

AUDITED STATUTORY-BASIS
FINANCIAL STATEMENTS

Blue Cross and Blue Shield of Massachusetts, Inc.
Years Ended December 31, 2010 and 2009
With Report of Independent Registered Public
Accounting Firm

Blue Cross and Blue Shield of Massachusetts, Inc.

Audited Statutory-Basis Financial Statements

Years Ended December 31, 2010 and 2009

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Blue Cross and Blue Shield of Massachusetts, Inc.

We have audited the accompanying statutory-basis balance sheets of Blue Cross and Blue Shield of Massachusetts, Inc. (the Company) as of December 31, 2010 and 2009, and the related statutory-basis statements of operations, changes in surplus, and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles also are described in Note 2. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Blue Cross and Blue Shield of Massachusetts, Inc. at December 31, 2010 and 2009, and the results of its operations or its cash flow for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Blue Cross and Blue Shield of Massachusetts, Inc. at December 31, 2010 and 2009, and the results of its operations and its cash flow for the years then ended in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance.

We have also audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Oversight Board (United States), the Company's internal control over statutory financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 25, 2011 expressed an unqualified opinion thereon.

April 25, 2011

Report of Independent Registered Public Accounting Firm

Board of Directors
Blue Cross & Blue Shield of Massachusetts, Inc.

We have audited Blue Cross and Blue Shield of Massachusetts, Inc.'s (the Company) internal control over statutory financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over statutory financial reporting, and for its assessment of the effectiveness of internal control over statutory financial reporting included in the accompanying Report of Management on the Company's Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over statutory financial reporting based on our audit.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over statutory financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over statutory financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over statutory financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance. A company's internal control over statutory financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the statutory financial statements.

Because of its inherent limitations, internal control over statutory financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over statutory financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the attestation standards established by the American Institute of Certified Public Accountants and in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statutory-basis balance sheets of Blue Cross & Blue Shield of Massachusetts, Inc. as of December 31, 2010 and 2009, and the related statutory-basis statements of operations, changes in surplus, and cash flow for the years then ended and our report dated April 25, 2011 expressed an unqualified opinion thereon.

April 25, 2011



MASSACHUSETTS

**Report of Management on Blue Cross and Blue Shield of Massachusetts, Inc.
Internal Control Over Financial Reporting**

April 25, 2011

We, as members of management of Blue Cross and Blue Shield of Massachusetts, Inc., (the Company) are responsible for establishing and maintaining effective internal control over financial reporting. Internal control is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation of reliable published financial statements in conformity with accounting practices prescribed by the NAIC and or permitted by the Commonwealth of Massachusetts Division of Insurance. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of inherent limitations in any internal control, no matter how well designed, misstatements due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the Company's internal control as of December 31, 2010 based on criteria for effective internal control over financial reporting described in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, we assert that the Company maintained effective internal control over financial reporting as of December 31, 2010 based on the COSO criteria.

Ernst & Young LLP audited the Company's statutory financial statements and has issued an attestation report on the Company's internal control over statutory financial reporting as of December 31, 2010. The attestation is included in our annual report.

Blue Cross and Blue Shield of Massachusetts, Inc.

by

Andrew Dreyfus, President and Chief Executive Officer

by

Allen Maltz, Executive Vice President and Chief Financial Officer

by

Brett Painchaud, Senior Vice President and Contoller

by

William T. Cushing, Jr., Senior Vice President and Chief Audit Executive

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Balance Sheets

(In thousands)

	December 31	
	2010	2009
Admitted assets		
Bonds	\$ 520,894	\$ 445,944
Preferred stock	2,699	750
Common stock	151,358	128,251
Properties occupied by the company	119,537	121,350
Cash, cash equivalents and short-term investments	(1,592)	116,416
Receivable for securities	910	2,728
Other invested assets	488,028	425,895
Total cash and invested assets	<u>1,281,834</u>	<u>1,241,334</u>
Accrued investment income	3,541	3,720
Premiums receivable	106,059	56,350
Reinsurance recoverable	8,200	7,013
Receivables related to uninsured plans	172,435	157,648
Income tax recoverable	7,291	1,335
Net deferred tax asset	22,157	14,585
Data processing equipment	4,038	4,583
Receivable from affiliates	2,260	36,446
Health care receivables	10,802	10,285
Other receivables	12,676	10,013
Other assets	41,513	33,456
Total admitted assets	<u>\$ 1,672,806</u>	<u>\$ 1,576,768</u>
Liabilities and surplus		
Health care claim reserves	\$ 218,257	\$ 244,152
Aggregate policy reserves	48,146	4,205
Premiums received in advance	72,570	75,832
Federal income taxes payable	-	3,340
Accounts payable and accrued liabilities	192,231	186,813
Borrowed funds	25,012	-
Ceded reinsurance payable	9,335	8,502
Payable for securities	3,918	8,942
Liability for amounts held under uninsured plans	315,475	270,539
Liability for post-retirement benefits	55,158	50,547
Total liabilities	<u>940,102</u>	<u>852,872</u>
Surplus	732,704	723,896
Total liabilities and surplus	<u>\$ 1,672,806</u>	<u>\$ 1,576,768</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Statements of Operations

(In thousands)

	Year Ended December 31	
	2010	2009
Premiums earned	\$ 2,294,423	\$ 2,319,244
Health care benefits	2,059,412	2,065,226
Claim adjustment expenses	168,610	155,941
General and administrative expenses	112,845	102,725
Total expenses	2,340,867	2,323,892
Underwriting loss	(46,444)	(4,648)
Net investment income	37,960	35,853
Net realized capital gains (losses), less capital gains tax (benefit) of \$ 2,973 and \$(1,335) in 2010 and 2009, respectively	11,892	(50,584)
Total investment gains (losses)	49,852	(14,731)
Other income	773	317
Net income (loss) before federal income tax expense	4,181	(19,062)
Federal income tax (benefit) expense	(1,269)	2,244
Net income (loss)	\$ 5,450	\$ (21,306)

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Statements of Changes in Surplus

(In thousands)

	Year Ended December 31	
	2010	2009
Balance at January 1	\$ 723,896	\$ 614,167
Net income (loss)	5,450	(21,306)
Change in net unrealized gains (losses), net of tax expenses (benefits) of \$12,605 and \$(34,292) for 2010 and 2009, respectively	26,751	(10,801)
Change in non-admitted assets	(40,495)	116,582
Change in net deferred income taxes	17,990	3,046
Pension liability adjustment, net of tax (benefits) expenses of \$(478) and \$11,958 for 2010 and 2009, respectively	(888)	22,208
Balance at December 31	\$ 732,704	\$ 723,896

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Statements of Cash Flow

(In thousands)

	Year Ended December 31	
	2010	2009
Operating activities		
Premiums received	\$ 2,284,462	\$ 2,310,897
Health care benefits paid	(2,087,446)	(2,105,842)
General and claim adjustment expenses paid	(266,025)	(255,029)
Net investment income received	43,547	38,288
Federal income taxes paid	(11,000)	(8,991)
Net cash (used in) provided by operating activities	<u>(36,462)</u>	<u>(20,677)</u>
Investing activities		
Sales, maturities and redemptions of investments	758,746	251,173
Cost of investments acquired	(870,772)	(266,727)
Other miscellaneous (applications) proceeds	(3,077)	5,115
Net cash used in investing activities	<u>(115,103)</u>	<u>(10,439)</u>
Financing or miscellaneous activities		
Borrowed funds	25,000	—
Other applications, net	8,557	67,024
Net cash provided by (used in) financing or miscellaneous activities	<u>33,557</u>	<u>67,024</u>
Net (decrease) increase in cash, cash equivalents and short-term investments	(118,008)	35,908
Cash, cash equivalents and short-term investments:		
Beginning of year	116,416	80,508
End of year	<u>\$ (1,592)</u>	<u>\$ 116,416</u>
Supplemental disclosure of cash flow information for non-cash transaction in investing activities:		
Transfer of certain assets associated with a software system to Core Administrative Systems, LLC II in exchange for a notes receivable	<u>\$ 1,360</u>	<u>\$ 75,868</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements

December 31, 2010

(Dollars in thousands)

1. Nature of Business

Blue Cross and Blue Shield of Massachusetts, Inc. (“BCBSMA” or the “Company”) is a nonprofit hospital and medical service corporation in the Commonwealth of Massachusetts, subject to regulation by the Commonwealth of Massachusetts Division of Insurance (“DOI”). The Company is organized for the purpose of establishing, maintaining and operating a nonprofit hospital and medical service company to provide hospital and medical care and reimbursement for other health services to its members. Hospitalization, medical and other health benefits are provided to members through contracts with hospitals, participating physicians, skilled nursing facilities, nursing homes, and other health care organizations. The Company participates in a national arrangement to process claims for other Blue Cross and Blue Shield companies throughout the country. The Company offers a variety of group indemnity plans, preferred provider networks, non-group plans, Medicare extension, dental and other supplementary programs for the benefit of its members. The Company has a wholly-controlled subsidiary, Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue”). HMO Blue and BCBSMA (collectively, the “Companies”) operate under common management and Board of Directors control.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared in accordance with the National Association of Insurance Commissioners (“NAIC”) *Statements of Statutory Accounting Principles* (“SSAP”), and in conformity with accounting practices prescribed or permitted by the DOI, which practices differ from accounting principles generally accepted in the United States (“GAAP”).

