

Report of Statutory Examination

As of December 31, 2010

of

Blue Cross Blue Shield of Vermont

NAIC Company Code 53295

by the

Vermont Department of Banking, Insurance, Securities
and Health Care Administration
Division of Insurance



The attached report of examination made of the condition and affairs as of December 31, 2010 of:

Blue Cross Blue Shield of Vermont
Berlin, VT

was recently completed by duly qualified examiners of the State of Vermont Department of Banking, Insurance, Securities and Health Care Administration.

Due consideration has been given to the comments of the examiners regarding the operations of Blue Cross Blue Shield of Vermont and its financial condition, as reflected in this report. This report is hereby, as of this date, approved, adopted, filed and made an official record of this Department.

IN WITNESS WHEREOF, I have hereunto set my hand, and affixed the official seal of this Department at the City of Montpelier this 4th day of April, 2012.

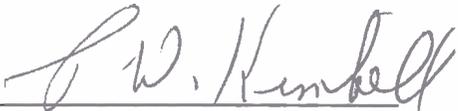

Stephen W. Kimbell, Commissioner

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**Blue Cross Blue Shield of Vermont
Statutory Examination Report
As of December 31, 2010**

February 7, 2012

Stephen W. Kimbell
Commissioner of Banking, Insurance, Securities
and Health Care Administration
89 Main Street
Montpelier, VT 05620-3101

Dear Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination has been made for the examination period ended December 31, 2010 of the financial condition, business affairs, transactions, and accounts and records of:

Blue Cross Blue Shield of Vermont
445 Industrial Lane, Berlin, VT 05602

The following examination report is respectfully submitted.

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Scope of Examination

We have performed our examination of Blue Cross Blue Shield of Vermont (the Company) as of December 31, 2010. The prior examination of the Company was conducted as of December 31, 2005. The current examination covered the period January 1, 2006 through December 31, 2010. As necessary, the examination team reviewed transactions occurring subsequent to December 31, 2010, but prior to the date of this report (i.e. the completion date of the examination).

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook (FCEH). The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, and, when applicable, to domestic state regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

Reliance on Outside Entities

Pursuant to Vermont's statutory requirements, the Company requested the independent accounting firm of KPMG, LLP to make available for review, all work papers pertinent to the audit of the Company's financial statements for the year ended December 31, 2010. We have reviewed their work papers and considered possible similarities in our examination approach and that of KPMG, LLP.

Summary of Significant Findings

There were no significant findings resulting from this examination.

Prior Report Exceptions

The Company has appropriately responded to the Comments and Recommendations noted in the prior examination report.

Subsequent Events

In 2011 the Company changed reinsurers to Munich Reinsurance American, Inc. (Delaware). This treaty is similar to the previous year, but the attachment point is reduced to \$650,000 and there is no annual maximum.

Effective December 31, 2011 the Company and the Vermont Health Plan (TVHP) entered into an agreement where the Company will guarantee all contractual and financial obligations of TVHP to its customers.

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Frank Duzy retired from the Board of Directors and was replaced by Nancy Eldridge in the first quarter of 2011.

A. John Bramley was elected to the Board of Directors in the first quarter of 2011 and subsequently resigned in the third quarter of 2011 due to professional obligations.

Robert Wheeler was named a Vice President in the third quarter of 2011.

In July of 2011 the SAPOR limits were removed and are of no further effect.

Company History

The Company was founded in 1944 as part of Blue Cross and Blue Shield of Vermont and New Hampshire. In 1981, the Vermont Plan formally separated its financial records and certain administrative functions from New Hampshire under orders from Vermont's Commissioner of Banking and Insurance. In 1988-89, the Company established full and independent administrative functions in Berlin, Vermont.

The Company is incorporated as a not-for-profit hospital/medical service corporation in the state of Vermont and is a member of the Blue Cross and Blue Shield Association. The Company offers varied products to employer groups including indemnity coverage, comprehensive major medical programs, and preferred provider organizations (PPO) coverage and point of service (POS) managed care plans. The Company also offers non-group and Medicare supplemental coverage to qualifying individuals. The Company began to offer Medicare Part D prescription drug coverage in 2006 through a joint enterprise with Blue Cross Blue Shield plans in Connecticut, Massachusetts and Rhode Island called Central New England PDP. The Company delivers its health maintenance organization product through TVHP.

