

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

OF

**Premera Blue Cross
Mountlake Terrace, Washington**

NAIC CODE 47570
DECEMBER 31, 2004

Order No. G 07-4
Premera Blue Cross
Exhibit A

SALUTATION

Seattle, Washington
March 1, 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

Premera Blue Cross

of

Mountlake Terrace, Washington

hereinafter referred to as "PBC" or the "Company," at the location of its home office, 7001 220th Street SW, Mountlake Terrace, Washington 98043. This report is respectfully submitted showing the condition of the Company as of December 31, 2004.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Premera Blue Cross of Mountlake Terrace, Washington. This report shows the financial condition and related corporate matters as of December 31, 2004.



Patrick H. McNaughton
Chief Examiner

3-1-2007

Date

TABLE OF CONTENTS

SCOPE OF THE EXAMINATION.....	1
INSTRUCTIONS.....	1
COMMENTS AND RECOMMENDATIONS.....	7
COMPANY PROFILE	7
Company History.....	7
Capitalization.....	7
Territory and Plan of Operation.....	7
Acquisitions, Mergers, Disposals, Dissolutions, Purchases, and Sales.....	8
Growth of Company	8
AFFILIATED COMPANIES	8
Organizational Chart.....	9
INTERCOMPANY AGREEMENTS.....	10
MANAGEMENT AND CONTROL.....	10
Ownership.....	10
Board of Directors	11
Senior Officers.....	11
Conflict of Interest.....	12
Fidelity Bond and Other Insurance.....	12
Officers', Employees', and Agents' Welfare and Pension Plans	12
CORPORATE RECORDS	13
ACTUARIAL REVIEW.....	13
REINSURANCE.....	13
SPECIAL DEPOSITS.....	13
ACCOUNTING RECORDS AND INFORMATION SYSTEMS.....	14
SUBSEQUENT EVENTS	14
FINANCIAL STATEMENTS	14
Assets, Liabilities, Capital and Surplus.....	15
Statement of Revenue and Expenses.....	16
Five Year Reconciliation of Surplus	17
NOTES TO THE FINANCIAL STATEMENTS.....	18
ACKNOWLEDGMENT.....	19
AFFIDAVIT	20

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2000 through December 31, 2004 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.

INSTRUCTIONS

The examiners reviewed the Company's filed 2004 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).

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 2004 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions.

a. Non-Admitted Accounts Receivable for Uninsured Plans

The Company misstated "Amounts receivable related to uninsured plans" in its 2004 NAIC Annual Statement. A receivable for \$88,187, that was past due over 90 days, was incorrectly included as an admitted receivable. In accordance with SSAP No. 47, paragraphs 9 and 10, amounts past due over 90 days cannot be included as an admitted receivable. (See examination adjustment No. 1, debiting "Unassigned funds (surplus)" and crediting "Amounts receivable relating to uninsured plans in the amount of \$88,187".)

b. Contingent Commitment NAIC Annual Statement Disclosure

Note No. 14.D., Contingencies, paragraph 7 and paragraph 9, in the Notes to Financial Statements, of the 2004 NAIC Annual Statement, is incorrect because the trailing zeros

have been truncated. The format for this reporting should be full numbers without truncation. In addition, the actual estimated retaliatory tax reserve used should have been \$4.4 million in 2004 rather than the \$2.5 million as reported in Note No. 14.D for the same estimate.

c. Real Estate Investment Disclosure

The real estate investment disclosure in the Notes to Financial Statements of the 2004 NAIC Annual Statement is incorrect regarding the wording which states, "The Company has no investments in real estate." The Company has investments in real estate and reported \$40,524,252 as real estate owned in the 2004 NAIC Annual Statement.

d. Unpaid Claims for Uninsured Plans

The Company erroneously reported incurred but not reported (IBNR) claims under several Administrative Service Contracts (ASC) in the amount of \$84,308,924 as "Liability for amounts held under uninsured accident and health plans" and a corresponding "Amounts receivable relating to uninsured plans". SSAP No. 47, paragraph 8, states that a receivable shall not be recorded for unpaid claims. (See examination adjustment No. 2, debiting, the liability account, and crediting the receivable account in the amount of \$84,308,924.)

e. Premium Reporting on Schedule T and the Underwriting and Investment Exhibit, Part 1

The Company erroneously reported earned premiums instead of written premiums on Schedule T and in the Underwriting and Investment Exhibit, Part 1, Column 1 in the 2004 NAIC Annual Statement. Pursuant to the 2004 NAIC Annual Statement Instructions, for the Underwriting and Investment Exhibit, Part 1, and Schedule T, written premiums should be reported. The Company correctly used written premiums for its premium tax calculations.

f. Remittances and Items Not Allocated Misclassified

The Company misclassified unapplied premium payments in the amount of \$7,159,225 as "Aggregate write-ins for other liabilities" in the 2004 NAIC Annual Statement. Pursuant to SSAP No. 67, paragraph 9, and the 2004 NAIC Annual Statement Instructions, the unapplied premium payments should have been reported as "Remittances and items not allocated". (See examination reclassification adjustment No. 3, debiting, "Aggregate write-ins for other liabilities" and crediting, "Remittances and items not allocated" in the amount of \$7,159,225.)

g. Securities Lending Annual Statement Disclosure

SSAP No. 18, paragraph 36.b, requires annual statement disclosure of securities lending transactions. The 2004 NAIC Annual Statement Instructions specifically require that the Company not alter the number scheme of the Notes to Financial Statements, and that the securities lending disclosures utilize Note No. 21.C. The Company disclosed its securities lending transactions in Note No. 1.C (12), Notes to the Financial Statements of the 2004 NAIC Annual Statement.