The more significant variances from GAAP are as follows:

Investments: Investments in bonds and preferred stock are reported at amortized cost or fair value based on their NAIC rating; for GAAP, such fixed maturity investments are designated at purchase as trading and reported at fair value, with unrealized holding gains and losses reported in operations. Fair value for statutory purposes, as with GAAP, is based on quoted market prices while the fair value of private placements and credit tenant loans is obtained from independent third party dealers.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Effective September 30, 2009, the Company adopted SSAP No. 43R, *Loan-Backed and Structure Securities Revised*, superseding SSAP No. 98, *Treatment of Cash Flows When Qualifying Changes in Valuation and Impairments*. This revised guidance provides information on accounting for structured securities and beneficial interests with the primary impact related to other-than-temporary-impairments (“OTTI”). It requires the bifurcation of impairment losses into interest and noninterest related portions. The noninterest portion is the difference between the present value of cash flows expected to be collected from the security and the amortized cost basis of the security. The interest portion is the difference between the present value of cash flows expected to be collected from the security and its fair value at the balance sheet date.

If there is no intent to sell and the Company has the intent and the ability to retain the investment to recovery, then only the noninterest loss is recognized through earnings. However, if there is intent to sell or the Company does not have the intent and ability to hold the investment for a period of time sufficient to recover the amortized cost basis, the security must be written down to fair value and the loss recognized through earnings. The implementation of SSAP 43R did not have a material impact on the Company’s statutory basis financial statements.

For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS and ABS securities), other than high credit quality securities, are adjusted using the prospective method when there is a change in estimated future cash flows. If it is determined that an other-than-temporary credit impairment has occurred, the amortized cost basis of the security is written down to the present value of estimated future cash flows using the original effective interest rate inherent in the security. If it is determined that a decline in fair value is other than temporary, the cost basis of the security is written down to fair value. If high credit quality securities are adjusted, the retrospective method is used.

Fair value of certain investments in bonds and stocks is based on values specified by the NAIC rather than on actual or estimated market values, and therefore, are not stated in accordance with GAAP.

Investments in real estate are reported net of related obligations rather than on a gross basis. Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset under GAAP, and investment income and operating expenses include rent for the Company’s occupancy of those properties.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Non-admitted Assets: Certain assets designated as “non-admitted,” including deferred federal income taxes in excess of certain statutory limits, furniture, fixtures and equipment, leasehold improvements, non-operating system software, prepaid expenses, certain premium receivable balances, and other assets not specifically identified as an admitted asset within the SSAP, are excluded from the accompanying balance sheets and are charged directly to surplus. Under GAAP, such assets are included in the balance sheets.

Admissibility of Deferred Income Tax Assets: The Company has elected to admit deferred tax assets expected to be realized in one year rather than three years pursuant to the option provided in Statement of Statutory Accounting Principles No. 10R (“SSAP 10R”), *Income Taxes – Revised, A Temporary Replacement of SSAP No. 10*.

Gross deferred tax assets are admitted in an amount equal to the sum of: (a) federal income taxes paid in prior years that can be recovered through loss carry-backs for existing temporary differences that reverse by the end of the subsequent calendar year; (b) the lesser of: (i.) the remaining gross deferred tax assets expected to be realized within one year of the balance sheet date; or (ii.) 10% of surplus excluding any net deferred tax assets, electronic data processing (“EDP”) equipment and operating software; and (c) the amount of remaining gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The remaining deferred tax assets are non-admitted.

The application of SSAP 10R requires a company to evaluate the recoverability of deferred tax assets and to establish a valuation allowance if necessary to reduce the deferred tax asset to an amount which is more likely than not to be realized.

Under GAAP, a deferred tax asset is recorded for the amount of gross deferred tax assets expected to be realized in future years, and a valuation allowance is established for deferred tax assets not realizable.

Employee Benefits: For purposes of calculating the Company’s pension and post-retirement benefit obligations, only vested participants and current retirees are included in the valuation. Under GAAP, active participants not currently eligible also would be included.

Statement of Cash Flow: Cash, cash equivalents, and short-term investments in the statements of cash flow represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Consolidation: Wholly-controlled subsidiaries are not consolidated for individual entity statutory reporting. Under GAAP, financial statements of wholly-controlled subsidiaries are consolidated with the parent.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Investments

Bonds not backed by loans are stated at amortized cost, with amortization calculated based on the scientific method, using lower of yield to call or yield to maturity. Prepayment assumptions for mortgage-backed securities and structured securities were obtained from broker-dealer survey values. These assumptions are consistent with the current interest rate and economic environment. The retrospective adjustment method is used to value all mortgage-backed securities.

Common stock is stated at fair value as determined by the NAIC Securities Valuation Office (“SVO”). Preferred stock is stated at cost, amortized cost or fair value based on the underlying characteristics and NAIC designation. The Company has various ownership interests in limited liability partnerships and limited liability companies. The Company carries these investments based on its ownership interest in the underlying GAAP equity of the investee. These investments are included as other invested assets on the balance sheets.

Unrealized gains and losses on stocks and other invested assets are reflected directly in surplus unless there is deemed to be an other-than-temporary decline in value, in which case the loss is charged to income. Realized gains and losses on investments sold are determined using the specific identification method and are included in income.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Amortization of bond premium and accretion of bond discount are recognized on a yield-basis method. Security transactions are accounted for on a trade-date basis, with any unsettled transactions recorded as due to or from investment broker and included as payable or receivable for securities in the Company's admitted assets and liabilities.

Investment income is recognized as income when earned. The Company periodically reviews the portfolio of securities to determine whether an other-than-temporary impairment has occurred. Any identified other-than-temporary impairment is recorded as part of net realized investment gains or losses. Accrued investment income is defined as investment income earned as of the reporting date, but not legally due to be paid to the Company until subsequent to the reporting date.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less and are principally stated at amortized cost. Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at amortized cost.

Real Estate

Land is recorded at cost, and other real estate, which includes expenditures for improvements, is recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of 50 years.

The Company and HMO Blue jointly own land and buildings with 349,058 square feet of office space in Quincy, Massachusetts and 328,945 square feet of office space in Hingham, Massachusetts.

The components of the Company's real estate are summarized as follows:

	<u>2010</u>	<u>2009</u>
Land and buildings	\$ 129,926	\$ 129,333
Less accumulated depreciation	(10,389)	(7,983)
Net real estate occupied by the Company	<u>\$ 119,537</u>	<u>\$ 121,350</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Under statutory reporting guidelines, BCBSMA and HMO Blue are required to calculate imputed rental income for owner-occupied real estate. The method for calculating imputed rental income is based on estimated rental rates of like property in the same area times rentable square feet. These imputed amounts are reported as investment income and operating expense in the statement of income reflecting that the Company had recorded annual rent of \$6,836 and \$7,800 in 2010 and 2009, respectively.

Furniture, Equipment and Capitalized Software

The admitted value of the Company's electronic data processing equipment and operating software is limited to three percent of adjusted surplus. The Company's admitted portion is reported at cost, less accumulated depreciation.

The components of the Company's EDP and operating software are summarized as follows:

	<u>2010</u>	<u>2009</u>
EDP equipment and operating software	\$ 38,933	\$ 36,254
Less accumulated depreciation	(34,895)	(31,671)
Net EDP equipment and operating software	<u>\$ 4,038</u>	<u>\$ 4,583</u>

The Company calculates depreciation on furniture, equipment, and leasehold improvements and amortization of capitalized software using the straight-line method. Furniture and equipment is depreciated over the lesser of its useful life or ten years; leasehold improvements over the lesser of its useful life or the term of the lease; operating software over the lesser of its useful life or three years; and internally developed software over the lesser of its useful life or five years.

Depreciation and amortization expense charged to income in 2010 and 2009 was \$22,871 and \$33,981, respectively.

The Company continually evaluates the recoverability of long-lived assets by assessing whether the carrying amount of asset balances can be recovered as measured against the future undiscounted net cash flows expected to be generated by the assets. The future undiscounted net cash flows are based on historical trends, revenue forecasts and market trends projected over the remaining life of the long-lived assets.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. BCBSMA did not have any impairment expense in 2010. The Company recorded \$19,888 of impairment expense in 2009 related to internally developed software.

Health Care Claim Reserves

The Company uses estimates for determining its claims incurred but not yet reported which are based on historical claim payment patterns, healthcare trends and membership and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

Liabilities at any year end are continually reviewed and re-estimated as information regarding actual claims payments become known. This information is compared to the originally established year end liability. Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate.

Aggregate Policy Reserves

Aggregate policy reserves represent a reserve for unearned premium income, a reserve for rate credits and experience rating refunds, and rate stabilization reserve.

Premium Deficiency

The Company evaluates its health care contracts to determine if it is probable that a loss will be incurred. A premium deficiency loss is recognized when it is probable that expected future paid claims, administrative expenses and reserves will exceed existing reserves plus anticipated future premiums on existing contracts. Anticipated investment income and overhead expenses are also considered in the calculation of premium deficiency losses. For all the periods presented, no premiums deficiencies were recorded.