TVHP was licensed and approved to operate as an HMO in Vermont in December, 1996 and was jointly owned by the Company (50.1%) and three provider organizations who owned the remaining 49.9%. In 2008, TVHP redeemed the full membership interest of the three provider organization, making the Company the sole owner of TVHP.

In 2008, the Company, through Catamount Insurance Services, Inc. (CIS), a wholly owned subsidiary, purchased the minority share of Comprehensive Benefits Administrator, Inc. (CBA) which made the Company the sole owner of CBA. In 2009, CBA established a limited liability company called Cobalt Benefits Group, LLC (Cobalt) and transferred substantially all of its assets and liabilities to Cobalt per the terms of a contribution agreement between the two parties.

As of December 15, 2009, the Company entered into a Joint Ownership Agreement with Blue Cross and Blue Shield of Massachusetts (BCBSMA) whereby BCBSMA purchased 50% of the membership interests in Cobalt from CBA.

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Corporate Records

The Company's main administrative offices and its corporate functions take place in Berlin, Vermont. The examiners reviewed the Minutes of the Board of Directors and key committees thereof and determined that the minutes adequately approve and support Company transactions and events. The meetings and minutes are in compliance with the Company's articles and bylaws.

Management and Control

Board of Directors

At December 31, 2010 the Board of Directors consisted of the following members:

| <u>Name</u> | <u>Principal Business Affiliation</u> |
|------------------------|---|
| Guy Boyer - Chair | Factory Point National Bank, President and CEO |
| Deborah Granquist | Granquist Associates |
| John Ewing | Retired |
| Frank Duzy | Retired Executive Vice President, CFO and Treasurer of Connecticut Blue Cross and Blue Shield |
| Rosalea W. Bradley | CEO, Vermont Economic Development Authority |
| John Collins | Retired, former president, DHMC Professional Liability Company |
| Peter F. Crosby | President, Passumpsic Bancorp. |
| Charles P. Smith IV | Senior Associate, Snelling Center for Government |
| Charles F. Kireker III | Managing Director Fresh Tracks Capital |

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| <u>Name</u> | <u>Principal Business Affiliation</u> |
|-------------------------------------|--|
| Don C. George Ex. Officio Member | President and Chief Executive Officer of BCBSVT President, Director and Chair of Caring for Children Foundation Director and Chair of Comprehensive Benefits Administrator, Inc. Director and President of Catamount Insurance Services, Inc. President and manager of The Vermont Health Plan LLC |
| Karen Nystrom-Meyer | Vice President of State and Federal Regulations, University of Vermont |
| Mary Powell | President, Green Mountain Power |
| Donald Webster | Riverview Café, Owner |

The Committees of the Board serving as of December 31, 2010 were as follows:

Executive Committee

Karen Nystrom-Meyer - Chair
John Collins
Guy Boyer
Charles F. Kireker III
Donald Webster
Deborah Granquist
John Ewing
Peter F. Crosby

Audit Committee

Peter F. Crosby - Chair
Guy Boyer
Charles P. Smith IV
Frank Duzy

Governance Committee

Donald Webster – Chair
Deborah Granquist
John Ewing
John Collins

Health Policy Committee

Charles P. Smith IV – Chair
John Ewing
Donald Webster
Mary Powell

Finance Committee

Charles F. Kireker III – Chair
Guy Boyer
Peter F. Crosby
Mary Powell
Rosalea W. Bradley

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Officers

The officers of the Company as of December 31, 2010 were as follows:

| <u>Title</u> | <u>Name</u> |
|---------------------------------------|-----------------------|
| President | Don C. George |
| Treasurer and Chief Financial Officer | John Trifone |
| Secretary | Christopher R. Gannon |
| Assistant Secretary | Alexa McGrath |

Conflict of Interest Policy

The Company has adopted a conflict of interest policy covering Directors, Officers and key employees. Annual certifications regarding compliance with the policy were collected from directors and officers. Beginning in 2007, conflict statements were also collected from key employees.

