

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
PREMERA BLUE CROSS  
MOUNTLAKE TERRACE, WASHINGTON

NAIC CODE 47570  
December 31, 2009

Participating States:  
Washington

**SALUTATION**

Seattle, Washington  
June 1, 2011

The Honorable Mike Kreidler, Commissioner  
Washington State Office of the Insurance Commissioner (OIC)  
Insurance Building-Capitol Campus  
302 Sid Snyder Avenue SW, Suite 200  
Olympia, WA 98504

Joseph Torti, III, Superintendent  
State of Rhode Island  
Department of Business Regulation  
Division of Insurance  
Chair, NAIC Financial Condition (E) Committee  
1511 Pontiac Avenue, Building 69-2  
Cranston, RI 02920

The Honorable Monica J. Lindeen, Commissioner  
Montana Office of the Commissioner of Securities and of Insurance  
NAIC Secretary, Western Zone  
840 Helena Avenue  
Helena, MT 59601

Dear Commissioners and Superintendent:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association 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 its home office located at 7001 220th Street Southwest, Mountlake Terrace, Washington 98043. This report is respectfully submitted showing the condition of PBC as of December 31, 2009.

**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, 2009.



Patrick H. McNaughton  
Chief Examiner

6-1-2011

Date

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## **SCOPE OF THE EXAMINATION**

This examination covers the period January 1, 2005 through December 31, 2009 and comprises a risk focused review of the books and records of the Company. The examination followed 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 (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination though the end of field work on April 11, 2011.

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 accountants' (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2009 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

## **INSTRUCTIONS**

The examiners reviewed the Company's filed 2009 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 outlined 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, Omissions, and Misclassifications**

The results of the examination disclosed instances in which the Company's filing of the 2009 NAIC Annual Statement did not conform to the NAIC AP&P Manual and the NAIC Annual Statement Instructions. Except for Instructions 1c and 1d, none of the following items in this instruction were material to the financial statements and no examination adjustments were necessary.

- a. **Schedule D - Part 1** - The Company reported the wrong NAIC designation for two long term bonds and the wrong CUSIP numbers for two other bonds on Schedule D - Part 1. The NAIC Annual Statement Instructions require correct CUSIPs and NAIC designations on Schedule D - Part 1.
- b. **Schedule D - Part 1** - The Company did not properly implement the new rating process for Residential Mortgage Backed Securities (RMBS) as required by the NAIC's "Interim Reporting

Instructions for the Year Ending December 31, 2009 For Use in Reporting Residential Mortgage Backed Securities." As a result, the book/adjusted carrying value for a few of its non-agency RMBS were understated on Schedule D, Part 1.

- c. **Liabilities, Capital, and Surplus** - The Company recorded \$24.7 million of the rate stabilization reserve from the Federal Employees Health Benefit Plan on page 3, line 8, "Premiums received in advance." The NAIC Annual Statement Instructions require this to be reported on page 3, line 4, "Aggregate health policy reserves." (See adjustment No. 1.)
- d. **Statement of Revenues and Expenses** - The Company included \$5.3 million of administration fees paid to Medco, its pharmaceutical benefit manager, as paid claims/prescription drug benefits on page 4, line 9. The NAIC Annual Statement Instructions, SSAP 55, paragraph 6, and SSAP 85, paragraph 4, require this to be reported as "General administrative expenses" on page 4, line 21. (See adjustment No. 2.)
- e. **Statement of Revenues and Expenses** - The Company reported \$1.4 million of fees paid to Nurseline, a vendor which provides phone support for members to call with questions, on page 4, line 9, "Hospital/medical benefits". Nurseline fees meet the definition of cost containment expenses. SSAP 85 and the NAIC Annual Statement Instructions require cost containment expenses to be reported on page 4, line 20, "Claims adjustment expenses."
- f. **Assets** - The Company reported tax sharing receivables/payables with affiliates of \$2.3 million on page 2, line 21, "Receivables from parent, subsidiaries and affiliates" and \$0.2 million on page 3, line 15, "Amounts due to parent, subsidiaries and affiliates." The NAIC Annual Statement Instructions require the net amount to be recorded on page 2, line 16.1, "Current federal and foreign income tax recoverable and interest thereon."
- g. **Schedule BA** - The Company failed to report an investment of \$19,100 in a nonaffiliated partnership on Schedule BA. As a result, Schedule BA did not agree with the trial balance on page 2, line 7, "Other invested assets (Schedule BA)." The NAIC Annual Statement Instructions require that investments in other long term invested assets be reported on Schedule BA.
- h. **Liabilities, Capital, and Surplus** - The Company reported uncovered claims in the covered claims column 1 on page 3, line 1, "Claims unpaid." The NAIC Annual Statement Instructions require uncovered claims unpaid to be reported in column 2. Of the total unpaid claims of \$237 million in column 3, \$225 million should have been reported in column 1 as covered and \$12 million should have been reported in column 2 as uncovered.
- i. **Liabilities, Capital, and Surplus** - The Company included certain amounts that belong to PBC's self-funded line of business on page 3, line 1, "Claims unpaid". SSAP 47 and SSAP 55 provide that a liability shall be established for the occurrence of insured events. NAIC Annual Statement Instructions state that line 1, "Claims unpaid", should exclude liabilities relating to uninsured plans and the uninsured portion of partially insured plans.
- j. **Liabilities, Capital, and Surplus** - The Company reported a liability on page 3, line 2, "Accrued medical incentive pool and bonus amounts" for two contracts that did not contain incentive clauses. The NAIC Annual Statement Instructions require page 3, line 2, to include liabilities for

