STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER

FINANCIAL EXAMINATION

of

Regence BlueShield
Seattle, Washington

NAIC CODE 53902
DECEMBER 31, 2005

Order No. G 07-202
Regence Blueshield
Exhibit A

SALUTATION

Seattle, Washington
July 2, 2007

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 – 14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.44.145 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Regence BlueShield

of

Seattle, Washington

hereinafter referred to as "RBS" or the "Company," at the location of its home office, 1800 9th Avenue, Seattle, Washington 98101. This report is respectfully submitted showing the condition of the Company as of December 31, 2005.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Regence BlueShield of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2005.

Patrick H. McNaughton

Patrick H. McNaughton
Chief Examiner

July 2, 2007

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2001 through December 31, 2005 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

Concurrent with the examination of Regence BlueShield, the following companies within The Regence Group (TRG) were also examined as of December 31, 2005: Regence BlueCross BlueShield of Oregon (RBCBSO), Regence Life and Health Insurance Company, Regence HMO Oregon, Regence Health Maintenance of Oregon, Inc., RegenceCare, Asuris Northwest Health (Asuris), Regence BlueShield of Idaho, Inc. (RBSI), Regence BlueCross BlueShield of Utah (RBCBSU) and HealthWise. This was part of a coordinated examination effort by the states of Oregon, Utah, Idaho, and Washington, with Oregon designated as the lead state. A separate report will be issued for each company.

INSTRUCTIONS

The examiners reviewed the Company's filed 2005 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P). Except for the examination reclassification under Instruction No.1b., no examination adjustments were required due to immateriality. The following summarizes the exceptions noted while performing this review.

1. NAIC Annual Statement Errors and Misclassifications

The results of the examination disclosed several instances where the Company's filing of the 2005 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

a. **Investment in Subsidiaries**

The fair value of two wholly owned non-insurance subsidiaries, CSN Acquisition Company and Healthcare Management Administrators, were incorrectly reported on Schedule D - Part 2 - Section 2. The investment values were based on 2004 valuations, instead of 2005 valuations, which resulted in an understatement of $122,629 and $782,523 for the investments in CSN Acquisition Company and Healthcare Management Administrators, respectively. However, the errors had no impact on the Company's surplus since the subsidiary valuation amounts were based on unaudited financial statements and thus were non-admitted in the 2005 NAIC Annual Statement in accordance with SSAP No. 88.

The Company's investment in Ninth and Howell Real Estate Joint Venture was incorrectly valued at $1,166,574 on Schedule BA – Part 1. In accordance with SSAP No. 48, Paragraph 7, and SSAP No. 88, the investment in a non-insurance joint venture is valued on the underlying audited statement based on the GAAP equity method of the investee, or $4,186,668, resulting in an understatement of assets by $3,020,095.

The Company's investment in Commencement Bay Life Insurance Company is incorrect on Schedule D - Part 2 - Section 2, in columns 6 and 8. The Company only included Commencement Bay's reported surplus as of December 31, 2005 in the amount of $19,270.977. The value that should have been reported was total capital and surplus of $21,670,977 under the equity method required by SSAP 46, Paragraph 7.b.

b. **Reclassification of Unearned Premium Reserves to Premiums Received in Advance**

The Company misclassified "Premiums received in advance" in the amount of $11,368,750 as "Unearned premium reserves" on Part 2D, Line 1 of the Underwriting and Investment Exhibit. In accordance with SSAP No. 54, unearned premiums are policy reserves and shall be required for all accident and health contracts for which premiums have been reported for a period beyond the date of valuation. Premiums received in advance are premiums that have been received prior to the valuation date but are due on or after the valuation date. (See examination reclassification No.1, debiting "Aggregate health policy reserves", and crediting "Premiums received in advance" in the amount of $ 11,368,750.)

c. **Retrospectively Rated Contract Disclosure**

SSAP No. 66, Paragraph 12, requires annual statement disclosure of premium amounts subject to retrospective rating. The financial statements were correct except for the amounts disclosed in Note 24.B. of the Notes to the Financial Statements. The retrospective premiums should have been $291,466,202 and $280,999,981 for 2005 and 2004 respectively, instead of the reported amount of $360,378,907 and $309,210,972.

d. **Retirement Plan Disclosure**

SSAP No. 14, Paragraph 15, requires annual statement disclosures of employees that participated in a defined contribution plan sponsored by the holding Company. In Note 12, Notes to the Financial Statements, the Company failed to disclose its 401(k) Plan, a defined contribution plan sponsored by its parent TRG. The fact that the Company has no legal obligation for the parent sponsored plan, the amount of the benefit expense incurred and the allocation methodology utilized by TRG should also be disclosed.

Under Note 12D, Notes to the Financial Statement, the Company disclosed the benefit expenses incurred for the Post Retirement Health Care and Life Insurance Benefit Plans, but failed to disclose, as required by SSAP No. 89, Paragraph 15, the allocation methodology utilized by TRG and the fact that it has no legal obligation for the TRG sponsored pension plans.

e. Security Lending Disclosure

Throughout the five year period under examination, the Company did not disclose its security lending program policy under Note 17.B.(2), Notes to the Financial Statement.