The Company also did not answer General Interrogatory No.19.1 correctly in the 2004 NAIC Annual Statement. The Company incorrectly answered "Yes", and it has loaned

securities under the exclusive control of the Company. The NAIC Annual Statement Instructions for General Interrogatory No. 19.1 requires a "No" answer when loaned securities are under the exclusive control of the Company. A "No" answer also requires the completion of information of General Interrogatory No. 19.2, which was not completed.

h. Other Assets Not Under the Exclusive Control of the Company Annual Statement Disclosure

The Company has reported other securities restricted as to sale, but left General Interrogatory No. 20.3 in the 2004 NAIC Annual Statement blank. The 2004 NAIC Annual Statement Instructions require the disclosure of the nature of the restriction, a description and the amount of the restriction in General Interrogatory No. 20.3 when its assets are not exclusively under control of the Company.

i. Securities Lending Accounting for Collateral Received on Securities Loaned

The Company erroneously reported securities lending collateral in the amount of \$118,112,893 in the 2004 NAIC Annual Statement balance sheet as an asset with a corresponding liability. The collateral received by the Company is not available for the general use of the transferor and therefore restricted. Pursuant to SSAP No. 18, paragraph 25, restricted collateral shall not be reflected in the transferor's balance sheet as an asset with a corresponding liability for the return of the collateral. (See examination report adjustment No. 4, debiting "Aggregate write-ins for other liabilities" and crediting, "Aggregate write-ins for other than invested assets" in the amount of \$118,112,893.)

j. Rental Income Footnote Disclosure

Footnote (d) in the 2004 NAIC Annual Statement, Exhibit of Net Investment Income on page 15 did not report \$5,267,842 in rental income for the Company's occupancy of its own buildings, and footnote (i) did not report \$2,012,484 for depreciation on real estate, both required by the NAIC Annual Statement Instructions. No examination report adjustment is required because these are only footnotes to the Exhibit of Net Investment Income.

k. Additional Data to the NAIC Annual Statement

The Company did not prepare the 2004 Additional Data to the Annual Statement correctly as required by WAC 284-07-050(8). The Company included in the small group category group sizes 2 up to 99 employees and association business. RCW 48.43.005(24) defines a small group as fewer than 51 eligible employees, and RCW 48.44.024(2) states that associations are not considered small groups.

l. Accrued Retrospective Premium Disclosure

The method used by PBC to estimate accrued retrospective premium adjustments was not described correctly and the amount of net premiums written as well as the corresponding percentage to the total net premiums written was not disclosed in Note No. 24 in the Notes to Financial Statements of the 2004 NAIC Annual Statement, pursuant to SSAP No. 66, paragraphs 12-14, and the 2004 NAIC Annual Statement Instructions for Note No. 24.

m. Special Deposit, Schedule E – Part 3, Reporting Error

PBC erroneously reported the fair market value of deposits in the amount of \$10,285,360 on Schedule E – Part 3 – Special Deposits as part of the indemnification deposit required under WAC 284-44-330. These funds were not designated for this purpose by the Company nor do they meet the restricted depository requirements under RCW 48.44.030. These deposits should not have been included in the “Washington” line on Schedule E, Part 3, but should have been correctly included under the line “Other” Schedule E, Part 3.

The Company is instructed to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs; 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 and the NAIC AP&P Manual.

2. Tax Allocation

Various subsidiary companies have been utilizing portions of the Federal income tax net operating loss carry forward of the Company without properly reimbursing the Company. Without reimbursement, the net income and unassigned funds for the Company and its subsidiaries have been reported incorrectly in the NAIC Annual Statements over the period of this examination. Accordingly, the Federal income tax on the Summary of Operations in the NAIC Annual Statements is not properly charged on a separate return calculation basis as is claimed in the Notes to Financial Statements. This distorts the presentation of the Company’s financial position and operating results because the subsidiaries are utilizing the Company’s net operating loss without accounting for the income tax reduction which resulted from the utilization. SSAP No. 25, paragraph 14a, requires that a transaction conducted between affiliates for business purpose “...shall be recorded at its fair value at the date of the transaction”. Accordingly, “Unassigned funds (surplus)” should be credited and “Receivables from parent, subsidiaries and affiliates” should be debited in the amount of \$9,960,000. (See adjustment No. 5)

The Company is instructed to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs; 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 and the NAIC AP&P Manual.

3. Holding Company Act Failure to Report All Required Data

PBC omitted naming LifeWise Health Plan of Arizona, Inc. (LWAZ) as a party to the Intercompany Cost Allocation agreement between the Company and LWAZ in its 2004 annual registration statement, Form B.

RCW 48.31C.040(1) requires every Washington health care service contractor subject to the Health Carrier Holding Company Act to keep current the information required to be disclosed in its registration statement by reporting all material changes or additions within

fifteen days after the end of the month in which it learns of each change or addition. RCW 48.31C.040(2)(c)(v) requires current agreements to be included with the annual registration statement (Form B).

The Company is instructed to comply with RCW 48.31C.040 and file all required information when submitting the annual registration statement or when material changes or additions are required to be filed with the OIC on an interim basis.

4. Investment Custodial Agreement Criteria

The Company's custodial and safekeeping agreement with the Bank of New York Trust Company (BNY) does not contain all the custodial agreement criteria as required by the 2004 NAIC Financial Condition Examiners Handbook (FCEH), Part 1 - General, Section IV.J. The 2004 NAIC Annual Statement Instructions for General Interrogatory No. 23 requires investment custodial safekeeping agreements to include language as required by the NAIC FCEH.

