

**THE 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, 2009**

**NAIC GROUP CODE 3637**

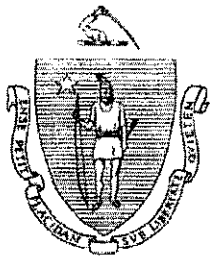
**NAIC COMPANY CODE 53228**

**EMPLOYER'S ID NO. 04-1045815**

# BLUE CROSS and BLUE SHIELD OF MASSACHUSETTS, INC.

## TABLE OF CONTENTS

Salutation	1
Scope of Examination	2
Status of Prior Examination Findings	2
History	
General	
Capital and Surplus	4
Territory and Plan of Operation	4
Products	4
Provider Contracts	5
Reserves	5
Reinsurance	6
Income Taxes	6
Management and Control	7
Articles of Organization and By-laws	7
Members and Membership	7
Board of Directors	7
Committees of the Board	9
Officers	10
Conflict of Interest Procedures	11
Corporate Records	11
Corporate Governance	11
Affiliated Companies	12
Organization Chart	12
Related Party Transactions	13
Fidelity Bond and Other Insurance	15
Commitments and Contingencies	15
Lease Obligations	16
Pension and Other Post Retirement Benefit Plans	16
Legal Proceedings	17
Accounts and Records	17
Financial Statements	18
Statement of Assets, Liabilities and Capital & Surplus	19
Statement of Revenue and Expenses	20
Capital & Surplus	21
Statement of Changes in Capital & Surplus	22
Acknowledgement	23



**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 • Fax (617) 521-7771  
TTY/TDD (617) 521-7490  
<http://www.mass.gov/doi>

**DEVAL L. PATRICK**  
GOVERNOR

**TIMOTHY P. MURRAY**  
LIEUTENANT 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 27, 2011

The Honorable Joseph Torti, III, Chairman  
Financial Condition (E) Committee, NAIC  
Deputy Director and Superintendent of  
Insurance and Banking  
Division of Insurance  
Department of Business Regulation  
State of Rhode Island  
1511 Pontiac Avenue, Bldg #69-2  
Cranston, Rhode Island 02920-4407

The Honorable Mila K. Smith, Secretary  
Northeastern Zone, NAIC  
Superintendent of Insurance  
Department of Professional & Financial  
Regulation  
Maine Bureau of Insurance  
4 State House Station  
Augusta, Maine 04333-0034

The Honorable Joseph G. Murphy  
Commissioner of Insurance  
Commonwealth of Massachusetts  
Office of Consumer Affairs and Business  
Regulation  
Division of Insurance  
1000 Washington Street, Suite 810  
Boston, MA 02118-6200

Honorable Commissioner Murphy and Superintendents Torti and Kofman:

Pursuant to your instructions and in accordance with Massachusetts General Laws, 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**

This statutory examination of Blue Cross and Blue Shield of Massachusetts, Inc., hereinafter referred to as "the Company," "the Corporation," "BCBSMA," or "the Plan," is as of December 31, 2009, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

The current examination was conducted at the direction of and under the overall management and control of the examination staff of the Massachusetts Division of Insurance (the "Division") in accordance with standards established by the NAIC Financial Condition (E) Committee as well as with the requirements of the *NAIC Financial Condition Examiners' Handbook*, the examination standards of the Division and with Massachusetts General Laws ("M.G.L."). Representatives from the firm of KPMG LLP ("KPMG") were engaged by the Division to assist in the examination by performing certain examination procedures at the direction of 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 adjustments expense reserves.

The principal focus of the examination was 2009 activity; however, transactions both prior and subsequent thereto were reviewed as deemed appropriate. The examination was conducted following the NAIC Risk Focused Examination Model.

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, provider contracts, reinsurance treaties, conflict of interest disclosure statements, fidelity bonds and other insurance, employees' pension and benefits plans, disaster recovery plan, 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.

In determining the scope of the statutory examination, after review and evaluation, the examination team placed reliance on certain work papers provided by the Company's independent auditor, Ernst & Young LLP ("E&Y"). Wherever possible and wherever deemed appropriate and effective, E&Y's independent work product was used to define, support, document and expedite the overall examination process.

### **Status of Prior Examination Findings**

The prior report of examination did not have any findings.

## 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 – in line with the original charter.

The Company is also the sole corporate member of The Health Care Assistance Foundation (HCAF). HCAF's mission is to promote the care of the elderly, disabled, and other persons who are experiencing financial hardship and to provide limited financial assistance for their care.

In 2003, BCBSF created the Massachusetts Medicaid Policy Institute (MMPI). MMPI is an independent and nonpartisan source for information and analysis of the Massachusetts Medicaid Program (often referred to as "MassHealth") and seeks to promote a broader understanding of the MassHealth program.

