REPORT OF

EXAMINATION

OF

BLUE CROSS AND BLUE SHIELD OF ALABAMA

HOOVER, ALABAMA

AS OF

DECEMBER 31, 2012

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EXAMINER'S AFFIDAVIT

STATE OF ALABAMA
COUNTY OF JEFFERSON

Mary B. Packard, CPA, CFE, being duly sworn, states as follows:

1. I have authority to represent Alabama in the examination of Blue Cross and Blue Shield of Alabama.

2. Alabama is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination workpapers and examination report, and the examination of Blue Cross and Blue Shield of Alabama was performed in a manner consistent with the standards and procedures required by the State of Alabama.

The affiant says nothing further.

Mary B. Packard
Examiner-in-Charge

Subscribed and sworn before me by Mary B. Packard on this

18th day of December.

(SEAL)

Kristi Lea Pitts
(Signature of Notary Public)

My commission expires 11/30/2014.

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
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ROBERT BENTLEY
GOVERNOR

JIM L. RIDLING
COMMISSIONER

DEPUTY COMMISSIONER
CHARLES M. ANGELL

CHIEF EXAMINER
RICHARD L. FORD

STATE FIRE MARSHAL
EDWARD S. PAULK

GENERAL COUNSEL
REYN NORMAN

December 18, 2013

Jim L. Ridling, Commissioner
State of Alabama
Department of Insurance
201 Monroe Street, Suite 502
Montgomery, Alabama 36104

Dear Commissioner Ridling:

Pursuant to your authorization and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

Blue Cross and Blue Shield of Alabama
Hoover, Alabama

at the home office located at 450 Riverchase Parkway East, Hoover, Alabama 35244, as of December 31, 2012. The report of examination is submitted herewith.

Where the description "Company" or "BCBSAL" appears herein, without qualification, it will be understood to indicate Blue Cross and Blue Shield of Alabama.

SCOPE OF THE EXAMINATION

The Company was last examined for the five-year period ended December 31, 2007. The current examination covers the intervening period January 1, 2008 through December 31, 2012, and was conducted by examiners representing the State of Alabama. The examination of the Company was coordinated with the examination of the subsidiary, United Trust Insurance Company. Where deemed appropriate, transactions, activities and similar items subsequent to December 31, 2012, were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the State of Alabama Insurance Code and the Alabama Insurance Department regulations and bulletins in addition to the procedures and guidelines promulgated by the National Association of Insurance Commissioners (NAIC), as deemed appropriate, and in accordance with generally accepted examination standards and practices.

The examination of the Company was conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. The examination was planned and performed to evaluate the financial condition of the Company as of December 31, 2012, and to identify the Company's prospective risks by obtaining information about the Company including corporate governance. In addition, the examination was planned and performed to identify and assess inherent risks within the Company and to evaluate system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements, management's compliance with statutory accounting principles and annual statement instructions.

An examination of the Company's information systems (IS) was conducted in conjunction with the financial examination. The IS examination included a review of management and organizational controls, logical and physical security controls, changes in application controls, system and program development controls, contingency planning controls, service provider controls, operations controls, processing controls, and network and internet controls. See the caption "**ACCOUNTS AND RECORDS**" – Page 32.

A market conduct examination was performed concurrently with the financial examination. The market conduct examination included a review of the Company's plan of operations, territory, producers' licensing, claims processing, marketing and sales, rates and forms, statistical reporting, dividends to policyholders, underwriting and rating, policyholder complaints and privacy standards. See the caption "**MARKET CONDUCT ACTIVITIES**" - Page26.

The Company's annual statements for each year under examination were compared with or reconciled to the corresponding general ledger account balances. During the period covered by the examination, the Company was audited by Ernst & Young, LLP, Birmingham, AL (E&Y). E&Y's workpapers were reviewed and were used in the examination as deemed appropriate by the examiners.

The workpapers of the Internal Audit Department (Internal Audit) were reviewed and were used in the examination as deemed appropriate.

A signed certificate of representation was obtained during the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2012.

ORGANIZATION AND HISTORY

The Company was organized on January 15, 1935, as the Hospital Service Corporation of Alabama, under the laws of the State of Alabama providing for the organization and regulation of nonprofit corporations for the establishment of health service plans. The Certificate of Incorporation was filed for record in the office of the Judge of Probate of Jefferson County, Alabama. An amendment to the Certificate of Incorporation, adopted at the regular annual meeting of the Board of Directors held on February 20, 1952, changed the Company's name to Blue Cross Blue Shield of Alabama.

To comply with the change required by Act Number 1041 enacted by the regular session of the Alabama Legislature of 1973, the Board of Directors held a meeting on October 24, 1973 and adopted several amendments to the Certificate of Incorporation and a revised set of Bylaws. The name of the Company was changed to Blue Cross and Blue Shield of Alabama, and the Board's composition was changed to reflect a majority of public directors.

To comply with the 1973 legislative changes, the objective and purpose of the Company was amended in the Certificate of Incorporation as follows:

> To establish, maintain, and operate health care service plans under which health services of all types and forms and other services and commodities incidental thereto may be furnished to such of the public who, under the rules and regulations of the Corporation, make application and are eligible therefore; and to carry on any other lawful business whatsoever which may seem to the Corporation capable of being carried on in connection with the above, or calculated directly or indirectly to promote the interests of the Corporation or to enhance the value of its properties or the conduct of its business affairs.

No amendments were made to the Company's Certificate of Incorporation during the examination period. At their regularly scheduled meeting held March 26, 2008, the Board of Directors amended the Bylaws of the Corporation adopting a new Governance Policy and Committee Charters.

Blue Cross and Blue Shield of Alabama is a non-stock not-for-profit corporation organized under ALA. CODE §10A-20-6.01 (2009), which provides that:

> Any nonstock corporations organized not for profit for the purpose of establishing, maintaining, and operating a health care service plan under which health services are furnished to the public who become subscribers to the plan pursuant to contracts are authorized and shall be governed by the provisions of this article.

At December 31, 2012, the Company had four wholly-owned subsidiaries. Two of these entities each wholly-owned a subsidiary. All six of the entities are domiciled in Alabama. In July 2010, the Company made an investment in Prime Therapeutics, LLC, a Delaware corporation, owned jointly with other non-profit Blue Cross Blue Shield plans to obtain pharmacy value for its members.

MANAGEMENT AND CONTROL

Board of Directors

The enabling statutes generally, and the *Bylaws* specifically, provide that the management and control of the business, property and affairs of the Company shall be vested in the Board of Directors, which shall have all of the powers of the Company. Article I, Section 2 of the *Bylaws* provided that:

> The Board of Directors shall be composed of 27 persons, consisting of the following:
>
> - Fourteen public directors, who shall reflect the social, economic and geographic characteristics of the population severed by the Corporation;
> - The Chief Executive Officer of the Corporation, who shall be a member of the Board during and by virtue of occupancy of the chief executive office and the Corporation, or, when the office of the Chief Executive Officer is vacant, the President of the Corporation who shall be a member of the Board and by virtue of occupancy of the office of President while the office of the Chief Executive Officer remains vacant;

- Six directors, who shall be representatives of health care facilities participating as members of the Corporation in accordance with Section 10-4-102 of the Alabama Code of 1975; and,
- Six directors, who shall be members of the medical profession in the state of Alabama.

No director (except the Chairman of the Board, the Chief Executive Officer and the President), who has served for two consecutive three-year terms, is eligible for re-election until he or she has not served on the Board for one year.

The composition of the Board of Directors, described above, complies with ALA. CODE § 10-4-103 (1975), which states in part:

> The board shall be composed of not less than 15 nor more than 27 directors…Providers of health care and their representatives may also serve on the board, but in no event may constitute a majority thereof. Persons who derive income from the delivery or administration of health care or services shall not be eligible to serve as public directors.