The Company also incorrectly listed BNY in General Interrogatory No. 23.01 of the 2004 NAIC Annual Statement as having custodial agreements that comply with the NAIC FCEH.

The Company is instructed to amend its custodial agreement with BNY to include appropriate wording and criteria as set forth in the NAIC FCEH pursuant to RCW 48.03.010(1) and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions.

In connection with the incorrect statement in General Interrogatory No. 23.01, the Company is also instructed to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs.

5. Initial Reporting of Subsidiary, Controlled and Affiliated (SCA) Entities to the Securities Valuation Office (SVO)

PBC has not completed or submitted subsidiary information (SUB 1-form) to the SVO for valuation of the common stock of its wholly owned subsidiary, Premera Blue Cross Blue Shield of Alaska (PBCBSA), pursuant to SSAP No. 46, paragraph 7.a.ii. PBCBSA was incorporated on January 29, 2003 with 1,000 shares of common capital stock at a cost of \$2.028 million. PBC listed the initial cost as the book value as of December 31, 2004.

The Company is instructed to complete and submit a SUB 1-form to the SVO as required in Part Eight, Section 2(a) and (b) of the SVO manual, pursuant to; SSAP No. 46, paragraph 23; RCW 48.03.010(1) which requires the consideration of criteria as set forth in the NAIC FCEH; 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 and the NAIC AP&P Manual.

6. Underwriting of Indemnity Deposit Deficiency

Pursuant to 48.44.030 RCW, the Company is required to place securities on deposit with the state of Washington in the amount equal to the greater of \$150,000 or the amount necessary to cover incurred but unpaid reimbursement or indemnity benefits as reported in the last annual statement filed with the insurance commissioner. The Company's calculated funded reserve for non service indemnity benefits as December 31, 2004 was \$49,590,633. The Company had \$47,812,670 securities on deposit with the insurance commissioner as of December 31, 2004. The required deposit is deficient by \$1,777,963.

The Company is instructed to comply with RCW 48.44.030, and WAC 284-44-340, which require a health care service contractor to maintain a minimum indemnity deposit with the state of Washington pursuant to the underwriting of indemnity calculation.

7. Statement of Actuarial Opinion (SAO) Issues

- a. The 2004 SAO was signed by two actuaries. One actuary used the term "I" or "my opinion" throughout the SAO, but also mentioned that the review was in conjunction with another actuary. The 2004 NAIC Annual Statement Instructions require the SAO to be signed by "a qualified actuary", not more than one actuary.
- b. The consulting actuary separated unpaid claims and unpaid claims adjustment expenses into actuarial and non-actuarial items, and stated that non-actuarial items are beyond the scope of actuarial review for the SAO. The 2004 NAIC Annual Statement Instructions and SSAP No. 55 require the actuary to calculate, examine, and opine on all items related to the unpaid claims and unpaid claims adjustment expenses as they are reported in the 2004 NAIC Annual Statement.
- c. The consulting actuary also did not state if there were any actuarial liabilities or any reserve for rate credits or experience rated refunds. Experience rated refunds were included in the "Health Policy Reserves", but the 2004 NAIC Annual Statement Instructions require the actuary to list experience rated refunds separately.
- d. Exhibit 1, attached to the 2004 SAO stated, "The Plan has not purchased reinsurance from an outside carrier." The Company does purchase reinsurance and cedes 100% of its long term care claims to reinsurance carriers as reported in the 2004 NAIC Annual Statement.

The Company is instructed to comply with WAC 284-07-060(2)(a) and include a SAO that is in compliance with the NAIC Annual Statement Instructions and NAIC AP&P Manual pursuant to WAC 284-07-050(2).

8. Understated and Overstated Unpaid Claims Adjustment Expense (CAE)

Unpaid CAE for health plans are usually based on the historical ratio of paid CAE to paid claims, multiplied by the unpaid claims. The Company has consistently understated and overstated the accrued unpaid CAE compared to actual paid CAE for the corresponding periods as indicated in the following schedule of ratios:

<u>Year</u>	<u>CAE Accrued Ratio</u>	<u>CAE Actual Ratio</u>	<u>Accrual was Overstated/(Understated)</u>
2004	15.37%	8.16%	7.21%
2003	10.94	10.80	0.14
2002	3.85	7.69	(3.84)
2001	3.51	6.80	(3.29)
2000	3.35	6.47	(3.12)

The Company is instructed to adequately account for unpaid claims adjustment expenses using past experience adjusted for current trends, pursuant to SSAP No. 55, paragraph 8, and comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs; with RCW 48.43.097 which requires the filing of its financial statements; and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the NAIC AP&P Manual.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

Premera Blue Cross is a state of Washington domiciled nonprofit corporation organized pursuant to Chapter 24.03 RCW and is licensed as a health care service contractor. The Company is engaged in the business of providing basic medical, hospital, major medical, comprehensive, and other prepaid health care benefits for its subscribers in the states of Washington and Alaska.

Capitalization

Minimum capital requirements pursuant to RCW 48.44.037 are met with \$446 million in Unassigned funds as of December 31, 2004. The Company does not have any capital stock. The sole voting member is PREMIERA, an upstream holding company.

Territory and Plan of Operation

PBC is registered as a health care service contractor in the state of Washington and a hospital and medical service corporation in the state of Alaska. It sells group contracts and individual subscription contracts in those states. It also sells long term care insurance. Significant types of subscriber contracts administered by the Company include individual indemnity, group

indemnity, group preferred provider organizations, group managed care, Medicaid, Medicare Supplement, and self-insured. The Company operated as fiscal intermediary for Medicare until September 30, 2004. Additionally, the Company ceased Medicaid operations effective June 1, 2004. PBC provides administrative services for self-insured groups in Washington and Alaska.