In January 2005, pursuant to a Master Reorganization Agreement (MRA), BCBSMA transferred its insured health maintenance organization line of business (with the exception of Blue Care 65, which was transferred on April 1, 2005) to Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (HMO Blue), a separately incorporated, and a wholly-owned subsidiary of BCBSMA. Since January 1, 2005, HMO Blue has provided hospitalization, medical and other health benefits as a licensed health maintenance organization. HMO Blue operates as a nonprofit, charitable organization and qualifies as a tax-exempt social welfare organization under Section 501 (c) (4) of the Internal Revenue Code.

Blue Cross and Blue Shield of Massachusetts, Inc.

**Capital and Surplus**

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 and capital and surplus of the Company for the years ended 2007 through 2009 are shown in the following schedule:

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Capital and Surplus</u>
2007	\$1,848,962,248	\$1,143,214,354	\$705,747,894
2008	1,841,061,426	1,226,894,335	614,167,091
2009	1,576,768,624	852,873,021	723,895,603

**TERRITORY AND PLAN OF OPERATION**

The Corporation 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, 2009, BCBSMA's service area included all of Massachusetts with a focus on the greater metropolitan Boston area.

**PRODUCTS**

The Company offers the following insured products:

- **Blue Care Elect** — Blue Care Elect is a 'non-gatekeeper' type preferred provider organization (PPO) that includes two levels of benefits—a higher level of benefits for health care services furnished by preferred providers and a lower level of benefits for health services furnished by non-preferred providers. Blue Care Elect is subject to Massachusetts General Laws, Chapters 176L.
- **Indemnity Plans** — Indemnity plans are "traditional" plan options that provide full or partial compensation for hospital and/or physician and other professional health services. These plans, which are approved under Massachusetts General Laws, Chapters 176A and 176B, include the Blue Cross and Blue Shield Plan.
- **Point-of-Service Plans** — Point-of-service (dual certificate) plans are comprised of two separate health benefit plans: an HMO plan and an indemnity plan. The "in-network" portion is an HMO Blue plan offered by Blue Cross and Blue Shield of Massachusetts HMO Blue Inc. that is licensed under Massachusetts General Laws, Chapter 176G. The "out-of-network" portion is an indemnity plan approved under Massachusetts General Laws, Chapters 176A and 176B. These plans include Blue Choice, Blue Choice New England and Access Blue Plus.

Blue Cross and Blue Shield of Massachusetts, Inc.

- **Nongroup Guaranteed Issue Preferred Provider Plans** — PPO Blue Direct and PPO Basic Blue Direct are nongroup guaranteed issue preferred provider plans in accordance with Massachusetts General Laws, Chapter 176M. (These plans were closed to new membership effective July 1, 2007.)
- **Medex Plans** — Medex plans are Medigap insurance programs that supplement benefits available under the Medicare Program (Part A and Part B only). Group Medex plans include Medex 3, Medex Silver and Medex Core. Direct-Billed Medex plans are offered to nongroup individuals and include Direct-Billed Medex Bronze and Direct-Billed Medex Core.
- **Medicare Prescription Drug Plans** — Medicare Prescription Drug Plans are Medicare Part D prescription plans. These plans include Blue Medicare RX Direct and Blue Medicare RX Group.
- **Dental Plans** — Dental plans are group insurance plans that provide full or partial compensation for dental care services. These plans include Dental Blue and Dental Blue PPO. These dental plans may include coverage for preventive, restorative, prosthodontic (tooth replacement), major restorative (crowns, inlays and onlays) and orthodontic services.

**PROVIDER CONTRACT**

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 and 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 § 52.

**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, 2009 and prior periods. For December 31, 2009, 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, 2009 UCL is narrow and the actuarial estimates are similar to BCBSMA's estimates with hindsight through September 30, 2010.

BCBSMA made a separate provision for Claim Adjustment Expenses (LAE/CAE) in 2009 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, 2009.



## REINSURANCE

In January 2008, the Company entered into a dental reinsurance and administrative services transfer agreement with US Able Life, Inc ("US Able Life"), a wholly-owned insurance subsidiary of Life and Specialty Ventures, LLC ("LSV"). The proportional share dental reinsurance agreement between BCBSMA (reinsured) and US Able Life (reinsurer) transfers 51% of dental insurance risk to US Able Life effective 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. The settlement amount for US Able Life was \$1,011,000 and \$755,000 at December 31, 2009 and 2008, respectively.

The Company has a reinsurance agreement with HM Life Insurance Company ("HM Life") in connection with the Federal Employee Vision Program to cede 100% of the risk to HM Life. The Company has a Specific Excess of Loss Reinsurance agreement with AC American Insurance Company to provide the Company with increased capacity to write large risks and maintain its exposure to loss within its capital resources. All three reinsurance agreements cannot be unilaterally cancelled except for nonpayment of premiums.

