



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

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

Boston, Massachusetts

As of December 31, 2009

NAIC COMPANY CODE: 12219

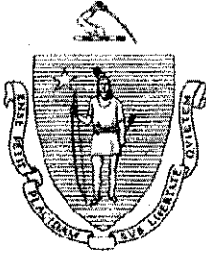
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EMPLOYER'S ID NO. 04-3362283

BLUE CROSS and BLUE SHIELD OF MASSACHUSETTS HMO BLUE, INC.

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May 27, 2011

The Honorable Joseph Torti, III, Chairman
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Honorable Commissioner Murphy and Superintendents Torti and Kofman:

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

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

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

SCOPE OF EXAMINATION

This statutory examination of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc., hereinafter referred to as "the Company," "the Corporation," "HMO Blue," 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. 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 adjustment 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 workpapers 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 (BCBSMA) began as the Associated Hospital Service Corporation of Massachusetts in 1937. The Corporation aimed to spread the cost of hospital treatment among a large group of employed persons and, upon its opening, was the twenty-sixth plan of its kind in the United States, differing from others in its offering of statewide coverage. In 1938, 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.

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., 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.

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	\$1,445,583,861	\$564,990,813	\$880,593,048
2008	1,268,808,236	561,767,603	707,040,633
2009	1,258,038,652	552,208,603	705,830,049

TERRITORY AND PLAN OF OPERATION

The Corporation is licensed to transact business in the Commonwealth of Massachusetts. Blue Cross Blue Shield of Massachusetts HMO Blue, Inc. is headquartered in Boston, MA. As of December 31, 2009, HMO Blue's service area included all of Massachusetts with a focus on the greater metropolitan Boston area.

PRODUCTS

The Company offers the following insurance products:

- **HMO Blue** — HMO Blue is licensed under Massachusetts General Laws, Chapter 176G. Members must reside in the service area, must generally choose a network primary care physician (PCP) upon enrollment and must follow plan rules in order to obtain the fullest extent of their coverage. These plans include HMO Blue, HMO Blue New England and Access Blue. Under HMO Blue New England plans, PCPs are available in Massachusetts and New England states. Access Blue is an 'open access' type HMO Blue plan that does not require members to choose a PCP or to obtain PCP referrals.
- **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 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 offered by Blue Cross and Blue Shield of Massachusetts, Inc. These plans include Blue Choice, Blue Choice New England and Access Blue Plus.
- **Preferred Blue PPO** — PPO plan which has two levels of benefits, in-network and out-of-network. There is no gatekeeper required and members may choose any provider within the network or go out of the network at a higher cost sharing.

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

- **Medicare Advantage Plans** — Medicare Advantage Plans, such as Medicare HMO Blue and Medicare PPO Blue, are part of the Medicare Program and are also called “Part C.” These plans provide all Part A (Hospital), Part B (Medical), Part D (prescription drug) and certain additional benefits under a contract with the Centers for Medicare & Medicaid Services (CMS). Medicare HMO Blue members must reside in the Medicare HMO Blue service area, choose a network primary care physician (PCP) upon enrollment and must follow plan rules in order to obtain the fullest extent of their coverage. Medicare PPO Blue is a preferred provider organization (PPO) plan that provides comprehensive in-network and out-of-network benefits, and members must reside in the Medicare PPO Blue service area. Medicare Advantage plans are offered both on a group and nongroup basis.

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 Company enters into contractual agreements with various health care providers to provide certain medical services to its members. Compensation arrangements vary by provider. Certain providers have entered into risk-sharing arrangements with the Company, whereby a settlement is calculated by comparing actual medical claims experience to a pre-approved and predetermined budgeted amount. These settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. 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 are removed from previously estimated liabilities as the claims are ultimately settled.

MPMG 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 HMO Blue business pays fairly quickly, the range of estimates for the December 31, 2009 UCL is narrow and the actuarial estimates are similar to HMO Blue’s estimates with hindsight through September 30, 2010.

HMO Blue 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.