Acquisitions, Mergers, Disposals, Dissolutions, Purchases, and Sales

In 1994, Blue Cross of Washington and Alaska (BCWA) affiliated with Medical Service Corporation of Eastern Washington (MSC) to form an upstream nonprofit holding company, PREMERA. BCWA and MSC continued to operate separately until June 1998 when BCWA merged with MSC and changed its name to Premera Blue Cross.

On December 22, 2000, one of PBC's affiliated companies, Premera HealthPlus, was merged into PBC. Premera HealthPlus was a nonprofit Washington corporation formed in 1981 and was licensed as a health maintenance organization in the states of Washington and Idaho.

Growth of Company

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

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Assets, Liabilities, Capital and Surplus:					
Admitted Assets	\$728,118,585	\$844,878,665	\$819,825,259	\$1,023,957,747	\$1,191,274,346
Liabilities	<u>\$457,018,995</u>	<u>\$515,889,888</u>	<u>\$508,212,481</u>	<u>\$650,885,522</u>	<u>\$745,283,421</u>
Capital and Surplus	<u><u>\$271,099,590</u></u>	<u><u>\$328,988,777</u></u>	<u><u>\$311,612,778</u></u>	<u><u>\$373,072,225</u></u>	<u><u>\$445,990,925</u></u>
Revenue and Expenses:					
Premiums Earned	\$1,770,441,528	\$2,074,425,407	\$2,147,810,056	\$2,295,421,096	\$2,319,788,450
Net Underwriting Deductions	<u>1,760,829,957</u>	<u>2,057,090,992</u>	<u>2,123,430,565</u>	<u>2,268,115,911</u>	<u>2,267,529,750</u>
Underwriting Gain or Loss	9,611,571	17,334,415	24,379,491	27,305,185	52,258,700
Investment and Other Income	<u>32,685,076</u>	<u>31,398,198</u>	<u>(10,390,035)</u>	<u>18,286,143</u>	<u>40,382,930</u>
Pre-Tax Income	42,296,647	48,732,613	13,989,456	45,591,328	92,641,630
Taxes Incurred	<u>11,140,054</u>	<u>10,227,992</u>	<u>6,464,448</u>	<u>10,554,372</u>	<u>25,162,701</u>
Net Income	<u><u>\$31,156,593</u></u>	<u><u>\$38,504,621</u></u>	<u><u>\$7,525,008</u></u>	<u><u>\$35,036,956</u></u>	<u><u>\$67,478,929</u></u>

AFFILIATED COMPANIES

PREMERA:

PREMERA is a non-profit holding company organized in the state of Washington under Chapter 24.06 RCW, and is the sole voting member of PBC.

LifeWise Health Plan of Arizona, Inc. (LWAZ):

LWAZ is domiciled in the state of Washington and licensed as a life and disability carrier in the states of Washington and Arizona. LWAZ does not sell policies in the state of Washington. PBC owns 100% of the outstanding shares of LWAZ.

Washington-Alaska Group Services, Inc. (WAGS):

WAGS is a for-profit insurance agency which, in turn, owns 100% of LifeWise Assurance Company, Inc. (LWAC), LifeWise Health Plan of Oregon, Inc. (LWOR), LWWA, Northstar Administrators, Inc. (NorthStar), LifeWise Administrators, Inc., and Calypso Healthcare Solutions (Calypso). PBC owns 100% of WAGS. WAGS owns 100% of the voting securities of LWAC and LWWA:

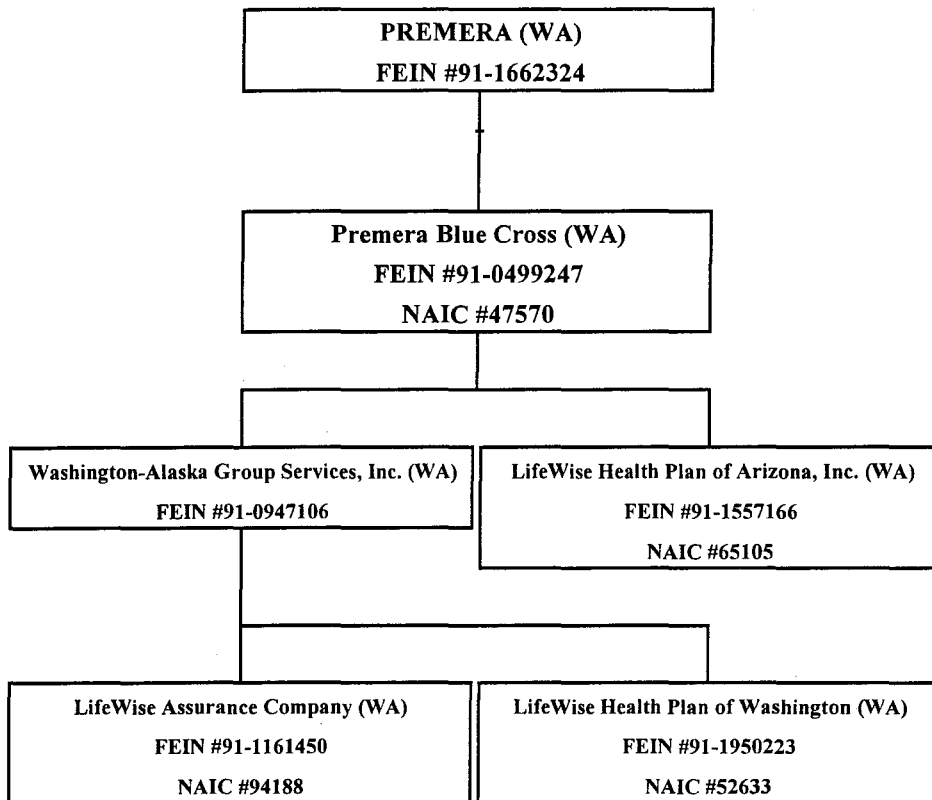
LifeWise Assurance Company, Inc. (LWAC):

LWAC is a for-profit life insurance company domiciled in the state of Washington and licensed to write group life, accident, disability, and medical contracts.