The Company has maintained a security-lending program during the examination period. The program is structured so that the Company calls back all loaned securities prior to the end of the year. To provide a complete disclosure, the Company is instructed to disclose its security lending policy in future NAIC Annual Statement filings in accordance with SSAP No. 91, Paragraph 88.h.

f. Reclassification of Premiums Received in Advance

Advance premium deposits as required by administrative service contracts (ASC) for uninsured plans in the amount of $2,525,510 are incorrectly classified in the 2005 NAIC Annual Statement as "Amounts withheld or retained for the account of others". The 2005 NAIC Annual Statement Instructions excludes liabilities related to uninsured plans from the account as "Amounts withheld or retained for the account of others". The correct classification for the advance premium deposits is "Premiums received in advance".

g. Commission Expenses Not Accrued

The Company did not accrue commission expenses associated with uncollected premiums and agents' balances in the course of collection. SSAP No. 54, Paragraph 12, requires that the amount of unpaid commissions, and the cost of collection associated with due and unpaid premiums, be carried as offsetting liabilities of uncollected premium. It was determined the amount was not material.

h. Number of Shares Owned of Regence Life and Health Insurance Company (RLHIC)

On Schedule D - Part 2 -Section 2 (Common Stock), the Company incorrectly reported the number of shares of stock owned in RLHIC, a subsidiary. The Company has an 18% ownership interest in RLHIC, which equates to 5,439 shares, not 4,139 shares.

The Company is instructed to file an accurate statement of its financial condition, transactions, and affairs in compliance with RCW 48.43.097, which requires the filing of its financial statements in accordance with the NAIC AP&P Manual, and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions.

2. Statement of Actuarial Opinion

The 2005 Statement of Actuarial Opinion (SAO), prepared by the Company's consulting actuary, failed to report the experience rated refund liability. The Company reported an experience rated refund liability in the Underwriting and Investment Exhibit, Part 1, Column 1, Line 4 of the 2005 NAIC Annual Statement in the amount of $26,736,208.

The Company is instructed to file its SAO pursuant to RCW 48.43.097 and WAC 284-07-060(2)(a), which require health care service contractors to file an SAO and financial statement in accordance with the AP&P Manual and the NAIC Annual Statement Instructions.

3. Inter-company Transactions and Agreements

The Company has numerous material inter-company financial relationships and transactions in its normal course of business. The existing inter-company agreement does not adequately cover the fiduciary and other responsibilities under the various inter-company relationships. The Company filed a Plan and Agreement of Affiliation (PAA) with the OIC effective July 28, 1997. The Company has stated that the PAA along with the Idaho Long-Term Contract and internal documents comprises the cost allocation system. No other cost allocation agreement is in effect as of December 31, 2005. In a review of the PAA, the following was noted as the only guidance for inter-company cost sharing:

a. Initial and subsequent capitalization of TRG will be based on initial capitalization percentage.
b. Payments by the Plans to TRG will be based on reasonable value of services rendered.
c. If one of the Plans renders a service to another of the Plans, payment will be based on the reasonable value of the service rendered.

From the above information contained in the PAA, the examination team was not able to determine the expense allocation methodologies or the types of services at either the Parent TRG level, Plan level, or affiliate inter-company level. We were not able to determine in detail how the fiduciary and other responsibilities for each company flowed across affiliate lines, the services rendered and allocation bases.

The following area was identified as deficient in the course of our examination and requires an amendment to the PAA agreement pursuant to RCW 48.31C.050: Specific methodology or basis used on how inter-company expenditures, fiduciary responsibilities, and types of service are allocated across and between Plans, TRG, and other affiliates.

An amended or new agreement should address and correct the deficiencies noted above to maintain compliance with RCW 48.31C.050(1)(d) which states,

> "The books, accounts and records of each party to all such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions,

including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties..."

The Company is instructed to file amendments to its Plan and Agreement of Affiliation or file a new agreement, which address areas noted above with the OIC pursuant to RCW 48.31C.050 in compliance with SSAP No. 70, Paragraph 8. The agreement should include additional documentation, which explicitly states the services, responsibilities and considerations under the performance of the contract.

4. **Premium Tax Base**

In computing its premium tax payment, the Company has been using earned premiums, instead of written premiums, as its premium tax base. This has led to an underpayment of premium taxes paid during the five-year examination period of $174,197. No examination adjustment is recommended due to immateriality.

The Company is instructed to calculate all future premium taxes based on written premiums in accordance with RCW 48.14.0201(2) and the premium tax return instructions.

5. **Investment Expense Allocation - Underwriting and Investment Exhibit**

In Column 4 -Investment Expenses of the Underwriting and Investment Exhibit, Part 3-Analysis of Expenses, the Company did not allocate investment expenses incurred internally. Only external investment expenses billed by outside parties were reported in Column 4. The internal investment expenses were misclassified as General Administration Expenses in Column 3.