Board members elected and serving at December 31, 2012 were as follows:

Directors/Residence	Principal Occupation
Terry Dee Kellogg Birmingham, Alabama	Chief Executive Officer Blue Cross and Blue Shield of Alabama
James Malcom Aycock Decatur, Alabama	President Cook's Pest Control
Marvell Bivins, Jr. Birmingham, Alabama	Vice President, Audit and Compliance Energen Corporation
Raymond James Browne, M.D Birmingham, Alabama	Physician Mayfair Internal Medicine
Clark Patrick Christianson Mobile, Alabama	President Providence Hospital

Barry Smith Cochran Fayette, Alabama	Administrator Fayette Medical Center
Edward Franklin Crowell Hope Hull, Alabama	Senior Vice President VT Miltope Corporation
Philip Craig Dotts Huntsville, Alabama	Managing Director Public Financial Management, LLC
Reid Bentley Dove Dothan, Alabama	Chief Executive Officer AAA Cooper Transportation
Howard Joseph Falgout, M.D Tuscaloosa, Alabama	Physician Surgical Specialists of Alabama, PC
Richard McConnell Freeman, M.D Auburn, Alabama	Physician Pediatric, Adolescent and Aviation Medicine
James Daniel Gifford, M.D Decatur, Alabama	Physician Nephrology of North Alabama, PC
Leonidas Keith Granger Birmingham, Alabama	President Trinity Medical Center
George Sanders Hammer Samson, Alabama	President Hammer LGC, Inc.
Walter Howlett, Jr. Birmingham, Alabama	President A.G. Gaston Construction Company, Inc.
Kenneth Earl Hubbard Birmingham, Alabama	Chairman and Chief Executive Officer Western Supermarkets
Fred Dominic Hunker, M.D Montgomery, Alabama	Physician Montgomery Pulmonary Consultants, PA
Donald Lee Large, Jr. Auburn, Alabama	Executive Vice President Auburn University
Susan Wood Matlock Birmingham, Alabama	President Innovation Depot, Inc.
Manly Eugene Moor, Jr. Birmingham, Alabama	Chairman of the Board Blue Cross and Blue Shield of Alabama
Paul Michael Nagrodzki, M.D Birmingham, Alabama	Physician Anesthesia Services of Birmingham, PC

Glenn Chamblee Sisk Sylacauga, Alabama	President Coosa Valley Medical Center
William Jackson Stevens Birmingham, Alabama	President Motion Industries, Inc.
Michael Dewitt Thompson Birmingham, Alabama	President Thompson Tractor Co., Inc.
Timothy John Thornton Alexander City, Alabama	Chief Financial Officer Russell Medical Center
James David Weidner Cullman, Alabama	President Cullman Regional Medical Center

Committees

Executive Committee

Article I, Section 14 of the Bylaws provided that the Company shall have an Executive Committee of the Board of Directors with authority to act as follows:

> During intervals between meetings of the Board of Directors, the Executive Committee shall have, subject to the control and direction of the Board, the authority to exercise any and all of the powers and to perform any and all duties of the Board of Directors as may lawfully be exercised and performed by such Committee.

The following directors were serving on the Executive Committee as of December 31, 2012:

Manly Eugene Moor, Jr., Chairman, ex officio
William Jackson Stevens, Vice Chairman, ex officio
James Malcom Aycock
Leonidas Keith Granger
Kenneth Earl Hubbard
Fred Dominic Hunker, M.D.
Terry Dee Kellogg, ex officio
Donald Lee Large, Jr.

Hospital Advisory Committee

Article I, Section 13 of the Bylaws provided that the Board of Directors shall establish a Hospital Advisory Committee consisting of five hospital representatives who are not members of the Board and are knowledgeable in providing health services. The Bylaws states:

> The Advisory Committee shall from time to time, as requested by the Board of Directors or any committee thereof, consult and advise with the Board of Directors or any committee or member thereof concerning matters as to which consultation or advice is requested by such Board or committee.

The following persons were serving on the Hospital Advisory Committee as of December 31, 2012:

David Coleman Wilson, Chairman, Baptist Medical Center
David Shannon Spillers, Huntsville Hospital
Sean Carey Tinney, St. Vincent's Hospital
Walter Russell Tyner, Baptist Health Center
Suzanne Elise Woods, Flowers Hospital

Other Committees

Article I, Section 15 of the Company's Bylaws states:

> The Board of Directors or the Chairman of the Board may appoint such committees from the members of the Board as may be deemed necessary or advisable and may prescribe their respective powers authorities and duties.

These other committees were in addition to the Executive Committee and the Hospital Advisory Committee, both of which were required by the Company's Bylaws.

The following committees had been established and existed as of December 31, 2012:

Medical Review Committee

Richard McConnell Freeman, M.D., Chairman
Raymond James Browne, M.D.
Howard Joseph Falgout, M.D.
James Daniel Gifford, M.D.
Fred Dominic Hunker, M.D.
Paul Michael Nagrodzki, M.D.

Audit Committee

James Malcom Aycock, Chairman
Manly Eugene Moor, Jr., ex officio

Marvell Bivins, Jr.
Walter Howlett, Jr.
Donald Lee Large, Jr.

Compensation Committee

William Jackson Stevens, Chairman
Manly Eugene Moor, Jr., ex officio
George Sanders Hammer
Kenneth Earl Hubbard
Susan Wood Matlock

Nominating Committee

Edward Franklin Crowell, Chairman
Manly Eugene Moor, Jr.
Clark Patrick Christianson
Philip Craig Dotts
James Daniel Gifford, M.D.
William Jackson Stevens

Facility Standards Committee

Glenn Chamblee Sisk, Chairman
Manly Eugene Moor, Jr., ex officio
Barry Smith Cochran
Reid Bentley Dove
Donald Lee Large, Jr.
Michael Dewitt Thompson
Timothy John Thornton
James David Weidner

Officers

The following officers were elected by the Board of Directors and were serving at December 31, 2012:

Position	Name
Chairman of the Board	Manly Eugene Moor, Jr.
Vice Chairman of the Board	William Jackson Stevens
President and Chief Executive Officer	Terry Dee Kellogg
Executive Vice President	Timothy Lee Kirkpatrick

Senior Vice President	Jeffrey Alan Ingrum
Senior Vice President	Brian Scott McGlaun
Senior Vice President	Vickie Ledbetter Saxon
Senior Vice President	Timothy Terrell Sexton
Senior Vice President and Treasurer	Cynthia Mizell Vice
Senior Vice President	Timothy Vines
Senior Vice President	Dick Dowling Briggs III, MD
Vice President and Chief Actuary	Noel Winfred Carden
Vice President	Tony Hayes Carter
Vice President	Rebekah Elgin Council
Vice President	Joseph Edward Dunsmore
Vice President	Brian David Edwards
Vice President	Joseph Jay Hall
Vice President	James Stanton Hill
Vice President	Scot Edward Hanley
Vice President	Edward Owen Harris
Vice President	Eugene Edward Linton, Jr.
Vice President	Carol Downer Mackin
Vice President	Douglas Edward McIntyre
Vice President	Robert Reynolds Orr, Jr.
Vice President and Secretary	Michael Lenard Patterson
Vice President	Joseph Robin Stone
Assistant Secretary	Lisa Talley Machado

Conflict of Interest

The Company requires that conflict of interest statements be completed annually by all directors, officers and exempt status employees. In addition, the Company requires every new employee, whether they are exempt, non-exempt, full-time, part-time or contracted, to attend a Code of Business Conduct and Compliance Program. This Program provides employees with a formal statement of the Company's standards and rules of ethical business. At the end of the program, the employees are required to sign a statement of understanding, which is maintained in the employees' personnel files.

Officers, directors and managers are also required to complete a Code of Ethics Certification on an annual basis. This certifies their understanding and agreement to abide by the Company's ethical standards and expectations.

A review was conducted of all conflict of interest statements filed by the Board of Directors and the Officers during the examination period. No items of disclosure, which may have had the potential of a material or adverse impact on the operations of the Company, were noted.

CORPORATE RECORDS

The Certificate of Incorporation and Bylaws and any amendments thereto, were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practices and applicable statutes and regulations.

On March 26, 2008, the Board of Directors adopted the Governance Policy and Guidelines and the standing committee charters. The Audit Committee's charter was replaced in its entirety as was the Salary Review Committee's charter. The Salary Review Committee's name was changed to the Compensation Committee. All other charters were adopted with no changes made.

HOLDING COMPANY AND AFFILIATE MATTERS

Holding Company

The Company is not subject to the Alabama Insurance Holding Company System Regulatory Act as defined in ALA. CODE § 27-29-1 (1975); however, its subsidiary, United Trust Insurance Company (UTIC) is registered with the Alabama Department of Insurance as registrant of an Insurance Holding Company System. UTIC is a wholly owned subsidiary of Alabama Industries Financial Corporation (AIFC). AIFC is a wholly owned subsidiary of the Company. See page 23 for the Company's organizational chart, which presents affiliated corporate relationships. Appropriate filings required under the Holding Company Act were made from time to time on behalf of the Company by UTIC as registrant.