LifeWise Health Plan of Washington (LWWA):

LWWA is a non-profit health care services contractor domiciled in the state of Washington and licensed to provide individual and group medical coverage to Washington State residents.

Organizational Chart:



INTERCOMPANY AGREEMENTS

The Company has several agreements with affiliates. As a member of an insurance company holding system, these agreements and any amendments must be filed with the OIC pursuant to RCW 48.31C.050(2)(c)(d) for health affiliates and RCW 48.31B.030(1)(b)(iv) for life affiliates, both which require that all such transactions are subject to approval by the commissioner, even without a written agreement. As of December 31, 2004, the Company was party to the following agreements:

Services Agreement (SA) (eff. 9-1-2000 between PBC & Calypso):

Calypso provides investigation and recovery services and related consultative, management and administrative services, including, without limitation, subrogation, coordination of benefits, claims audit, and claim overpayment identification and recoveries. This agreement was terminated on January 31, 2005 and replaced with a new agreement effective February 1, 2005.

Management Agreement (MA)

The MA states that PBC will provide all management and administrative services for LWAC as described in the agreement including accounting and financial management.

Intercompany Agreement (Allocation of Costs)

PBC maintains an activity based cost accounting system. Operating expenses are accumulated in accordance with GAAP and allocated to the lines of business based upon an appropriate quantifiable measure supporting the activities performed.

Restated Intercorporate Tax Sharing Agreement

This agreement specifies the manner in which the parties will share that portion of the consolidated tax liability of the affiliated group that is allocated to PBC under the agreement, and any reimbursements that are required to be made by or to PBC under the agreement for utilization of tax attributes.

Subsidiary Tax Sharing Agreement

This agreement specifies the manner in which the parties will share among themselves that portion of the consolidated tax liability of the affiliated group that is allocated to PBC under the Intercorporate Tax Sharing Agreement.

Guaranty Agreement

PBC agreed to provide a guarantee of admitted assets of LWAC in the amount necessary to maintain the minimum ratio of admitted assets to liabilities of 120%, but not to exceed \$5,000,000.

MANAGEMENT AND CONTROL

Ownership

The Company's Articles of Incorporation state that the corporation shall have no capital stock and that no one shall receive any pecuniary gain or benefit by reason of their membership in the corporation. PREMERA is the sole voting member of PBC.

Board of Directors (BOD)

Management of the Company is vested in a BOD made up of no more than fourteen members, all of whom are subject to the approval of its sole voting member, PREMERA, as provided for by the Company's Bylaws. The BOD holds its annual meetings in the second quarter of every year and meets no less than four times each calendar year. A majority of the directors constitutes a quorum for the transaction of business. The BOD also has an executive committee made of six members who possess and may exercise the power of the board during the intervals between meetings of the BOD. In addition, the BOD has appointed an investment committee which reviews and approves investment transactions, and an audit committee which deals with internal control, and accounting and reporting practices of the company. There are also compensation and governance committees.

The following individuals were Directors as of December 31, 2004:

H.R. Brereton Barlow	Eleanor L. Andrews
Paula E. Boggs	Patrick M. Fahey
Richard D. Ford	Richard P. Fox
John G. Golhofer, MD	Sarah M. Jewell
William N. Lampson	Maria M. Pope
John Thomas Rulon, MD	Thomas A. Waltz, MD

Senior Officers

The president and chief executive officer is a member of the BOD, and is appointed by the sole voting member, subject to ratification and approval by the BOD for an unspecified term ending upon the election of a successor or earlier removal from office. The remaining senior officers are elected or appointed by the BOD at the annual meeting of the BOD for a one year term.

The following individuals were senior officers as of December 31, 2004:

H.R. Brereton Barlow	President and Chief Executive Officer
Yoram Milo	Secretary and Executive VP – Chief Legal & Public Policy Officer
Kent S. Marquardt	Treasurer and Executive VP – Chief Financial Officer
Brian E. Ancell	Executive VP – Health Care Services & Strategic Development
L. Heyward R. Donigan	Executive VP – Chief Marketing Executive
Karen M. Bartlett	Senior VP – Operations
John P. Domeika	Senior VP – General Counsel
John L. Castiglia M.D.	Senior VP – CMO & SVP of Care Facilitation
Audrey L. Halvorson	Senior VP – Chief Actuary
Barbara B. Magusin	Senior VP – Human Resources
Richard A. Maturi	Senior VP - HCDS
Jack C. McRae	Senior VP – Congressional/Legal Affairs
Sri Sagadevan	Senior VP – Chief Underwriter
Alan E. Smit	Senior VP – Chief Information Officer

Conflict of Interest

The Company has adequate reporting procedures in place to reveal potential conflicts of interest to the chair of the BOD or the president of the Company.