Premium

The Company receives premium revenue from insured business. Member premiums are billed in advance of their respective coverage periods. Premium receivables are recorded when due. Premium earned is recorded during the coverage period. Aggregate policy reserves are established to cover the unexpired portion of premiums written and are computed by pro-rata methods for direct business.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Expenses incurred in connection with acquiring new insurance business, including acquisition costs such as sales commissions, are charged to administrative expenses as incurred. The premium paid by subscribers prior to the effective date is recorded in the balance sheet as premiums received in advance and subsequently credited to income as earned during the coverage period.

For uncollected premium, after the calculation of non-admitted amounts, an evaluation is made of the remaining admitted assets in accordance with SSAP No. 5, *Liabilities, Contingencies and Impairment of Assets*, to determine if there is a collectability issue. If it is probable that the balance is uncollectible, any uncollectible amount is written off and charged to income in the period the determination is made. In 2010 and 2009, the amount charged to income was \$851 and \$2,198, respectively.

Administrative Services Contract (“ASC”)

ASC is referred to as uninsured business under SSAP No. 47, *Uninsured Plans*. ASC is a business where the Company pays benefits on the behalf of employers using the Company’s check stock. The Company receives an administrative fee for providing these services. Premiums and claim expenses are not included in the Company’s financial statements. The administrative fees earned are reported as a reduction to operating expenses in the Company’s statements of income.

ASC accounts are billed monthly, in arrears, for actual medical claims plus administrative fees. The remaining balance of receivables from uninsured plans, after assessment for collectability, are included in the Company’s admitted assets and liabilities, respectively. The uninsured admitted receivables are recorded net of any available deposits. The balance of deposits reported in the liability section represents the net balance for those customers whose deposits exceed accounts receivable balance.

Health Care Receivables

The Company enters into contractual agreements with various health care providers to provide certain medical services to its members. Compensation arrangements vary by provider. Certain providers have entered into risk-sharing arrangements with the Company, whereby a settlement is calculated by comparing actual medical claims experience to a pre-approved and predetermined budgeted amount. These settlements are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. Estimated settlements for these risk-sharing arrangements are reflected in health care receivables on the Company’s balance sheets.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Other amounts included in health care receivables represent pharmaceutical rebates, claims overpayments, advances to the providers and capitation arrangement receivables. Pharmaceutical rebates are arrangements with pharmaceutical companies, negotiated by the Company's pharmacy benefit manager ("PBM"), in which, the Company receives rebates based upon certain drug utilization of its subscribers. Claim overpayments occur as a result of several events, including, but not limited to, claim payments paid in error to a provider. The Company also makes advances to providers when those advances are supported by legally enforceable contracts and are generally entered into at the request of the providers.

Income Taxes

For federal income tax purposes, the Company is treated as a stock property and casualty insurance company subject to special provisions of the Internal Revenue Code applicable to Blue Cross and Blue Shield organizations. The Company is exempt from Massachusetts state income taxes.

Fair Value of Financial Instruments

The fair value of investment securities is estimated based on NAIC quoted prices for those or similar investment securities. The carrying amounts of cash, cash equivalents and short-term investments approximate fair value because of the short maturity of these instruments.

Reclassification

Certain amounts for the year ended December 31, 2009 have been reclassified to be consistent with the presentation of the amounts for the year ended December 31, 2010.

Medicare Part D Premium and Expenses

The Company has a Medicare Part D Inter-Plan Services Agreement to offer a Blue Cross and Blue Shield branded prescription drug plan ("PDP") under contract with the Centers for Medicare & Medicaid Services ("CMS"). The CMS premium, the member premium, and the low-income premium subsidy represent payments for the Company's insurance risk coverage under the Medicare Part D program and therefore are recorded as premium earned in the statement of income. Premium revenue is earned ratably over the period in which eligible individuals are entitled to receive prescription drug benefits.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Subsidies and reinsurance payments from CMS represent cost reimbursements under the Medicare Part D program. Amounts received for these subsidies are not reflected in premium earned, but rather are accounted for as deposits, with the related liability included in accounts payable and accrued liabilities in the balance sheet. Pharmacy benefit costs and administrative costs under the contract are expensed as incurred.

Reinsurance

The Company ceded certain premiums and benefits to other insurance companies under various reinsurance agreements to reduce overall risk, including exposure to large losses. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

3. Cash and Investments

Included in various investment related line items in the financial statements are certain financial instruments carried at statutory-basis NAIC fair value. NAIC fair values are based on quoted market prices when available. When market prices are not available, NAIC fair value is generally estimated by incorporating current market inputs for similar financial instruments. In instances where there is little or no market activity for the same or similar instruments, the Company estimates NAIC fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price.

The Company's statutory-basis financial assets and liabilities carried at NAIC fair value have been classified, for disclosure purposes, based on a hierarchy defined by SSAP No.100, *Fair Value Measurement* ("SSAP 100"). The levels of the fair value hierarchy are as follows:

Level 1 – Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 – Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Level 3 – Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company’s best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Investments in mutual funds are carried at estimated fair value based on quoted market prices and are recorded in the statutory-basis balance sheets as common stock. These assets include primarily actively-traded exchange-listed mutual funds identified as common stock. Unadjusted quoted prices for these securities are provided to the Company by independent pricing services. These investments are included within the scope of SSAP 100.

Level 3 recurring investments include holdings in real estate investment trusts (“REITs”) and other privately issued stock holdings. Fair values of the REIT holdings are provided to the Company by the trust manager either monthly or quarterly and are derived from limited observable inputs as a result of low transaction volume. The Company also holds privately issued common stocks that experience similarly low transaction volume. The Company obtains SVO prices for these investments quarterly and considers these prices to approximate of fair value.

Investments in partnerships and similar investments are recorded in the statutory-basis balance sheets as other invested assets. Other invested asset investments in subsidiary, controlled and affiliated entities are recorded using the statutory equity method. These investments are not included within the scope of SSAP 100.

Fair value measurements at December 31, 2010 and 2009:

Description	December 31, 2010			Total
	Level 1	Level 2	Level 3	
Assets at fair value				
Common stock - unaffiliated	\$ 128,368	\$ –	\$ 22,955	\$ 151,323
Common stock - affiliate	–	–	35	35
Total assets at fair value	\$ 128,368	\$ –	\$ 22,990	\$ 151,358

Description	December 31, 2009			Total
	Level 1	Level 2	Level 3	
Assets at fair value				
Common stock - unaffiliated	\$ 109,347	\$ –	\$ 18,889	\$ 128,236
Common stock - affiliate	–	–	15	15
Total assets at fair value	\$ 109,347	\$ –	\$ 18,904	\$ 128,251

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Fair Value Measurements in Level 3:

	Balance at 01/01/2010	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2010
Common Stock	\$ 18,904	\$ -	\$ -	\$ -	\$ 3,920	\$ 166	\$ 22,990
Total	\$ 18,904	\$ -	\$ -	\$ -	\$ 3,920	\$ 166	\$ 22,990

	Balance at 01/01/2009	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2009
Common Stock	\$ 32,274	\$ -	\$ -	\$ -	\$ (13,886)	\$ 516	\$ 18,904
Total	\$ 32,274	\$ -	\$ -	\$ -	\$ (13,886)	\$ 516	\$ 18,904

The cost or amortized cost, gross unrealized gains (losses), and NAIC fair value of cash and investments are as follows:

	December 31, 2010			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
Cash, cash equivalents and short-term investments	\$ (1,592)	\$ -	\$ -	\$ (1,592)
Bonds:				
U.S. Government securities	162,644	3,204	(1,436)	164,412
Industrial and miscellaneous	163,861	5,960	(852)	168,969
Mortgage-backed securities	194,468	5,202	(972)	198,698
Total bonds	520,973	14,366	(3,260)	532,079
Common stock	143,439	11,815	(3,896)	151,358
Preferred stock	2,699	50	-	2,749
Total cash and investments	\$ 665,519	\$ 26,231	\$ (7,156)	\$ 684,594

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

	December 31, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
Cash, cash equivalents and short-term investments	\$ 116,416	\$ –	\$ –	\$ 116,416
Bonds:				
U.S. Government securities	181,933	2,205	(564)	183,574
Industrial and miscellaneous	91,579	5,535	(148)	96,966
Mortgage-backed securities	172,536	5,126	(539)	177,123
Total bonds	446,048	12,866	(1,251)	457,663
Common stock	129,199	6,725	(7,673)	128,251
Preferred stock	750	50	–	800
Total cash and investments	<u>\$ 692,413</u>	<u>\$ 19,641</u>	<u>\$ (8,924)</u>	<u>\$ 703,130</u>

At December 31, 2010 and 2009, the total cost or amortized cost includes \$79 and \$104, respectively, of bonds that are non-admitted due to a default or near default status.

Cash and investments include \$239,814 and \$174,708 at December 31, 2010 and 2009, respectively, of securities that are pledged as collateral for a Depository Agreement with the Blue Cross and Blue Shield Association to meet certain licensure standards.

The following tables show gross unrealized losses and fair values of fixed maturities and equities and length of time that individual securities have been in a continuous unrealized position.