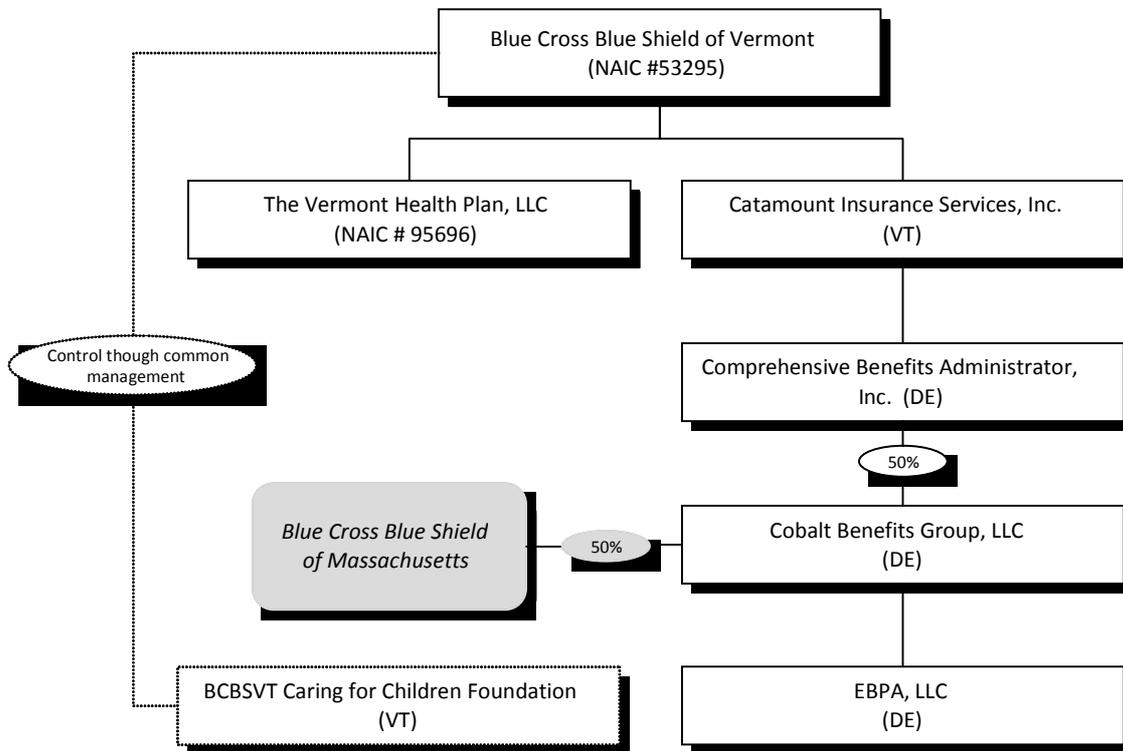
Indemnification of Directors and Officers

The By-laws state that the Company shall indemnify its Directors and Officers, and by the affirmative vote of majority of its Directors, may indemnify its employees and agents, against liability incurred by any of them in their capacity as such, to the full extent permitted by and in accordance with the laws of Vermont, as amended from time to time. Such indemnification shall continue as to a person who ceased to be a Director, Officer, employee or agent and shall inure to the benefit of the heirs, executives and administrators of such persons.

Holding Company Organizational Structure

The Companies are members of a holding company structure illustrated in the following chart:

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NOTE: All ownership percentages are 100% unless otherwise indicated.

Services Agreement

TVHP has no employees and therefore has entered into a “Services Agreement” with the Company effective January 1, 2006. Under the terms of the “Services Agreement” the Company’s employees perform all required core services for TVHP including all information technology support and systems, and all regulatory filings and compliance requirements to which TVHP is subject.

In consideration for performing the previously mentioned services TVHP reimburses the Company an agreed fee amount that is charged per member per month. Both parties, based upon a mutual agreement can annually have the option to review and revise the fees based on the actual costs incurred by the Company in providing the “Services” during the prior year.

Fidelity Bonds and Other Insurance

The Company is a named insured on a financial institution bond for employee dishonesty meeting the coverage levels recommended by the NAIC. In addition, the Company maintains insurance coverage consistent with its scope of operations. Coverages include Directors and Officers liability, commercial general liability, commercial umbrella liability, commercial auto, employer’s liability, workers compensation and property protection for damage to the home office building and its contents.