Fidelity Bond and Other Insurance

The Company is a named insured on a Financial Institution Fidelity Bond. An aggregate and single loss limit of coverage in the amount of \$5,000,000 is provided for all of the affiliated companies, and the single loss deductible is \$100,000. The minimum amount recommended by the NAIC for the insured companies is \$2,500,000 to \$3,050,000. The amount of coverage is adequate to cover the exposure risk of the Company and its affiliates.

The Company is also provided protection against certain property and liability losses as a named insured on several other purchased insurance policies. Policies in effect at December 31, 2004 provided the following coverages:

- Directors and Officers Liability Insurance including Employment Practices Liability Coverage.
- Errors and Omission Coverage.
- Umbrella.
- Property.

The review of the Company insurance policies indicates that adequate insurance coverage has been purchased and is in force covering the 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 the parent, PREMERA

Officers', Employees', and Agents' Welfare and Pension Plans**Defined Benefit Plan**

The Company participates in a PREMERA pension equity plan covering substantially all of its employees and employees of its subsidiaries, a postretirement benefit plan which provides certain health care benefits for eligible retired employees, and a non-qualified defined benefit supplemental retirement program covering executive management.

Defined Contribution Plans

The Company also participates in a PREMERA non-qualified contribution retirement program for executive management employees, and a deferred compensation plan for officers and members of the PREMERA Board of Directors. The Company funds the deferred benefits of these programs through the establishment of a separate deferred benefit trust. The Company's employees also participate in a PREMERA defined contribution retirement savings plan, pursuant to Section 401(k) of the Internal Revenue Code, for employees in the quarter following the date of hire.

Consolidated/Holding Company Plans

The Company participates in a PREMERA pension equity plan covering substantially all of its employees and employees of its subsidiaries.

The Company also has adequate procedures in place to determine and monitor various accrued liabilities for salaries, severance pay, vacation pay and retirement benefits. No under-accruals were noted and reasonable amounts were appropriately included as general expenses due and accrued.

CORPORATE 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, 2004. This review included: examining the Company's reserving philosophy and methods to determine the reasonableness of the claim liabilities; verifying that claim liabilities included provisions for all components noted in SSAP NO. 55, paragraphs 7 and 8; reviewing historical paid claims and loss ratios; checking the consistency of the incurred-paid data from the Company system to the amounts reported in the 2004 NAIC Annual Statement; and estimating claims unpaid as of December 31, 2004.

The OIC health actuary found several items in the 2004 Statement of Actuarial Opinion (SAO) that were not consistent with the 2004 NAIC Annual Statement Instructions and SSAP No. 55, paragraphs 7 and 8 (See Instruction No. 7a-7d). Additionally, several items in the 2004 NAIC Annual Statement did not represent accurate actuarial information (See Instruction No. 1k and 1l)

REINSURANCE

The Company ceded 100% of its long term care business during the period of the examination. A contract was prepared with Continental Casualty Company effective October 1, 1999 and was renewed annually until October 1, 2004 when a new contract was written with MedAmerica Insurance Company. The Company has no other reinsurance agreements.

SPECIAL DEPOSITS

The OIC requires the filing of the "Underwriting of Indemnity Calculation or Funded Reserve" form pursuant to WAC 284-07-050(8). The calculation as of December 31, 2004, pursuant to WAC 284-44-340, requires a minimum deposit in the amount of \$49,590,633. The Company also maintains an additional voluntary special deposit that is not required by the state of Washington, but is in connection with the merger of Premera HealthPlus into PBC.

Various securities with a total fair market value in the amount of \$58,098,030 are being held in a special deposit account by the custodian, BNY. \$10,285,360 of the total is the fair market value

of securities held pursuant to the contractual provisions for the aforementioned merger. When the total value is reduced by the amount attributed to the merger, the "Underwriting of Indemnity" reserve is deficient in the amount of \$1,777,963, pursuant to requirements of WAC 284-44-340. Consequently, the Company is not in compliance with the filing requirements of WAC 284-07-050(8) as of December 31, 2004. (See Instruction No. 6). Subsequent to the examination date, the Company added \$3 million in May 2005 to correct the deficiency.

The deposits were confirmed directly with the custodian by the examiners.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young LLP. The Company received an unqualified opinion 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 exceptions were noted.

The management of PBC is sufficiently knowledgeable of the information system process. Systems 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 Technology Department has the ability to recover from an incident or disaster and has documented the procedures in a detailed, written disaster recovery plan.

SUBSEQUENT EVENTS

There has been one event subsequent to December 31, 2004, which would have a material effect on the financial condition of the Company. The Company made a request to OIC to change its corporate structure from a nonprofit company to a for profit company. The OIC denied the conversion request and the matter was appealed by the Company and is currently pending in the Washington State Supreme Court.

FINANCIAL STATEMENTS

The following examination financial statements show the financial conditions of Premera Blue Cross as of December 31, 2004:

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

**PREMERA BLUE CROSS
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
AS OF DECEMBER 31, 2004**

	<u>BALANCE PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Assets				
Bonds	\$521,404,477		\$0	\$521,404,477
Preferred stocks	101,000			101,000
Common stocks	185,513,046			185,513,046
Real estate:				
Properties occupied by the company	40,524,252			40,524,252
Cash and short-term investments	28,042,521			28,042,521
Other invested assets	20,034			20,034
Investment income due and accrued	5,443,537			5,443,537
Premiums and considerations:				
Uncollected premiums and agents' balances	109,631,301			109,631,301
Accrued retrospective premium	50,982			50,982
Amounts receivable relating to uninsured plans	99,923,770	1 & 2	(84,397,111)	15,526,659
Net deferred tax asset	15,337,016			15,337,016
Electronic data processing equipment and software	9,090,437			9,090,437
Receivables from parent, subsidiaries and affiliates	12,113,797	5	9,960,000	22,073,797
Health care and other amounts receivable	7,835,033			7,835,033
Aggregate write-ins for other than invested assets:				
Miscellaneous accounts receivable	5,696,806			5,696,806
Deferred benefit trust	22,601,823			22,601,823
Providers deferred plan assets	9,831,621			9,831,621
Summary of remaining write-ins from overflow page	118,112,893	4	(118,112,893)	0
Total Assets	<u>\$1,191,274,346</u>		<u>(\$192,550,004)</u>	<u>\$998,724,342</u>
Liabilities, Capital, and Surplus				
Claims unpaid	\$297,861,996		\$0	\$297,861,996
Accrued medical incentive pool and bonus amounts	554,000			554,000
Unpaid claims adjustment expenses	45,770,454			45,770,454
Aggregate health policy reserves	18,492,235			18,492,235
Premiums received in advance	66,984,057			66,984,057
General expenses due or accrued	33,258,100			33,258,100
Current federal and foreign income tax payable	6,825,982			6,825,982
Amounts withheld or retained for the account of others	154,240			154,240
Remittance and items not allocated	0	3	7,159,225	7,159,225
Amounts due to parent, subsidiaries and affiliates	39,542			39,542
Payable for securities	4,607,099			4,607,099
Liab. for amounts held under uninsured A&H plans	84,340,873	2	(84,308,924)	31,949
Aggregate write-ins for other liabilities:				
Advance deposits	1,766,272			1,766,272
Unapplied receipts	19,030,605	3	(7,159,225)	11,871,380
Deferred employee benefits	27,539,444			27,539,444
Summary of remaining write-ins	138,058,522	4	(118,112,893)	19,945,629
Total Liabilities	<u>745,283,421</u>		<u>(202,421,817)</u>	<u>542,861,604</u>
Unassigned funds (surplus)	445,990,925	1 & 5	9,871,813	455,862,738
Total Capital and Surplus	<u>445,990,925</u>		<u>9,871,813</u>	<u>455,862,738</u>
Total Liabilities, Capital and Surplus	<u>\$1,191,274,346</u>		<u>(\$192,550,004)</u>	<u>\$998,724,342</u>

**PREMERA BLUE CROSS
STATEMENT OF REVENUE AND EXPENSES
FOR THE YEAR ENDING DECEMBER 31, 2004**

	<u>BALANCE PER COMPANY</u>	ref.	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	9,886,403			9,886,403
Net premium income	\$2,326,336,929		\$0	\$2,326,336,929
Change in unearned premium reserves	(6,548,479)			(6,548,479)
Total revenues	<u>2,319,788,450</u>		<u>0</u>	<u>2,319,788,450</u>
<u>Hospital and Medical:</u>				
Hospital/medical benefits	1,655,012,937			1,655,012,937
Prescription drugs	283,427,677			283,427,677
Incentive pool, withhold adjustments and bonus amounts	995,137			995,137
Subtotal	<u>1,939,435,751</u>		<u>0</u>	<u>1,939,435,751</u>
<u>Less:</u>				
Net reinsurance recoveries	6,901,132			6,901,132
Total hospital and medical	<u>1,932,534,619</u>		<u>0</u>	<u>1,932,534,619</u>
Claims adjustment expenses	163,006,186			163,006,186
General administrative expenses	172,170,391			172,170,391
Increase in reserves for A&H contracts	(181,446)			(181,446)
Total underwriting deductions	<u>2,267,529,750</u>		<u>0</u>	<u>2,267,529,750</u>
Net underwriting gain or (loss)	<u>52,258,700</u>		<u>0</u>	<u>52,258,700</u>
Net investment income earned	29,442,514			29,442,514
Net realized capital gains or (losses)	8,993,218			8,993,218
Net investment gains or (losses)	<u>38,435,732</u>		<u>0</u>	<u>38,435,732</u>
Aggregate write-ins for other income or expenses				
Loss on sale of property	(60,169)			(60,169)
Miscellaneous expense, net	2,007,367			2,007,367
Net income or (loss) before federal income taxes	<u>92,641,630</u>		<u>0</u>	<u>92,641,630</u>
Federal and foreign income taxes incurred	<u>25,162,701</u>			<u>25,162,701</u>
Net Income (Loss)	<u>\$67,478,929</u>		<u>\$0</u>	<u>\$67,478,929</u>
<u>CAPITAL AND SURPLUS ACCOUNT</u>				
Capital and surplus prior reporting period	\$373,072,225		\$0	\$373,072,225
Net Income (Loss) from above	67,478,929			67,478,929
Net unrealized capital gains and losses	20,609,486			20,609,486
Change in net deferred income tax	27,081,064			27,081,064
Change in nonadmitted assets	(42,335,121)			(42,335,121)
Aggregate write-ins for gains or (losses) in surplus				
Other comprehensive income	84,342			84,342
Amts. rec. rel. to uninsured plans (90 days overdue)		1	(88,187)	(88,187)
NOL adjustment for prior years		5	9,960,000	9,960,000
Net change in capital and surplus	<u>72,918,700</u>		<u>9,871,813</u>	<u>82,790,513</u>
Capital and surplus end of reporting period	<u>\$445,990,925</u>		<u>\$9,871,813</u>	<u>\$455,862,738</u>