## INCOME TAXES

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 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.

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, whereby 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, 2009 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.



**MANAGEMENT AND CONTROL**

**Articles of Organization and By-Laws**

The name and purposes of the Corporation are set forth in the Articles of Organization. The Corporate By-Laws, the powers of the Corporation and of its members, directors and officers, and all matters concerning the conduct and regulation of the affairs of the Corporation are subject to the Articles of Organization.

**Members and Membership**

The Company's By-Laws indicate the following regarding its corporate membership:

**Members** – In accordance with the Company's By-Laws, 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 Directors 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 of Directors. Members and Directors of the Corporation shall be elected in accordance with Section 2 of Article II (Directors) of the Corporate By-Laws.

**Board of Directors**

The By-Laws 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 By-Laws, specify that the Directors are to hold an annual meeting for 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, 2009, the Board was comprised of eighteen (18) directors, which was in compliance with the Company By-Laws. Directors duly elected and serving at December 31, 2009, and business affiliations, are as follows:

<u>Director</u>	<u>Principal Occupation</u>	<u>Tenure</u>
George R. Alcott III	President, Local 1301 Communication Workers of America	4 years
Mara G. Aspinall	CEO, On-Q-ity, Inc.	2 years
Brian M. Barefoot	President Emeritus, Babson College	6 years
Samuel Cabot III	Chairman, Samuel Cabot, Inc.	10 years
Helen G. Drinan	President, Simmons College,	15 years
Richard C. Garrison	President, Bink, Inc.	9 years
Paul Guzzi	President and CEO, Greater Boston Chamber of Commerce	9 years
Robert J. Haynes	President, Massachusetts AFL-CIO	19 years
Marian L. Heard	President and CEO, Oxen Hill Partners	18 years
Philip W. Johnston	President, Philip W. Johnston Associates	12 years
Cleve L. Killingsworth, Jr. <sup>1</sup>	Chairman, President and CEO, Blue Cross and Blue Shield of Massachusetts	5 years
Karen E. Kruck	Partner, Walker Lane Capital	2 years
Gloria Cordes Larson	President, Bentley University	4 years
William G. Lavelle, M.D.	Professor and Chairman, Department of Otolaryngology, University of Massachusetts Medical School	18 years
James H. Lunt	President and CEO, Rogers, Lunt & Bowlen Company	16 years
Ralph C. Martin II	Partner, Bingham McCutchen LLP	8 years
Robert F. Meenan, M.D.	Dean, Boston University School of Public Health	6 years
Benaree Wiley	Principal, The Wiley Group	6 years

<sup>1</sup> - Mr. Killingsworth resigned from the Company effective March 16, 2010. Paul Guzzi was elected Chair of the Board as of March 4, 2010.

## Committees of the Board

The Board may delegate such of its powers as it considers advisable, except those powers which by law, the Articles of Organization, or the By-Laws may not be so delegated, to such committees as the Board or the By-Laws 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 of Directors 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 financial 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 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 CEO 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 Delivery and Quality Committee** – The Health Care Delivery and Quality Committee provides assistance to the Board of Directors in its oversight responsibility for service to BCBSMA's members and coordinating the quality of health care delivery with providers. The Health Care Delivery and Quality 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

The Corporate By-Laws require that the Corporation has as its officers a Chair of the Board, one or more Vice Chairs of the Board, a 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 Secretary, a Treasurer, one or more Assistant Secretaries, and one or more Assistant Treasurers. The Chair and each Vice Chair of the Board must also be Directors.

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 By-Laws to any officer or officers of the Corporation shall be in addition to and not in limitation of any authority granted by vote of the Directors.

The Chair of the Board and each officer of the Corporation who is elected or appointed pursuant to the By-Laws must be annually sworn and their oaths entered on record in the books of the Corporation. The Secretary, the Treasurer, each Assistant Secretary and each Assistant Treasurer are covered by an existing Fidelity Bond. The elected officers and their respective titles at December 31, 2009 were as follows:

<u>Officer</u>	<u>Elected Title</u>
Cleve L. Killingsworth, Jr. <sup>1</sup>	Chairman, President and Chief Executive Officer
Gloria Larson <sup>2</sup>	Vice Chair and Lead Director
Allen P. Maltz	Chief Financial Officer and Treasurer
Sandra L. Jesse	Executive Vice President, Chief Legal Officer and Assistant Secretary
Fredi Shorrock	Senior Vice President and Secretary
Keith Gendall	Senior Vice President and Assistant Treasurer
William T. Cushing, Jr.	Senior Vice President and Chief Audit Executive
Rita Vertes <sup>3</sup>	Senior Vice President and Chief Actuary

<sup>1</sup> – Mr. Killingsworth resigned from the Company effective March 16, 2010. Paul Guzzi was elected Chair of the Board as of March 4, 2010. William Van Faasen, BCBSMA's retired President and CEO, returned to serve as President and CEO on an interim basis from March 16, 2010 through September 7, 2010. Andrew Dreyfus, the Company's Executive Vice President of Health Care Services was selected as the President and CEO on September 7, 2010.