Administrative Service Agreements

The Company (BCBSAL) provided various services under Administrative Service Agreements to the following affiliated companies at December 31, 2012.

Alabama Industries Financial Corporation (AIFC)

The Company entered into an Administrative Service Agreement with AIFC effective January 6, 1986. AIFC was organized for the purpose of conducting the business of an insurance holding company. AIFC owns all the common stock of UTIC and is a wholly-owned insurance subsidiary of BCBSAL.

Under the Agreement, BCBSAL is to provide the following:

- To prepare all necessary legal documents, including regulatory, tax and other governmental filings for the conduct of AIFC business.
- To provide all data processing, accounting and legal services necessary for the operation of AIFC.
- To act on behalf of AIFC for the purpose of negotiating, coordinating and servicing activities necessary to implement the Agreement or to AIFC's business.
- To provide all functions associated with the marketing of AIFC's services.
- To provide personnel staffing, office equipment and other managerial, administrative, and professional services as may reasonably be necessary to conduct AIFC's business.

BCBSAL agrees that its Administrative charges shall be established so as to reimburse BCBSAL for its costs of provision of such services on a non-profit basis. BCBSAL will bill AIFC for costs incurred on the latter's behalf during the previous month.

The Agreement shall be in effect from January 6, 1986, through December 31, 1986 and shall be automatically renewed thereafter for terms of one (1) year unless written notice to the contrary is given by either party to the other not less than sixty (60) days before the effective date of any one (1) year term.

United Trust Insurance Company (UTIC)

UTIC is an Alabama company organized for the purpose of providing disability insurance to persons residing in the state of Alabama. In addition, UTIC has the responsibility to act as an agent and/or provide administrative services for a range of insurance options.

The Company entered into a new Administrative Service Agreement with UTIC effective May 31, 2010. Under terms of the Agreement, the Company will assume and carry out the following responsibilities:

- To prepare master policies and other related legal documents necessary for the conduct of UTIC's marketing program.
- To compensate USAble in accordance with the Agreement between UTIC and USAble.
- To provide reports and records in accordance with the Agreement between UTIC and USAble.

- To act on behalf of UTIC for the purpose of servicing activities necessary to implement the Agreement.
- To provide personnel staffing as needed, all accounting, legal and auditing services necessary to implement the Agreement.
- To provide all other managerial, administrative and professional services as reasonably necessary for the conduct of UTIC business.
- To file the master policy and all other required documents with the State Department of Insurance.

UTIC agrees to assume and carry out the following responsibilities:

- To issue and cause to be issued Master Policies to persons enrolled in UTIC's disability insurance.
- To provide BCBSAL a written description of the benefits provided by UTIC and other descriptive literature of UTIC procedures and operations.
- To reimburse BCBSAL in accordance with Article VI hereof for administrative services provided under this Agreement.

The administrative charges shall be established so as to reimburse BCBSAL for its cost of provision of such services on a non-profit basis. BCBSAL will bill UTIC monthly for costs incurred on the latter's behalf during the previous month. All amounts billed shall be paid by the 30th of each month, following the month billed.

The agreement is in effect from May 31, 2010 through April 30, 2011 and is automatically renewed thereafter for successive like terms for one (1) year unless written notice to the contrary is given by either party to the other party not less than one hundred eighty (180) days before the end of any one year term.

In December 2012, UTIC transferred to USAble Life the short-term disability insurance products. As a result, UTIC no longer received premiums and was only processing those claims that occurred prior to the transfer date. Subsequently, the Company is in the process of amending its ASA with UTIC to reflect this transfer.

Cahaba Government Benefit Administrators, LLC (CGBA)

CGBA is a single-member limited liability company that operates to assume the responsibilities of BCBSAL as Medicare fiscal intermediary and carrier responsibilities for Parts A and B of the Medicare Program under contracts with the Centers for Medicare & Medicaid Services (CMS). BCBSAL entered into an administrative services agreement with CGBA effective April 1, 2006.

Under this agreement CGBA will manage the Medicare Part B contract and Part A subcontract, while BCBSAL will provide the following services for CGBA.

- Facilities, personnel and experience in bidding on and negotiating Medicare Administrator Contractor (MAC) contracts and other Medicare Work.
- Prepare and forward billing and fee collection.
- Provide consultative functions with respects to bidding on MAC contracts and other Medicare work.
- Provide human resources, system support, purchasing, LAN administration, telecommunication services, and graphic services, compliance support and other operating functions.

The administrative charges consist of fully loaded labor rates and are established so as to reimburse BCBSAL for its costs of provision of such services on a non-profit basis. BCBSAL will bill CGBA monthly for costs incurred on the latter's behalf during the previous month.

The Agreement was in effect from April 1, 2006 through March 31, 2007 and automatically renewed for successive terms of one (1) year. The Agreement may be terminated by written notice given by either party to the other not less than one hundred eighty (180) days before the end of any one-year term.

Cahaba Safeguard Administrators, LLC (CSA)

The Company entered into an administrative services agreement with CSA effective April 12, 2012. CSA is a contractor that provides program integrity services and auditing services for governmental healthcare programs. Their main customer is CMS and their work is concentrated within the Center of Program Integrity (fraud work), the Office of Financial Management (audit work) and the Center for Innovation (audit/special project work).

Under terms of the agreement, the Company will provide the following services to CSA.

- Multiple types of services including information technology, systems security, corporate communications, accounting, human resources, physical security, maintenance, facilities, purchasing and operational services.
- The agreement sets out a basis for managing and measuring the performance of the services by BCBSAL.

- BCBSAL shall submit monthly invoices to CSA and shall contain the invoice date, period of performance, the total direct costs and total indirect costs and a breakout for the costs incurred by cost center.

- A duly authorized representative of BCBSAL shall sign the invoice as consideration of a certification as to its accuracy. Payment of an invoice will be made within 30 calendar days following receipt of the invoice.

The agreement was to be in effect from April 24, 2012 through April 23, 2013. It shall automatically renew thereafter for successive terms of one year. This Agreement may be terminated by either party within 60 days written notice.

The Caring Foundation (TCF)

The Company entered into an administrative services agreement with TCF effective May 31, 2010. TCF is a non-profit corporate foundation formed to channel most of BCBSAL's charitable contributions.

The agreement provides that BCBSAL is to provide the following services to TCF:

- Accounting, data processing, legal services, and other managerial, administrative and professional services.

- To act on behalf of TCF for the purpose of negotiating, coordinating, and servicing activities necessary to implement the Agreement.

Both parties agree to maintain in accordance with standard and accepted accounting practices such financial and accounting records as shall be necessary, appropriate or convenient for the proper administration of this Agreement.

The term of this agreement is one year from the effective date of March 31, 2010 through April 30, 2011, and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notification to the contrary is given by either party to the other not less than one hundred eighty (180) days before the end of any one-year term. In the event of termination of the Agreement in the manner provided above, it will terminate at the end of the one-year term in which such written notice of termination is given.

The Service Agreement does not provide for billing or payment for administrative charges.

Preferred Care Services, Inc. (PCSI)

The Company entered into an administrative services agreement with PCSI May 31, 2010. PCSI was formed as a separate wholly-owned entity to hold title to real estate acquired for future growth and expansion of BCBSAL and/or its subsidiary and affiliated companies and to provide certain property development and management services on their behalf if needed into the future.

The agreement provides that PCSI contracts with the Company to provide the following:

- Preparation of forms of Group Agreements and other legal documents necessary for the conduct of PCSI business.
- Billing and collection from Health Care Entities or Employers having Group Agreement for Health Care Services.
- Perform all marketing functions associated with PCSI's Health Care Services.
- Act on behalf of PCSI for negotiations, coordinating and servicing activities to implement the agreement.
- To provide managerial, administrative, and professional services necessary to conduct PCSI business.

BCBSAL agrees that the administrative charges shall be established so as to reimburse BCBSAL for its costs of providing such services on a non-profit basis. BCBSAL will bill PCSI monthly for costs incurred on the latter's behalf during the previous month. All amounts shall be paid within ninety (90) days of the billing date.

This Agreement shall be in effect from May 31, 2010 through April 30, 2011, and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notice to the contrary is given by either party to the other not less than one hundred eighty (180) days before the end of any one-year term. In the event of termination in the manner provided above, it will terminate at the end of the one-year term in which such written notice of termination is given.

