

Report on Examination
of
Blue Cross and Blue Shield
of Florida, Inc.
Jacksonville, Florida
as of
December 31, 2006

By The
State of Florida
Office of Insurance Regulation

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Tallahassee, Florida

March 31, 2008

Kevin M. McCarty, Commissioner
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Gentlemen:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (F.S.), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2006, of the financial condition and corporate affairs of:

**Blue Cross and Blue Shield of Florida, Inc.
4800 Deerwood Campus Parkway
Jacksonville, Florida 32246**

hereinafter referred to as the "Company." Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2002 through December 31, 2006. The Company was last examined by the Florida Office of Insurance Regulation (the "Office") as of December 31, 2001.

Planning for the current examination began on April 2, 2007. The fieldwork commenced on April 9, 2007 and concluded on January 24, 2008. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

This was a statutory financial condition examination conducted in accordance with the *NAIC Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual, and Annual Statement Instructions* as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (F.A.C.), with due regard to the requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value, and integrity of the statement assets and the determination of liabilities, as they affect the Company's solvency.

The examination included a review of corporate and other selected records deemed pertinent to the Company's operations and practices. In addition, *Best's Insurance Reports*, the Company's independent audit reports, and certain work papers prepared by the Company's independent CPA were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the Company's assets and liabilities as reported by the Company in its 2006 annual statement. Transactions subsequent to December 31, 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which require special explanation or description.

After considering the Company's control environment and the materiality level set for this examination, we relied on work performed by the Company's CPA in the area of commitments and contingent liabilities.

STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION

The prior examination report did not contain any significant adverse regulatory disclosures or findings related to the Company's solvency.

HISTORY

GENERAL

The Company was incorporated in Florida on July 1, 1980, and is a not-for-profit mutual insurance company.

As of the date of this examination, the Company was authorized to transact accident and health insurance coverage in Florida, in accordance with Section 624.401, F.S.

The Company's bylaws were amended twice during the period covered by this examination, once on May 16, 2003 and again on May 19, 2006.

PROFITABILITY

For the period of this examination, the Company reported the following:

(In billions)	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net premiums	\$4.959	\$4.056	\$3.517	\$3.024	\$2.662
Total revenues	\$4.968	\$4.068	\$3.520	\$3.171	\$2.706
Net income	\$0.249	\$0.312	\$0.218	\$0.289	\$0.166
Total surplus	\$1.994	\$1.720	\$1.423	\$1.246	\$0.847

MANAGEMENT

The annual members meeting for the election of directors was held in accordance with Section 607.0701, F.S. Directors serving as of December 31, 2006 were as shown on the following page.

Directors

<u>Name and Location</u>	<u>Principal Occupation</u>
Charles D. Ausley Tallahassee, Florida	Attorney - Ausley & McMullen
Robert M. Beall, II Bradenton, Florida	Executive Chairman - Bealls, Inc.
Henry H. Beckwith Jacksonville, Florida	Senior Vice President - W.W. Gay Mechanical Contractors, Inc.
Catherine P. Bessant Charlotte, North Carolina	Global Treasury Services President - Bank of America Corporation
Edward L. Boykin Lutz, Florida	Certified Public Accountant
Leerie T. Jenkins, Jr. Jacksonville, Florida	Chairman and CEO - Reynolds, Smith and Hills, Inc.
Tracy A. Leinbach Miami, Florida	Retired executive
Robert I. Lufrano, M.D. Jacksonville, Florida	Chairman, CEO and President - Blue Cross and Blue Shield of Florida, Inc.
John B. Ramil Tampa, Florida	President and COO - TECO Energy, Inc.
Frank P. Scruggs, Jr. Delray Beach, Florida	Attorney
Barbara S. Thomas Bellevue, Florida	Retired executive
Gonzalo F. Valdes-Fauli Key Biscayne, Florida	Chairman - Broadspan Capital, LLC

At December 31, 2006, members of the principal committees of the Board were:

**Audit and
Compliance
Committee**

Henry H. Beckwith
Edward L. Boykin
Tracy A. Leinbach
John B. Ramil
Barbara S. Thomas

**Board of Governance
and Nominating
Committee**

Charles D. Ausley
Robert M. Beall, II
Catherine P. Bessant
Leerie T. Jenkins, Jr.
Frank P. Scruggs, Jr.