<sup>2</sup> – Ms. Larson's position as Vice Chair and Lead Director was changed to simply Vice Chair when the role of Lead Director was eliminated. This occurred on March 4, 2010 when the roles of the Chair and CEO were formally separated and Paul Guzzi was elected as Chair of the Board.

<sup>3</sup> – Ms. Vertes was replaced as the Chief Actuary by Allen Maltz who assumed the position of Interim Chief Actuary on December 14, 2010.

## **Conflict of Interest Procedures**

The Company has adopted a conflict of interest policy 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 which is in or is likely to conflict with his/her official duties.

Each Director of the Board shall annually deliver to the Board, at or about the time of the Annual Meeting, a true and complete conflicts of interest statement (a "Conflicts Statement") in the form approved by the Board; provided that each person described above shall deliver only one Conflicts Statement regardless of the number of positions listed above that he or she holds. Each Director shall promptly update his or her most recent Conflicts Statement upon the occurrence of an event that makes the information contained in such Conflicts Statement no longer true or that would be required to be reported in such Conflicts Statement at the time it is delivered to the Board.

The completed Conflict of Interest Disclosure Statements for Directors, Officers and Senior Managers for 2007, 2008 and 2009 were reviewed. No discrepancies were noted in the response to the General Interrogatories regarding conflicts of interest as reflected in the Company's December 31, 2009 Annual Statement.

## **Corporate Records**

### Articles of Incorporation and By-Laws

A review of the By-Laws indicated that they were amended effective December 14, 1993.

### Board of Directors Minutes

The minutes of the Board and Committee meetings for the period under statutory examination were read and indicated that all meetings were held in accordance with the Company By-Laws and the laws of the Commonwealth of Massachusetts. Activities of the committees were reported upon at various meetings to the Board.

### Management Continuity and National Emergency

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 §§ 180M-180Q.

## **Corporate Governance**

The Company's Board of Directors has significant influence on the entity's control consciousness. The Board, through its own activities and supported by its audit committee, is responsible for overseeing all financial reporting policies and procedures. The Board appears appropriately experienced and qualified as there has not been any significant turnover on the Board since the last Examination.

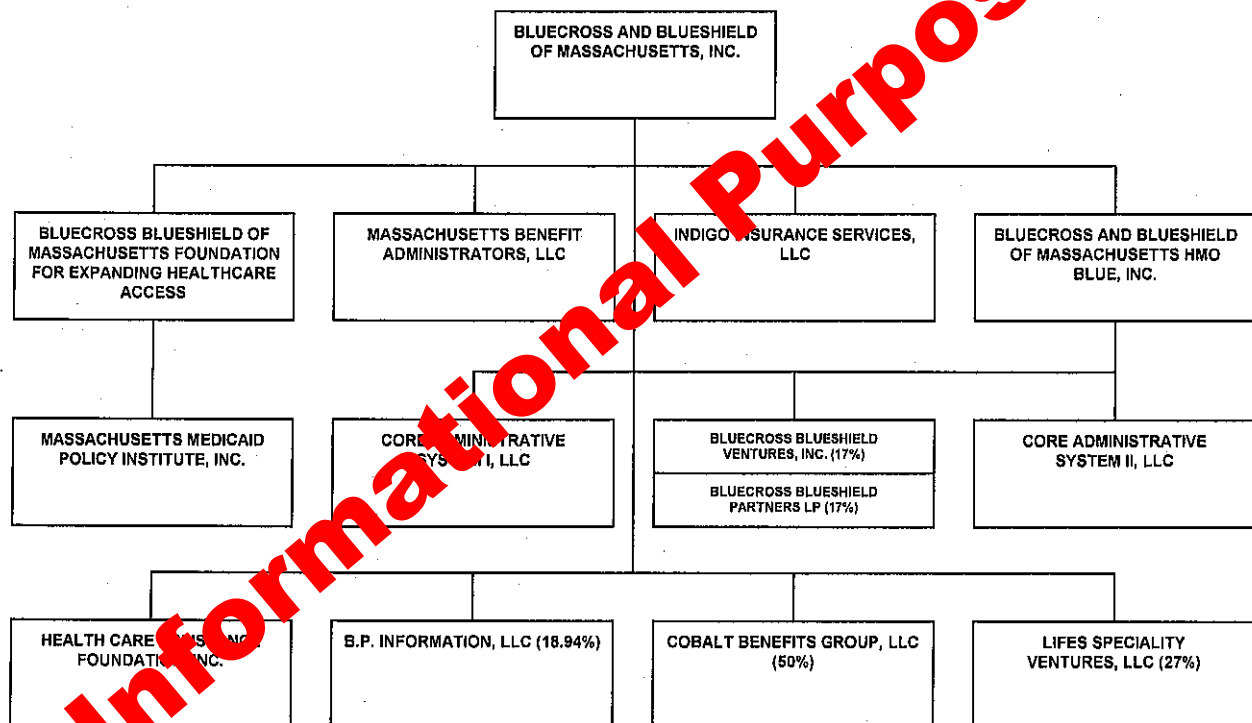
Blue Cross and Blue Shield of Massachusetts, Inc.