SSAP No. 70, Paragraph 9, states, "Any basis adopted to apportion expenses shall be the one which would yield the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses." In addition, SSAP No. 70, Paragraph 5, states that the allocation of expenses for health insurers should be based on a method that yields the most accurate results.

The Company is instructed to allocate internal investment expenses into the proper categories in Column 4 pursuant to RCW 48.43.097 which requires the filing of its financial statements in accordance with the AP&P Manual; and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P Manual.

6. **Form B - Annual Registration Statement Disclosure**

The Company loaned $1,820,000 to TRG for a term of 20 years with interest compounded annually at the prime rate for standard commercial loans. However, the Company's 2005 Form B - Annual Registration Statement incorrectly states that the Company has no loans with affiliates. The aforementioned loan should have been fully disclosed in the registration statement.

In accordance with RCW 48.31C.040(2)(c)(i), the Company is instructed to include current information on any loans with affiliates on its Form B - Annual Registration Statement.

COMMENTS AND RECOMMENDATIONS

1. Incurred-Paid Triangle Error

The paid claim amounts for one self-funded group, Northshore School District, was erroneously included in the incurred-paid loss triangle data submitted to the examination team. The amount was immaterial and the Company found and corrected the error during our examination.

It is recommended that the Company establish procedures to ensure that claims for the self-funded groups are not recorded, or reported, as claim expense in the Company's loss triangles.

2. Safekeeping of Private Placements

The Company needs to improve its procedures or controls for the safekeeping of private placement securities. The following security certificate was lost, or misplaced, and had to be replaced: Plans Liability Insurance Company - Stock certificate representing 12.15 shares originally issued on December 1, 1998 were replaced on August 2, 2005.

It is recommended that the Company implement additional controls over private placement securities, which are kept on-site, to prevent stock certificates from being lost or misplaced.

3. 401(k) Plan

Payroll data transmitted to the Company's 401(k) Plan trustee was incomplete, thus the non-discrimination test (NDT) performed by the Plan trustee was invalid. The NDT is an important test that a qualified retirement plan must pass in order to qualify for favorable tax accounting treatment. Without a valid NDT, the 401(k) Plan is potentially at risk of losing its qualified status since plan non-compliance issues may not be detected, and rectified, in a timely manner. The Company later was able to identify the errors and the Plan's status was not adversely affected.

It is recommended that the Company establish procedures and implement controls to ensure that all future information transmitted to the Plan trustee is accurate and complete.

COMPANY PROFILE

Company History

Regence BlueShield (RBS) is a nonprofit corporation organized pursuant to Chapter 24.03 RCW and is licensed as a health care service contractor pursuant to 48.44 RCW. RBS was originally incorporated as King County Medical Service Corporation (KCMSC) in 1933, and was issued a Certificate of Registration by the Office of Insurance Commissioner on September 5, 1947. On November 23, 1970, KCMSC changed its name to King County Medical Blue Shield (KCMBS). Between 1983 and 1995 KCMBS merged with seven (7) other medical bureaus:

- Lewis County Medical Services
- Pierce County Medical Bureau (PCMB)
- Cowlitz Medical Service
- Thurston County Medical Bureau
- Snohomish County Physicians Corporation
- Grays Harbor Medical Bureau
- Clallam County Physicians Service, Inc.

The name was changed again on April 1, 1997 to Regence Washington Health and on April 16, 1998, to Regence BlueShield (RBS). On January 1, 2000, RBS merged with Northwest Washington Medical Bureau. The surviving entity is RBS.

Separately RBS, RBCBSO and RBSI agreed to unite under the common control of TRG in a Plan and Agreement of Affiliation signed in 1995. The agreement was amended in 1997 to add RBCBSU into TRG. RBS, RBCBSO, RBSI and RBCBSU are referred to collectively as "the Plans" or in the singular as "the Plan".

Capitalization

Minimum net worth requirements pursuant to RCW 48.44.037 are met with $717 million in unassigned funds as of December 31, 2005. The Company does not have any capital stock. The sole voting member is TRG, an Oregon nonprofit corporation.

Territory and Plan of Operation

The Company is registered as a health care service contractor in the state of Washington only. Its authorized lines of business are: Comprehensive (hospital and medical), Medicare Supplement, Dental, Federal Employees Health Benefit Plan, Medicare, and Medicaid. Approximately 80% of the business comes from the comprehensive line.

RBS, together with its affiliates, RBCBSO, RBCBSU, RBSI, consolidated many aspects of their operations while still maintaining local presences at the Plans targeted markets. Overall, TRG operates 29 multi-function facilities, sales or subsidiary offices throughout the states of Washington, Oregon, Utah, and Idaho.

