and sponsors a defined benefit plan covering medical, life and dental benefits.

Accumulated benefit obligations for fully and partially vested participants in the RIT were \$707,445,000; \$589,036,000; and \$504,894,000 at December 31, 2012, 2011, and 2010, respectively. Fair value of the plan assets for the RIT was \$573,332,000; \$486,330,000; and \$488,483,000 at December 31, 2012, 2011, and 2010, respectively. The net periodic benefit cost for 2012, 2011, and 2010 was \$36,421,000; \$28,789,000; and \$29,955,000 for the RIT and \$12,271,000; \$11,499,000; and \$11,956,000 for the post-retirement benefits plan, respectively.

A minimum pension liability is required when the actuarial present value of accumulated plan benefits exceeds plan assets and accrued pension liabilities. The minimum pension liability adjustment, net of tax benefit, is reported as a change in surplus. The Company reported a pension liability adjustment of \$101,710,000, \$77,982,000 and \$9,547,000 in the years ended December 31, 2012, 2011, and 2010, respectively.

During 2012, the NAIC adopted SSAP No. 92, *Accounting for Postretirement Benefits Other Than Pensions*, A Replacement of SSAP No. 14 and SSAP No. 102, *Accounting for Pensions*, A Replacement of SSAP No. 89. Both of these standards require significant changes to the accounting and disclosure of pension and postretirement benefits. Most notably, the standards require reporting entities to recognize a liability equal to the unfunded projected benefit obligation over a period not to exceed ten years. The effective date of SSAP No. 92 and SSAP No. 102 is January 1, 2013. The estimated impact of adoption is a reduction in surplus of \$59,740,000 and \$36,160,000 for SSAP No. 92 and SSAP No. 102, respectively.

Defined Contribution Plan

Employees of the Company are covered by a qualified defined contribution pension plan sponsored by the Company. BCBSMA also has a savings 401(k) plan for eligible employees. Under the employee savings plan, BCBSMA contributes an amount equal to 100% of employee contributions,

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up to a maximum of 4% of each employee's compensation, subject to pretax Internal Revenue Service limits. The Company's contribution for the 401(k) plan was \$5,390,000; \$6,090,000; and \$5,738,000 for 2012, 2011, and 2010, respectively. At December 31, 2012, 2011, and 2010, the fair market value of 401(k) plan assets was \$383,289,000; \$335,541,000; and \$329,660,000; respectively.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact business in the Commonwealth of Massachusetts. Blue Cross and Blue Shield of Massachusetts, Inc. is headquartered in Boston, MA. As of December 31, 2012, BCBSMA'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. Receivables and earned income for such premiums are recorded during the coverage period. Unearned portions of premiums received for future coverage periods are reported on the balance sheet as advanced premium. Health premiums are earned ratably over the terms of the related insurance and reinsurance contracts or policies. Expenses incurred in connection with acquiring new insurance business, including acquisition costs such as sales commissions, are charged to operations as incurred.

The liability for medical claims payable includes claims received and in process. Claim processing expenses for unpaid claims, including claims incurred but not yet received and claims received but not yet paid, are accrued based on estimated expenses necessary to process such claims. The provision for claims incurred but not yet received, is actuarially determined based on historical claims payment experience and other statistics. The methods used to develop the reserves for claims incurred but not yet received are subject to continuing review and refinement and any necessary adjustments are recorded in operations in the year which they are determined to be necessary.

The Company contracts with various health care providers to provide certain medical services to its members. Compensation arrangements include fee-for-service, capitation payments, institutional per diem payments, institutional Diagnosis-related group payments based on percentage of predetermined fees or charges, and special incentive deals. As part of an incentive program, the Company accrues a portion of participating physicians' payments at risk sharing funds. At year-end, the variance between estimated and actual medical expense is calculated. Physician incentive and percentage of surplus are distributed if the variance is favorable. In the event of an unfavorable variance, such providers bear risk to the extent of incentive funds. Recently, the Company developed and implemented a new provider contract model: the Alternative Quality Contract ("AQC"). The AQC combines a per-patient global budget with significant performance incentives based on quality measures. Medical expenses include all amounts incurred by the Company under the aforementioned contracts.

GROWTH OF COMPANY

The growth of the Company for the years 2010 through 2012 is shown in the following schedule, which was prepared from the Company's annual statements:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Net Premium Income</u>
2010	\$1,672,806,423	\$940,102,556	\$732,703,867	\$2,338,365,090
2011	1,874,684,157	1,163,504,134	711,180,023	2,392,806,171
2012	2,018,365,907	1,277,556,958	740,808,949	2,458,863,743

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. 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 BCBSMA business pays fairly quickly, the range of estimates for the December 31, 2012 UCL is narrow and the actuarial estimates are similar to BCBSMA's estimates with hindsight through June 30, 2013.