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>		<u>Number of Securities</u>
	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	
	At December 31,						
	2010						
Bonds	\$ 149,200	\$ (2,980)	\$ 18,459	\$ (280)	\$ 167,659	\$ (3,260)	248
Common stock	85,340	(3,753)	1,297	(143)	86,637	(3,896)	5
Total	<u>\$ 234,540</u>	<u>\$ (6,733)</u>	<u>\$ 19,756</u>	<u>\$ (423)</u>	<u>\$ 254,296</u>	<u>\$ (7,156)</u>	<u>253</u>
	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>		
	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Number of Securities</u>
At December 31,							
2009							
Bonds	\$ 75,019	\$ (316)	\$ 37,639	\$ (935)	\$ 112,658	\$ (1,251)	133
Common stock	4,399	(76)	85,062	(7,597)	89,461	(7,673)	5
Total	<u>\$ 79,418</u>	<u>\$ (392)</u>	<u>\$ 122,701</u>	<u>\$ (8,532)</u>	<u>\$ 202,119</u>	<u>\$ (8,924)</u>	<u>138</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Management regularly reviews the fair value of the Company's investments. If the fair value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- The length of time and the extent to which the fair value has been below cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;
- Volatility inherent in the asset class to which the investment belongs;
- Management's intent and ability to hold the respective fixed maturity securities long enough for it to recover its value.

At December 31, 2010 and 2009, included in the Company's investments are unrealized losses deemed to be temporary. These investments reflect a range of industries, and the Company deems the current market volatility as temporary.

In 2010, there were no other-than-temporary impairment write downs. In 2009, there were write downs of \$2,079 of preferred stocks, \$17,825 of common stocks and \$25,338 of other invested assets for declines in fair value determined by management to be other-than-temporary.

The amortized cost and NAIC fair value of bonds at December 31, 2010, by stated maturity, are shown below. Fixed maturities subject to early or unscheduled prepayments have been included based upon their stated maturity dates. Actual maturities may differ from stated maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Cost or Amortized Cost</u>	<u>NAIC Fair Value</u>
Within 1 year	\$ 21,116	\$ 21,714
After 1 year through 5 years	172,851	176,450
After 5 years through 10 years	109,262	111,180
After 10 years	217,744	222,735
Total bonds	<u>\$ 520,973</u>	<u>\$ 532,079</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Proceeds from the sale of debt securities were approximately \$632,905 and \$118,047 with realized gains on sales of \$12,798 and \$1,861, and realized losses of \$1,425 and \$7,023 for the years ended December 31, 2010 and 2009, respectively.

Major categories of net investment income are summarized as follows:

	Year ended December 31	
	2010	2009
Income:		
Bonds	\$ 17,447	\$ 16,834
Other invested assets	13,519	12,409
Common stock	9,481	7,842
Preferred stock	–	13
Real estate	6,836	7,800
Short-term investments and cash	162	160
Other miscellaneous	839	319
Total investment income	<u>48,284</u>	<u>45,377</u>
Less: Investment expenses	7,916	7,118
Depreciation	2,408	2,406
Net investment income	<u>\$ 37,960</u>	<u>\$ 35,853</u>

Gross realized investment gains and losses, including impairments, are as follows:

	2010	2009
Gross gains	\$ 17,443	\$ 3,920
Gross losses	(2,578)	(55,839)
Net realized investment gains (losses)	<u>\$ 14,865</u>	<u>\$ (51,919)</u>

Included in other invested assets is a \$10,000 surplus note purchased by the Company in November 2004 from Neighborhood Health Plan, Inc. (“NHP”). Accrued interest payments on this note, subject to approval from the DOI, are due semi-annually in arrears on or before each April 1 and October 1, until payment in full of all amounts is received.

Principal payments on this note, subject to approval from the DOI, are due and payable in semi-annual installments, commencing on April 1, 2014, with a final installment due and payable on October 1, 2018. There are no payments outstanding from NHP at December 31, 2010.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

4. Health Care Benefits, Net of Reinsurance

The Company's health care benefits, net of recoveries, are summarized in the reconciliation of the beginning and ending balances of claims payable, claims incurred but not yet reported and health care receivables as follows:

	<u>2010</u>	<u>2009</u>
Net balance at January 1	\$ 229,316	\$ 207,878
Incurred related to:		
Current year	2,060,592	2,073,960
Prior years	(1,180)	(8,734)
Total incurred	<u>2,059,412</u>	<u>2,065,226</u>
Paid related to:		
Current year	1,859,175	1,844,744
Prior years	228,271	199,044
Total paid	<u>2,087,446</u>	<u>2,043,788</u>
Net balance at December 31	<u>\$ 201,282</u>	<u>\$ 229,316</u>

Negative amounts reported for incurred related to prior years result from claims being settled for amounts less than originally estimated. The favorable development in medical claims payable for the years ended December 31, 2010 and 2009 is primarily attributable to actual claim payment patterns and cost trends differing from those assumed at the time the liability was established.

At December 31, 2010 and 2009, health care receivables include \$6,173 and \$4,551, respectively, that are non-admitted in accordance with SSAP No. 84, *Certain Health Care Receivables and Receivables Under Government Insured Plans*.

Estimated subrogation credits of \$4,388 and \$3,479 were taken into account in determining health care benefits reserves as of December 31, 2010 and 2009, respectively.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate at December 31, 2010 and 2009.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans

All employees are eligible to participate in the Retirement Income Trust Plan (“RIT”), which grants benefits to retired employees at various levels based on age and years of service. The plan was amended to provide employees hired after June 30, 2010 with a cash balance benefit. The December 31, 2010 obligations were not affected by this change, since there is a one year waiting period for plan participation. The Company also participates in two noncontributory retirement plans for eligible employees, and sponsors a defined benefit plan covering medical, life and dental benefits. The Company uses a December 31 measurement date for all of its plans.

A summary of assets, obligations and assumptions of the RIT pension and other post-retirement benefit plans are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2010	2009	2010	2009
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 461,508	\$ 413,042	\$ 95,196	\$ 99,048
Service cost	23,003	18,920	6,772	3,471
Interest cost	27,561	25,925	5,660	6,174
Actuarial loss (gain)	25,156	36,262	(4,124)	(6,585)
Benefits paid	(24,849)	(29,334)	(7,253)	(7,351)
Settlement payments	(6,508)	(2,382)	—	—
Medicare Part D reimbursement	—	—	593	439
Administrative expenses paid	(977)	(925)	—	—
Benefit obligation at end of year	\$ 504,894	\$ 461,508	\$ 96,844	\$ 95,196

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

	Pension Benefits		Post-retirement Benefits	
	2010	2009	2010	2009
Change in plan assets				
Fair value at beginning of year	\$ 434,636	\$ 341,397	\$ 38,815	\$ 19,589
Actual return on plan assets	59,633	76,597	5,711	6,873
Employer contribution	26,548	49,283	8,084	19,265
Benefits paid	(24,849)	(29,334)	(5,377)	(5,704)
Settlement payments	(6,508)	(2,382)	–	–
Medicare Part D reimbursement	–	–	593	439
401(h) benefit payments	–	–	(1,876)	(1,647)
Administrative fees paid	(977)	(925)	–	–
Fair value at end of year	<u>\$ 488,483</u>	<u>\$ 434,636</u>	<u>\$ 45,950</u>	<u>\$ 38,815</u>
Reconciliation of funded status				
Funded status	\$ (16,411)	\$ (26,872)	\$ (50,893)	\$ (56,381)
Unrecognized actuarial loss (gain)	149,161	162,183	(2,196)	4,291
Unrecognized transition obligation	4,302	4,733	5,743	8,615
Unrecognized prior service cost	917	1,332	–	–
Prepaid assets (accrued liabilities)	<u>\$ 137,969</u>	<u>\$ 141,376</u>	<u>\$ (47,346)</u>	<u>\$ (43,475)</u>
Benefit obligation for non-vested employees				
	<u>\$ 9,370</u>	<u>\$ 16,330</u>	<u>N/A</u>	<u>N/A</u>
Components of net periodic benefit cost				
Service cost	\$ 23,003	\$ 18,920	\$ 6,772	\$ 3,471
Interest cost	27,561	25,925	5,660	6,174
Expected return on plan assets	(35,074)	(29,500)	(3,348)	(2,594)
Amortization of unrecognized transitional obligation	430	430	2,872	2,872
Recognized actuarial loss	12,435	15,396	–	615
Amortization of prior service cost	416	288	–	–
Total net periodic benefit cost	<u>\$ 28,771</u>	<u>\$ 31,459</u>	<u>\$ 11,956</u>	<u>\$ 10,538</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

A minimum pension liability is required when the actuarial present value of accumulated benefits exceeds plan assets and accrued pension liabilities. The minimum pension liability adjustment, less allowable intangible assets, net of tax benefit, is reported as a change in surplus. At December 31, 2010 and 2009, the additional minimum pension liability was \$9,547 and \$8,966 and the intangible asset was \$5,244 and \$6,030, respectively.

The noncontributory nonqualified retirement plans include both projected and accumulated benefit obligations in excess of plan assets of \$18,331 and \$19,299, at December 31, 2010 and 2009, respectively.