During the period under Examination and through completion of examination fieldwork, it appears that the Company's internal audit department objectives and strategies are clear and well-documented. Audits were performed on a regular basis with results communicated to senior management, the respective department heads and external auditors. The Company's external auditors did not identify any deficiencies in internal controls that were considered to be material.

**AFFILIATED COMPANIES**

**Organization Chart**

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2009 is illustrated below:





## Related Party Transactions

BCBSMA and HMO Blue operate under common Board of Directors management and control. The Company participates in a bilateral inter-company agreement with HMO Blue to settle any claims, fees, administrative 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 what had been BCBSMA's 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 (the "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 payment of claims and operating expenses and receipt of funds. The Companies' pension and post-retirement benefits 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.

The Company is the sole corporate member of two Foundations ("Foundations"): Health Care Assistance Foundation, Inc. ("HCAF") and Blue Cross Blue Shield of Massachusetts Foundation, Inc. ("BCBSF") and as such, has a variety of powers, including appointment and approval of board members.

BCBSF is the sole corporate member of the Massachusetts Medicaid Policy Institute, Inc. ("MMPI"), which provides independent research and support on matters related to Medicaid in Massachusetts. BCBSMA provided substantial financial support to BCBSF of \$1,399,000 and \$3,531,000 in 2009 and 2008, respectively.

Indigo Insurance Services, LLC ("Indigo") is a wholly-owned for-profit subsidiary of BCBSMA. The subsidiary acts as an insurance agency and provides BCBSMA with the ability to offer a more comprehensive portfolio of products and services. Those products initially include group and voluntary life insurance, accidental death and dismemberment insurance, as well as group and voluntary short and long-term disability insurance.

BCBSMA has an 18.9% ownership interest in B.P. Informatics, LLC ("BPI"). BPI 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 in 2007 and 2008, respectively. BPI was established to address the need for greater transparency in health care cost and quality.

Blue Cross and Blue Shield of Massachusetts, Inc.

In 2008, the Company acquired a 27% ownership interest in Life and Specialty Ventures, LLC ("LSV"), an insurance holding company. LSV is a joint venture between Blue plans of Massachusetts, Arkansas, Florida, Hawaii, and Tennessee created to offer a broad range of insurance products and services to individuals and groups.

In 2008, BCBSMA and HMO Blue committed to invest \$20,000,000 in BlueCross BlueShield Ventures, Inc. (the "General Partner") and BlueCross BlueShield Venture Partners, L.P. (the "Partnership"), in the form of purchase of 20 Class A shares of the General Partner and a 17% limited interest in the Partnership in accordance with the Assignment and Assumption Agreement. BlueCross BlueShield Ventures 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. BCBSMA has contributed \$1,493,000 and \$1,750,000 in 2009 and 2008, respectively, to the Partnership. At December 31, 2009, the Company had an outstanding contingent commitment for additional funding of \$7,832,000 related to the future equity contributions in the Partnership.

In 2009, BCBSMA and HMO Blue management decided to manage the operation of the Blue Core administrative system ("Blue Core") by maintaining it in separate limited liability corporations named Core Administrative System I, LLC ("CASI") and Core Administrative System II, LLC ("CASII"). Given that Blue Core is jointly owned by BCBSMA and HMO Blue, a new separate wholly-owned and controlled LLC was created for each company. On June 1, 2009, BCBSMA and HMO Blue each transferred its respective share of Blue Core to CASI and CASII in exchange for a 10-year note receivable in the amount of the net book value at the date of transfer. Each note accrues interest at a rate of four percent (4%) per year compounded daily and paid quarterly. On the same date, BCBSMA and HMO Blue each entered into arms-length 10-year service agreements with CASI and CASII, respectively, for access to use of Blue Core, under which both BCBSMA and HMO Blue will make quarterly payments in the amount of \$2,359,000 and \$2,092,000 due to its subsidiaries, respectively. The Company and HMO Blue have each guaranteed the \$30,000,000 indebtedness of CASI and CASII related to the secured loan agreement with Banc of America Leasing & Capital, LLC. As of December 31, 2009, the Companies had a combined liability of \$27,196,000. Both loans will mature on July 31, 2013. Pursuant to the terms of this guarantee, the Companies would be required to perform in the event of a default by CASI and CASII.