Growth of the Company

The following reflects the growth of the Company based on its filed NAIC Annual Statements for the years ending December 31:

	2001	2002	2003	2004	2005
Assets, Liabilities, Capital and Surplus:					
Admitted Assets	$779,697,916	$754,212,980	$887,632,619	$968,749,171	$1,109,753,273
Liabilities	368,053,664	408,573,991	386,677,913	350,633,042	393,171,622
Capital and Surplus	$411,644,252	$345,638,989	$500,954,706	$618,116,129	$716,581,651
Revenue and Expenses:					
Premiums Earned	$1,452,713,554	$1,505,859,772	$1,660,031,664	$1,664,894,919	$1,757,774,250
Net Underwriting Deductions	1,432,868,797	1,506,934,148	1,620,020,860	1,555,115,204	1,647,275,093
Underwriting Gain or Loss	19,844,757	(1,074,376)	40,010,804	109,779,715	110,499,157
Investment and Other Income	19,653,605	10,747,399	(16,576,271)	42,895,687	70,542,747
Pre-Tax Income	39,498,362	9,673,023	23,434,533	152,675,402	181,041,904
Taxes Incurred	(386,402)	(768,488)	2,684,044	30,443,050	52,935,532
Net Income	$39,884,764	$10,441,511	$20,750,489	$122,232,352	$128,106,372

AFFILIATED COMPANIES

The Regence Group (TRG):

TRG is an Oregon nonprofit public benefit corporation. It is authorized to do business in Washington, Idaho, Montana, Utah, California, New Mexico, Texas and Colorado.

TRG is the sole voting member of RBS, RBCBSO, and RBCBSU. As the sole voting member, TRG has authority to approve elections to the governing Board of Directors (BOD) of these three affiliated corporations, and to discharge members of the governing BOD at any time, with or without cause. In addition, TRG manages RBSI under terms of a 20-year Management and Administrative Service Agreement.

Regence BlueCross BlueShield of Oregon (RBCBSO):

RBCBSO is an Oregon domiciled nonprofit health care service contractor. Its sole voting member is TRG.

Regence Blue Cross BlueShield of Utah (RBCBSU):

RBCBSU is a Utah domiciled nonprofit health service insurance company. Its sole voting member is TRG.

Regence BlueShield of Idaho (RBSI):
RBSI is an Idaho domiciled mutual disability insurance company. All corporate powers are vested in a Board of Directors. Effective June 1, 1995, the Company and TRG entered into a 20 year Management and Administrative Services Agreement.

RegenceCare:
RegenceCare was originally incorporated on March 17, 1986 as HMO Washington, Inc., a wholly owned subsidiary of King County Medical Blue Shield (KCMBS). It was issued a Certificate of Registration by the OIC on May 1, 1986. HMO Washington, Inc. changed its name to RegenceCare in March 1998. On December 31, 2005, RegenceCare surrendered its certificate of registration.

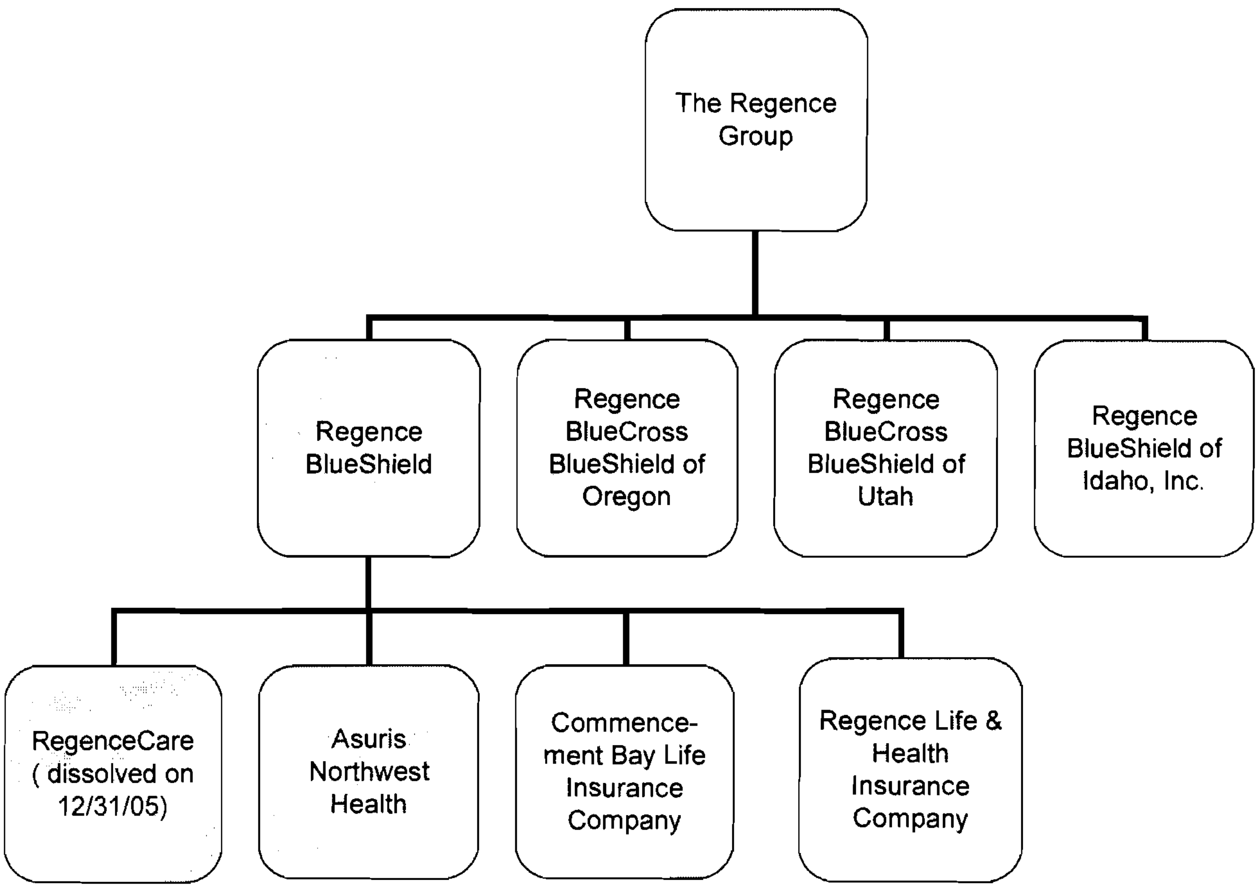
Asuris Northwest Health (Asuris):
Asuris was originally incorporated as Walla Walla Valley Medical Service Corporation in 1933, and was issued a Certificate of Registration as a Health Service Contractor under RCW 48.44 by the OIC on September 5, 1947. It was acquired by RBS in November 1994. The name was changed to Regence Northwest Health in 1997 and to Asuris Northwest Health in September 2002.