Income Tax Allocation Agreements

At December 31, 2012, BCBSAL had tax sharing agreements (TSA) with Alabama Industries Financial Corporation (AIFC), United Trust Insurance Company (UTIC), Cahaba Safeguard Administrators LLC (CSA), Cahaba Government Benefit Administrators (CGBA), and Preferred Care Services, Inc. (PCSI) for the purpose of allocating federal income taxes with respect to the consolidated federal income tax return. The terms of each TSA are noted as follows:

AIFC

The Agreement was entered into December 31, 2000 and effective January 1, 2001. The terms of the agreement are as follows:

- In the event that AIFC has a net operating loss for any calendar year, BCBSAL agrees to pay AIFC an amount equal to the federal income tax rate to which the company is subject pursuant to these consolidated filings (hereinafter referred to as the applicable federal tax rate) of the net operating loss. At year-end BCBSAL will book a payable to AIFC for said amount. AIFC will book a receivable for said amount.

- In the event that AIFC has a net operating gain for any calendar year, AIFC agrees to pay BCBSAL an amount equal to the applicable federal tax rate of that net operating gain. At year end, BCBSAL will book a receivable from AIFC for said amount. AIFC will book a payable for said amount.

- Subject to regulatory approval, the agreement shall be in effect from January 1, 2001 and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notice to the contrary is given to either party not less than thirty (30) days before the end of any one-year term.

- The agreement may be amended at any time by mutual agreement of both parties provided that any such amendment is in writing and executed by an officer of BCBSAL and AIFC.

- Any notice required or permitted to be given under the agreement shall be in writing and shall be sufficient if mailed with first-class postage prepaid to the other party at its respective address.

Effective January 1, 2005, Amendment Number 1 was added as follows:

- Article II: Within 90 days following the filing of the BCBSAL federal tax consolidated return, intercompany balances shall be settled.

UTIC

BCBSAL entered into an Administrative Services Agreement with UTIC as of December 31, 1994 and effective January 1, 1987. The agreement set forth their respective rights and obligations in the establishment and administration of a tax sharing agreement as an addition to their previous agreement. The terms of the tax sharing agreement were as follows:

- In the event of a net operating loss for any calendar year, BCBSAL agrees to pay to UTIC an amount equal to twenty percent (20%) of the net operating loss. At year-end, BCBSAL will book a payable to UTIC for said amount. UTIC will book a receivable for said amount.

- In the event of a net operating gain for any calendar year, UTIC agrees to pay to BCBSAL an amount equal to twenty percent (20%) of the net operating gain. At year-end, BCBSAL will book a receivable from UTIC for said amount. UTIC will book a payable for said amount.

The agreement is in effect from January 1, 1987 and shall be automatically renewed thereafter for successive like terms of one (1) year unless notice to the contrary is given by either party to the other party not less than one hundred eighty (180) days before the end of any one-year term.

The Agreement was amended effective January 1, 2005 by Amendment Number 1 as follows:

- The title of Agreement was changed from Administrative Services Agreement to Tax Sharing Agreement.

- In the event UTIC has a net operating loss for any calendar year, BCBSAL agrees to pay UTIC an amount equal to the federal income tax rate to which the Company is subject to pursuant to the consolidated tax filings...
- In the event UTIC has a net operating gain for any calendar year, UTIC agrees to pay BCBSAL an amount equal to the applicable federal tax rate of that net operating gain... Within 90 days following the filing of BCBSAL's federal consolidated return, intercompany tax balances will be settled.

CGBA

The Agreement was entered into and effective April 1, 2006. The terms of the Agreement were as follows:

- In the event that CGBA has a net operating loss for any calendar year, BCBSAL agrees to pay CGBA an amount equal to the federal income tax rate to which the company is subject pursuant to these consolidated filings, (hereinafter referred to as the applicable federal tax rate) of the net operating loss. At year-end, BCBSAL will book a payable to CGBA for said amount. CGBA will book a receivable for said amount.

- In the event that CGBA has a net operating gain for any calendar year, CGBA agrees to pay BCBSAL an amount equal to the applicable federal tax rate of that net operating gain. At year-end, BCBSAL will book a receivable from CGBA for said amount. CGBA will book a payable for said amount.

- The agreement will be in effect from April 1, 2006 and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notice to the contrary is given by either party to the other not less than thirty (30) days before the end of the one-year term.
- The agreement may be amended at any time by mutual agreement of CGBA and BCBSAL provided that any such amendment is in writing and executed by a manager of CGBA and an officer of BCBSAL, respectively.
- Within ninety (90) days following the filing of the BCBSAL federal consolidated tax return, intercompany tax balances will be settled.

In November 2009, the intercompany tax settlement rate provision was revised as follows:

- For 2008, the consolidated federal tax return settlement rate shall be 35%. For settlement of the 2009 and subsequent consolidated federal tax returns, the intercompany settlement rate shall be 20% so long as the consolidated return is subject to alternative minimum tax. In the event the consolidated federal tax return is not subject to alternative tax, the intercompany settlement shall reflect the rate to which the consolidated entity is subject.
- For intercompany settlement of the 2008 consolidated federal tax returns, the net operating loss shall be calculated deducting amounts for pension funding equal to the 2008 expense per CGBA's income statement. For 2009 and subsequent years, the CGBA net operating gain or loss for return filing purposes will be calculated deducting amounts for pension funding equal to the expense per CGBA's income statement for the applicable tax year.

CSA

The agreement was entered into and executed on June 21, 2006 and effective January 1, 2006. The terms of the agreement are as follows:

- In the event that CSA has a net operating loss for any calendar year, BCBSAL agrees to pay CSA an amount equal to the federal income tax rate to which the Company is subject pursuant to these consolidated filings (hereinafter referred to as the applicable federal tax rate) of the net operating loss. At year-end, BCBSAL will book a payable to CSA for said amount. CSA will book a receivable for said amount.

- In the event that CSA has a net operating gain for any calendar year, CSA agrees to pay BCBSAL an amount equal to the applicable federal tax rate of that net operating gain. At year-end, BCBSAL will book a receivable from CSA for said amount. CSA will book a payable for said amount.

- This agreement shall be in effect from January 1, 2006 and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notice to the contrary is given by either party in writing to the other not less than thirty (30) days before the end of any one-year term.

- Within ninety (90) days following the filing of the BCBSAL federal consolidated tax return, intercompany tax balances will be settled.

In November 2009, the intercompany tax settlement rate provision was revised as follows:

- For 2008, the consolidated federal tax return settlement rate shall be 35%. For settlement of 2009 and subsequent federal tax returns, the intercompany settlement rate shall be 20% so long as the consolidated return is subject to alternative minimum tax. In the event the consolidated federal tax return is not subject to alternative minimum tax, the intercompany settlement shall reflect the rate to which the consolidated entity is subject.
- For intercompany settlement of the 2008 consolidated federal tax return, the net operating loss shall be calculated deducting amounts for pension funding equal to the 2008 expense per CSA's income statement. For 2009 and subsequent years, the CSA net operating gain or loss for return filing purposes will be calculated deducting amounts for pension funding equal to the expense per CSA's income statement for the applicable tax year.

PCSI

The agreement was entered into as of December 31, 2000 and effective January 1, 2001. Terms of the agreement are as follows:

- In the event that PCSI has a net operating loss for any calendar year, BCBSAL agrees to pay PCSI an amount equal to the federal income tax rate to which the company is subject pursuant to these consolidated filings... At year-end, BCBSAL will book a payable to PCSI for said amount. PCSI will book a receivable for said amount.

- In the event PCSI has a net operating gain for any calendar year, PCSI agrees to pay to BCBSAL an amount equal to the applicable federal tax rate of that net operating gain... At year-end, BCBSAL will book a receivable from PCSI for said amount. PCSI will book a payable for said amount.

- The agreement shall be in effect from January 1, 2001 and shall be automatically renewed thereafter for successive like terms of one (1) year unless written notice to the contrary is given by either party to the other not less than thirty (30) days before the end of any one-year term.
- The agreement may be amended at any time by mutual agreement of PCSI and BCBSAL, provided that any such amendment is in writing and executed by an officer of PCSI and BCBSAL respectively.

The agreement was amended December 27, 2005 and was effective January 1, 2005 by Amendment Number 1. This amendment to Article III, item 3 stated:

- Within 90 days following the filing of the BCBSAL federal consolidated tax return, intercompany tax balances will be settled.

The Tax Sharing Agreements with AIFC, UTIC and PCSI did not include language concerning the 20% settlement rate as disclosed in the 2012 Annual Statement, *Notes To Financial Statements* No. 9 F.