arrangements with providers and other risk sharing arrangements. These amounts did not meet the definition of a liability per SSAP 5, paragraph 2.

**The Company is instructed to comply with RCW 48.43.097 by filing its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.**

### **2. Due Date for Related Party Transactions**

The General Agency Agreement between PBC and Ucentris, effective August 1, 2009, did not provide for the timely settlement of amounts owed within a specified due date. SSAP 96, paragraph 2, requires the agreement to provide for the timely settlement of amounts owed within a specified due date. If the due date is not addressed in the written agreement, any uncollected receivable is non-admitted.

**The Company is instructed to comply with WAC 284-07-050(2) which requires adherence to the AP&P, by amending its agreement to be in compliance with SSAP 96, and file a Form D for OIC approval in accordance with RCW 48.31C.050(2)(d) and WAC 284-18A-420.**

### **3. Unpaid Claims Adjustment Expenses**

The Company could not demonstrate that the amount reported on page 3, line 3, was consistent with the cost of settling claims using past experience adjusted for current trends, and any other factor that would modify past experience, as required by SSAP 55, paragraph 8. Furthermore, SSAP 85, paragraph 3, and SSAP 55, paragraph 6, define unpaid claim adjustment expenses for accident and health reporting entities as those costs expected to be incurred in connection with the adjustment and recording of accident and health claims. The NAIC Annual Statement Instructions require page 3, line 3, "Unpaid claims adjustment expenses" to provide for the estimated expenses necessary to adjust all unpaid claims, in accordance with SSAP 85 and SSAP 55.

**The Company is instructed to comply with RCW 48.43.097 by filing its financial statements in accordance with the AP&P and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.**

## **COMMENTS AND RECOMMENDATIONS**

None

## **COMPANY PROFILE**

### **Company History**

PBC is a Washington State domestic, non-profit corporation. It was incorporated as a health care service contractor on May 9, 1945 pursuant to RCW 24.03. On July 8, 1948, the Company was issued a Certificate of Registration by the OIC. PBC was also issued a Certification of Authority as a Hospital and Medical Service Corporation in the state of Alaska on May 28, 1952. It is a member of the Blue Cross and Blue Shield Associations.

### Capitalization

Pursuant to RCW 48.44.037, the Company met minimum capital requirements with \$789,955,793 of capital and surplus as of December 31, 2009. The Company does not have any capital stock. The sole voting member is PREMERA, an upstream holding company.

### Territory and Plan of Operation

PBC provides basic medical, hospital, major medical, comprehensive, and other prepaid health care benefits for its subscribers in the states of Washington and Alaska. The Company sells contracts to individuals and groups of small, mid, and large sizes. Additional lines of business include Medicare Supplement, the Federal Employees Health Benefit Plan, and self insured groups. The Company provides preferred provider organization networks which are types of managed care to both insured and self insured groups.