Commencement Bay Life Insurance Company (CBLIC):
CBLIC was incorporated on September 1, 1992 as a Washington stock life and disability insurance company. It is a wholly owned subsidiary of RBS. Since inception, the primary business activity of CBLIC is to provide stop loss insurance for administrative service contracts.

Regence Life and Health Insurance Company (RLHIC):
RLHIC is an Oregon domiciled life and accident and health company. It is 68% owned by RBCBSO, 18% owned by RBS, 12% owned by RBCBSU, and 2% owned by RBSI.

Organizational Chart

The following organization chart as of December 31, 2005 shows the Company's parent and direct reporting insurance subsidiaries.



Inter-company agreements

Service Mark and Trade Name License Agreement

RBS, together with the other three Plans, are parties to this agreement. Effective October 1, 1999, each Plan has agreed to pay an annual license fee to TRG for the use of "Regence" in its corporate name.

Plan and Agreement of Affiliation

RBS, RBCBSO, and RBCBSU agreed to unite under the common control of TRG; RBSI agreed to participate in the affiliation by a Management/Administration Service Contract. The original Agreement with an effective date of June 1, 1995 only included TRG, RBS, BCBSO, and RBSI. RBCBSU was added to the Agreement in a 1997 amendment.

Federal Employee Program (FEP) Shared System Service and Cost Agreement

RBS, together with the other three Plans, are parties to this agreement. Under the agreement, RBS agreed to provide and maintain the computer software claims system on behalf of TRG for administration of the federal employee health benefit plan. Each TRG Plan shares in RBS' cost of maintaining and administering the FEP shared system, which processes claims of federal employees, retirees, and family members within the various states. The original agreement with an effective date of January 1, 1997, only included RBS, RBCBSO, and RBSI. RBCBSU was added to the agreement in a 1998 Amendment.

Consolidated Tax Allocation Agreement

TRG and its eligible affiliates and subsidiaries (including both RBS and Asuris) have entered into a consolidated Federal Income Tax Agreement effective September 2000.

Administrative Service Agreement between CBLIC and RBS

Effective August 2004, RBS has been providing operational, administrative, and management services for CBLIC.

MANAGEMENT AND CONTROLS

Ownership

The Company's Articles of Incorporation state that the corporation shall not have or issue shares of capital stock. There shall be but a single member of the Corporation, which shall be The Regence Group, an Oregon nonprofit corporation (the "Sole Member"). The Sole Member shall have all rights, powers and privileges to manage the Company.

Board of Directors (BOD)

Management of the Company is vested in a BOD comprised of no less than five directors, all of which are subject to the approval of its sole voting member, TRG. The Company's Bylaws stipulate that one director's position must be filled by the Chief Executive Officer of TRG at all times, and that at least three directors must be Washington residents.

The Board has no standing committees, but has established a non-fiduciary Community Board for the primary purposes of acting as a liaison with communities served by the Company and providing advice and counsel to the president and BOD of the Company. The Organizational and Governance Committee, Investment Committee, Personnel and Compensation Committee, Audit and Compliance Committee, and Health Care Service Committee (formally know as the Provider Affairs Committee) are at the TRG level only and provide oversight of RBS and its three other affiliated Plans.