On December 31, 2009, 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"), for the purpose of administering third-party administration business. BCBSVT established Cobalt as a limited liability company owned by Comprehensive Benefits Administrator, Inc. ("CBA"), which is a wholly-owned subsidiary of Catamount Insurance Services, Inc. ("CIS"), which is a wholly-owned subsidiary of BCBSVT. Per the terms of the agreement, CBA transferred some of its assets and liabilities to Cobalt, including its ownership interest in Employee Benefit Plan Administration, LLC (a wholly-owned subsidiary of CBA), operational contracts, furniture and equipment, company records and files, goodwill, and employees.

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

Upon completion of this transaction on December 31, 2009, BCBSMA purchased a 50% ownership in Cobalt from CBA for \$5,600,000. In conjunction with the Cobalt purchase transaction, on December 31, 2009, BCBSMA has created a new wholly-owned subsidiary organized under MGL section 156C as a limited liability company named Massachusetts Benefit Administrators, LLC ("MBA"). MBA markets and sells third-party employee benefit administration services.

BCBSMA and HMO Blue have jointly entered into two revolving credit agreements. Borrowings under these lines of credit bear interest on a fixed or floating interest rate basis. The facilities are unsecured and one facility for \$100 million, which matured in June 2010, has been renewed until June 2011 and the second facility matured in October 2010 and has been renewed for \$50 million until June 2011. There are no amounts outstanding under these credit facilities at December 31, 2009.

As of December 31, 2009 the BCBSMA inter-company balances with HMO Blue, CASI, Indigo, BPI and Foundations were as follows (000's):

	Receivables		Payables	
	2009	2008	2009	2008
HMO Blue	\$35,929	\$18,761	\$ 0	\$ 0
CASI	7	-	-	-
Indigo	191	-	-	-
Foundations	319	18	-	2,354
BPI	-	296	-	-
<b>Totals</b>	<b>\$36,446</b>	<b>\$19,105</b>	<b>\$ 0</b>	<b>\$2,354</b>

### FIDELITY BOND AND OTHER INSURANCE

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

In addition to the fidelity insurance, 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, 2009.

### COMMITMENTS AND CONTINGENCIES

As a condition of granting an HMO license to HMO Blue, the Division required the Companies 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 of the company's health risk-based capital ("RBC") is significantly higher than the other company's RBC. Under the terms of its license with Blue Cross and Blue Shield Association, BCBSMA has also entered into a unilateral agreement with HMO Blue to guarantee all current and future financial obligations of HMO Blue.

Blue Cross and Blue Shield of Massachusetts, Inc.

The Company pledges certain of its securities as collateral for a Depository Agreement with the Blue Cross and Blue Shield Association to meet certain licensure standards. Cash and investments of the Company include \$174,708,000 and \$182,972,000 at December 31, 2009 and 2008, respectively, of securities that are pledged.

**LEASE OBLIGATIONS**

The Company and HMO Blue jointly have a long-term operating lease agreement for approximately 500,000 square feet of office space for its corporate headquarters. The term of the lease is 15 years, commencing in May 2000, with an option to extend for one period of four years and eleven months.

The Company and HMO Blue jointly entered into several other long-term, non-cancelable operating lease agreements for office space and equipment. These leases have expired or were extended through various dates in 2010. For the years ended December 31, 2009 and 2008, the Company recorded rental expense of approximately \$12,178,000 and \$12,100,000, respectively.

At December 31, 2009, allocated minimum rental commitments on significant non-cancelable operating leases for the Company are as follows (000's):

2010	\$16,656
2011	15,564
2012	10,293
2013	10,296
2014	8,677
Thereafter	3,564

In addition, the Companies have an agreement with an outside vendor to provide certain information technology ("IT") services for substantially all of the Companies' business operations. The Companies' minimum commitments under this agreement are approximately \$61,161,000 per year.

In 2009, the Companies' management decided to change the IT services provider. As of December 31, 2009, in accordance with Statements of Statutory Accounting Principles (SSAP) No. 5 BCBSMA recorded a \$9,250,000 accrual related to the termination fees of the agreement with its current vendor.

**PENSION AND OTHER POST RETIREMENT BENEFIT PLANS**

All employees 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 \$461.5 million and \$413 million at December 31, 2009 and 2008, respectively. Fair value of the plan assets for the RIT were \$434.6 million and \$341.4 million at December 31, 2009 and 2008, respectively. The net periodic benefit cost for 2009 and 2008 was \$31.9 million and \$8.4 million for the RIT and \$10.5 million and \$10.9 million for the post-retirement benefits plan, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

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 \$22,208,000 and (\$22,693,000) in the years ended December 31, 2009 and 2008, respectively.