BCBSMA made a separate provision for Claim Adjustment Expenses ("LAE/CAE") in 2012 and the resulting expense percentage levels used are within industry norms. 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

On January 1, 2005, BCBSMA transferred the operations of its health maintenance organization (“HMO”) 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 (3) that 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.

For federal income tax purposes, the Company is treated as a stock property and casualty insurance company subject to special provisions of the Internal Revenue Code applicable to Blue Cross and Blue Shield organizations. Accordingly, the Company is subject to Alternative Minimum Tax provisions, thereby the Company’s income is taxed at a rate of 20%. The Company is exempt from Massachusetts state income taxes.

Under the asset and liability method, the Company provides for deferred taxes for the estimated future tax effects attributable to future taxable or deductible temporary differences between amounts recognized in its financial statements and income tax returns. These items primarily represent depreciation and amortization, post-retirement benefits, certain accrued liabilities, accrued pension costs and discounting of unpaid claims liabilities and expenses.

BCBSMA’s December 31, 2012 provisions and roll forwards for federal income taxes were reviewed by KPMG. Based upon the assumptions and assertions by Company management, the tax provisions for income tax and current and deferred tax balances appear reasonable.

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.

REINSURANCE

BCBSMA has a dental reinsurance agreement with USABLE Life, Inc (“USABLE Life”), a 100% owned insurance subsidiary of LSV. The proportional dental reinsurance contract between BCBSMA (“reinsured”) and USABLE Life (“reinsurer”) transferred 51% of dental insurance risk to USABLE Life on and after the effective date of January 1, 2008. The difference between the amount arrived at by subtracting the aggregate value of claims incurred plus the ceded commission from the reinsurance premiums, is invoiced monthly and settled between the parties within 45 days.

Blue Cross and Blue Shield of Massachusetts, Inc.

BCBSMA has a Specific Excess of Loss Reinsurance agreement with Munich RE Company. This ceding reinsurance agreement provides the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. Both reinsurance agreements cannot be unilaterally cancelled except for nonpayment of premiums. Premiums earned and healthcare benefits incurred have been reduced for premiums ceded of \$106,421,000; \$101,245,000; and \$93,741,000 and healthcare benefits ceded of \$89,236,000; \$85,738,000; and \$78,724,000 in 2012, 2011 and 2010, respectively.

Neither BCBSMA nor any of its related parties control, directly or indirectly, any reinsurers with whom the Company conducts business. No policies issued by BCBSMA have been reinsured with a foreign company, which is controlled, either directly or indirectly, by a party not primarily engaged in the business of insurance. BCBSMA does not have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel the agreement. At December 31, 2012, there are no reinsurance agreements in effect such that the amount of losses paid or accrued exceed the total direct premium collected.

The net amount of increase in surplus if all reinsurance agreements were cancelled would be \$11,603,000; \$10,423,000; and \$10,070,000 as of December 31, 2012, 2011 and 2010, respectively. In 2012, BCBSMA entered into a Specific and Aggregate Excess of Loss Reinsurance agreement with Gerber Life Insurance Company and American Fidelity Assurance Company. This assumed reinsurance agreement provides the Company with the ability to expand into the National Stop Loss market. There were no material transactions related to assumed stop loss reinsurance in 2012.

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 differences 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 are audited annually by Ernst & Young LLP, independent certified public accountants, in accordance with 211 CMR Section 26.00.

Blue Cross and Blue Shield of Massachusetts, Inc.

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, Inc.
Statement of Assets, Liabilities, Surplus, and Other Funds
As of December 31, 2012

Assets	As Reported by the Company	Examination Changes	Per Statutory Examination
Bonds	\$ 621,529,246	\$ 0	\$ 621,529,246
Stocks:			
Preferred stocks	750,000		750,000
Common stocks	330,905,113		330,905,113
Real estate occupied by the company	114,630,131		114,630,131
Cash, cash equivalents and short-term investments	84,398,625		84,398,625
Other invested assets	449,062,176		449,062,176
Receivable for securities	11,997,201		11,997,201
Subtotals, cash and invested assets	1,613,272,492	0	1,613,272,492
Investment income due and accrued	3,442,026		3,442,026
Premiums and considerations:			
Uncollected premiums and agents' balances			
in the course of collection	151,815,291		151,815,291
Amounts recoverable from reinsurers	6,215,928		6,215,928
Amounts receivable relating to uninsured plans	104,416,078		104,416,078
Current federal and foreign income tax			
recoverable and interest thereon	1,508,692		1,508,692
Net deferred tax asset	36,754,672		36,754,672
Electronic data processing equipment and software	5,351,702		5,351,702
Receivables from parent, subsidiaries and affiliates	25,412,332		25,412,332
Health care and other amounts receivable	31,501,593		31,501,593
Other than invested assets	38,675,101		38,675,101
Total Assets	<u>\$ 2,018,365,907</u>	<u>\$ 0</u>	<u>\$ 2,018,365,907</u>