The following five individuals were Directors as of December 31, 2005:

Mack L. Hogans
Mary Oliver McWilliams
Mark Burns Ganz
Jack Gilbert Strother
William Gardner Marsh, MD

Officers
Officers are appointed annually by the BOD. Officers as of December 31, 2005 were:

Mary Oliver McWilliams	President
Eric Michael Tanaka	Treasurer
Kerry Evan Barnett	Secretary
Leonard Ashley Hagen	Assistant Secretary
Audrey Jean Nudd	Vice President
Murphy Jonathan Hensley	Vice President
Maureen Tressel Lewis	Vice President

Conflict of Interest
The Company's policy requires that members of the BOD, officers and all employees sign a conflict of interest statement each year. The purpose of the statement is to detect any activities or participation on the part of an employee that could possibly be interpreted as having the appearance of a conflict of interest. No such conflicts were noted during the examination period.

Fidelity Bond and Other Insurance
The Company is a named insured, along with other members of TRG, on a financial institution fidelity bond. The aggregate limit of coverage was $20 million, and the single loss limit is $10 million as of December 31, 2005. The coverage limit amounts exceed the NAIC recommended minimum coverage range of $3.3 million to $3.5 million.

The Company, along with other members of TRG, is also protected under various other insurance policies. Those policies are:

- Workers Compensation and Employers Liability Insurance Policy
- Computer Crime Policy for Financial Institutions
- Fire Insurance Policy
- Executive Liability and Entity Liability, Fiduciary Liability Policy

The review of the Company insurance policies indicate insurance coverage has been purchased and is in force covering hazards to which the Company is exposed as of the examination date. All affiliated companies are covered as named insured's under policies purchased by TRG.

Officers', Employees', and Agents' Welfare and Pension Plans

The Regence Group Retirement Plan

The Company participates in a Defined Benefit Pension Plan sponsored by TRG that covers substantially all full-time employees having one or more years of service. Benefits are based upon years of service and the employee's final average compensation. TRG has fully funded the plan as of December 31, 2005.

The Regence Group Supplemental Executive Retirement Plan

The Company participates in a Supplemental Executive Retirement Plan (SERP) sponsored by TRG to cover key employees meeting certain eligibility requirements. The SERP is a nonqualified defined benefit pension plan that is not subject to Employee Retirement Income Security Act (ERISA) minimum funding requirements. The plan is funded only on a "pay-as-you go" basis. The Company has no legal obligation for benefits under this plan; the obligation is carried by TRG. In fiscal year 2005, RBS contributed $1.55 million for its share of net expenses.

The Regence Group Postretirement Benefit Plan

The Company participates in a Postretirement Benefit Plan sponsored by TRG that provides certain health care and life insurance benefits to retired employees with ten or more years of continuous service. To be eligible for the plan, the employees must have been hired on or before January 1, 2004 and were active participants in health plans at the time of retirement. The Company has no legal obligation for benefits under this Plan; the obligation is carried by TRG. In fiscal year 2005, the Company's share of net expense for the postretirement benefit plan was $759,871.

The Regence Group 401(k) Plan

The Company participates in a 401(k) plan sponsored by TRG in which the Company matches employee contributions up to 50% on the first 6% of salary. The plan is fully funded as of December 31, 2005 and the Company's share of the employer match for the 401(k) plan was $1,353,555 in 2005.

Physician Deferred Compensation Plans

The Company maintains a separate non-qualified deferred compensation plan covering certain member physicians who voluntarily defer their billings for services provided. The Company funds the obligations primarily through the purchase of group flexible paid-up life insurance contracts for active participants and annuity contracts for retired participants. Since the Company is both the owner and beneficiary of these contracts, assets ("Aggregate write-ins for other than invested assets") and liabilities ("Amounts withheld or retained for account of others") were debited and credited, respectively, in the amount of $25,978,000, as of December 31, 2005.

Deferred Income Program for Directors and Senior Leaders

The Company offers a non-qualified deferred compensation plan to certain key employees whereby participants may defer a portion of their compensation. The Company has also adopted a Director's Deferred Compensation Plan, whereby non-employee directors can receive fees, including retainer fees, in a form other than direct payment. Assets (Aggregate write-ins for invested assets line) and liabilities (Amounts withheld or retained for account of others line) were debited and credited, respectively, for $5,344,000, as of December 31, 2005.

COPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration, and minutes of the BOD and committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present.

ACTUARIAL REVIEW

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2005. The claim liabilities were determined to be within a reasonable range. The review included examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities, verifying that claim liabilities include provisions for all components noted in SSAP No. 55 Paragraph 7, reviewing historical paid claims and loss ratios, checking the consistency of the incurred-paid data from the Company's system with the figures reported in the 2005 NAIC Annual Statement, and estimating claims unpaid for the valuation date of December 31, 2005. Several issues and one reclassification were noted in the review. (See Instruction Nos. 1b, 1c, 2, and Comment and Recommendation No. 1)

REINSURANCE

The Company has not engaged in any reinsurance transactions during the examination period.