### Growth of Company

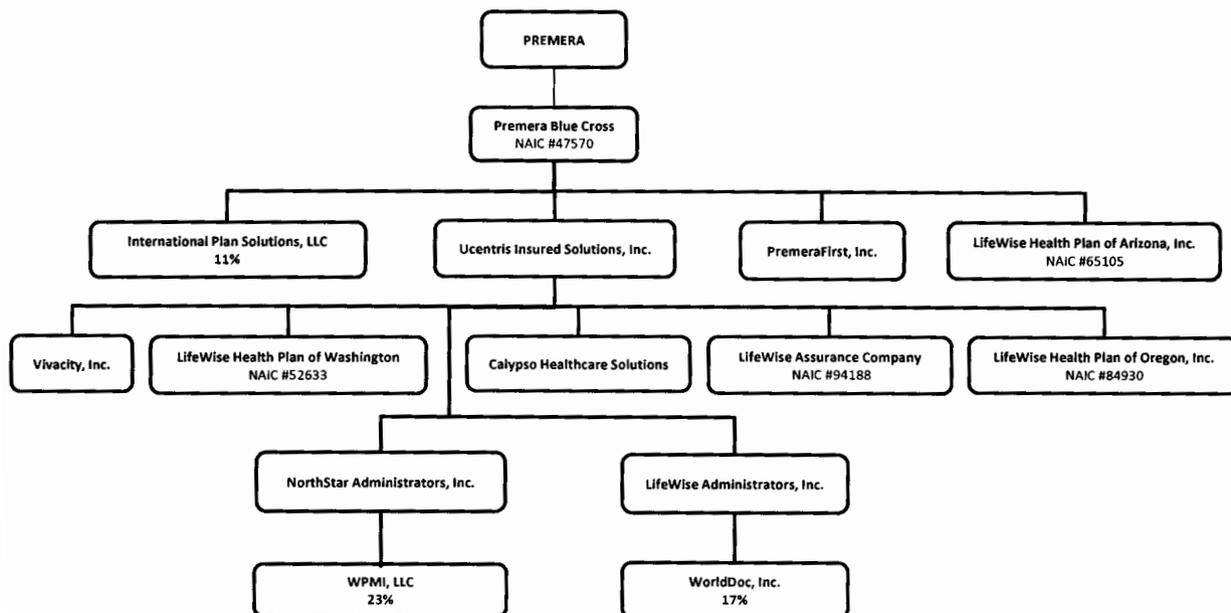
The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the five year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>
2009	\$1,287,469,794	\$497,514,001	\$789,955,793
2008	1,197,340,481	525,104,320	672,236,161
2007	1,319,699,260	535,803,808	783,895,452
2006	1,270,520,659	609,034,162	661,486,497
2005	1,083,064,820	557,617,345	525,447,475

<u>Year</u>	<u>Total Revenue</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2009	\$2,439,686,222	\$17,774,822	\$9,108,399	\$21,048,694
2008	2,552,089,123	56,816,088	(16,240,961)	34,929,920
2007	2,489,847,796	79,635,630	49,230,143	105,875,522
2006	2,334,037,934	82,643,799	44,443,250	103,062,032
2005	2,346,350,882	69,015,518	37,796,838	84,107,037

**Affiliated Companies**

The following is an organization chart as of December 31, 2009:



**PREMERA**

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

**International Plan Solutions, LLC (IPS)**

IPS is a Delaware Limited Liability Company and shareholder of a company holding system providing health coverage for expatriates and students. The approximate percentage of ownership is divided as follows; QCC Insurance Company (40 percent), Blue Cross Blue Shield of South Carolina (14 percent), PBC (11 percent), BCS Financial Corporation (8 percent), and ten other Blues companies making up a total of 27 percent.

**PremeraFirst, Inc. (PremeraFirst)**

PremeraFirst is a Washington for-profit corporation that serves, on behalf of certain affiliates, as an agent contracting services with providers. PBC non-admitted its investment in PremeraFirst, Inc. (approximately \$50,000) since the financial statement was not audited in accordance with SSAP 97.

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

LWAZ, a Washington for-profit corporation is a life and disability carrier in the states of Washington and Arizona. LWAZ began providing health insurance coverage to the residents of Arizona beginning in 2004. On February 19, 2009, LWAZ announced that it will cease sales of new group and individual health policies. Its assets were sold to Blue Cross Blue Shield of Arizona.

**Ucentris Insured Solutions, Inc. (Ucentris)**

Ucentris is a Washington for-profit corporation doing business as an insurance sales agency. PBC owns 100 percent of Ucentris, which in turn owns 100 percent of Vivacity, Inc., LifeWise Health Plan

of Washington, LifeWise Assurance Company, Calypso Healthcare Solutions, LifeWise Health Plan of Oregon, Inc., NorthStar Administrators, Inc., and LifeWise Administrators, Inc.

**Vivacity, Inc. (Vivacity)**

Vivacity is a Washington for-profit corporation that provides health and wellness consulting services. PBC owns 100 percent of Ucentris which, in turn, owns 100 percent of Vivacity, Inc. Vivacity was incorporated in August 2009.

**LifeWise Health Plan of Washington (LWWA)**

LWWA is a Washington non-profit health care service contractor domiciled in the state of Washington. LWWA was originally incorporated on November 19, 1998 as a for-profit stock corporation in the state of Washington. LWWA reorganized pursuant to RCW 24.06, and filed Articles of Amendment of Restated Articles of Incorporation changing from a for-profit corporation to a non-profit corporation on May 2, 2000. LWWA received its certificate of registration on August 31, 2000.