Weighted-average assumptions as of December 31, 2010 and 2009 are as follows:

	Pension Benefits		Post-retirement Benefits	
	2010	2009	2010	2009
Discount rate used for benefit obligations	5.86%	6.20%	5.86%	6.20%
Discount rate used for benefit costs	6.20%	6.50%	6.20%	6.50%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Average rate of compensation increase	3.00%	Range of 3.50% to 4.00%	N/A	N/A

For benefit costs measurement purposes, the rate of increase in the per capita cost of covered health care benefits was assumed to be in the range of 5.1% to 7.9% for 2011. The rate is assumed to decrease gradually to 4.5% over the next 18 years and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage-point change in assumed health care cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Increase (decrease) in total of service and interest cost components	\$ 446	\$ (437)
Increase (decrease) in post-retirement benefit obligation	\$ 3,356	\$ (3,288)

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

The Company's pension benefit weighted-average asset allocations at December 31, 2010 and 2009, by asset category, are as follows:

Asset category	Pension Benefits		Post-Retirement Benefits	
	2010	2009	2010	2009
Equity securities	50%	51%	50%	51%
Debt securities	20	22	20	22
Real Estate	5	4	5	4
Other	25	23	25	23
Total	100%	100%	100%	100%

The target range allocation for the plan assets are 47% to 57% equity securities, 15% to 25% debt securities, 2% to 8% real estate, and 20% to 36% other investments. Equity securities primarily include global investments in separate accounts and funds that include international, large-cap and small-cap companies. Debt securities invest in various high yield and domestic fixed income bond funds. Real estate securities invest in funds and other category includes allocations to absolute return and funding account balances.

The Company's portfolio is managed within ERISA guidelines to ensure adequate funding of the pension obligation and to maximize the returns. The asset allocation has been structured to enable an 8.0% return target on the assets. The targets and ranges were established based on the results of an asset liability study which was done in 2003. The Company considered the historical returns and future expectations for returns for each asset class, as well as target allocation of the portfolio to develop the expected long-term rate of return on assets assumption. This resulted in the selection of the 8.0% long-term rate of return on assets assumption.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

The fair value of BCBSMA's pension and post retirement plan assets at December 31, 2010 and 2009, by asset category are as follows:

Plan assets:	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Money market funds	\$ 10	\$ –	\$ –	\$ 10
103-12 investment entities (commingled funds)	–	30,360	–	30,360
Common collective trusts	–	246,489	–	246,489
Partnership/joint venture interests	–	26,160	19,276	45,436
Registered investment companies	153,190	–	–	153,190
Common stocks:				
Domestic	56,574	–	–	56,574
International	2,374	–	–	2,374
Total investments	<u>\$ 212,148</u>	<u>\$ 303,009</u>	<u>\$ 19,276</u>	<u>534,433</u>
Less: investments related to 401(h) account				<u>(45,950)</u>
Total investments at fair value				<u>\$ 488,483</u>

Plan assets:	December 31, 2009			
	Level 1	Level 2	Level 3	Total
Money market funds	\$ –	\$ 1,317	\$ –	\$ 1,317
103-12 investment entities (commingled funds)	–	35,515	–	35,515
Common collective trusts	–	228,945	–	228,945
Partnership/joint venture interests	–	25,044	17,650	42,694
Registered investment companies	134,913	–	–	134,913
Common stocks				
Domestic	27,952	–	–	27,952
International	2,115	–	–	2,115
Total investments	<u>\$ 164,980</u>	<u>\$ 290,821</u>	<u>\$ 17,650</u>	<u>473,451</u>
Less: investments related to 401(h) account				<u>(38,815)</u>
Total investments at fair value				<u>\$ 434,636</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

Fair value measurement in Level 3:

	Balance at 01/01/2009	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2009
Partnership/ Joint venture interests	\$ 25,325	\$ –	\$ –	\$ –	\$ (6,285)	\$ (1,390)	\$ 17,650
Total	\$ 25,325	\$ –	\$ –	\$ –	\$ (6,285)	\$ (1,390)	\$ 17,650

	Balance at 01/01/2010	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2010
Partnership/ Joint venture interests	\$ 17,650	\$ –	\$ –	\$ –	\$ 1,626	\$ –	\$ 19,276
Total	\$ 17,650	\$ –	\$ –	\$ –	\$ 1,626	\$ –	\$ 19,276

The Company's fair value hierarchy levels under SSAP 100 are defined in Note 3.

The Company has a non-pension post-retirement benefit plan. On December 31, 2010 and 2009, the Company's other benefits, included in its post-retirement plan, are medical, dental and life benefits for retired employees. The 401(h) account was instituted by BCBSMA in December 2003. The Companies made a contribution of \$3,300 in 2010 and \$14,000 in 2009.

At December 31, 2010, the Company's projected benefit payments are as follows:

	Pension Benefits	Post-Retirement Benefits	Medicare Subsidy
2011	\$ 37,064	\$ 8,361	\$ 551
2012	34,266	8,925	615
2013	32,811	9,480	678
2014	33,862	10,113	744
2015	39,821	10,642	829
Next five years	224,934	59,205	5,514

The Company and its actuarial advisors determined that benefits provided by the post-retirement benefit plan as of the date of the enactment of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 were at least actuarially equivalent to Medicare Part D, and, accordingly, the Company is entitled to the federal subsidy.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

5. Pension and Other Post-retirement Benefit Plans (continued)

The Company determined that the aggregate effect of the federal subsidy on the service cost, interest cost, and amortization of the actuarial experience gains and is a reduction in annual net periodic post-retirement benefit cost of \$1,339 and \$2,080 in 2010 and 2009, respectively.

The accumulated post-retirement benefit obligation decreased by \$12,108 and \$11,970 at December 31, 2010 and 2009, respectively, due to the effect of the Act. The calculation excludes non-vested employees costs per Interpretation 04-17, *Impact of Medicare Modernization Act on Post-retirement Benefits* (“INT 04-17”).

The Company has considered certain provisions of the recently passed healthcare reform legislation Patient Protection Affordable Care Act (“PPACA”). Company management believe there is limited financial implication for the excise tax on “Cadillac” plans starting in 2018 as plan benefits are capped for most retirees. Therefore, any additional liability is not included for these provisions. In addition, healthcare reform requirements related to preventive care and dependent care coverage will be reflected in the 2011 rates.

In 2010, the Company applied for reimbursements through Early Retiree Reinsurance Program (“ERRP”), but the exact amount of approved subsidy was unknown as of December 31, 2010. Due to this fact, and the fact the reduction to the APBO liability is expected to be negligible, the impact is not reflected in the 2010 year end liability.

The Company also has a savings 401(k) plan for eligible employees. Under the employee savings plan, the Company contributes an amount equal to 100% of employee contributions, up to a maximum of 4% of each employee’s compensation, subject to pretax Internal Revenue Code limit of \$16,500 for 2010 and 2009. Contributions are maintained in investment funds established under the employee savings plan. The Company’s contributions charged to income amounted to \$5,732 and \$4,964 in 2010 and 2009, respectively.

6. Income Taxes

The Company’s federal income tax rate is less than the regular tax rate of 35% for corporations due to utilization of the special deduction available to Blue Cross and Blue Shield Plans under Internal Revenue Code section 833. The special deduction subjects the Company to the Alternative Minimum Tax (“AMT”) provisions. The AMT provisions tax income at a rate of 20% and limits utilization of net operating loss carry-forwards to 90% of taxable income.

Under the asset and liability method, the Company’s temporary differences represent the estimated future tax effects attributable to future taxable or deductible temporary differences between amounts recognized in the financial statements and income tax returns.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes (continued)

These items primarily represent depreciation and amortization, post-retirement benefits, certain accrued liabilities, accrued pension costs and discounting of unpaid claims liabilities and expenses. The components of net deferred tax assets (“DTA”) and deferred tax liabilities (“DTL”) recognized in the Company’s assets, liabilities and surplus as of December 31 are as follows:

	2010			2009		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross DTA	\$ 433,382	\$ 14,987	\$ 448,369	\$ 407,464	\$ 16,556	\$ 424,020
Statutory valuation allowance	(38,491)	–	(38,491)	(38,899)	–	(38,899)
Adjusted Gross DTA	394,891	14,987	409,878	368,565	16,556	385,121
Gross DTL	–	(41,197)	(41,197)	–	(22,711)	(22,711)
DTA (DTL) before admissibility Test	394,891	(26,210)	368,681	368,565	(6,155)	362,410
Admitted pursuant to:						
Paragraph 10. a.	11,551	–	11,551	14,585	–	14,585
Paragraph 10. b.	10,606	–	10,606	–	–	–
Paragraph 10. c.	–	41,197	41,197	–	22,711	22,711
Additional admitted pursuant to:						
Paragraph 10. e.i.	–	–	–	–	–	–
Paragraph 10. e.ii.	–	–	–	–	–	–
Paragraph 10. e.iii.	–	–	–	–	–	–
Admitted DTA	22,157	41,197	63,354	14,585	22,711	37,296
DTL	–	(41,197)	(41,197)	–	(22,711)	(22,711)
Net admitted DTA	\$ 22,157	\$ –	\$ 22,157	\$ 14,585	\$ –	\$ 14,585
Non-admitted DTA			\$ 385,015			\$ 386,724

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes (continued)

The Company has elected not to admit DTA's pursuant to paragraph 10.e. SSAP 10R, Income Taxes – Revised, for both current and prior reporting periods. Such election is available for 2011.