Blue Cross and Blue Shield of Massachusetts, 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
Liabilities			
Claims unpaid	\$ 225,651,221	\$ 0	\$ 225,651,221
Unpaid claims adjustment expenses	4,824,689		4,824,689
Aggregate health policy reserves	132,657,314		132,657,314
Premiums received in advance	70,734,600		70,734,600
General expenses due or accrued	326,929,009		326,929,009
Ceded reinsurance premiums payable	9,264,991		9,264,991
Amounts withheld or retained for the account of others	122,748		122,748
Borrowed money and interest thereon	639		639
Amounts due to parent, subsidiaries and affiliates	4,082,652		4,082,652
Payable for securities	17,418,717		17,418,717
Liability for amounts held under uninsured accident and health plans	447,693,277		447,693,277
Other liabilities	38,177,101		38,177,101
Total Liabilities	<u>1,277,556,958</u>	<u>0</u>	<u>1,277,556,958</u>
Capital and surplus:			
Unassigned funds (surplus)	<u>740,808,949</u>		<u>740,808,949</u>
Total capital and surplus	<u>740,808,949</u>	<u>0</u>	<u>740,808,949</u>
Total Liabilities, Surplus, and Other Funds	<u>\$ 2,018,365,907</u>	<u>\$ 0</u>	<u>\$ 2,018,365,907</u>

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

	As Reported by the Company	Examination Changes	Per Statutory Examination
Premiums Earned	\$ 2,458,863,743	\$ 0	\$2,458,863,743
Change in unearned premium reserves and reserve for rate credits	(57,300,337)		(57,300,337)
Total revenues	2,401,563,406		2,401,563,406
Hospital and Medical:			
Hospital/medical benefits	1,578,612,895		1,578,612,895
Other professional services	243,362,077		243,362,077
Emergency room and out-of-area	39,289,065		39,289,065
Prescription drugs	364,116,531		364,116,531
Subtotal	2,225,380,568		2,225,380,568
Less: Net reinsurance recoveries	88,267,097		88,267,097
Total hospital and medical	2,137,113,471		2,137,113,471
Claims adjustment expenses	151,475,941		151,475,941
General administrative expenses	113,638,206		113,638,206
Total underwriting deductions	2,402,227,618		2,402,227,618
Net underwriting loss	(664,212)		(664,212)
Net investment income earned	32,620,657		32,620,657
Net realized capital losses	12,430,057		12,430,057
Net investment gain	45,050,714		45,050,714
Other income	1,291,400		1,291,400
Net gain after capital gains tax and before all other federal income taxes	45,677,902		45,677,902
Federal and foreign income taxes incurred	(412,795)		(412,795)
Net Income	\$ 46,090,697	\$ 0	\$ 46,090,697

Blue Cross and Blue Shield of Massachusetts, 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	\$ 711,180,023	\$ 0	\$ 711,180,023
Net income	46,090,697		46,090,697
Change in net unrealized capital gains	27,934,243		27,934,243
Change in net deferred income tax	(361,733,913)		(361,733,913)
Change in nonadmitted assets	322,916,037		322,916,037
Cumulative effect of changes in accounting principles	10,355,627		10,355,627
Aggregate write-ins for (losses) in surplus	(15,933,765)		(15,933,765)
Net change in capital and surplus	<u>29,628,926</u>	<u>0</u>	<u>29,628,926</u>
Capital and Surplus, December 31, current year	<u><u>\$ 740,808,949</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 740,808,949</u></u>

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

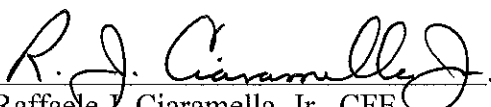
	2010	2011	2012
Capital and Surplus, December 31, prior year	\$ 723,895,603	\$ 732,703,867	\$ 711,180,023
Net income	5,450,415	16,555,727	46,090,697
Change in net unrealized capital gains	26,750,823	53,201,863	27,934,243
Change in net deferred income tax	17,990,951	(1,767,246)	(361,733,913)
Change in nonadmitted assets and related items	(40,495,526)	(44,520,712)	322,916,037
Change in surplus as a result of other write-ins	(888,399)	(44,993,476)	(15,933,765)
Cumulative effect of changes in accounting principles			10,355,627
Net change in capital and surplus for the year	8,808,264	(21,523,844)	29,628,926
Capital and Surplus, December 31, current year	<u>\$ 732,703,867</u>	<u>\$ 711,180,023</u>	<u>\$ 740,808,949</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


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