**LifeWise Assurance Company (LWAC)**

LWAC is a Washington for-profit corporation offering group life, accident, disability, and stop loss insurance in a number of states. In November 1981, LWAC began to write business in Washington upon receiving a certificate of authority to transact life and disability insurance business. It was subsequently granted certificates of authority in Alaska, Arizona, California, Idaho, Montana, New Mexico, North Dakota, Oregon, Utah, and Wyoming.

**LifeWise Health Plan of Oregon, Inc. (LWOR)**

LWOR is an Oregon for-profit corporation doing business as a life and health insurer. LWOR was incorporated on August 7, 1986 and was issued a certificate of authority under Oregon Revised Statutes, Chapter 732, to transact life and health lines of business.

**Calypso Healthcare Solutions (Calypso)**

Calypso is a Washington non-profit organization that provides investigation and recovery services to health plans and self-funded employer benefit plans.

**NorthStar Administrators, Inc. (NorthStar)**

NorthStar is a Washington for-profit corporation that provides claims administrative services to self-funded plan sponsors. It owns approximately 23 percent interest in WPMI, LLC, a Delaware limited liability company. As of December 31, 2009, NorthStar was a holding company for investment in WPMI, Inc., with no other business transactions.

**LifeWise Administrators, Inc. (LWA)**

LWA is a Washington for-profit corporation providing third party administrative services to affiliates. In 2009, LWA invested in a 17 percent interest in WorldDoc, Inc.

**WPMI, LLC (WPMI)**

WPMI is a Delaware limited liability company providing third-party administrative services in the People's Republic of China. NorthStar owns approximately 23 percent interest in WPMI, LLC.

### **WorldDoc, Inc. (WorldDoc)**

WorldDoc is a Nevada for profit corporation that provides a web-based portal with a suite of health and wellness applications. In 2009, LWA invested in a 17 percent interest in WorldDoc, Inc.

### **Intercompany Agreements**

As of December 31, 2009, the Company had the following intercompany agreements in force:

#### **Intercompany Agreement (Allocation of Costs)**

The initial agreement entered into by PBC and its affiliates was effective January 10, 1994. The parties as of December 31, 2009 were PBC, Ucentris, LWAC, NorthStar, LWOR, PremeraFirst, LWWA, LWAZ, Calypso, and LWA. The agreement allocates operating expense to the lines of business/affiliates based on a system of cost accounting. The agreement was amended on October 31, 2007 for compliance with SSAP 96 and on April 30, 2009 to list PBC as a limited purchasing agent for all affiliates.

#### **Subsidiary Tax Sharing Agreement**

The PBC agreement with its affiliates was originally effective November 21, 1994 and amended on October 31, 2005. All affiliates within the PREMERA holding company are allocated their proportional share of tax liability, which is calculated as if the entities had filed separate returns.

#### **General Agency Agreement**

The PBC agreement with Ucentris was effective August 1, 2009. Ucentris can provide the following services: marketing, proposal, enrollment, account management, producer commission accounting, and renewal on behalf of PBC in exchange for a fixed commission. This agreement is not in compliance with SSAP 96 which requires all written agreements to provide for a specific due date of amounts owed. (See Instruction No. 2.)

#### **Administrative Services Agreement**

The PBC agreement with LWWA was effective January 1, 2005. PBC can provide administrative and/or claims services to LWWA. PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

#### **Administrative Services Agreement**

The PBC agreement with LWAC was effective March 23, 2009. PBC agrees to provide administrative and management services to manage operations relating to LWAC student policies. PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

#### **Administrative Services Agreement**

The PBC agreement with LWAC was effective August 1, 2009. PBC agrees to provide administrative and management services to manage operations relating to LWAC medical expense reimbursement Plans (MERP). PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

#### **Management Agreement**

The PBC agreement with LWAC was effective August 15, 2005. PBC provides to LWAC all management and administrative services reasonably required by LWAC in relation to its long term care insurance policies. PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

### **Management Agreement**

The PBC agreement with Vivacity was effective June 3, 2009. PBC provides to Vivacity all management and administrative services as reasonably required by Vivacity to carry out its business transactions relating to providing health and wellness consulting services. PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

### **Vivacity, Inc. Master Services Agreement for Wellness Products and Services to Carriers and Third Party Administrators**

The PBC agreement with Vivacity was effective November 5, 2009. Vivacity offers wellness products and consulting services to employer groups that have purchased health care products from PBC. Vivacity is compensated based on a fee schedule.