The Company did not complete the *Notes To Financial Statements* in their 2012 Annual Statement in accordance with guidance of the NAIC *SSAP No. 101, Income Taxes, A Replacement for SSAP No. 10R and SSAP No. 10*, Disclosures 28 and the NAIC *Annual Statement Instructions, Notes To Financial Statements* No. 9 Income Taxes, F which states:

> If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed: b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a part to the consolidation... Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup its federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

Network Marketing Services Agreement – ABS and BCBSAL

Effective August 1, 2006, this agreement was between BCBSAL, the Company and Able Benefit Solutions, Inc. (ABS).

Per the terms of the agreement, the Company was responsible for:

- Reimbursement to ABS for underwriting, rating, risk analysis, contract issuance, licensing fees and related functions performed on behalf of the Company for its customers in accordance with the terms negotiated by ABS and the Company.

ABS was responsible for:

- Selecting suitable insurers to provide employee group programs not otherwise available through BCBSAL or UTIC.
- Obtaining and maintaining appropriate licensing status as a corporate agency under all applicable laws and regulations.
- Obtaining and monitoring individual agent license and licensing status of all marketing representatives.
- Overseeing and assuring that all appropriate licenses are obtained, maintained, and are appropriately monitored consistent with all applicable laws and regulations.
- Coordinating in conjunction with BCBSAL and the Company all proposals, request for rates, training, preparation, and distribution of marketing literature and other similar requirements related to the marketing and servicing of ABS, BCBSAL, and the Company's products.
- Reimbursing BCBSAL for all direct and indirect costs incurred that was mutually agreed upon in this agreement.
- ABS did not have binding authority and had the responsibility of advising all group applicants that the insurance coverage applied for would not become effective until the application had been accepted by the selected carriers.

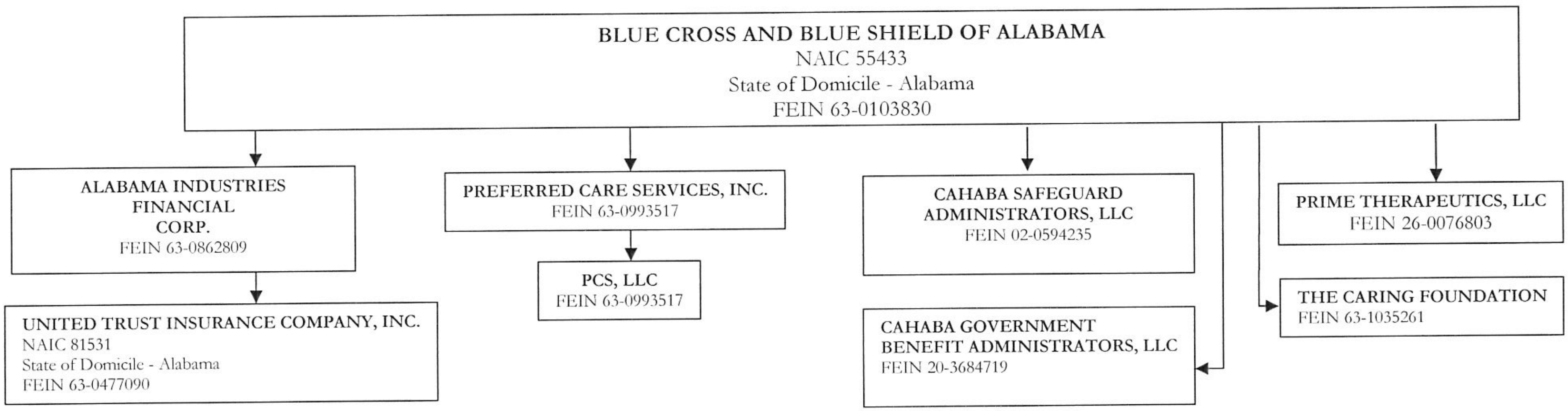
ABS reimbursed BCBSAL for all direct costs incurred related to providing services to customers which were attributable to the marketing of ABS products. BCBSAL did not share in the profits/losses of ABS.

The agreement contained dispute resolution/arbitration, confidentiality, and termination provisions. The agreement was continuous and could be terminated by either party via sixty days prior written notice.

ORGANIZATIONAL CHART

The following chart presents the corporate affiliations of the Company as of December 31, 2012. See page 23 for organizational chart.

ORGANIZATIONAL CHART



DIVIDENDS TO STOCKHOLDERS OR POLICYHOLDERS

The Company is not a stock or a mutual corporation; therefore, no dividends were paid by the Company. For discussion of the Company Incorporation, see "**ORGANIZATION AND HISTORY**" on page 3.

FIDELITY BOND AND OTHER INSURANCE

The Company was a named insured with Travelers Indemnity Company for an aggregate amount, which met the suggested minimum requirements of the NAIC *Financial Condition Examiners Handbook*. In addition to this coverage, the Company also had insurance coverage for the following:

- Auto Coverage provided by Phoenix Insurance Company.
- Blanket Coverage provided by Travelers Indemnity Company which included:
    - Building and Personal Property
    - Personal Property on Each Premises and In-Transit
    - Valuable Papers
    - Earthquake or Volcanic Eruption
    - Windstorm or Hail
    - Flood
    - Accounts Receivables on Premises and In-Transit
    - Newly Constructed or Acquired Building
    - Utility Service
- Umbrella Excess Liability provided by Travelers Property and Casualty Company of America.
- Directors and Officers Liability provided by BCS Insurance Company.
- Managed Care Errors and Omissions provided by BCS Insurance Company.
- Employment Practices Liability provided by BCS Insurance Company.
- Electronic Crimes andl Fidelity provided by Allied World Assurance (U.S.) Inc.
- Excess Errors and Omissions Liability provided by American Guarantee and Liability Insurance Company.
- Fiduciary Liability provided by Federal Insurance Company.
- Network Security Coverage provided by Allied World Assurance Inc.

- Nurses Liability provided by American Casualty Company, Reading Pennsylvania.

The Company was shown as the Insured Plan on all policies. Each policy included all subsidiaries as a group or by named entity. The single loss limit of liability for agents of the life insurance company including general agents, soliciting agents, servicing agents, servicing contractors and third party administrators was $0.

PENSION, STOCKOWNERSHIP AND INSURANCE PLANS

The Company offered the following benefit plans for its employees and agents at December 31, 2012.

Paid Time Off	Life, Accident and Disability Insurance
Paid Holidays	401k Deferred Compensation
Paid Jury Duty	Tuition Reimbursement
Funeral Leave	Retirement Plan
Military Leave	"Ask A Nurse" and Wellness Services
Health Insurance	Off-Site Sick Care for Children
Dental Insurance	Associate Assistance Program
Long Term Care Insurance	Service Incentive Award
Performance Incentive Plan (for exempt)	Off-Site Child Development Center
Performance Based Pay (non-exempt)	Dependent Care Assistance Plan
Supplemental Benefit Plan	FMLA Leave- Medical Leave
Air Med	

At its March 2012 meeting, the NAIC adopted SSAP No. 102, *Accounting for Pensions, A Replacement for SSAP No. 89* and SSAP No. 92, *Accounting for Postretirement Benefits Other than Pensions, A Replacement of SSAP No. 14.* Both SSAPs will require significant changes to the accounting and disclosure of pension and other postretirement benefits. Most notably, they will require reporting companies to recognize a liability equal to the unfunded projected benefit recorded directly to surplus, but it can be amortized over a period not to exceed 10 years. The effective date of the SSAPs is January 1, 2013, but companies can elect to start reporting it at year-end 2012. BCBSAL elected to adopt SSAP No. 92 early but not SSAP No. 102. To amend the Postretirement Benefits Plan from 2011 to 2012 would cost approximately $206 million per the *2012 Annual Statement - Notes to Financial Statement 12 (10).* BCBSAL amortized this cost, and reported a liability for post-retirement benefits of $9,231,672 to surplus on the 2012 Annual Statement. During the first quarter 2013, BCBSAL adopted SSAP No. 102 and recognized a liability of $6,883,965 with corresponding offset included in other adjustments to unassigned funds.