**PREMERA BLUE CROSS
FIVE YEAR RECONCILIATION OF SURPLUS
FOR THE YEARS ENDED DECEMBER 31**

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Capital and Surplus, Prior Reporting Year	<u>\$373,072,225</u>	<u>\$311,612,778</u>	<u>\$328,988,777</u>	<u>\$271,099,590</u>	<u>\$248,588,754</u>
Net income or (loss)	67,478,929	35,036,956	7,525,008	38,504,621	31,156,593
Net unrealized capital gains and losses	20,609,486	30,826,219	9,853,437	5,570,300	507,447
Change in net deferred income tax	27,081,064	(4,127,284)	12,363,165	14,318,631	
Change in nonadmitted assets	(42,335,121)	(231,452)	(45,677,057)	(89,583,231)	(6,003,204)
Cumulative effect of changes in accounting principles			(1,391,394)	89,078,866	
Aggregate write-ins for gains or (losses) in surplus:					
Contribution to WAGS for investment in subsidiary					(3,150,000)
Other comprehensive income adjustment	84,342	(44,992)	(49,158)		
Amts. Rec. rel. to uninsured plans (90 days overdue)	(88,187)			0	0
NOL adjustment for prior years	9,960,000			0	0
Net change in capital and surplus	<u>82,790,513</u>	<u>61,459,447</u>	<u>(17,375,999)</u>	<u>57,889,187</u>	<u>22,510,836</u>
Capital and Surplus, End of Reporting Period	<u><u>\$455,862,738</u></u>	<u><u>\$373,072,225</u></u>	<u><u>\$311,612,778</u></u>	<u><u>\$328,988,777</u></u>	<u><u>\$271,099,590</u></u>

NOTES TO THE FINANCIAL STATEMENTS

The Company has no special consents, permitted practices or orders from the state of Washington. There were five examination report adjustments.

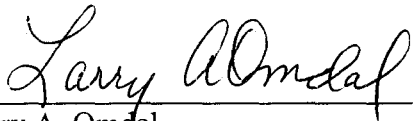
1. PBC misstated "Amounts receivable related to uninsured plans" in the 2004 NAIC Annual Statement pursuant to SSAP No. 47, paragraphs 9 and 10. \$88,187 was inadvertently omitted in the Company's compilation of balances 90 days past due for "Amounts receivable related to uninsured plans". An examination adjustment debiting "Unassigned funds (surplus)" and crediting "Amounts receivable relating to uninsured plans" is reflected in the preceding financial statements. (See Instruction No. 1a)
2. PBC incorrectly reported incurred but not reported (IBNR) claims under several Administrative Service Contracts (ASC) in the amount of \$84,308,924 as "Liability for amounts held under uninsured accident and health plans" and a corresponding "Amounts receivable relating to uninsured plans," pursuant to SSAP No. 47, paragraph 8. An examination adjustment debiting, "Liability for amounts held under uninsured accident and health plans", and crediting, "Amounts receivable relating to uninsured plans" is reflected in the preceding financial statements. (See Instruction No. 1d)
3. PBC misclassified unapplied premium payments in the amount of \$7,159,225 as "Aggregate write-ins for other liabilities in" the 2004 NAIC Annual Statement. Pursuant to SSAP No. 67, paragraph 9, and the 2004 NAIC Annual Statement Instructions, it should have been reported as "Remittances and items not allocated". An examination reclassification adjustment, debiting, "Aggregate write-ins for other liabilities" and crediting, "Remittances and items not allocated" is reflected in the preceding financial statements. (See Instruction No. 1f)
4. PBC reported securities lending collateral received in the amount of \$118,112,893 as an asset, "Aggregate write-ins for other than invested assets", with a corresponding liability as "Aggregate write-ins for other liabilities" in the 2004 NAIC Annual Statement. Pursuant to SSAP No. 18, paragraph 25, restricted collateral shall not be reflected in the transferor's balance sheet as an asset with a corresponding liability for the return of the collateral. An examination adjustment debiting "Aggregate write-ins for other liabilities" and crediting "Aggregate write-ins for other than invested assets" is reflected in the preceding financial statements. (See Instruction No. 1i)
5. The various subsidiary companies have been utilizing portions of the net operating loss carry forward of its parent PBC, without properly reimbursing the parent, thus, causing net income and unassigned funds to be misstated. An examination adjustment in the amount of \$9.96 million dollars, debiting "Receivables from parent, subsidiaries and affiliates", and crediting, "Unassigned funds (surplus)" is reflected in the preceding financial statements. (See Instruction No. 2)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Premera Blue Cross during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Supervising Examiner; John R. Jacobson, AFE, CISA, AES, Information Systems Specialist; Lichiou Lee, ASA, MAAA, Health Actuary; Friday P. Enoye, Insurance Examiner; Richard V. Bologna, Insurance Examiner; Kathleen Hicks, CPA, Insurance Examiner; Ann V. Kaufman, Insurance Examiner; Jeanette Liao, AFE, Insurance Examiner; and Youngjae Lee, Insurance Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



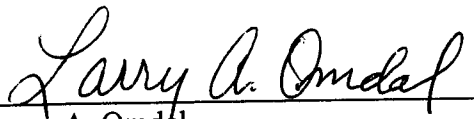
Larry A. Omdal
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF KING }

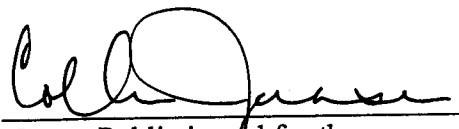
Larry A. Omdal, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Premera Blue Cross 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).



Larry A. Omdal
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 1st day of March, 2007.



Notary Public in and for the
State of Washington.