### **Services Agreement**

The PBC agreement with LWAC was effective July 18, 2008. PBC provides licensed medical professionals to evaluate LWAC claims under the policies in the timeframe requested by LWAC. PBC is reimbursed based on the Intercompany Agreement (Allocation of Costs).

### **Member Portal License and Services Agreement**

The PBC agreement with WorldDoc was effective November 20, 2008. PBC engages the services of WorldDoc to provide its members with a web-based portal that allows members to better manage their health. The services that will be implemented in phases include health and wellness programs, access to personal health records, and the integration of claims data. WorldDoc is compensated based on a fee schedule, which is adjusted at the completion of each phase.

### **Services Agreement**

The PBC agreement with Calypso was effective February 1, 2005. Calypso provides investigation and recovery administrative services including subrogation, coordination of benefits, recoveries, claims audits, and overpayment identification for PBC and its affiliated health care companies. Calypso is compensated based on a fee schedule.

## **MANAGEMENT AND CONTROL**

### **Board of Directors (BOD)**

Management of the Company is vested in a BOD made up of not less than ten and 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. Nominations are made by the BOD's Governance and Nominating Committee, approved by the BOD, and submitted to the sole voting member for approval. The term of the director is designated by the voting member for a period not to exceed three years. One director is the president and CEO. The CEO was Herbert R. B. Barlow as of December 31, 2009.

Directors as of December 31, 2009:

Herbert R. B. Barlow	Chair of the BOD
Eleanor L. Andrews	Director
Paula E. Boggs	Director
Patrick M. Fahey	Director

Richard P. Fox	Director
John G. Gollhofer	Director
Kathryn L. Munro	Director
Carol K. Nelson	Director
Maria M. Pope	Lead Director
Gary E. Pruitt	Director
Robert C. Wallace	Director

## Officers

Officers as of December 31, 2009:

Herbert R. B. Barlow	President
Brian E. Ancell	Executive Vice President
Karen M. Bartlett	Executive Vice President
Louise H. R. Donigan	Executive Vice President
Kent S. Marquardt	Executive Vice President and Treasurer
Yoram Milo	Executive Vice President, Chief Legal Officer, and Secretary
Rakesh T. Chauhan	Senior Vice President
Kirsten C. Kemp	Senior Vice President
Barbara B. Magusin	Senior Vice President
Richard A. Maturi	Senior Vice President
Jack C. McRae	Senior Vice President
John H. Pierce	Senior Vice President
Kirsten M. Simonitsch	Senior Vice President
David J. Braza	Vice President

## Conflict of Interest

The Company's policy requires that members of the BOD and officers file an annual conflict of interest statement by April of each year. Any conflict is referred to the Company's Office of Ethics and Business Conduct or general counsel for final resolution. The purpose of the statement is to detect any activities or participation on the part of the directors/officers that could possibly be interpreted as a conflict of interest. No exceptions were noted during our review.

## Fidelity Bond and Other Insurance

PBC is a named insured on a financial institution fidelity bond. An aggregate liability coverage of \$20 million and single loss limit of liability of \$10 million are provided for all affiliated companies, and a single loss deductible of \$200,000. The aggregate amount of coverage meets the recommended guidelines by the NAIC.

In addition, the Company is a named insured on policies for property, auto, and general liability insurance with umbrella coverage.

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

### Defined Benefit Plan

The Company sponsors a PREMERA-wide pension equity plan covering substantially all of its employees and employees of the affiliated group, a postretirement benefit plan which provides certain health care benefits for eligible retired employees, and a non-qualified defined benefit supplemental retirement program covering certain officers as approved by PBC's president and the BOD. PBC provides a non-

qualified supplemental retirement benefit for its president and CEO. The costs that are associated with these plans are allocated to the affiliates based on the Intercompany Agreement (Allocation of Costs).

#### Defined Contribution Plans

The Company also sponsors a PREMERA-wide non-qualified contribution retirement program for employees who hold a position approved by PBC's President and the BOD as having a significant corporate-wide impact on accomplishing the Company's strategic goals and objectives. The Company funds the deferred benefits of these programs through the establishment of a separate deferred benefit trust. The Company's employees are also automatically enrolled in PREMERA-wide deferred contribution retirement saving plan, pursuant to Section 401(k) of the Internal Revenue Code, within thirty days following the date of hire unless they have affirmatively elected not to participate. The costs that are associated with these plans are allocated to the affiliates based on the Intercompany Agreement (Allocation of Costs).

### **CORPORATE RECORDS**

The Company's bylaws were restated on May 13, 2009 to change the minimum number of directors to ten and to further define director independence. The minutes of the meetings of directors and committees adequately document appropriate approvals and support the Company's transaction and events.