18 U.S.C § 1033 Compliance

The Violent Crime Control and Law Enforcement act of 1994, US Code, Title 18, Section 1033 (e)(1)(A) and ALA. ADMIN. CODE 482-1-146 (2009), in part, prohibits individuals who have been convicted of specified criminal activity from engaging in the business of insurance without written consent from the [sic Alabama] Commissioner of Insurance. The Company, as part of its hiring procedures, requires potential employees and contractors to disclose and explain any criminal convictions, and criminal background checks are performed on all new hires. The Company also requires all employees to sign a conflict of interest statement yearly stating that they have not been convicted of a felony since becoming an associate of the Company. The Company performs criminal reinvestigations on all associates at least once every five years and compares that information to associates' conflict of interest statements.

MARKET CONDUCT ACTIVITIES

Management and Operations

Territory

The Company's certificate of authority was issued by the State of Alabama's Department of Insurance with an effective date of June 1, 1991 and remains in effect until suspended, cancelled, or revoked, as long as fees and taxes are currently paid.

The Company marketed its products in all 67 counties in the state of Alabama. Blue Cross and Blue Shield of Alabama (BCBSAL)a wrote Health, Dental and Pharmacy policies for the Commercial Market and Health and Pharmacy policies for the Medicare market. The Company was only licensed in Alabama to write and issue: Health, Comprehensive (Hospital and Medical), Medicare Supplement, Dental, Federal Employees Health Benefit Plan, and Title XVIII Medicare.

Plan of Operation

BCBSAL is a non-stock, not-for-profit Company, which maintains and operates health care plans under which services are offered to the public. BCBSAL offered Health and Dental products to the group and individual markets in all 67 counties of the state. The Company utilized Account Executives, District Account Representatives and District Sales Representatives for the employer group market. Insurance Advisors sold to the individual consumers along with the fewer than 15 employee small groups. In addition, the consumers and small groups with less than 15 employees could purchase coverage on the Company's website. In late 2010, BCBSAL closed its Long-Term Care (LTC) insurance product to new business;

however, the Company continued to maintain the active policies that have already been issued.

The Company is headquartered in Birmingham, Alabama, with service and satellite offices throughout the state of Alabama.

Marketing and Sales

The Company's advertising and marketing strategy was delivered through a variety of mediums including: television, direct mail, radio, print, paid search, remarketing, online display and social media. According to Blue Cross and Blue Shield Association guidelines, advertising and direct mail messages were targeted within Alabama. Advertising materials were coordinated through the Company's marketing department.

The Company used Account Executives to sell and renew groups over 1,000 employees; District Account Representatives to manage employer groups with 15-999 employees and District Sales Representatives to handle both individual product consumer sales for the over and under 65 market, as well as small employer groups with 2-14 employees.

Complaint Handling

A review of a sample of 158 Alabama complaints selected from a population of 2077 complaints received from 2008 through 2012 was conducted. It was determined that the Company did not keep complete documentation for seven complaint files in accordance with ALA. CODE § 10A-20-6.11 (1975), which requires:

> The Commissioner of Insurance or any of his or her designated deputies or examiners shall have the power of visitation and examination into the affairs of the corporation, shall have free access to all books, papers, and documentation that relate to the business of the corporation....

It was determined that the Company did not respond to seven ALDOI complaints within ten (10) working days in accordance with ALA. ADMIN. CODE 482-1-118.06, which requires:

> The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner. When the requested record or response is not produced or cannot be produced by the insurer within

> ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay.

Claims Handling

The 2012 paid claims for hospital (Cross), physician (Shield), drug and dental were reviewed with regard to compliance with policy provision, adequacy of documentation and timeliness of payments. From a population of approximately 44.3 million claims, a sample of 109 was selected. From a population of 1,632 Long-Term Care claims paid during the examination period of 2008 - 2012, a sample of 107 paid claims was reviewed with regard to compliance with policy provisions, eligibility requirements and adequacy of documentation with no issues noted. No issues were noted in either sample.

Compliance with Producer Licensing Requirements

As of December 31, 2012, the Company had 233 producers appointed and licensed. All of the producers were licensed to solicit business for accident and health lines of business. The producers who received a commission payment from the Company were properly appointed with the Company.

Terminated Producer

A sample of 79 termination notices was selected from a population of 120 and was reviewed. The terminated notices were to be sent the Alabama Department of Insurance (ALDOI) in accordance with ALA. CODE § 27-7-30 1975(e), which states:

> Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner."

It was determined that the Company did not send the ALDOI proper notification for five of its terminated producers.

The Company's management indicated that, they had not been sending out terminated producer notices to the producer's last known address in accordance with ALA. CODE § 27-7-30, which states:

> Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

Underwriting and Ratings

A sample of 79 premiums from the Company's 2012 written premiums was selected. It was determined that the premiums were calculated in accordance with the Company's guidelines and its rates filed with the Alabama Department of Insurance (ALDOI). The examination indicated that all of the forms, endorsements and premium rates utilized in Alabama during the examination period had been properly filed and approved by the ALDOI in accordance with ALA. CODE §10A-20-6.10(1975) which states:

> ...A health care service corporation shall file with the Commissioner of Insurance any change in its rates, charges, fees and dues, and, as soon as reasonably possible after the filing has been made the commissioner shall, in writing, approve or disapprove the same, provided that, unless disapproved within 30 days after the filing, the changed rates, charges, fees, or dues shall be deemed to be approved...

Privacy Standards

The Company's HIPAA Privacy Notice described how the medical information about the customer may be disclosed and how the customer can gain access to the information. The Privacy Statement detailed the privacy objectives regarding Security Practices, Use of Email, Cookies, Surveys and Forms, Updates to the Statement and Confidentiality. The Company did not disclose nonpublic personal financial information that it received from nonaffiliated financial institutions. Blue Cross Blue Shield of Alabama had reasonable administrative, technical, and physical safeguards in place to secure the privacy of Protected Health Information.

SPECIAL DEPOSITS

The Company maintained the following deposits with the respective statutory authorities at December 31, 2012, as required or permitted by law.

States and Territories		Book Value		Fair Value
Alabama	$	30,000	$	30,000
TOTAL	$	30,000	$	30,000

FINANCIAL CONDITION AND GROWTH OF THE COMPANY

Year	Admitted Assets	Liabilities	Policyholders' Surplus	Net Premium Income
2012*	$2,630,441,100	$1,511,576,465	$1,118,864,635	$4,082,333,469
2011	$2,381,166,366	$1,390,106,115	$991,060,251	$4,150,255,238
2010	$2,188,947,856	$1,333,146,196	$855,801,660	$4,335,638,747
2009	$1,990,486,185	$1,341,454,202	$649,034,983	$4,320,066,040
2008	$1,906,945,024	$1,250,584,204	$656,360,820	$3,992,026,178
2007*	$1,917,173,084	$1,172,719,108	$744,453,976	$3,495,234,465

*Per Examination

SCHEDULE T – EXHIBIT OF PREMIUMS WRITTEN

States		Accident & Health Premiums		Medicare Title XVIII		Federal Employees Health Benefit Program Premiums		Total
Alabama	$	3,039,542,306	$	378,142,393	$	672,573,873	$	4,090,258,572
Reporting entity contributions for Employee Benefit Plans		246,273						246,273
TOTAL	$	3,039,788,579	$	378,142,393	$	672,573,873	$	4,090,504,845

LOSS EXPERIENCE

	2012	2011	2010	2009	2008
Estimated Claim Reserve and Claim Liability 12/31/PY	$ 301,469,111	$ 326,639,882	$ 385,902,641	$ 351,594,388	$ 327,365,333
Claims Incurred Prior to 1/1/CY and Claims Unpaid 12/31/PY	253,387,715	273,594,152	319,105,485	296,442,429	279,111,680
More(Less) Sufficient Reserve Based on PY Estimate	**$ 48,081,396**	**$ 53,045,730**	**$ 66,797,156**	**$ 55,151,959**	**$ 48,253,653**

REINSURANCE

Assumed Reinsurance

The Company did not assume any reinsurance during the examination period.

Ceded Reinsurance

100% Reinsurance Agreement – United Trust Insurance Company

On February 9, 2011, Management informed the Department of Insurance that the Company would transfer 100% of the risk associated with its long-term care (LTC) policies to United Trust Insurance Company (UTIC), a wholly-owned subsidiary. The Company had discontinued writing new LTC business in 2010. This risk transfer would be effective January 1, 2011, and all LTC policies would remain on BCBSAL paper. BCBSAL would financially guarantee the obligations assumed by UTIC and would fund the reserve liability at January 1, 2011.