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Pension and Other Postretirement Plans

The Company participates in a nationally sponsored, noncontributory, defined benefit pension plan covering employees meeting certain age and service requirements. Benefits are based upon years of service and the employee's compensation during the last five years of employment. The pension benefit formula was amended effective July 1, 2010. After that date, employees participating in the defined benefit pension program who do not meet certain age and/or service requirements will have their future benefits calculated under a cash balance benefit formula. The rights of those employees to their benefits that accrued under the traditional benefit formula prior to July 1, 2010, will remain intact. New employees hired on and after July 1, 2010, who are eligible to participate in the pension plan, will accrue benefits only under the cash balance formula. Employees meeting the specified age and/or service requirements will continue to accrue benefits under the traditional benefit formula without change. Pension fund assets are part of the Blue Cross Blue Shield National Retirement Trust, which invests in a variety of equity and fixed income securities.

In addition to pension benefits, the Plan provides certain health care and life insurance benefits (postretirement) for retired employees. Employees may become eligible for these benefits if they attained age 55 and 15 years of service with the Plan. For medical coverage, these requirements must have been met by December 31, 1998. The Plan has Supplemental Executive Retirement Plans (SERP) covering certain executives. These non-qualified plans are designed to offset the impact of restrictions in the qualified pension plan, which limit benefits for highly compensated employees and to defer federal and state income taxes to future periods. Benefits under the SERP are determined based on a formula applied to compensation, reduced for the benefits under the qualified pension plan. The present value of the future benefit is accrued over the estimated remaining service life of the employees.

A 401-(k) voluntary defined contribution plan is available to full-time employees meeting certain requirements. Under the terms of the 401(k) plan, the Plan will match 60% of an employee's contribution up to the first 6% of the individual employee's salary, as limited by federal law. The cost of this benefit is reflected in current operations on an incurred basis.

The discount rate used to determine the liability for the Pension and SERP plan was 5.75% and 6.5% at December 31, 2010 and December 31, 2009, respectively. KPMG reviewed the Company's calculations and determined amounts due under the plans were funded and no additional liability recognition was required.

Territory and Plan of Operations

The Company is licensed only in the State of Vermont and offers benefits for covered hospital and medical services to individuals through a broad range of group and non-group underwriting contracts. Several non-underwritten groups are serviced on a cost plus basis, where the groups pay their own claims and are essentially self-insured. The Company also processes claims for members of other Blue Plans known as National Accounts and BlueCard (Out of Area Program), and under a contract with the Federal Employees Program.

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Large group products are available to employer groups with more than fifty employees. These may be written on an indemnity or a cost-plus basis. Cost-plus programs include an option to purchase stop loss coverage from the Company. Small group products are available to employer groups from one to fifty employees. The Company also offers individual plans, known as non-group. Small group and non-group plans are community rated.

Health Maintenance Organization (HMO) products are offered through the Company's subsidiary, The Vermont Health Plan, LLC.

Growth of the Company

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|---------------------------|---------------|---------------|---------------|---------------|---------------|
| Premium Income | \$278,605,517 | \$286,576,170 | \$290,006,412 | \$281,867,533 | \$315,586,954 |
| Total Admitted Assets | 164,035,952 | 135,908,200 | 139,951,340 | 135,194,853 | 161,150,888 |
| Total Liabilities | 65,271,338 | 54,948,487 | 68,461,916 | 65,319,949 | 83,437,285 |
| Total Capital and Surplus | 98,764,614 | 80,959,713 | 71,489,424 | 69,874,904 | 77,713,603 |
| Net Income | 11,792,618 | 3,621,507 | (75,430) | 2,747,030 | 6,079,468 |

Loss Experience

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Premium Income | \$278,605,517 | \$286,576,170 | \$290,006,412 | \$281,867,533 | \$315,586,954 |
| Medical and Hospital Expenses | 231,944,448 | 250,044,747 | 250,976,245 | 246,297,107 | 272,911,285 |
| Pure Loss Ratio | 83.3% | 87.3% | 86.5% | 87.4% | 86.5% |

Reinsurance

Assumed

The Company had no assumed business during the examination period.