### **ACTUARIAL REVIEW**

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2009. 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 55, paragraphs 7 and 8, and SSAP 54, paragraphs 12, 13, 18 and 19; 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 2009 NAIC Annual Statement; and estimating claims unpaid at December 31, 2009.

Reserves were in compliance with statutory requirements, and except for the finding as noted in Instruction No. 3, the methods, assumptions, and methodologies used by the Company were appropriate. The techniques applied to establish the Claims Unpaid amount on page 1, line 3 for 2009 have resulted in an adequate level of provision based on the claim runoff outcomes observed through April 2010 together with the estimated 2009 amounts remaining unpaid at that date.

### **REINSURANCE**

The Company has three ceded reinsurance contracts. The first contract is for long-term care which is 100 percent ceded to Medamerica Insurance Company. The second contract is a 100 percent quota share reinsurance with HM Life Insurance Company for the Federal Employees Health Benefit BlueVision Plan. The third contract is a stop loss contract with Presidio Excess Insurance Services, Inc. All contracts were reviewed by the OIC reinsurance specialist and no exceptions were noted.

The Company has controls in place to monitor its reinsurance program including the financial condition of the reinsurers. In addition, the Company utilizes the services of a reinsurance intermediary to solicit, negotiate, and place reinsurance cessions on its behalf.

### **INDEMNITY DEPOSITS**

The Company maintained the following statutory deposits as of December 31, 2009:

<b>State</b>	<b>Type</b>	<b>Book Value</b>	<b>Fair Value</b>
Washington	Bond	\$58,201,209	\$59,224,205
<b>Total</b>		<b>\$58,201,209</b>	<b>\$59,224,205</b>

The Company maintains a voluntary, special deposit with a book value of \$13,015,349 in connection with the merger of Premera HealthPlus into PBC. In addition, it maintains a voluntary special deposit with a book value of \$14,558,978 in connection with the BlueCross BlueShield Association deposit requirements.

### **ACCOUNTING RECORDS AND INFORMATION SYSTEM**

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 KPMG, 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 Company's IT environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT system and controls were evaluated to gain an understanding of general IT control risks and assess the effectiveness of these controls. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels.

### **SUBSEQUENT EVENTS**

None

### **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

The Company did not comply with the following instruction from the last examination report dated December 31, 2004:

The Company did not adequately account for unpaid claims adjustment expense on page 3, line 3. The amount reported and the methodology used were not in compliance with SSAP 55, paragraph 8. (See Instruction No. 3.)

### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of Premera Blue Cross as of December 31, 2009:

Assets, Liabilities, Capital and Surplus

Statement of Revenue and Expenses

Five Year Reconciliation of Surplus

Analysis of Changes in Financial Statements Resulting from the Examination

**Premera Blue Cross  
Assets, Liabilities, Capital and Surplus  
December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>ASSETS</b>			
Bonds	\$442,309,587	\$0	\$442,309,587
Stocks			
Common stocks	433,358,240		433,358,240
Real Estate			
Properties occupied by the company	39,839,027		39,839,027
Cash and short-term investments	80,903,488		80,903,488
Other invested assets	5,019,100		5,019,100
Receivables for securities	23,067,584		23,067,584
Investment income due and accrued	4,211,685		4,211,685
Premiums and considerations			
Uncollected premium and agents' balances in the course of collection	108,400,979		108,400,979
Accrued retrospective premiums	186,563		186,563
Reinsurance			
Amount recoverable from reinsurers	120,562		120,562
Amounts receivable relating to uninsured plans	53,792,820		53,792,820
Current federal and foreign income tax recoverable and interest thereon	7,506,454		7,506,454
Net deferred tax asset	18,905,552		18,905,552
Electronic data processing equipment and software	11,868,419		11,868,419
Receivables from parent, subsidiaries and affiliates	14,389,722		14,389,722
Health care and other amounts receivable	14,211,430		14,211,430
Aggregate write-ins for other than invested assets	29,378,582		29,378,582
<b>Total assets</b>	<b><u>\$1,287,469,794</u></b>	<b><u>\$0</u></b>	<b><u>\$1,287,469,794</u></b>