A properly written reinsurance agreement was not executed during the period covered by examination. ALA. ADMIN. CODE 482-1-105-.13 Reinsurance Contract states:

> Credit will not be granted, nor an asset or reduction for liability allowed, to a ceding insurer for reinsurance effected with assuming insurers meeting the requirements of Rules 482-1-105-.04, 482-1-105-.06, 482-1-105-.07 or 482-1-105-.09 or otherwise in compliance with the Act after

the adoption of this chapter unless the reinsurance agreement includes both of the following:

(a) A proper insolvency clause pursuant to Sections 27-5-12 and 27-32-39, Code of Alabama 1975.

(b) A provision pursuant to the Act whereby the assuming insurer, if an unauthorized assuming insurer, has submitted to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, has agreed to comply with all requirements necessary to give such court or panel jurisdiction, has designated an agent upon whom service of process may be effected, and has agreed to abide by the final decision of such court or panel.

ACCOUNTS AND RECORDS

Information Systems and Other Security Areas

The Company maintained both Local and Wide Area Networks. These networks utilized Microsoft, Unix, and IBM z/OS operating systems to facilitate a wide variety of business systems. The Company's two IBM mainframes utilized an internal fiber optic circuit and dark fiber dense wave multiplexing to ensure near real-time system redundancy. Both the Pope Technology Center and the Riverchase building computer rooms were secured using biometric scanners and were continually monitored by security personnel.

The Company's information systems were functionally apportioned into three divisions: Technology Support, Application Development and Professional Services. These divisions reported directly to the CIO; who was accountable to the Chief Administrative Officer.

Technology Support was responsible for the design, implementation, operation, and support of networks, workstations, mainframes, servers, databases, system software, phones, corporate level applications, asset management, IT purchasing, vendor management and batch production jobs.

Application Development was generally responsible for the analysis, design, development, and maintenance of all Company information systems.

Professional Services was responsible for all data security and access assignment, security compliance, business continuity and disaster recovery, IT forensics and application architecture. This department was also responsible for ensuring the successful implementation of IT projects.

The following key IT systems were used by the Company to process claims and billing:

- The Claims Processing System, (CPS), was developed by the Company for the processing of Blue Cross, Blue Shield, and major medical claims. The CPS subroutines were mainframe derived using a DB2 data structure. Changes to the system were formally managed.
- The Automated Cost Plus Billing System (ACPBS) was developed by the Company and used to facilitate automated group billing.
- The Group Enrollment Maintenance System, (GEMS), and Subscriber Enrollment Maintenance System (SEMS) were developed by the Company and were the principle systems used to support customer enrollment and eligibility, as well as billing, editing, and claim adjudication. These systems were highly complex and consisted of a multi-tiered application architecture supported by a DB2 data structure.
- The "Connect:Enterprise" system was a commercially developed system used by providers and third-party keyers to submit electronic claims. These submissions were aggregated on a network server using a proprietary database.

The Company utilized numerous methods of exchanging information with its customers. These methods included encrypted email, browser based secure file transfer protocols, and encrypted electronic tapes.

Health Risk Based Capital Ratio

The Risk Based Capital Ratios for the years of this examination were taken from the Company's Health Risk-Based Capital Reports as follows:

2012	1069.914%
2011	945.594%
2010	708.488%
2009	497.186%
2008	580.815%

In late 2010, the Company started discussions regarding changes to the Company's Health Risk Based Capital (HRBC) guidelines with the Alabama Department of Insurance (ALDOI). The Company began to project the impact health care reform rules and regulations would have on surplus in addition to possibly operating in a volatile market in 2014. Effective December 1, 2011, the ALDOI and Blue Cross and Blue Shield of Alabama reached a new agreement with a target range of 700% - 1200%. If Company falls below 700% or goes above 1200%, there will be ALDOI approved remedial actions implemented over 36 months. Should RBC fall below 600% or above 1400%, there will need to be remedial actions in place within 12 months. The agreement was effective December 1, 2011 and was executed on January 24, 2012 by BCBSAL and the Alabama Insurance Commissioner. As noted above, the 2012 HRBC ratio was within the established range outlined in the 2011 Agreement.

Ernst & Young, LLP (E&Y), Birmingham, Alabama, audited the Company for the five year examination period. Audit workpapers, reports, and management letters for 2008 - 2012 were reviewed and utilized in the examination to the extent deemed appropriate.

The Company's opining actuary for the examination period was Noel Winfred Carden, FSA, MAAA, Vice President and Chief Actuary for BCBSAL.

FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records and the valuations and determinations made during the course of the examination for the year 2012. Amounts shown in the comparative statements for the years 2008, 2009, 2010 and 2011 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Blue Cross and Blue Shield of Alabama
Statement of Assets
For the Year Ended December 31, 2012

ASSETS	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 933,219,666	$ -	$ 933,219,666
Stocks: Preferred stocks	-	-	-
Stocks: Common stocks	399,031,273	-	399,031,273
Real estate: Properties occupied by the Company	136,768,247	1,130,445	135,637,802
Cash, cash equivalents and short-term investments	517,363,854	-	517,363,854
Other invested assets	19,981,943	-	19,981,943
Subtotal, cash and invested assets	**$ 2,006,364,983**	**$ 1,130,445**	**$ 2,005,234,538**
Investment income due and accrued	9,554,526	-	9,554,526
Premium considerations:			
Uncollected premiums and agents' balances in the course of collection	318,675,774	482,470	318,193,304
Accrued retrospective premiums	14,435,888		
Amounts receivable relating to uninsured plans	188,490,073		188,490,073
Net deferred tax asset	93,838,613	71,926,541	21,912,072
Electronic data processing equipment and software	20,105,764	17,453,494	2,652,270
Furniture and equipment, including health care delivery assets	3,011,413	3,011,413	-
Receivable from parent, subsidiaries and affiliates	4,235,688	-	4,235,688
Health care and other amounts receivable	90,232,060	33,321,787	56,910,273
Other assets nonadmitted	108,822,318	108,822,318	-
Premium tax recoverable	8,822,468	-	8,822,468
TOTAL	**$ 2,866,589,568**	**$ 236,148,468**	**$ 2,630,441,100**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Blue Cross and Blue Shield of Alabama
Statement of Liabilities, Capital and Surplus
For the Year Ended December 31, 2012

LIABILITIES		2012
Claims unpaid	$	322,011,736
Unpaid claims adjustment expenses		9,366,420
Aggregate health policy reserves		474,774,149
Premiums received in advance		56,114,944
General expenses due or accrued		478,991,075
Current federal and foreign income tax payable and interest thereon		247,047
Amounts withheld or retained for the account of others		49,479,379
Amounts due to parent, subsidiaries and affiliates		4,339,105
Liability for amounts held under uninsured plans		107,020,938
Liability for benefits		9,231,672
TOTAL LIABILITIES	$	**1,511,576,465**
CAPITAL AND SURPLUS		
Unassigned funds (surplus) - **Note 1**		1,118,864,635
TOTAL LIABILITIES, CAPITAL AND SURPLUS	$	**2,630,441,100**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Blue Cross and Blue Shield of Alabama
Statement of Revenue and Expenses
For the Year Ended December 31, 2012, 2011, 2010, 2009 and 2008