Ceded

The Company had reinsurance coverage provided by BCS Life Insurance Company during the period under examination. The reinsurance program provided coverage for organ transplants and bone marrow transplants on a quota share basis for up to 90% of losses, with combined kidney-pancreas transplants limited to 50%. Starting in 2009, the Company replaced their transplant coverage and non-transplant coverage with a straight "Excess of Loss" coverage. Under this coverage, 90% of the claims per member, per year, over \$675,000 were reinsured regardless of the type of claim, with a \$2 million annual maximum. In 2010 the attachment point was increased from \$675,000 to \$725,000.

The subsequent events section details a change in reinsurance subsequent to 12/31/2010.

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Accounts and Records

The accounts and records of the Company are primarily electronic. In 2003, the Company outsourced its systems development, computer operations, help desk, and network engineering and telecommunications support to Keane IT Services (“Keane”). Beginning in 2005, the Company engaged Keane Architectural Services to assess IT architecture resulting in a series of initiatives targeting overall architectural improvements. The IT organization is a joint Company/Keane collaborative approach with management of each IT functional area including IT contract, project and information security management reporting to the Company Vice President and Chief Financial Officer. The IT organization is directly supported by key IT technology staff from Keane IT Consulting Services Group.

In the summer of 2009, the Company reorganized its IT Department by assuming all functional management areas – Core Applications, Infrastructure Operations, Business Enable Applications, Association Programs, EDI Services, and Data Management. Contemporaneously the Keane IT Services Contract was renegotiated with Keane technical consulting services staff operationally reporting to Company managers of the functional areas.

General ledger journal entries are manually created in Excel from information generated by various management systems and uploaded to the general ledger. Additionally, entering of financial statements, including the claims schedules created in Excel by the Actuarial Department, are manually entered into SunGard EFS. The Company recognizes the need to move to integrated financial management systems with the advantage of only one transaction system.

The independent consulting firm, Jennan Enterprises, was retained by the Department to review the information systems of the Company.

Statutory Deposits

The Company is licensed to conduct business only in the State of Vermont and is not required to maintain a statutory deposit.

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Financial Statements

The following financial statements of the Company are shown:

- Statutory Statement of Assets as of December 31, 2010
- Statutory Statement of Liabilities and Surplus as of December 31, 2010
- Statutory Statement of Revenue and Expenses for the year ending December 31, 2010
- Surplus Account for the year ending December 31, 2010

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Statutory Statement of Assets

| | |
|---|---------------------------------|
| Bonds | \$75,585,043 |
| Common stocks | 36,294,627 |
| Properties occupied by the company | 7,779,841 |
| Cash, cash equivalents and short-term investments | 8,155,601 |
| Investment Income Due and Accrued | 622,392 |
| Uncollected premiums and agents' balances in the course of collection | 857,123 |
| Accrued retrospective premiums | 2,039,925 |
| Amounts recoverable from reinsurers | 272,353 |
| Amounts receivable relating to uninsured plans | 5,088,285 |
| Current federal and foreign income tax recoverable | 2,451,257 |
| Net deferred tax asset | 2,425,652 |
| Electronic data processing equipment and software | 282,948 |
| Receivable from parent, subsidiaries and affiliates | 13,073,835 |
| Health care and other amounts receivable | 8,696,190 |
| Aggregate write-ins for other than invested assets | <u>410,880</u> |
| Total Assets | <u><u>\$164,035,952</u></u> |

Statutory Statement of Liabilities and Surplus

| | |
|--|---------------------------------|
| Claims unpaid | \$15,772,950 |
| Unpaid claims adjustment expenses | 1,325,000 |
| Aggregate health policy reserves | 2,039,925 |
| Premiums received in advance | 17,206,817 |
| General expenses due or accrued | 9,867,642 |
| Ceded reinsurance premiums payable | 405,122 |
| Amounts withheld or retained for the account of others | 287,754 |
| Remittances and items not allocated | 170,522 |
| Borrowed money and interest thereon | 10,233 |
| Liability for amounts held under uninsured plans | 12,243,993 |
| Aggregate write-ins for other liabilities | <u>5,941,380</u> |
| Total Liabilities | <u>\$ 65,271,338</u> |
| Unassigned funds (surplus) | <u>\$98,764,614</u> |
| Total Surplus | <u>\$ 98,764,614</u> |
| Total Liabilities and Surplus | <u><u>\$164,035,952</u></u> |