INCOME TAXES

The Company is reporting as an organization exempt from federal income taxes under Internal Revenue Code Section 501(c)(4) and is exempt from Massachusetts state income taxes. The Company is subject to tax on any income unrelated to its operations as a tax-exempt health maintenance organization. The amount of unrelated business income tax for the Company for both 2009 and 2008 was immaterial.

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 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 IRS had stopped issuing rulings regarding Section 501(m) and the definition of "commercial-type" insurance as it related to HMO's. Because of the lack of authoritative guidance by the Internal Revenue Service (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.

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:

- **Membership** – The sole member of the Corporation is Blue Cross and Blue Shield of Massachusetts, Inc., acting through its Board of Directors.
- **Meetings** – The Annual Meeting of the Member shall be held on such day and at such time and place as the Member may from time to time determine. There shall be such further meetings as may be called by the Board of Directors or the Member.
- **Action on Behalf of the Corporation** – The standing committees of the Board of Directors of the Member shall have the power to take actions for, and on behalf of the Corporation.
- **Action without a Meeting** – Any action required or permitted to be taken may be taken without a meeting if the Member, by unanimous written consent of its Board of Directors, consents in writing and if such written consent is filed with the records of the Corporation. Such consent shall be treated for all purposes as a vote at a meeting.
- **Waiver of Notice** – Whenever any written notice is required to be given by the By-Laws, a waiver of notice that is signed either before or after the action for which notice is required shall have the effect of written notice.

Board of Directors

The Company's By-Laws indicate the following regarding its Board of Directors (the "Board"):

The general management of the business, property, and affairs of the Corporation shall be vested in a Board of no fewer than five (5) nor more than twenty-one (21) Directors. At each Annual Meeting of the Member, the Member, acting through its Board of Directors, shall determine the number of Directors of the Corporation for the ensuing year, and the elected persons to fill any vacancies. The term of office of each Director shall be three (3) years, except that a Director may be elected for a possible term less than three (3) years so that, as nearly as possible, one-third of the Directors shall be elected each year. The Board of Directors shall meet annually immediately following the Annual Meeting of the Member. Regular meetings shall be at such place and time as the Board of Directors may from time to time determine. Special meetings may be called by the President or a majority of the Board of Directors and shall be called by the Clerk, or in the case of the death, absence, incapacity or refusal of the Clerk, by any other officer upon the written application of Directors representing at least ten (10) percent of the quorum of Directors required for a vote at all meetings of the Board of Directors. A special meeting may be held in lieu of the Annual Meeting of the Directors.

Any action required or permitted to be taken may be taken without a meeting if all those entitled to vote consent in writing and if written consents are filed with the records of the Corporation. Such consents shall be treated for all purposes as a vote at a meeting.

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

At December 31, 2009, the Board was comprised of five (5) 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>
Cleve L. Killingsworth, Jr. ¹	Chairman, President and Chief Executive Officer	6 years
Sandra L. Jesse	Assistant Clerk	6 years
Allen Maltz	Treasurer	6 years
Fredi Shonkoff	Clerk	6 years
Andrew Dreyfus	EVP, Health Care Services	2 years

¹ – Mr. Killingsworth resigned from the Company effective March 16, 2010. Paul Gizzi 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. There are no current standing committees of the Board of Directors.

Officers

The officers have the powers and perform the duties customarily belonging to their respective offices, including the powers and duties listed below:

- a. The Chair shall preside at all meetings of the Board of Directors at which he or she is present and shall represent the Corporation as the Board of Directors may deem appropriate.
- b. Unless otherwise provided by the Board, the President shall be the chief executive officer of the Corporation responsible to the Board of Directors for the administration of its affairs. Except as otherwise provided by the Board of Directors or the By-Laws, the President or his or her duly authorized designee shall sign for the Corporation all deeds, agreements, and other formal instruments.
- c. The Treasurer shall be the chief financial officer of the Corporation and shall be in charge of all funds and securities of any type. With the advice and consent of the Board of Directors, the Treasurer shall have the power to invest and reinvest surplus funds. The Treasurer shall render to the Board of Directors at the Annual Meeting and whenever else it so requests an accurate account of all sums received and disbursed during the preceding fiscal year and of all sums and funds which are not expended.
- d. The Clerk shall keep records of all meetings of the Board of Directors and make a report thereon and shall issue calls and notices of meetings as provided herein.