Admitted pursuant to paragraph:			
2010	10.a.	10.b.	10.c.
Ordinary	\$ 11,551	\$ 10,606	\$ –
Capital	–	–	41,197
Total	\$ 11,551	\$ 10,606	\$ 41,197
<hr/>			
2009	10.a.	10.b.	10.c.
Ordinary	\$ 14,585	\$ –	\$ –
Capital	–	–	22,711
Total	\$ 14,585	\$ –	\$ 22,711
<hr/>			
Change	10.a.	10.b.	10.c.
Ordinary	\$ (3,034)	\$ 10,606	\$ –
Capital	–	–	18,486
Total	\$ (3,034)	\$ –	\$ 18,486

	2010			2009		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Paragraphs 10.a, 10b. and 10.c.						
a. Admitted DTA's	\$ 22,157	\$ –	\$ 22,157	\$ 14,585	\$ –	\$ 14,585
b. Admitted assets	\$ –	\$ –	\$ 1,672,806	\$ –	\$ –	\$ 1,576,768
c. Adjusted statutory surplus	\$ –	\$ –	\$ 704,534	\$ –	\$ –	\$ 702,372
d. Total adjusted capital from DTA's	\$ –	\$ –	\$ 732,704	\$ –	\$ –	\$ 723,896
Increases due to paragraph 10.e.						
e. Admitted DTA's	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
f. Admitted assets	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
g. Adjusted statutory surplus	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes (continued)

The Company does not employ tax planning strategies. There are no temporary differences for which a DTL has not been established.

The provision for incurred federal income taxes on earnings for the years ended December 31 is:

	<u>2010</u>	<u>2009</u>
Federal income tax (benefit) expense	\$ (2,257)	\$ 8,659
Federal income tax expense (benefit) on net capital gains (losses)	2,973	(1,335)
Federal income tax expense (benefit) prior year adjustment	988	(6,415)
Federal income taxes incurred	<u>\$ 1,704</u>	<u>\$ 909</u>

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31 are as follows:

	<u>2010</u>	<u>2009</u>	Character
Deferred tax assets:			
Post-retirement benefits	\$ 20,435	\$ 20,857	Ordinary
Other-than-temporary impairment of securities	14,987	16,556	Capital
Fixed assets	13,334	18,524	Ordinary
Intangible assets	38,310	38,931	Ordinary
Net operating losses and AMT credits	311,618	310,069	Ordinary
Non-admitted assets	21,837	-	Ordinary
Accrued expenses	27,848	19,083	Ordinary
Total deferred tax assets	<u>448,369</u>	424,020	
Statutory valuation allowance	(38,491)	(38,899)	
Non-admitted deferred tax assets	<u>(346,524)</u>	<u>(347,825)</u>	
Admitted deferred tax assets	63,354	37,296	
Deferred tax liabilities:			
Investment in equity method investments	(14,196)	(8,314)	Capital
Unrealized gains on securities	(27,001)	(14,397)	Capital
Total deferred tax liabilities	<u>(41,197)</u>	<u>(22,711)</u>	
Net admitted deferred tax asset	<u>\$ 22,157</u>	<u>\$ 14,585</u>	

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes (continued)

As of December 31, the change in net deferred income taxes is comprised of the following:

	<u>2010</u>	<u>2009</u>	<u>Change</u>
Total gross deferred tax assets	\$448,369	\$424,020	\$ 24,349
Total gross deferred tax liabilities	(41,197)	(22,711)	(18,486)
Net deferred tax assets	<u>\$407,172</u>	<u>\$401,309</u>	5,863
Tax effect of unrealized gain			12,605
Tax effect of pension liability adjustment			<u>(478)</u>
Change in net deferred income taxes			<u><u>\$ 17,990</u></u>

The Company's provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate of 35% to net gain from operations before taxes. The significant items causing these differences are as follows:

	<u>2010</u>
Statutory provision computed at statutory rate	\$ 2,504
Non-deductible expenses	336
Dividends received deductions	(319)
Income (loss) from affiliates	(868)
Foreign tax credit	(258)
Rabbi Trust	(784)
Change in non-admitted assets	(18,291)
Section 162(m) compensation limitation	481
Net operating loss write-off	408
Other	505
Total incurred federal income tax expense	<u>\$ (16,286)</u>
Federal income taxes incurred	\$ 1,704
Change in net deferred income taxes	<u>(17,990)</u>
Total statutory taxes	<u>\$ (16,286)</u>

At December 31, 2010, the Company had net operating loss carry-forwards of \$109,974, expiring through the year 2018; capital loss carry-forwards of \$1,987, expiring through the year 2014; and AMT credits of \$273,128, which do not expire.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes (continued)

During 2006, the Internal Revenue Service (“IRS”) conducted an examination of the tax years 2001 through 2004 and the Company accepted an IRS settlement offer regarding the tax basis of certain intangible assets as of January 1, 1987. This settlement is reflected in the 2006 federal income tax benefit of the statements of income. During 2007, the IRS concluded the above examination and the Company arrived at a settlement regarding certain issues raised by the IRS during the examination. The Company had previously established an adequate provision for the issues agreed upon. During 2010 and 2009, as part of the above settlement process, the Company also reflected additional income tax benefits related to the settlement offer regarding the tax basis of certain intangible assets as of January 1, 1987.

The Company would be required to adopt Accounting Standards Codification No. 740-10, *Income Taxes* (“ASC 740”, formerly FIN No. 48), *Accounting for Uncertainty in Income Taxes*, if it prepared GAAP-basis financial statements for the year ending December 31, 2010. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Similar guidance has not yet been adopted by the NAIC. If the Company were to adopt the guidance for statutory reporting purposes, it would have no impact on the financial statements.

The Company files income tax returns in the US federal jurisdiction. The Company’s open tax years are 2006 through 2010. The Company would recognize any interest and penalties resulting from ASC 740 in general and administrative expenses.

The amount of federal income taxes incurred and available for recoupment in the event of future net losses is \$4,027 and \$8,312 from 2010 and 2009, respectively.

7. State Transferable Tax Credits

The General Laws of the Commonwealth of Massachusetts (the “Commonwealth”) provide film tax credits that apply to Massachusetts income and excise taxes relating to expenditures making motion pictures in the Commonwealth. These film tax credits are transferable and are, therefore, available through purchase to any taxpayer in the Commonwealth.

The Company estimates the utilization of any remaining unused state tax credits by projecting the annual premium tax liability taking into account policy growth and rate changes, projecting future premium tax liability based on projected premium, tax rates and tax credits, and comparing projected future tax liability to the availability of remaining tax credits.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

7. State Transferable Tax Credits (continued)

As of December 31, 2010 and 2009 the carrying value of the Massachusetts tax credits gross of any related tax liabilities was \$32,201 and \$23,752, respectively. As of December 31, 2010 the value of unused Massachusetts tax credits was \$5,879. As of December 31, 2009, the Company did not have any unused Massachusetts tax credits.

8. Surplus

Chapter 160 of the Acts of 1988 requires that the Company maintain surplus of not less than 5% of all expenses and insured claims incurred in each year. At December 31, 2010 and 2009, the Company's surplus was in excess of the regulatory Chapter 160 requirements.

In addition, the NAIC has imposed regulatory risk-based capital ("RBC") requirements on health insurance companies, including the Company. The RBC calculation serves as a benchmark for the regulation of health insurance companies' solvency by state insurance regulators. At December 31, 2010 and 2009, the Company's total adjusted capital is in excess of the regulatory RBC requirements.

9. Permitted Statutory Accounting Practices

State insurance laws and regulations prescribe accounting practices for determining statutory net income and surplus for insurance companies. In addition, state regulators may permit statutory accounting practices that differ from prescribed practices. The Company had no permitted practices that would have an effect on statutory surplus at December 31, 2010 and 2009.

10. Federal Employees Program

The Company participates in the Federal Employee Health Benefits Program ("FEHBP") with other BlueCross BlueShield plans ("Plans"). This program includes a fully-insured experience-rated contract, commonly known as the Federal Employee Program ("FEP"), between the Office of Personnel Management ("OPM") and Blue Cross Blue Shield Association ("BCBSA"), which acts as an agent for the participating Plans. In addition, each participating Plan, including the Company, executes a contract with BCBSA which obligates each participating Plan to underwrite FEP benefits in its service area.

Premium rates are developed by BCBSA and negotiated with OPM annually. These rates determine the funds that will be available to the participating Plans to provide insurance to Federal employees that enroll with the BlueCross BlueShield FEP. The excess of gross premiums for the life of the program over the charges for the life of the program on an accrual

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

10. Federal Employees Program (continued)

basis is accounted for as a rate stabilization reserve (commonly referred to as the special reserve), as required by the contract between OPM and BCBSA. Any premiums that remain in the rate stabilization reserve upon termination of the BCBSA contract after the claims run-out and reimbursement of allowable administrative expenses would be returned to OPM for the benefit of the FEHBP. The FEP contract renews automatically each year unless written notice of termination is given by either party.