**Finance
Committee**

Henry H. Beckwith
Edward L. Boykin
Tracy A. Leinbach
John B. Ramil
Barbara S. Thomas

**Personnel and
Compensation
Committee**

Charles D. Ausley
Robert M. Beall, II
Catherine P. Bessant
Leerie T. Jenkins, Jr.
Frank P. Scruggs, Jr.

The Company's senior officers as of December 31, 2006, as appointed by its board of directors in accordance with the Company's bylaws, were as follows:

Senior Officers

<u>Name</u>	<u>Title</u>
Robert I. Lufrano, M.D.	Chief Executive Officer and President
Robert C. Doerr	Executive Vice President, Chief Administrative Officer and Chief Financial Officer
Charles S. Joseph	Senior Vice President, General Counsel and Corporate Secretary
John A. Kennett	Vice President, Chief Investment Officer and Treasurer
Lester J. Grantham	Executive Vice President, Corporate Strategy
Arnold D. Livermore	Executive Vice President, Operations
Barbara H. Hunter	Senior Vice President, Human Services
Cyrus M. Jollivette	Senior Vice President, Public Affairs
Deanna M. McDonald	Group Vice President and Health Business Chief Financial Officer
Daryl J. Veach	Vice President and Chief Actuary

CONFLICT OF INTEREST PROCEDURE

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with Section 607.0832, F.S. No exceptions were noted during this examination.

CORPORATE RECORDS

The recorded minutes of the membership, Board of Directors, Audit and Compliance, Board of Governance and Nominating, Finance, and Personnel and Compensation Committee meetings were reviewed for the period examined. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, F.S., including the authorization of investments as required by Section 625.304, F.S. A review of the prior report of examination by the Office was not documented in the minutes of the Board.

SURPLUS DEBT

As of December 31, 2006, the Company was obligated for surplus notes in the total amount of \$150 million as follows:

Holder	Maturity	Interest Rate	Amount
Bank of New York	11/15/2011	8.25%	\$59,717,000
Investors Bank	11/15/2011	8.25%	450,000
Legent, LLC	11/15/2011	8.25%	4,000
Northern Trust	11/15/2011	8.25%	20,850,000
SunTrust Banks	11/15/2011	8.25%	6,000,000
Fifth Third Bank	11/15/2011	8.25%	6,000,000
Bear Stearns	11/15/2011	8.25%	13,000
J.A. Glynn & Co.	11/15/2011	8.25%	17,000
Mellon Trust	11/15/2011	8.25%	12,000,000
SEI Private	11/15/2011	8.25%	100,000
U.S. Bank	11/15/2011	8.25%	5,000
Citigroup	11/15/2011	8.25%	17,000
JPMCB NA	11/15/2011	8.25%	12,500,000
NFS, LLC	11/15/2011	8.25%	2,000
SSB&T Co.	11/15/2011	8.25%	15,000,000
Wells Bank	11/15/2011	8.25%	<u>17,325,000</u>
			\$150,000,000
Unamortized discount			<u>(749,851)</u>
Total			<u><u>\$149,250,149</u></u>

In accordance with Section 628.401, F.S., the surplus note debt is included in the Company's surplus.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), F.A.C. Its latest holding company registration statement was filed with the State of Florida, as required by Section 628.801, F.S., and Rule 69O-143.046, F.A.C., on January 12, 2007.

The following agreements were in force between the Company and its affiliates on December 31, 2006:

ADMINISTRATIVE SERVICES AGREEMENTS

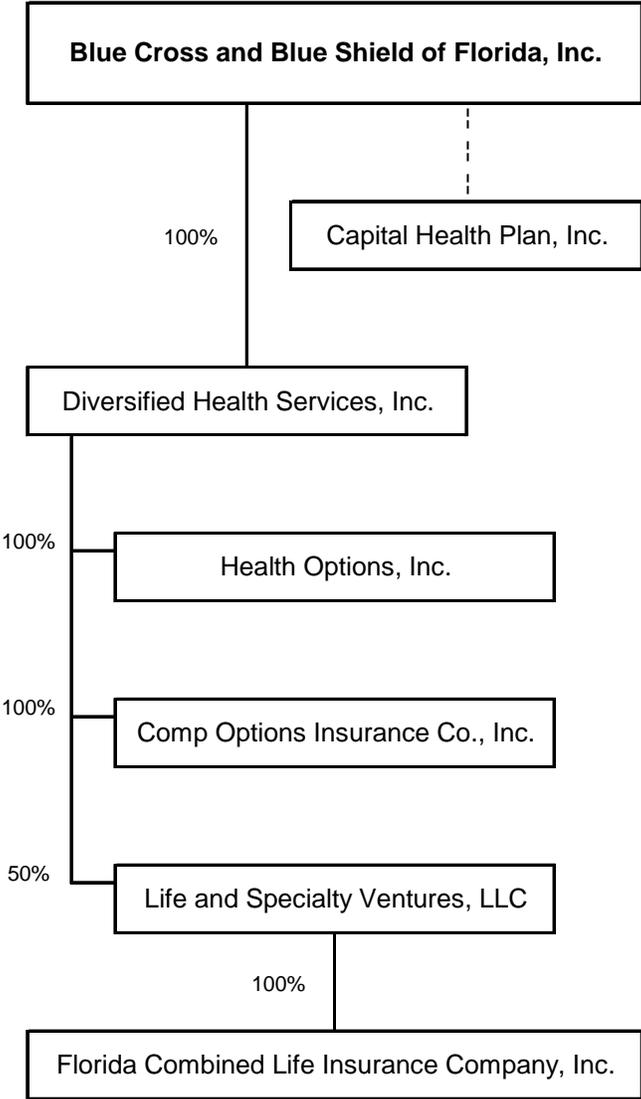
The Company entered into numerous administrative services agreements with its subsidiaries and affiliates, providing such services as administrative, managerial, professional, and technical services. Aggregate fees received in return for services rendered amounted to \$484.7 million, \$420.0 million, \$449.8 million, \$327.4 million, and \$320.9 million in years 2002 through 2006, respectively.

TAX ALLOCATION AGREEMENT

The Company files a consolidated federal income tax return that includes the operations of certain of its affiliates pursuant to a tax sharing agreement dated January 1, 2001. The agreement provides that a company with a net operating loss is reimbursed for the tax benefit associated with its loss in the year the loss is used in the consolidated federal income tax return. Inter-company tax balances are settled annually after the consolidated tax return is filed.

An abbreviated organizational chart as of December 31, 2006 reflecting the holding company system is shown below. Schedule Y of the Company's 2006 annual statement provided the names of all related companies in the holding company group.

**Blue Cross and Blue Shield of Florida, Inc.
Organizational Chart
December 31, 2006**



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage of up to \$15 million with a deductible of \$300,000 which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC of \$3.3 million.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company provided eligible employees fringe benefits including group medical and life, long and short-term disability, dental, and vision insurance coverage, and compensated time off. It also offered a defined benefit pension plan and an unfunded, non-qualified pension program for certain employees. A Section 401(k) deferred compensation program was offered to eligible employees.

STATUTORY DEPOSITS

The Company maintained a cash deposit of \$100,000 with the State of Florida as required by Section 624.411, F.S.

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company offered health insurance products such as traditional and preferred provider health insurance, and specialty products such as long-term care programs marketed throughout Florida. Other major lines offered included Medicare supplement and federal employees health benefit plan coverage.

TERRITORY AND PLAN OF OPERATION

At December 31, 2006, the Company was authorized to transact insurance solely in the State of Florida.

TREATMENT OF POLICYHOLDERS

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(j), F.S., and maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

ASSUMED

The Company assumed risk, primarily on a coinsurance basis, from one affiliate and one unaffiliated company.

CEDED

The Company ceded 100% of its long-term care business on a quota share basis to one affiliated company and to one unaffiliated company.

The reinsurance contracts were reviewed by the Company's actuary and utilized in determining the ultimate loss opinion.

The reinsurance agreements reviewed were found to meet NAIC standards with respect to the standard insolvency, arbitration, indemnification, and termination clauses, transfer of risk, reporting, and settlement information deadlines.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory-basis financial statements annually for years 2002 through 2006 pursuant to Section 624.424(8), F.S. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, F.A.C.

The Company's accounting records were maintained on a computerized system. Its balance sheet accounts were verified with the line items of its annual statement submitted to the Office.

The Company's main administrative office was located in Jacksonville, Florida, where this examination was conducted.

RISK-BASED CAPITAL

The Company reported its risk-based capital at an adequate level.

The following agreements were in effect between the Company and non-affiliates:

CUSTODIAL AGREEMENT

The Company entered into a custodial agreement with The Bank of New York on May 1, 1990 for the holding and safekeeping of its stocks, certificates, bonds, and other securities. Fees related to this agreement were \$169,385, \$536,060, \$375,710, \$598,791, and \$580,816 for years 2002 through 2006, respectively.