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

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. ¹	Chairman, President and Chief Executive Officer
Allen P. Maltz	Treasurer
Fredi Shonkoff	Clerk
Keith Renaldi	Assistant Treasurer
Sandra L. Jesse	Assistant Clerk
Rina Vertes ²	Chief Actuary

¹ – 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.

² – 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. 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 any 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 July 13, 2005.

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 of 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

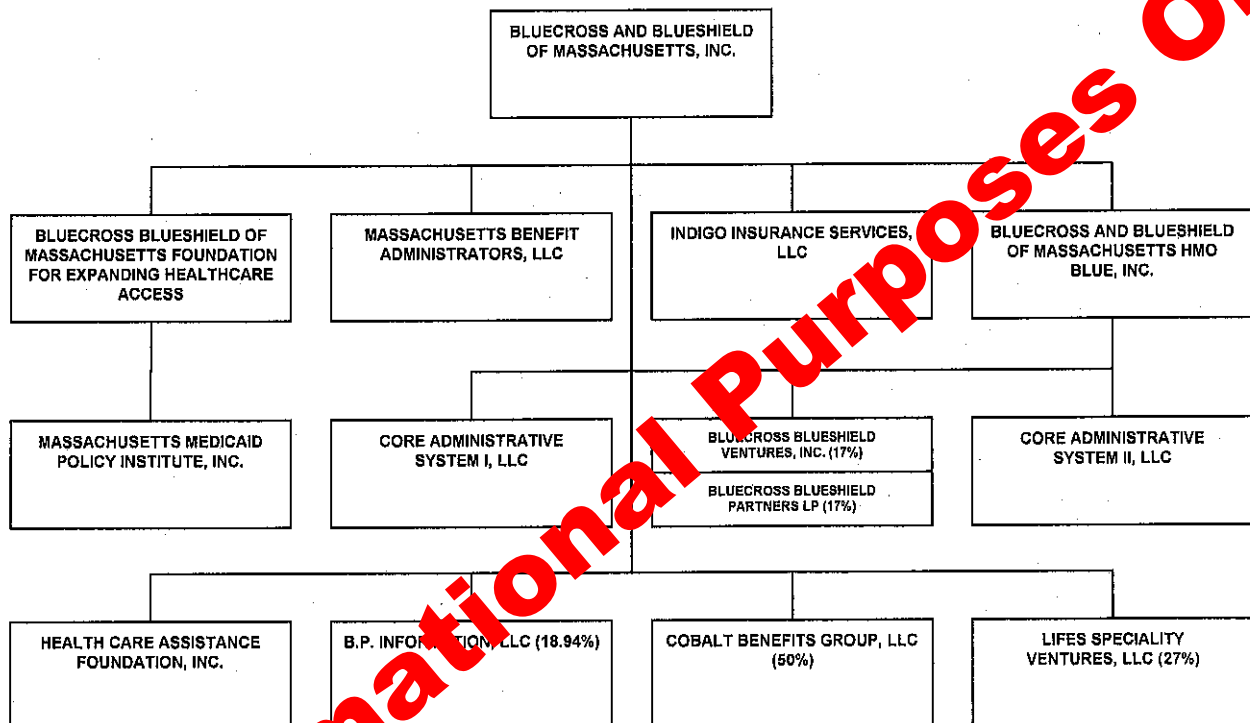
The Company's Board of Directors has significant influence on the entity's control consciousness. The Board, through its own activities and supported by its audit committee, is responsible for overseeing all financial reporting policies and procedures. The Board appears appropriately experienced and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

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. BCBSMA participates in a bilateral inter-company 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. 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.

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, based on HMO Blue's allocated share of the benefit plans' expenses.