The Company has recorded its allocable share of the special reserve funds held in the U.S. Treasury as an admitted asset, with an equivalent amount recorded as a rate stabilization reserve.

These amounts were \$46,149 and \$1,324 as of December 31, 2010 and 2009, respectively, and are included in premium receivables and aggregate policy reserves in the accompanying balance sheet.

11. Related Party Transactions

HMO Blue and BCBSMA operate under common Board of Directors management and control. HMO Blue provides hospitalization, medical and other health benefits as a licensed health maintenance organization.

The Company participates in a bilateral inter-company agreement with HMO Blue to settle any claims, fees, administrative cost expense allocation and pass-through cash and expenses paid by one company on behalf of the other company.

As a condition of granting an HMO license to HMO Blue, the DOI required the Companies to enter into an agreement with the DOI granting the DOI discretionary authority to require either company to issue a surplus note to the other company if either of the company's health RBC is significantly higher than the other company's RBC.

Under the terms of its license with Blue Cross and Blue Shield Association, BCBSMA has also entered into a unilateral agreement with HMO Blue to guarantee all current and future financial obligations of HMO Blue.

Both BCBSMA and HMO Blue have an undivided interest in what had been BCBSMA's property and equipment. The initial basis of the property and equipment were systematically allocated to each company. Ongoing depreciation expenses are charged to each company based on utilization.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

11. Related Party Transactions (continued)

Existing employees of the Companies (the “Associates”) are either concurrently employed by both BCBSMA and HMO Blue or solely employed by BCBSMA. Those individuals solely employed by BCBSMA include senior level management (“SLM”). The compensation, benefits and administrative expenses of the concurrently employed Associates are charged to BCBSMA and HMO Blue in accordance with their provision of services to each company.

With respect to individuals solely employed by BCBSMA, the pro rata portion of compensation, benefits and administrative expenses attributable to services provided to HMO Blue is charged to HMO Blue on an arm’s length basis, including a mark-up. A common paymaster arrangement has been set up for payroll and payroll related benefits. An agency arrangement has been established for payment of claims and operating expenses and receipt of funds.

The Companies’ pension and post-retirement benefits plans (“benefit plans”) continue to be sponsored by BCBSMA and BCBSMA will continue to be liable for the benefit plans. BCBSMA charges HMO Blue, as a participating employer of the benefit plans, a fee based on HMO Blue’s allocated share of the benefit plans’ expenses.

Because of the significant related-party transactions with HMO Blue, the Company’s financial condition and the results of operations may not necessarily be indicative of the financial condition or results of operations that would have occurred if the Company had been operated as an unaffiliated company.

The Company is the sole corporate member of two Foundations (“Foundations”): Health Care Assistance Foundation, Inc. (“HCAF”) and Blue Cross Blue Shield of Massachusetts Foundation, Inc. (“BCBSF”) and as such, has a variety of powers, including appointment and approval of board members.

The mission of HCAF is to promote the care of the elderly, disabled and other persons who are experiencing financial hardship and to provide financial assistance for their care.

The mission of BCBSF is to promote and support programs, research and policies that will help to expand access to high quality, affordable health care for Massachusetts residents. BCBSF was the sole corporate member of the Massachusetts Medicaid Policy Institute, Inc. (“MMPI”), which provided independent research and support on matters related to Medicaid in Massachusetts. On October 12, 2010, MMPI was merged into BCBSF.

BCBSMA provided substantial financial support to BCBSF of \$1,090 and \$1,399 in 2010 and 2009, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

11. Related Party Transactions (continued)

Indigo Insurance Services, LLC (“Indigo”) is a wholly-owned for-profit subsidiary of BCBSMA. The subsidiary acts as an insurance agency and provides BCBSMA with the ability to offer a more comprehensive portfolio of products and services. Those products initially include group and voluntary life insurance, accidental death and dismemberment insurance, as well as group and voluntary short and long-term disability insurance.

BCBSMA has an 18.9% ownership interest in B.P. Informatics, LLC (“BPI”). BPI was formed by BCBSMA and Blue Cross and Blue Shield Plans from Arkansas, Florida, and North Carolina. Health Care Services Corporation and Highmark, Inc. joined BPI in 2007 and 2008, respectively. BPI was established to address the need for greater transparency in health care cost and quality.

The Company has a 27.5% ownership interest in Life and Specialty Ventures, LLC (“LSV”), an insurance holding company. LSV is a joint venture between Blue plans of Massachusetts, Arkansas, Florida, Hawaii, and Tennessee created to offer a broad range of insurance products and services to individuals and groups.

BCBSMA and HMO Blue committed to invest \$20,000 in BlueCross BlueShield Ventures, Inc. (the “General Partner”) and BlueCross BlueShield Venture Partners, L.P. (the “Partnership”), in form of purchase of 20 Class A shares of the General Partner and 17% limited interest in the Partnership in accordance with the Assignment and Assumption Agreement. BlueCross BlueShield Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield plans to invest in emerging companies that will bring greater innovation, efficiency, consumer-focus and transparency to healthcare. BCBSMA has contributed \$2,687; \$1,493 and \$575 in 2010, 2009 and 2008, respectively, to the Partnership. At December 31, 2010, the Company had an outstanding contingent commitment for additional funding of \$5,145 related to the future equity contributions in the Partnership.

In 2009, BCBSMA and HMO Blue management decided to manage the operation of the Blue Core administrative system (“Blue Core”) by maintaining it in separate limited liability corporations named Core Administrative System I, LLC (“CASI”) and Core Administrative System II, LLC (“CASII”). Given that Blue Core is jointly owned by BCBSMA and HMO Blue, a new separate wholly-owned and controlled LLC was created for each company.

On June 1, 2009, BCBSMA and HMO Blue each transferred its respective share of Blue Core to CASI and CASII in exchange for a 10-year note receivable in the amount of the net book value at the date of transfer. Each note accrues interest at a rate of four percent (4%) per year compounded daily and paid monthly. On the same date, BCBSMA and HMO Blue each entered into arms-length 10-year service agreements with CASI and CASII, respectively, for access to use of Blue Core.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

11. Related Party Transactions (continued)

On June 1, 2010, BCBSMA and HMO Blue each transferred its additional share of Blue Core to CASI and CASII in exchange for a 9-year note receivable in the amount of \$1,360 and \$1,206, respectively. Each note accrues interest at a rate of four percent (4%) per year compounded daily and paid monthly. On the same date, BCBSMA and HMO Blue each entered into additional arms-length 9-year service agreements with CASI and CASII, respectively, for access to use of the additional Blue Core assets.

In December, 2010, the Company recognized \$433 impairment write-offs of its investment in CASI, related to expired access and use of specific software modules. The Company's total service agreement payments to CASI were \$10,135 and \$5,848 in 2010 and 2009, respectively.

In December, 2009, BCBSMA executed a Joint Ownership Agreement with Blue Cross Blue Shield of Vermont ("BCBSVT") whereby BCBSVT and BCBSMA jointly own and operate a new entity, Cobalt Benefits Group, LLC ("Cobalt"), for the purpose of administering third-party administration business. BCBSVT established Cobalt as a limited liability company owned by Comprehensive Benefits Administrator, Inc. ("CBA"), which is a wholly-owned subsidiary of Catamount Insurance Services, Inc. ("CIS"), which is a wholly-owned subsidiary of BCBSVT. Per the terms of the agreement, CBA transferred some of its assets and liabilities to Cobalt, including its ownership interest in Employee Benefit Plan Administration, LLC (a wholly-owned subsidiary of CBA), operational contracts, furniture and equipment, company records and files, goodwill, and employees.

Upon completion of this transaction in December, 2009, BCBSMA purchased a 50% ownership in Cobalt from CBA for \$5,600. Using the statutory purchase method of accounting, BCBSMA recorded \$2,356 of goodwill as a component of its investment in Cobalt. The positive goodwill is amortized to unrealized gains and losses over a period of 5 years. The Company amortized \$494 in 2010.

In conjunction with the Cobalt purchase transaction, on December 31, 2009, BCBSMA has created a new wholly-owned subsidiary organized under MGL section 156C as a limited liability company named Massachusetts Benefit Administrators, LLC ("MBA"). MBA markets and sells third-party employee benefit administration services.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

11. Related Party Transactions (continued)

On December 30, 2010, BCBSMA acquired 16.7% ownership of National Account Service Company, LLC (“NASCO”) by contributing \$18,647 in cash. NASCO, a Delaware limited liability company, provides a single-system claims processing solution for the Blue Cross and Blue Shield plans. BCBSMA currently processes 25% of its claims through the NASCO platform. BCBSMA will transfer the Company's core administrative processes, claims, enrollment and billing, from their current technology platforms to NASCO. The migration is based on NASCO's ability to provide a lower risk than modernizing BCBSMA's current systems, improve efficiencies, and take full advantage of IT investments through a shared investor model.