SPECIAL DEPOSITS

The OIC requires the filing of the Underwriting of Indemnity Calculation of Funded Reserve form pursuant to WAC 284-07-050(8). The calculation as of December 31, 2005, pursuant to WAC 284-44-330 and WAC 284-44-340, requires a minimum deposit in the amount of $25,935,008.

Various securities with a total fair market value in excess of $41,000,000 are being held in a special deposit account by the Company's custodian, Bank of America, pursuant to RCW 48.44.030. The deposits were confirmed to be held by the Company for the protection of its policyholders.

ACCOUNTING RECORDS AND INFORMATION SYSTEM

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) basis and adjusts it to Statutory Accounting Practice (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the CPA firm of Deloitte and Touche, LLP. The Company received unqualified opinions for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no significant exceptions were noted.

The management of RBS is sufficiently knowledgeable of the information system process. System development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate internal controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the internal controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's information system department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written recovery plan.

SUBSEQUENT EVENTS

There were no material events adversely impacting the Company between the examination date and the last date of our field work.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of the Company as of December 31, 2005:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Five-Year Reconciliation of Surplus

Regence BlueShield
Assets, Liabilities, Capital and Surplus
As of December 31, 2005

Assets	Balance Per Company	ref.	Examination Adjustment	Balance Per Examination
Bonds	$ 544,171,424		$0	$ 544,171,424
Preferred stocks	536,000			536,000
Common stocks	324,292,424			324,292,424
Real Estate:				-
Properties occupied by the company	17,898,078			17,898,078
Properties held for the production of income	948,715			948,715
Properties held for sale	312,381			312,381
Cash, cash equivalent, and short-term investments	60,483,545			60,483,545
Other invested assets	19,164,180			19,164,180
Receivables for securities	1,745,334		0	1,745,334
Subtotals, cash and invested assets	969,552,081		0	969,552,081
Investment income due and accrued	8,270,950			8,270,950
Premiums and considerations:				
premiums and agents' balances in the course of collection	63,977,028			63,977,028
Amounts receivable relating to uninsured plans	15,474,184			15,474,184
Current federal and foreign income tax recoverable	2,737,987			2,737,987
Net deferred tax asset	7,728,769			7,728,769
Electronic data processing equipment and software	326,820			326,820
Receivables from parent; subsidiaries and affiliates	3,488,907			3,488,907
Health care and other amounts receivable	2,712,744			2,712,744
Aggregate write-ins for other than invested assets:				
Assets held for member physician plan	25,978,363			25,978,363
Employee deferred compensation	5,343,931			5,343,931
Cash value of exec. life insurance	4,161,509		0	4,161,509
Total Assets	**$ 1,109,753,273**		**$0**	**$ 1,109,753,273**
Liabilities, Capital, and Surplus				
Claims unpaid	$ 159,869,688		$0	$ 159,869,688
Accrued medical incentive pool and bonus amounts	775,219			775,219
Unpaid claims adjustment expenses	5,181,233			5,181,233
Aggregate health policy reserves	78,192,737	1	(11,368,750)	66,823,987
Premiums received in advance	35,594,251	1	11,368,750	46,963,001
General expenses due or accrued	23,271,727			23,271,727
Amounts withheld or retained for the account of others	37,165,949			37,165,949
Remittance and items not allocated	557,757			557,757
Amounts due to parent; subsidiaries and affiliates	41,220,653			41,220,653
Payable for securities	2,252,683			2,252,683
Liability for amounts held under uninsured plans	5,629,833			5,629,833
Aggregate write-ins for other liabilities:				
Stale Dated Checks	3,211,904			3,211,904
Misc. Accounts Payable	247,988			247,988
Total liabilities	**393,171,622**		**0**	**393,171,622**
Unassigned funds (surplus)	716,581,651		0	716,581,651
Total capital and surplus	**716,581,651**		**0**	**716,581,651**
Total liabilities; capital and surplus	**$ 1,109,753,273**		**$0**	**$ 1,109,753,273**

Regence BlueShield
Statement of Revenue and Expenses
For the Year Ended December 31, 2005