**Premera Blue Cross**  
**Assets, Liabilities, Capital and Surplus (Continued)**  
**December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>	<u>NOTES</u>
<b>LIABILITIES, CAPITAL AND SURPLUS</b>				
Claims unpaid	\$237,029,543	\$0	\$237,029,543	
Accrued medical incentive pool and bonus amounts	1,160,031		1,160,031	
Unpaid claim adjustment expenses	54,426,369		54,426,369	
Aggregate health policy reserves	19,995,850	24,739,211	44,735,061	1
Premium received in advance	50,944,426	(24,739,211)	26,205,215	1
General expenses due or accrued	39,924,246		39,924,246	
Ceded reinsurance premium payable	29,169		29,169	
Amounts withheld or retained for the account of others	124,282		124,282	
Remittances and items not allocated	263,231		263,231	
Amounts due to parent, subsidiaries and affiliates	158,311		158,311	
Payable for securities	11,621,695		11,621,695	
Liability for amounts held under uninsured plans	31,235,857		31,235,857	
Aggregate write-ins for other liabilities	50,600,991		50,600,991	
<b>Total liabilities</b>	<b>497,514,001</b>	<b>0</b>	<b>497,514,001</b>	
Unassigned fund (surplus)	789,955,793		789,955,793	
Less treasury stock at costs	0		0	
<b>Total capital and surplus</b>	<b>789,955,793</b>	<b>0</b>	<b>789,955,793</b>	
<b>Total liabilities, capital and surplus</b>	<b>\$1,287,469,794</b>	<b>\$0</b>	<b>\$1,287,469,794</b>	

**Premera Blue Cross**  
**Statement of Revenue and Expenses**  
**For the Year Ended December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>	<u>NOTES</u>
Member months	7,346,218		7,346,218	
Net Premium Income	\$2,446,291,877	\$0	\$2,446,291,877	
Change in unearned premium reserves and reserve for rate credits	<u>(6,605,655)</u>		<u>(6,605,655)</u>	
Total revenues	<u>2,439,686,222</u>	<u>0</u>	<u>2,439,686,222</u>	
<b>Hospital and Medical:</b>				
Hospital/medical benefits	1,633,826,819	(5,339,524)	1,628,487,295	2
Emergency room and out-of-area	205,259,334		205,259,334	
Prescription drugs	287,108,286		287,108,286	
Incentive pool, withhold adjustments and bonus amounts	<u>613,990</u>		<u>613,990</u>	
Subtotal	<u>2,126,808,429</u>	<u>(5,339,524)</u>	<u>2,121,468,905</u>	
<b>Less:</b>				
Net reinsurance recoveries	<u>8,890,291</u>		<u>8,890,291</u>	
Total hospital and medical	2,117,918,138	(5,339,524)	2,112,578,614	
Claims adjustment expenses	156,362,306		156,362,306	
General administrative expenses	<u>147,630,956</u>	<u>5,339,524</u>	<u>152,970,480</u>	2
Total underwriting deductions	<u>2,421,911,400</u>	<u>0</u>	<u>2,421,911,400</u>	
Net underwriting gain or (loss)	<u>17,774,822</u>	<u>0</u>	<u>17,774,822</u>	
Net investment income earned	32,899,543		32,899,543	
Net realized capital gains (losses) less capital gains tax	<u>(23,791,144)</u>		<u>(23,791,144)</u>	
Net investment gains (losses)	<u>9,108,399</u>	<u>0</u>	<u>9,108,399</u>	
Aggregate write-ins for other income or expenses	<u>8,485,550</u>		<u>8,485,550</u>	
Net income or (loss) after capital gains tax and before all other federal income taxes	35,368,771	0	35,368,771	
Federal and foreign income taxes incurred	<u>14,320,077</u>		<u>14,320,077</u>	
<b>Net income or (loss)</b>	<u><b>\$21,048,694</b></u>	<u><b>\$0</b></u>	<u><b>\$21,048,694</b></u>	

**Premiera Blue Cross**  
**Statement of Revenue and Expenses (Continued)**  
**For the Year Ended December 31, 2009**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>			
<b>Capital and surplus, prior reporting year</b>	<b><u>\$672,236,161</u></b>	<b><u>\$0</u></b>	<b><u>\$672,236,161</u></b>
Net income or (loss)	21,048,694		21,048,694
Change in net unrealized capital gains (losses) less capital gains tax	116,624,516		116,624,516
Change in net deferred income tax	(42,399,925)		(42,399,925)
Change in nonadmitted assets	(35,966,774)		(35,966,774)
Cumulative effect of changes in accounting principles	2,746,407		2,746,407
Aggregate write-ins for gains or (losses) in surplus	<u>55,666,714</u>		<u>55,666,714</u>
<b>Net change in capital and surplus</b>	<b><u>117,719,632</u></b>	<b><u>0</u></b>	<b><u>117,719,632</u></b>
<b>Capital and surplus, end of reporting period</b>	<b><u>\$789,955,793</u></b>	<b><u>\$0</u></b>	<b><u>\$789,955,793</u></b>