REVOCABLE TRUST AGREEMENT

The Company entered into a revocable trust agreement with Northern Trust Company on August 1, 1991 for the care, custody, management, and investment of the certain assets.

TPA AGREEMENTS

At December 31, 2006, the Company had in effect third party administrator agreements with nine companies which were authorized to pay claims, provide data processing services, collect premiums, and provide marketing services on behalf of the Company. Fees related to these agreements were \$3.4 million, \$3.5 million, \$7.2 million, \$6.8 million, and \$9.6 million in years 2002 through 2006, respectively.

INDEPENDENT AUDITOR AGREEMENT

The Company contracted with PricewaterhouseCoopers LLP to audit its statutory-basis financial statements. Fees related to the agreements were \$375,490, \$441,000, \$475,750, \$513,700, and \$750,000 in years 2002 through 2006, respectively.

FINANCIAL STATEMENTS PER EXAMINATION

The following four pages contain statements of the Company's financial position at December 31, 2006, as determined by this examination, and the results of its operations for the year then ended as reported by the Company.

Blue Cross and Blue Shield of Florida, Inc.
Assets
December 31, 2006

	Per Company	Examination Adjustments	Per Examination
Bonds	\$1,694,120,970	\$0	\$1,694,120,970
Preferred stocks	5,868,902	0	5,868,902
Common stocks	1,303,706,856	0	1,303,706,856
Properties occupied by the company	161,193,271	0	161,193,271
Cash, cash equivalents & short-term investments	(121,772,718)	0	(121,772,718)
Other invested assets	26,199,637	0	26,199,637
Receivables for securities	2,039,235	0	2,039,235
	<u>3,071,356,153</u>	<u>0</u>	<u>3,071,356,153</u>
Investment income due and accrued	21,982,717	0	21,982,717
Uncollected premiums and agents' balances	519,611,294	0	519,611,294
Deferred premiums, agents' balances	23,940,649	0	23,940,649
Accrued retrospective premiums	320,063	0	320,063
Funds held by reinsured companies	569,112	0	569,112
Amounts receivable relating to uninsured plans	134,578,600	0	134,578,600
Current income tax recoverable	61,502,165	0	61,502,165
Net deferred tax asset	59,846,563	0	59,846,563
Electronic data processing equipment & software	17,995,482	0	17,995,482
Receivables from parent, subsidiaries & affiliates	53,340,467	0	53,340,467
Health care and other amounts receivable	8,087,192	0	8,087,192
Aggregate write-ins - other than invested assets	178,994,910	0	178,994,910
Totals	<u><u>\$4,152,125,367</u></u>	<u><u>\$0</u></u>	<u><u>\$4,152,125,367</u></u>

Blue Cross and Blue Shield of Florida, Inc.
Liabilities, Surplus and Other Funds
December 31, 2006

Liabilities	Per Company	Examination Adjustments	Per Examination
Claims unpaid	\$482,157,288	\$0	\$482,157,288
Accrued medical incentive pools and bonuses	4,188,846	0	4,188,846
Unpaid claims adjustment expenses	31,886,180	0	31,886,180
Aggregate health policy reserves	680,572,834	0	680,572,834
Unearned premium reserves	7,658,181	0	7,658,181
Premiums received in advance	401,453,510	0	401,453,510
General expenses due or accrued	352,019,795	0	352,019,795
Current federal and foreign income tax payable	2,789,101	0	2,789,101
Amounts withheld or retained for others	3,745,610	0	3,745,610
Remittances and items not allocated	30,089,400	0	30,089,400
Amounts due to parent, subsidiaries & affiliates	2,707,164	0	2,707,164
Payable for securities	15,988,564	0	15,988,564
Amounts held under uninsured plans	64,660,697	0	64,660,697
Aggregate write-ins for other liabilities	78,472,939	0	78,472,939
Total liabilities	<u>2,158,390,109</u>	<u>0</u>	<u>2,158,390,109</u>
Capital and Surplus			
Surplus notes	149,250,149	0	149,250,149
Unassigned funds	1,844,485,109	0	1,844,485,109
Total capital and surplus	<u>1,993,735,258</u>	<u>0</u>	<u>1,993,735,258</u>
Totals	<u>\$4,152,125,367</u>	<u>\$0</u>	<u>\$4,152,125,367</u>