	2012	2011	2010	2009	2008
Net premium income	$ 4,082,333,469	$ 4,150,255,238	$ 4,335,638,747	$ 4,320,066,040	$ 3,992,026,178
Change in unearned premium reserves	(4,693,776)	(44,703,933)	(62,316,341)	(36,496,909)	(24,627,010)
Total revenues	$ 4,077,639,693	$ 4,105,551,305	$ 4,273,322,406	$ 4,283,569,131	$ 3,967,399,168
Hospital and Medical:					
Hospital/medical benefits	$ 2,100,108,656	$ 2,050,827,194	$ 2,502,542,957	$ 2,735,860,553	$ 2,401,906,058
Other professional services	535,368,578	499,178,479	580,219,410	598,366,548	592,604,079
Emergency room and out-of-area	293,349,137	293,272,844	271,789,607	276,754,651	241,494,466
Prescription drugs	714,105,879	693,239,501	441,841,431	446,647,707	435,562,093
Incentive pool, withhold adjustments and bonus amounts	2,227,653	1,100,770	901,260	896,081	-
Subtotal	$ 3,645,159,903	$ 3,537,618,788	$ 3,797,294,665	$ 4,058,525,540	$ 3,671,566,696
Less:					
Net reinsurance recoveries	$ 10,152	$ 758,461	$ 762,047	$ 886,346	$ (61,649)
Total hospital and medical	3,645,149,751	3,536,860,327	3,796,532,618	4,057,639,194	3,671,628,345
Claim adjustment expenses	116,176,143	117,166,223	121,452,420	106,635,124	94,434,400
General administrative expenses	214,239,294	201,148,458	196,302,092	231,458,539	225,001,547
Total underwriting deductions	$ 3,975,565,188	$ 3,855,175,008	$ 4,114,287,130	$ 4,395,732,857	$ 3,991,064,292
Net underwriting gain or (loss)	102,074,505	250,376,297	159,035,276	(112,163,726)	(23,665,124)
Net investment income earned	40,028,586	41,557,559	44,795,694	48,650,677	62,916,795
Net realized capital gains (losses)	9,215,615	13,854,382	9,316,295	(25,283,216)	(1,013,461)
Net investment gains (losses)	49,244,201	55,411,941	54,111,989	23,367,461	61,903,334
Net income or (loss) after capital gains tax and before other federal income taxes	151,318,706	305,788,238	213,147,265	(88,796,265)	38,238,210
Federal income taxes incurred	$ 36,706,422	$ 48,871,794	$ 50,173,174	$ (36,237,759)	$ 9,631,937
Net income (loss)	**$ 114,612,284**	**$ 256,916,444**	**$ 162,974,091**	**$ (52,558,506)**	**$ 28,606,273**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Blue Cross and Blue Shield of Alabama
Statement of Revenue and Expenses (cont.) - Capital and Surplus Account
For the Year Ended December 31, 2012, 2011, 2010, 2009 and 2008

	2012	2011	2010	2009	2008
Capital and Surplus Account					
Capital and surplus prior reporting period	$ 991,060,251	$ 855,801,660	$ 649,034,983	$ 656,360,820	$ 744,453,976
Net income	114,612,284	256,916,444	162,974,091	(52,558,506)	28,606,273
Change in net unrealized capital gains (losses)	$ 16,791,218	$ (12,497,391)	$ 28,589,031	$ 50,395,745	$ (82,337,756)
Change in net deferred income tax	$ (73,764,468)	$ 1,692,227	$ 2,166,894	$ (256,560,317)	$ 59,983,190
Change in nonadmitted assets	89,692,379	(81,521,879)	24,199,747	249,942,015	(79,227,620)
Cumulative effect of changes in accounting principles	$ 13,075,174				
Change in additional minimum liability of defined benefit plans	$ (21,613,957)	$ (27,384,647)	$ (8,956,997)	$ 2,063,861	$ (17,056,577)
Change in intangible asset for defined benefit plans	$ (1,796,413)	$ (2,204,649)	$ (2,928,307)	$ (2,271,639)	$ (90,175)
Deferred gain in unassigned funds	$ 39,839	$ 258,486	$ 722,218	$ 1,663,004	$ 2,029,509
Liability for benefits	(9,231,672)	-	-	-	-
Net change in capital & surplus	$ 127,804,384	$ 135,258,591	$ 206,766,677	$ (7,325,837)	$ (88,093,156)
Capital and surplus end of reporting period	**$ 1,118,864,635**	**$ 991,060,251**	**$ 855,801,660**	**$ 649,034,983**	**$ 656,360,820**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

<u>Note 1</u> - <u>Unassigned funds (surplus)</u> **<u>$1,118,864,635</u>**

Unassigned funds (surplus), as determined by this examination, was the same as reported by the Company in its 2012 Annual Statement.

CONTINGENT LIABILITITES AND PENDING LITIGATION

The examination for contingent liabilities and pending litigation included a review of the Company's Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No unreported contingent liabilities were noted and all litigation pending against the Company, at December 31, 2012, appeared to be within the ordinary course of its business.

The Company's Chief Executive Officers and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities and contingencies as of December 31, 2012.

SUBSEQUENT EVENTS

A review of events subsequent to the December 31, 2012 examination date was done. The following items were noted during this review:

Two members of the Board of Directors terms expired and were replaced with two new outside directors.

On January 1, 2013, Healthcare Business Solutions, LLC (HBS) was formed. HBS is a wholly-owned subsidiary of the Company formed to strategically position the Company for success in the government market by providing marketing services and pursuing new business opportunities in government programs on behalf of the Blue Cross companies that perform services for the government. As of October 31, 2013, HBS was the parent of Cahaba Government Benefit Administrators, LLC; Cahaba Safeguard Administrators, LLC., Government Management Services, LLC and AlaHealth, Inc.

Effective February 21, 2013, the Compensation Committee Charter was amended. Section III.A.2 was amended to give the Committee more flexibility in governance and management more flexibility in succession planning.

In March 2012, the NAIC issued SSAP No. 102 - *Accounting for Pensions, A Replacement for SSAP No. 89* and SSAP No. 92 - *Accounting for postretirement Benefits Other Than Pensions, A Replacement of SSAP No. 14*. During the first quarter 2013, the Company adopted SSAP No. 102.

On August 7, 2013, the Company formed AlaHealth, Inc., an Alabama corporation as a wholly-owned subsidiary of Healthcare Business Solutions (HBS).

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regards to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with those recommendations.

COMMENTS AND RECOMMENDATIONS

Administrative Service Agreements – Page 11

It is recommended that the Company complete the Annual Statement *Notes To Financial Statements* in accordance with NAIC *SSAP No. 101, Income Taxes, A Replacement for SSAP No. 10R and SSAP No. 10, Disclosures* 28 and with the NAIC *Annual Statement Instructions*, *Notes To Financial Statements* No. 9 F which states:

If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed: b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a part to the consolidation... Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup its federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

Complaint Handling – Page 27

It is recommended that the Company keep complete documentation of its complaints files in accordance with ALA. CODE § 10A-20-6.11 (1975), which states:

> The Commissioner of Insurance or any of his or her designated deputies or examiners shall have the power of visitation and examination into the affairs of the corporation, shall have free access to all books, papers, and documentation that relate to the business of the corporation, and may summon and qualify witnesses under oath and examine them in relation to the affairs, transactions, and conditions of the corporation...

It is also recommended that the Company respond to ALDOI complaints in accordance with ALA. ADMIN. CODE 482-1-118-.06(6)(2003), which states:

> The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay.

<u>Compliance with Producer Licensing</u> – **Page 28**

It is recommended that the Company send notification to its terminated producers within 15 days in accordance with ALA. CODE § 27-7-30, which requires that,

> Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

It is recommended that the Company send notification to the Alabama Department of Insurance in accordance with ALA. CODE §27-7-30 1975(e), which states:

> Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner.

<u>Ceded Reinsurance</u> – Page 31

It is recommended that the Company comply with ALA. ADMIN. CODE 482-1-105-.13 Reinsurance Contract states:

> Credit will not be granted, nor an asset or reduction for liability allowed, to a ceding insurer for reinsurance effected with assuming insurers meeting the requirements of Rules 482-1-105-.04, 482-1-105-.06, 482-1-105-.07 or 482-1-105-.09 or otherwise in compliance with the Act after the adoption of this chapter unless the reinsurance agreement includes both of the following:
>
> > (a) A proper insolvency clause pursuant to Sections 27-5-12 and 27-32-39, Code of Alabama 1975.
> >
> > (b) A provision pursuant to the Act whereby the assuming insurer, if an unauthorized assuming insurer, has submitted to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, has agreed to comply with all requirements necessary to give such court or panel jurisdiction, has designated an agent upon whom service of process may be effected, and has agreed to abide by the final decision of such court or panel.

CONCLUSION

Acknowledgement is hereby made of the courteous cooperation extended by the officers of Blue Cross and Blue Shield of Alabama during the course of this examination.

The customary insurance examination procedures, as recommended by the NAIC have been followed to the extent appropriate in connection with the verification and valuation of assets and determination of liabilities set forth in this report.

In addition to the undersigned, Toni Bean, CFE; Jerry Hyche, AIE, FMLI, IR; Theo Goodin, MCM; Mora Perkins-Taylor, MCM; and Charles Turner, CISA examiners for the Alabama Department of Insurance, and Michael Berman, FSA, MAAA and Kirk Braunius, ASA, MAAA, consulting actuaries with Merlinos & Associates, Inc. represented the Alabama Department of Insurance and participated in the examination of Blue Cross and Blue Shield of Alabama.

Respectfully submitted,

Mary B. Packard

Mary B. Packard, CPA, CFE
Examiner-in-charge
State of Alabama
Department of Insurance