**Premera Blue Cross**  
**Five Year Reconciliation of Surplus**  
**For the Years Ended December 31,**

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>Capital and surplus, prior reporting year</b>	<b><u>\$672,236,161</u></b>	<b><u>\$783,895,452</u></b>	<b><u>\$661,486,497</u></b>	<b><u>\$525,447,475</u></b>	<b><u>\$445,990,925</u></b>
Net income or (loss)	21,048,694	34,929,920	105,875,522	103,062,032	84,107,037
Change in net unrealized capital gains (losses) less capital gains tax	116,624,516	(127,163,723)	12,576,944	32,525,595	(672,029)
Change in net deferred income tax	(42,399,925)	95,490,484	(10,860,999)	39,100,356	13,725,124
Change in nonadmitted assets	(35,966,774)	(61,202,853)	14,174,477	(38,561,351)	(27,145,300)
Cumulative effect of changes in accounting principles	2,746,407				
Aggregate write-ins for gains or (losses) in surplus	55,666,714	(53,713,119)	643,011	(87,610)	9,441,718
<b>Net change in capital and surplus</b>	<b><u>117,719,632</u></b>	<b><u>(111,659,291)</u></b>	<b><u>122,408,955</u></b>	<b><u>136,039,022</u></b>	<b><u>79,456,550</u></b>
<b>Capital and surplus, end of reporting period</b>	<b><u>\$789,955,793</u></b>	<b><u>\$672,236,161</u></b>	<b><u>\$783,895,452</u></b>	<b><u>\$661,486,497</u></b>	<b><u>\$525,447,475</u></b>

**Premera Blue Cross**  
**Analysis of Changes in Financial Statements Resulting from the Examination**  
**December 31, 2009**

	<u>Per Annual Statement</u>	<u>Per Examination</u>	<u>Notes</u>	<u>Increase (Decrease) in Surplus</u>	<u>Total</u>
<b>Capital and surplus 12/31/2009 per Annual Statement</b>					<b>\$789,955,793</b>
<b>Liabilities</b>					
Aggregate health policy reserves	19,995,850	44,735,061	1	24,739,211	
Premiums received in advance	50,944,426	26,205,215	1	(24,739,211)	
Change in surplus					<u>0</u>
<b>Capital and surplus 12/31/2009 per Examination</b>					<b><u>\$789,955,793</u></b>

## NOTES TO THE FINANCIAL STATEMENTS

### **1. Rate Stabilization Reserve**

To reclassify \$24.7 million of the rate stabilization reserve from the Federal Employees Health Benefit Plan from page 3, line 8, "Premiums received in advance", to page 3, line 4, "Aggregate health policy reserves" per the NAIC Annual Statement Instructions. (See Instruction No. 1c.)

### **2. Administrative Fees**

To reclassify \$5.3 million of paid administrative fees from page 4, line 9 "Hospital/medical benefits" to page 4, line 21 "General administrative expenses" per SSAP 55, paragraph 6, SSAP 85, paragraph 4, and the NAIC Annual Statement Instructions. (See Instruction No. 1d.)

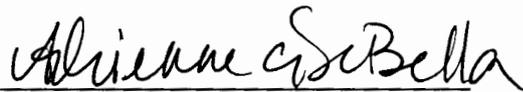
The Company has a special consent order to acquire and hold a single entity's NAIC non-exempt listed mutual funds, totaling not more than four percent of Company assets. This special consent order is subject to an aggregate investment limitation of the lesser of twenty percent of Company assets or fifty percent of its surplus over its minimum required surplus for all common stocks and NAIC non-exempt listed mutual fund, excluding the Company's investment in the common stock of its subsidiaries. Also, the special consent order allows the Company to acquire and hold a single entity's or entities' exempt listed mutual funds in an unlimited amount.

## ACKNOWLEDGMENT

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

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Susan Campbell, CPA, FLMI, CFE, ARA, Reinsurance Specialist; Carl Baker, CPA, CFE, CISA, Health Field Supervising Examiner; Timothy F. Hays, CPA, JD, Investment Specialist; Shiraz Jetha, FSA, MAAA, CERA, Health Actuary; Kathy Hicks, CPA, Financial Examiner; Bert Karau, CPA, CFE, FLMI, Financial Examiner; Friday Enoye, AFE, Financial Examiner; Tony Quach, AFE, Financial Examiner; and Youngjae Lee, CPA, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,

A handwritten signature in black ink that reads "Adrienne DeBella". The signature is written in a cursive style and is positioned above a horizontal line.

Adrienne DeBella, CPA, CFE  
Examiner-in-Charge  
State of Washington