Blue Cross and Blue Shield of Florida, Inc.
Summary of Operations
For The Year Ended December 31, 2006

Net premium income		\$4,959,013,534
Change in unearned premiums & reserve for rate credits		(4,362,486)
Aggregate write-ins for other health care related revenues		4,468,832
Aggregate write-ins for other non-health revenues		8,458,350
Total revenues		<u>4,967,578,230</u>
Hospital/medical benefits	\$2,905,969,919	
Outside referrals	43,455,017	
Emergency room and out-of-area	64,703,506	
Prescription drugs	819,339,383	
Aggregate write-ins for other hospital and medical	253,767,734	
Incentive pool, withhold adjustments and bonuses	5,347,051	
	<u>4,092,582,610</u>	
Net reinsurance recoveries	<u>2,591,903</u>	4,089,990,707
Non-health claims		7,104,096
Claims adjustment expenses		218,020,224
General administrative expenses		561,474,053
Increase in reserves for life and A&H contracts		83,103,295
Total underwriting deductions		<u>4,959,692,375</u>
Net underwriting gain		7,885,855
Net investment income earned	239,792,817	
Net realized capital gains	14,101,780	253,894,597
Aggregate write-ins for other income or expenses		<u>2,265,162</u>
Income before income taxes		264,045,614
Federal and foreign income taxes incurred		<u>15,191,349</u>
Net income		<u><u>\$248,854,265</u></u>

Blue Cross and Blue Shield of Florida, Inc.
Capital and Surplus Account
For The Year Ended December 31, 2006

Capital and surplus - December 31, 2005		\$1,720,113,435
Net income	\$248,854,265	
Change in net unrealized capital gains	10,584,289	
Change in net deferred income tax	62,188,723	
Change in nonadmitted assets	(48,116,815)	
Change in surplus notes	116,936	
Aggregate write-ins for gains or (losses) in surplus	(5,575)	
Examination adjustments	<u>0</u>	<u>273,621,823</u>
Capital and surplus - December 31, 2006		<u><u>\$1,993,735,258</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Claims Unpaid	\$482,157,288
Aggregate Health Policy Reserves	\$680,572,834

The Company's appointed actuary rendered an opinion that the amounts carried in the Company's balance sheet as of December 31, 2006 reasonably provided for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements. The Office actuary reviewed work papers provided by the Company and concurred with this opinion.

Based on the results of the Office actuary's review and analysis of work papers and data provided by the Company, we concluded that the aggregate liability was not materially misstated.

Blue Cross and Blue Shield of Florida, Inc.
Comparative Analysis of Changes in Capital and Surplus
December 31, 2006

The following is a reconciliation of capital and surplus between that reported by the Company and as determined by the examination.

Capital and surplus, December 31, 2006 - per annual statement				\$1,993,735,258
	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Increase</u> <u>(Decrease)</u> <u>In Surplus</u>	
Total assets	\$4,152,125,367	\$4,152,125,367	\$0	
Total liabilities	\$2,158,390,109	\$2,158,390,109	<u>\$0</u>	
Net change in capital and surplus				<u>0</u>
Capital and surplus, December 31, 2006 - per examination				<u><u>\$1,993,735,258</u></u>

SUMMARY OF FINDINGS

COMPLIANCE WITH PREVIOUS DIRECTIVES

There were no directives or significant adverse findings from the prior examination on which to comment.

CURRENT EXAMINATION COMMENTS AND CORRECTIVE ACTION

The current financial condition examination did not result in any material findings of non-compliance with statutes, rules, or other requirements on the part of the Company.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Blue Cross and Blue Shield of Florida, Inc.** as of December 31, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's total capital and surplus was \$1,993,735,258, which was in compliance with Section 624.408, F.S. Its required minimum capital and surplus at December 31, 2006 was \$100 million.

In addition to the undersigned, the following participated in this examination: Walter F. Banas, CIE, Financial Specialist; Tom Cook, Financial Examiner/Analyst; Wenzhang "Mike" Du, Actuarial Analyst; Cathy S. Jones, CPA, Financial Examiner/Analyst Supervisor; Kerry A. Krantz, Actuary; M. Alison Miele, Financial Examiner/Analyst; David C. Schleit, CFE, CPA, Financial Examiner/Analyst Supervisor; and Steven A. Steele, Financial Specialist.

Respectfully submitted,

C. A. Irvin, Financial Administrator
Florida Office of Insurance Regulation