The Company had payable to BCBSMA of \$35,929,000 and \$18,761,000 at December 31, 2009 and 2008, respectively.

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. HMO Blue has contributed \$1,493,000 and \$575,000 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.

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

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 BCBSMA 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 30, 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.

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.

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 bond 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 BCBSMA and HMO Blue to enter into an agreement with the Division granting the Division discretionary authority to require either company to issue a surplus note to the other company if either of the company's health risk-based capital (RBC) is more than seventy-five (75) percentage points higher than the other company's RBC. Under the terms of its license with Blue Cross and Blue Shield Association, BCBSMA has entered into a unilateral agreement with HMO Blue to guarantee all current and future financial obligations of HMO Blue.

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 \$36,318,000 at December 31, 2009 of securities that are pledged.

LEASE OBLIGATIONS

The Company and BCBSMA 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 BCBSMA jointly have entered into several other long-term non-cancelable operating lease agreements for office space that expire at various dates through 2015. For the years ended December 31, 2009 and 2008, the Company recorded rental expense of \$10,799,000 and \$10,802,000, respectively.

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

2010	\$14,771
2011	13,800
2012	9,278
2013	9,130
2014	7,695
Thereafter	3,161

In addition, the Companies have an agreement with an outside vendor to provide certain information technology services for substantially all of the Companies' business operations. The Companies minimum commitments under this agreement are approximately \$61,200,000 per year.

PENSION AND OTHER POST RETIREMENT BENEFIT PLANS

The pension and other post-retirement benefit plans ("Plans") are sponsored by BCBSMA and the associated costs are shared by the Companies. All employees are eligible to participate in BCBSMA's Retirement Income Trust Plan ("RIT"), which grants benefits to retired employees at various levels based on age and years of service. BCBSMA also participates in two noncontributory retirement plans for eligible employees. BCBSMA uses a December 31 measurement date for all of its plans. The Company is an active participating employer of the Plans. The pension and other post-retirement benefits costs allocated to the Company in 2009 and 2008 are \$19,410,000 and \$15,247,000, respectively.

BCBSMA also sponsors a defined benefit plan covering medical, life and dental benefits. The 401(h) account was instituted by BCBSMA in December 2003. The Companies made a contribution of \$14,000,000 in 2009 and made no contributions in 2008.

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 new Internal Revenue Service limits. The Company's costs for the 401(k) plan were \$2,990,000 and \$3,444,000 in 2009 and 2008, respectively.

SPECIAL DEPOSITS

The special deposits of the Company at December 31, 2009 are as follows:

Description of Deposit	Where Deposited	Par or Book Value	Statement Value	Market Value
US Treasury	Massachusetts	\$1,025,000	\$1,022,032	\$1,106,764

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 read 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:

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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.

For Informational Purposes Only

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

Blue Cross and Blue Shield of Massachusetts HMO Blue, 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>
Assets:			
Bonds	\$ 490,603,360	—	\$ 490,603,360
Stocks:			
Preferred stocks	—	—	—
Common stocks	144,839,305	—	144,839,305
Real estate:			
Properties occupied by the company	107,612,652	—	107,612,652
Cash, cash equivalents and short-term investments	61,884,863	—	61,884,863
Other invested assets	400,451,146	—	400,451,146
Receivable for securities	2,061,641	—	2,061,641
Subtotals, cash and invested assets	\$ 1,207,452,967		\$ 1,207,452,967
Investment income due and accrued	4,209,086	—	4,209,086
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	25,316,444	—	25,316,444
Electronic data processing equipment and software	4,063,815	—	4,063,815
Receivables from parent, subsidiaries and affiliates	6,297	—	6,297
Health care and other amounts receivable	14,733,133	—	14,733,133
Other than invested assets	2,256,910	—	2,256,910
Total assets	\$ 1,258,038,652	—	\$ 1,258,038,652
Liabilities:			
Claims unpaid	\$ 293,929,461	—	\$ 293,929,461
Unpaid medical incentive pool and bonus amounts	55,611,009	—	55,611,009
Unpaid claims adjustment expenses	4,186,620	—	4,186,620
Aggregate health policy reserves	20,336,381	—	20,336,381
Premiums received in advance	105,842,996	—	105,842,996
General expenses due or accrued	732,081	—	732,081
Current federal and foreign income tax payable and interest thereon	1,267	—	1,267
Amounts due to parent, subsidiaries and affiliates	35,928,691	—	35,928,691
Payable for securities	6,766,036	—	6,766,036
Other liabilities	28,874,061	—	28,874,061
Total liabilities	\$ 552,208,603	—	\$ 552,208,603
Capital and surplus:			
Unassigned funds (surplus)	705,830,049	—	705,830,049
Total capital and surplus	705,830,049	—	705,830,049
Total liabilities, capital and surplus	\$ 1,258,038,652	—	\$ 1,258,038,652