	Balance Per Company	ref.	Examination Adjustment	Balance Per Examination
Member months	10,329,559			10,329,559
Net premium income	$ 1,762,118,916		$0	$ 1,762,118,916
Change in unearned premium reserves	(4,344,666)			(4,344,666)
Total revenues	1,757,774,250		0	1,757,774,250
Hospital and Medical:				
Hospital/medical benefits	583,967,973			583,967,973
Other professional services	534,025,593			534,025,593
Outside referrals	19,187,685			19,187,685
Emergency room and out-of-area	37,403,122			37,403,122
Prescription drugs	181,766,813			181,766,813
Incentive pool; withhold adjustments and bonus amounts	1,504,447			1,504,447
Subtotal	1,357,855,633		0	1,357,855,633
Less:				
Total hospital and medical	1,357,855,633			1,357,855,633
Claims adjustment expenses	101,630,084			101,630,084
General administrative expenses	187,789,376			187,789,376
Total underwriting deductions	1,647,275,093		0	1,647,275,093
Net underwriting gain or (loss)	110,499,157		0	110,499,157
Net investment income earned	39,123,538			39,123,538
Net realized capital gains or (losses) less capital gains tax	27,347,674		0	27,347,674
Net investment gains or (losses)	66,471,212		0	66,471,212
Net gain(loss) from agents' or premium balances charged off	795			795
Aggregate write-ins for other income or expenses	4,070,749		0	4,070,749
Net income or (loss); after capital gains tax and before FIT	181,041,913			181,041,913
Federal and foreign income taxes incurred	52,935,532			52,935,532
Net income (loss)	**$ 128,106,381**		**$0**	**$ 128,106,381**
CAPITAL AND SURPLUS ACCOUNTS				
Capital and surplus prior-reporting period	$ 618,116,129		$0	$ 618,116,129
Net income(loss) from above	128,106,381			128,106,381
Change in net unrealized capital gain(loss) less capital tax	(23,336,866)			(23,336,866)
Change in deferred income tax	(1,027,849)			(1,027,849)
Change in nonadmitted assets	(5,276,144)			(5,276,144)
Net change in capital and surplus	98,465,522		0	98,465,522
Capital and surplus end of reporting period	**$ 716,581,651**		**$0**	**$ 716,581,651**

Regence BlueShield
Five Year Reconciliation of Surplus
For the Years Ended December

	2005	2004	2003	2002	2001
Capital and Surplus, Prior Reporting Year	$ 618,116,129	$ 500,954,706	$ 345,638,989	$ 411,644,252	$ 390,069,839
Net income or (loss)	128,106,381	122,232,352	20,750,489	10,441,511	39,884,764
Net unrealized capital gains and losses	(23,336,866)	22,399,641	55,346,832	(16,045,536)	(3,059,086)
Change in net deferred income tax	(1,027,849)	(15,077,163)	(3,862,376)	44,749,730	(11,456,087)
Change in nonadmitted assets	(5,276,144)	100,699,294	91,826,578	(104,294,993)	(43,222,810)
Cumulative effect of changes in accounting principles					17,037,857
Aggregate write-ins for gains or (losses) in surplus:					
Grant to Regence BlueShield of Idaho			(5,000,000)		
IBNR - uninsured accident and health plans		(113,092,701)	(3,937,299)	(580,000)	23,420,000
Change in minimum premium liability - SERP			1,733,570	(72,339)	(1,030,225)
Reverse capital lease				102,400	
Transfer of post employment liability to TRG			(1,542,077)	(306,036)	
Net change in capital and surplus	98,465,522	117,161,423	155,315,717	(66,005,263)	21,574,413
Capital and Surplus, End of Reporting Period	**$ 716,581,651**	**$ 618,116,129**	**$ 500,954,706**	**$ 345,638,989**	**$ 411,644,252**

NOTES TO THE FINANCIAL STATEMENTS

The Company has no special consents, permitted practices or orders from the state of Washington. There is one examination reclassification, debiting “Aggregate health policy reserves”, and crediting “Premiums received in advance” in the amount of $11,368,750. (See Instruction No. 1b)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Regence BlueShield during the course of this examination.

In addition to the undersigned, the following individuals participated in the examination and the preparation of this report. Representing the Washington State Office of the Insurance Commissioner: Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Field Supervisor; Lichiou Lee, ASA, MAAA, Health Actuary; Friday P. Enoye, Insurance Examiner; Ann V. Kaufman, CPA, Insurance Examiner; Bert Karau, CPA, AFE, Insurance Examiner; Youngjae Lee, CPA, Insurance Examiner; and Tarik Subbagh, CPA, CFE, Insurance Examiner. Representing the Oregon Department of Consumer and Business Services, Insurance Division: Michael Phillips, CPA, CFE, AES, Examiner-in-charge; Raymond W. Anderson, AFE, Insurance Examiner; Mark A. Giffin, CFE, Insurance Examiner; Timothy R. Hurley, CFE, Insurance Examiner. Representing the Idaho Insurance Department: Lois Haley, CPA, CFE, Examiner-in-charge. Representing the Utah Insurance Department: David Daulton, CFE, Examiner-in-charge.

Respectfully submitted,

Je Liao

Jeanette Jiangtao Liao, CPA, AFE
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
} **ss**
COUNTY OF KING }

Jeanette Jiangtao Liao, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of her knowledge and belief.

She attests that the examination of Regence BlueShield was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Jeanette Jiangtao Liao, CPA, AFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me on this 2nd day of July 2007.

COLLEEN JANSEN
NOTARY PUBLIC
COMMISSION EXPIRES 5-17-08
STATE OF WASHINGTON

Notary Public in and for the
State of Washington, residing
at Seattle.
My commission expires 5/17/08.