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Statutory Statement of Revenue and Expenses

| | <u>Total Current Year</u> |
|--|-------------------------------|
| Member months | 1,413,391 |
| Net premium income | \$280,238,076 |
| Change in unearned premium reserves and reserve for rate credits | <u>(1,632,559)</u> |
| Total Revenue | \$278,605,517 |
| Hospital and Medical: | |
| Hospital/medical benefits | 140,653,819 |
| Outside referrals | 2,117,104 |
| Emergency room and out-of-area | 45,664,919 |
| Prescription drugs | <u>43,704,435</u> |
| Subtotal | \$232,140,277 |
| Less: | |
| Net reinsurance recoveries | <u>195,829</u> |
| Total Hospital and Medical | \$231,944,448 |
| Claims adjustment expenses, including \$5,964,888 cost containment expense | 24,278,480 |
| General administrative expenses | <u>12,942,733</u> |
| Total Underwriting Deductions | \$269,165,661 |
| Net underwriting gain less capital gains tax | 9,439,856 |
| Net investment income earned | 3,344,910 |
| Net realized capital gains | <u>529,898</u> |
| Net investment gains | \$3,874,808 |
| Aggregate write-ins for other income or expenses | <u>2,018,424</u> |
| Net income after capital gains tax and before federal income taxes | \$15,333,088 |
| Federal and foreign income taxes incurred | <u>3,540,470</u> |
| Net Income | <u><u>\$11,792,618</u></u> |

Surplus Account

| | |
|---|-----------------------------|
| Surplus, December 31, 2009 | \$ 80,959,713 |
| Net income | 11,792,618 |
| Change in net unrealized capital gains less capital gains tax | 4,080,583 |
| Change in net deferred income tax | 3,153,073 |
| Change in nonadmitted assets | (583,526) |
| Aggregate write-ins for losses in surplus | <u>(637,847)</u> |
| Net change in capital and surplus | <u>\$ 17,804,901</u> |
| Surplus, December 31, 2010 | <u><u>\$ 98,764,614</u></u> |

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Summary of Recommendations

There were no significant findings as a result of the examination. A comment letter was issued to the Board of Directors as a result of this exam addressing opportunities for improvement and other items that did not reach a level of significance to warrant inclusion in this report.

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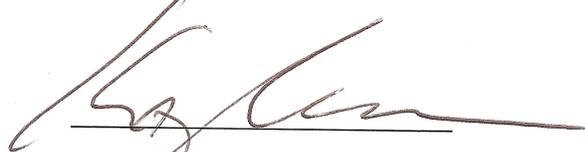
Conclusion

As a result of this examination, the financial condition of the Company as of December 31, 2010 and related increases and decreases since the prior exam was determined to be as follows:

| | <u>2005</u> | <u>2010</u> | <u>Increase (Decrease)</u> |
|-------------------|----------------|----------------|----------------------------|
| Admitted assets | \$ 160,969,103 | \$ 164,035,952 | \$ 3,066,849 |
| Liabilities | \$ 85,443,662 | \$ 65,271,338 | \$ (20,172,324) |
| Capital & Surplus | \$ 75,525,441 | \$ 98,764,614 | \$ 23,239,173 |

In addition to the undersigned, Jesse Lussier, Robert Crawford, CFE, Sharon Sybrandt, CFE, Bill Tank, Cara Bostick, Mike McNulty, CFE, and Jenny Jeffers, AES also participated in this examination. We wish to express our appreciation to the officers, Directors, and employees of the Company for the courteous cooperation extended during the course of the examination.

Respectfully submitted,



Kaj Samsom, CFE
Chief Examiner
Vermont Department of Banking, Insurance,
Securities and Health Care Administration
STATE OF VERMONT
COUNTY OF WASHINGTON

Kaj Samsom, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Subscribed and sworn to before me
this 23 day of March, 2012


Notary Public

Fredrick M. Barrett
Notary Public State of Vermont at Large
My Commission Expires February 10, 2015