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

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

	Annual statement	Statutory examination adjustment	Per statutory examination
Member Months	\$ 10,943,422	—	\$ 10,943,422
Net premium income	4,400,791,063	—	4,400,791,063
Change in unearned premium reserves and reserve for rate credits	(1,051,916)	—	(1,051,916)
Total revenues	4,399,739,147	—	4,399,739,147
Hospital and Medical:			
Hospital/medical benefits	3,173,531,919	—	3,173,531,919
Other professional services	143,872,939	—	143,872,939
Emergency room and out-of-area	91,386,441	—	91,386,441
Prescription drugs	576,495,346	—	576,495,346
Incentive pool, withhold adjustments and bonus amounts	67,095,462	—	67,095,462
Total hospital and medical	4,052,382,107	—	4,052,382,107
Claims adjustment expenses	236,030,981	—	236,030,981
General administrative expenses	221,003,820	—	221,003,820
Total underwriting deductions	4,509,416,908	—	4,509,416,908
Net underwriting loss	(109,677,761)	—	(109,677,761)
Net investment income earned	41,555,390	—	41,555,390
Net realized capital losses	(59,964,252)	—	(59,964,252)
Net investment losses	(18,408,862)	—	(18,408,862)
Other income (expense)	179,657	—	179,657
Net loss after capital gains tax and before all other federal income taxes	(127,906,966)	—	(127,906,966)
Federal and foreign income taxes incurred	3,173	—	3,173
Net loss	\$ (127,910,139)	—	\$ (127,910,139)

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

Blue Cross and Blue Shield of Massachusetts HMO Blue, 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	\$ 707,040,633	—	\$ 707,040,633
Net income or (loss)	(127,910,139)	—	(127,910,139)
losses less capital gains tax	37,216,605	—	37,216,605
Change in net deferred income tax	—	—	—
Change in nonadmitted assets	89,482,950	—	89,482,950
Net change in capital and surplus	(1,210,584)	—	(1,210,584)
Capital and Surplus, December 31, 2009	<u>\$ 705,830,049</u>	<u>—</u>	<u>\$ 705,830,049</u>

For Informational Purposes Only

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

Blue Cross and Blue Shield of Massachusetts HMO Blue, 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	\$ 839,661,676	880,593,048	\$ 707,040,633
Net income (loss)	63,097,243	21,684,897	(127,910,139)
Change in net unrealized capital gains (losses)	3,551,560	(185,810,094)	37,255,607
Change in nonadmitted assets and related items	(25,717,431)	(9,427,218)	89,482,550
Net change in capital and surplus for the year	<u>40,931,372</u>	<u>(173,552,415)</u>	<u>(1,171,984)</u>
Capital and Surplus, December 31, current year	<u>\$ 880,593,048</u>	<u>707,040,633</u>	<u>\$ 705,830,049</u>

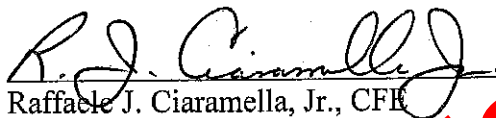
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ACKNOWLEDGEMENT

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 HMO Blue, 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 HMO Blue, 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