BCBSMA also has a savings 401(k) plan for eligible employees. Under the employee savings plan, BCBSMA contributes an amount equal to 65% of employee contributions, up to a maximum of 6% of each employee's compensation, subject to pretax Internal Revenue Service limits. The Company's contribution for the 401(k) plan was \$4.5 million and \$4.3 million for 2009 and 2008, respectively. At December 31, 2009, the fair market value of these plan assets was \$288.9 million for BCBSMA and HMO Blue combined.

### LEGAL PROCEEDINGS

The Company is involved in pending and threatened litigation of the character incidental to its business or arising out of its insurance operations, and is from time to time involved as a party in various governmental and administrative proceedings. Management continues to monitor these matters, and believes the Company has accrued adequate reserves against potential liabilities.

### 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, Ernst & Young LLP in 2009, and including work papers generated to support the requirements of the Sarbanes-Oxley Act of 2002.

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 (ISQ) 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 ISQ. 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 CPA firm'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 2009 Annual Statement. No material exceptions were noted.



## FINANCIAL STATEMENTS

The Financial Statement section includes the following: Page

Statutory Statement of Assets, Liabilities and Capital & Surplus as of December 31, 2009 19

Statement of Revenue and Expenses for the Year Ended December 31, 2009 20

Capital & Surplus for the Year Ended December 31, 2009 21

Statement of Changes in Capital & Surplus for Three Years Ended December 31, 2009 22

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance and by the National Association of Insurance Commissioners as of December 31, 2009.



Blue Cross and Blue Shield of Massachusetts, Inc.

**Blue Cross and Blue Shield of Massachusetts, Inc.**  
**Statutory Statement of Assets, Liabilities and Capital & Surplus**  
**As of December 31, 2009**

	<u>Annual statement</u>	<u>Statutory examination adjustment</u>	<u>Per statutory examination</u>
<b>Assets:</b>			
Bonds	\$ 445,944,004	—	\$ 445,944,004
Stocks:			
Preferred stocks	750,000	—	750,000
Common stocks	128,251,418	—	128,251,418
Real estate:			
Properties occupied by the company	121,350,436	—	121,350,436
Cash, cash equivalents and short-term investments	116,416,175	—	116,416,175
Other invested assets	425,894,522	—	425,894,522
Receivable for securities	2,727,450	—	2,727,450
Subtotals, cash and invested assets	\$ 1,241,334,005		\$ 1,241,334,005
Investment income due and accrued	3,720,385	—	3,720,385
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	56,350,418	—	56,350,418
Amounts recoverable from reinsurers	7,012,567	—	7,012,567
Amounts receivable relating to uninsured plans	157,648,220	—	157,648,220
Current federal and foreign income tax recoverable and interest thereon	1,335,496	—	1,335,496
Net deferred tax asset	14,585,120	—	14,585,120
Electronic data processing equipment and software	4,582,574	—	4,582,574
Receivables from parent, subsidiaries and affiliates	36,445,832	—	36,445,832
Health care and other amounts receivable	20,298,356	—	20,298,356
Other than invested assets	33,455,651	—	33,455,651
Total assets	\$ 1,576,768,624	—	\$ 1,576,768,624
<b>Liabilities:</b>			
Claims unpaid	\$ 178,560,091	—	178,560,091
Unpaid claims adjustment expense	4,268,714	—	4,268,714
Aggregate health policy reserve	4,204,573	—	4,204,573
Premiums received in advance	75,831,824	—	75,831,824
General expenses due or accrued	93,696,843	—	93,696,843
Current federal and foreign income tax payable and interest thereon	3,340,085	—	3,340,085
Ceded reinsurance premiums payable	8,502,112	—	8,502,112
Amounts withheld or retained for the benefit of others	233,009	—	233,009
Payable for securities	8,942,184	—	8,942,184
Liability for amounts held under uninsured accident and health plans	179,141,749	—	179,141,749
Other liabilities	296,151,837	—	296,151,837
Total liabilities	\$ 852,873,021	—	\$ 852,873,021
<b>Capital and surplus:</b>			
Unassigned funds (surplus)	723,895,603	—	723,895,603
Total capital and surplus	723,895,603	—	723,895,603
Total liabilities, capital and surplus	\$ 1,576,768,624	—	\$ 1,576,768,624

Blue Cross and Blue Shield of Massachusetts, Inc.

**Blue Cross and Blue Shield of Massachusetts, Inc.  
Statement of Revenue and Expenses  
For the Year Ended December 31, 2009**

	Annual statement	Statutory examination adjustment	Per statutory examination
Member Months	\$ 12,026,810	—	\$ 12,026,810
Net premium income	2,315,615,176	—	2,315,615,176
Change in unearned premium reserves and reserve for rate credits	3,628,666	—	3,628,666
Total revenues	2,319,243,842	—	2,319,243,842
Hospital and Medical:			
Hospital/medical benefits	1,585,152,938	—	1,585,152,938
Other professional services	197,303,757	—	197,303,757
Emergency room and out-of-area	38,893,628	—	38,893,628
Prescription drugs	309,353,569	—	309,353,569
Subtotal	2,130,703,892	—	2,130,703,892
Less : Net reinsurance recoveries	65,477,956	—	65,477,956
Total hospital and medical	2,065,225,936	—	2,065,225,936
Claims adjustment expenses	155,941,119	—	155,941,119
General administrative expenses	102,724,612	—	102,724,612
Total underwriting deductions	2,323,891,667	—	2,323,891,667
Net underwriting losses	(4,647,825)	—	(4,647,825)
Net investment income earnings	35,852,638	—	35,852,638
Net realized capital losses	(50,583,775)	—	(50,583,775)
Net investment losses	(14,731,137)	—	(14,731,137)
Other income (expense)	317,704	—	317,704
Net loss after capital gains tax and before all other federal income taxes	(19,061,258)	—	(19,061,258)
Federal and foreign income taxes incurred	2,244,442	—	2,244,442
Net loss	\$ (21,305,700)	—	\$ (21,305,700)

Blue Cross and Blue Shield of Massachusetts, Inc.

**Blue Cross and Blue Shield of Massachusetts, Inc.**  
**Capital & Surplus**  
**For the Year Ended December 31, 2009**

	<u>Annual statement</u>	<u>Statutory examination adjustment</u>	<u>Per statutory examination</u>
Capital and Surplus, December 31, 2008	\$ 614,167,091	—	\$ 614,167,091
Net income or (loss)	(21,305,700)	—	(21,305,700)
Change in net unrealized capital gains and losses less capital gains tax	(10,801,740)	—	(10,801,740)
Change in net deferred income tax	3,046,406	—	3,046,406
Change in nonadmitted assets	116,581,474	—	116,581,474
Aggregate write-ins for gains (losses) in surplus	<u>22,208,072</u>	<u>—</u>	<u>22,208,072</u>
Net change in capital and surplus	<u>109,728,512</u>	<u>—</u>	<u>109,728,512</u>
Capital and Surplus, December 31, 2009	<u>\$ 723,895,603</u>	<u>—</u>	<u>\$ 723,895,603</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

**Blue Cross and Blue Shield of Massachusetts, Inc.**  
**Statement of Changes in Capital & Surplus**  
**For Three Year Period Ended December 31, 2009**

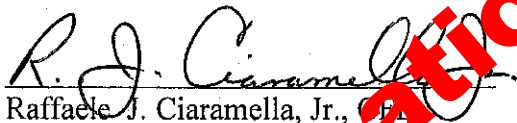
	<u>2007</u>	<u>2008</u>	<u>2009</u>
Capital and Surplus, prior year	\$ 628,187,598	\$ 705,747,894	\$ 614,167,091
Net income (loss)	145,628,465	83,702,718	(21,305,700)
Change in net unrealized capital gains (losses)	4,602,259	(93,122,998)	(10,801,740)
Change in net deferred income tax	36,006,957	16,321,061	3,046,400
Change in nonadmitted assets and related items	(108,964,122)	(75,788,721)	116,811,554
Change in surplus as a result of other write-ins	286,737	(22,692,863)	22,289,772
Net change in capital and surplus for the year	<u>77,560,296</u>	<u>(91,580,803)</u>	<u>109,728,512</u>
Capital and Surplus, December 31, current year	<u>\$ 705,747,894</u>	<u>\$ 614,167,091</u>	<u>\$ 723,895,603</u>

**ACKNOWLEDGEMENT**

This is to certify that the undersigned is a duly qualified Certified Financial Examiner (CFE) and that, in conjunction with KPMG LLP, applied certain agreed-upon procedures to the accounting and corporate records of Blue Cross and Blue Shield of Massachusetts, Inc. in order for the Division of Insurance of the Commonwealth of Massachusetts to fulfill the Commonwealth's requirements regarding periodic Statutory Examinations of Massachusetts' domiciled insurers.

The undersigned's participation in this Statutory Examination as the Examiner-in-Charge encompassed responsibility for the coordination and direction of the statutory examination performed which was in accordance with, and substantially complied with, those standards established by the Financial Condition (E) Committee of the NAIC and the *NAIC Financial Condition Examiners' Handbook*. This participation consisted of involvement in the planning (development, supervision and review of agreed upon procedures), administration, review of work papers and preparation of the statutory examination report.

The cooperation and assistance of the officers and employees of Blue Cross and Blue Shield of Massachusetts, Inc. extended to all examiners during the course of the examination is hereby acknowledged.



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