As of December 31, the BCBSMA inter-company receivable balances with HMO Blue, CASI, Indigo, BCBSF and MBA were as follows:

	Receivable from affiliates	
	2010	2009
HMO Blue	\$ 1,110	\$ 35,929
CASI	10	7
Indigo	156	191
BCBSF	968	319
MBA	16	–
Totals	\$ 2,260	\$ 36,446

12. Third Party Administrators

The Company has entered into a Medicare Part D Inter-Plan Services Agreement to offer a Blue Cross and Blue Shield branded prescription drug plan (“PDP”) with Anthem Blue Cross Blue Shield, Blue Cross and Blue Shield of Rhode Island, and Blue Cross and Blue Shield of Vermont (the “Plans”). The Plans have collectively entered into a contract with the Centers for Medicare Services to offer a branded PDP in Region 2, based on the regulations contained with the Medicare Modernization Act of 2003. Effective January 1, 2009, Silverscripts LLC, a subsidiary of CVS Caremark, is acting as a third party administrator to process premiums and claims under the PDP.

The Company has an agreement with Health Reinsurance Management Partnership (HRMP) for Stop Loss Third Party Claims Administrative Services. HRMP acts, in effect, as the accident and health reinsurance department of London Reinsurance Group, managing excess medical reinsurance for the group. It is also a fully licensed third party administrator.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

12. Third Party Administrators (continued)

The Company has an agreement with Health Reinsurance Management Partnership (HRMP) for Stop Loss Third Party Claims Administrative Services. HRMP acts, in effect, as the accident and health reinsurance department of London Reinsurance Group, managing excess medical reinsurance for the group. It is also a fully licensed third party administrator.

Name and Address of Third Party Administrator	FEIN Number	Exclusive Contract	Type of Business Written	Type of Authority Granted	Total Direct Premium Written
Silverscripts LLC, a subsidiary of CVS Caremark, Inc. 9501 E Shea Blvd, Scottsdale, AZ 85260	33-1113587	No	Medicare Part D	Administrative Services	\$116,927
Health Reinsurance Management Partnership 5 Hutchinson Drive, Danvers MA 01923	51-0397873	No	Stop loss	Administrative Services	\$11,017

13. Reinsurance

The Company has a dental reinsurance and administrative services transfer agreements with US Able Life, Inc (“US Able Life”), a wholly-owned insurance subsidiary of Life and Specialty Ventures, LLC (“LSV”) as disclosed in Note 10. The proportional share dental reinsurance agreement between BCBSMA (“reinsured”) and US Able Life (“reinsurer”) transfers 51% of dental insurance risk to US Able Life effective January 1, 2008. The difference between the amount arrived at by subtracting the aggregate value of claims incurred plus the ceded commission from the reinsurance premiums is invoiced monthly and settled between the parties within 45 days. The settlement amount due to US Able Life was \$600 and \$1,011 at December 31, 2010 and 2009, respectively.

The Company has a reinsurance agreement with HM Life Insurance Company (“HM Life”) in connection with the Federal Employee Vision Program to cede 100% of the risk to HM Life.

The Company has a Specific Excess of Loss Reinsurance agreement (“Excess of Loss Agreement”) with ACE American Insurance Company to provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources.

All three reinsurance agreements cannot be unilaterally cancelled except for nonpayment of premiums.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

13. Reinsurance (continued)

Premiums earned and healthcare benefits incurred have been reduced for premiums ceded of \$93,741 and \$80,456 and healthcare benefits ceded of \$78,724 and \$67,041 in 2010 and 2009, respectively.

Neither BCBSMA nor any of its related parties control, directly or indirectly, any reinsurers with whom the company conducts business. No policies issued by BCBSMA have been reinsured with a foreign company, which is controlled, either directly or indirectly, by a party not primarily engaged in the business of insurance. BCBSMA does not have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel the agreement. At December 31, 2010 there are no reinsurance agreements in effect such that the amount of losses paid or accrued exceed the total direct premium collected.

The net amount of increase in surplus if all reinsurance agreements were cancelled is \$10,070 and \$8,775 as of December 31, 2010 and 2009, respectively.

14. Retrospectively Rated Contracts and Contracts Subject to Redetermination

The Company estimates accrued retrospective premium adjustments for its retrospectively rated business through a mathematical approach consistent with the Company's underwriting rules and experience rating practices.

The amount of net premiums written by the Company for the years ended December 31, 2010 and 2009 that are subject to retrospective rating features was \$93,709 and \$85,778 or 4.1% and 3.7%, respectively, of the total net premiums written for the Company. No other premiums written by the Company are subject to retrospective rating features.

Profits and losses associated with the direct pay Blue Cross Blue Shield branded PDP are pooled and allocated amongst the Plans based upon membership in the applicable branded area and reported as other expense of \$812 and \$1,107 in 2010 and 2009, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

15. Health Care Receivables

Amounts receivable for pharmaceutical rebates are estimated based on a per script calculation. Rebate amounts are typically paid on a quarterly basis 150 days after the end of each quarter.

The Company's pharmacy rebate receivable balances are as follows:

Quarter	Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Billed or Otherwise Confirmed	Actual Rebates Collected Within 90 days	Actual Rebates Collected Within 91 to 180 days	Actual Rebates Collected in More Than 180 days
12/31/2010	\$ 3,775	\$ 3,775	\$ -	\$ -	\$ -
9/30/2010	3,753	3,914	-	-	-
6/30/2010	3,839	3,965	-	215	-
3/31/2010	3,816	4,233	-	199	3,775
12/31/2009	2,948	3,654	-	1,275	2,249
9/30/2009	2,859	3,721	-	1,026	2,512
6/30/2009	2,846	3,714	-	1,092	2,606
3/31/2009	2,773	3,593	-	960	2,624
12/31/2008	3,975	3,781	3,775	6	-
9/30/2008	3,259	3,259	3,259	-	-
6/30/2008	3,223	3,223	2,258	965	-
3/31/2008	3,018	3,018	3,018	-	-

16. ASC Business

The Company provides certain claim administration services for its uninsured customers through ASC arrangements. The net gain or loss from income related to these contracts is as follows at December 31, 2010 and 2009:

	ASC Uninsured Plans	
	2010	2009
Gross reimbursement for medical cost incurred	\$ 7,334,864	\$ 6,927,168
Gross administrative fees accrued	301,669	292,971
Gross expenses incurred (claims and administrative)	(7,723,700)	(7,264,702)
Net loss from operations	\$ (87,167)	\$ (44,563)

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

16. ASC Business (continued)

At December 31, 2010 and 2009, the Company admitted assets of \$172,435 and \$157,648, respectively in net accounts receivable for uninsured plans and amounts due from agents. The Company routinely assesses the collectability of its receivables.

At December 31, 2010 and 2009, the Company recorded gross ASC administrative fees accrued and not billed of \$24,281 and \$25,072, respectively.

17. Leases

The Company and HMO Blue jointly have a long-term operating lease agreement for approximately 500,000 square feet of office space for its corporate headquarters. The term of the lease is 15 years, commencing in May 2000, with an option to extend for one period of four years and eleven months.

The Company and HMO Blue jointly entered into several other long-term, non-cancelable operating lease agreements for office space and equipment that expire at various dates through 2016. For the years ended December 31, 2010 and 2009, the Company recorded rental expense of approximately \$14,914 and \$12,178, respectively.

At December 31, 2010, allocated minimum rental commitments on significant non-cancelable operating leases for the Company are as follows:

2011	\$	15,603
2012		10,241
2013		9,520
2014		8,992
2015		3,848
Thereafter		189

In addition, the Companies have an agreement with an outside vendor to provide certain information technology ("IT") services for a significant portion of the Companies' business operations. The Companies minimum commitments under this agreement are approximately \$75,885, with the amount decreasing each year until completion of the contract in September 2015.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

17. Leases (continued)

In 2009, the Companies' management decided to change the IT services provider. As of December 31, 2009, in accordance with SSAP 5 BCBSMA recorded \$9,250 accrual related to the termination fees of the agreement with this vendor. In 2010, the Company transferred its IT services to the new provider, paid termination fees of \$8,639 to the old vendor and reversed the remainder of the contingency reserve.

18. Revolving Line of Credit

The Companies jointly entered into two revolving credit agreements. Borrowings under these lines of credit bear interest on a fixed or floating interest rate basis. These facilities are unsecured and one facility for \$100,000, which matured in June, 2010, has been renewed until June, 2011 and the second facility which matured in October, 2010, has been renewed for \$50,000 until June, 2011.

At December 31, 2010, the Company had \$25,000 outstanding under these facilities, accrued interest of \$1 calculated at 1.03% and accrued fees of \$11 calculated at 0.20%. These amounts are reported as borrowed money on the balance sheet. During the year the Company incurred \$294 of interest on these facilities. There were no amounts outstanding under these credit facilities at December 31, 2009.

19. Commitments and Contingencies

The Company is involved in pending and threatened litigation of the character incidental to its business or arising out of its insurance operations, and is, from time to time, involved as a party in various governmental and administrative proceedings. Management continues to monitor these matters, and believes the Company has accrued adequate reserves against potential liabilities.

20. Subsequent Events

The Company's management evaluated the subsequent events through April 25, 2011 the date the financial statements are available to be issued.

AUDITED STATUTORY-BASIS FINANCIAL
STATEMENTS

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.
Years Ended December 31, 2010 and 2009
With Report of Independent Registered Public Accounting
Firm

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Audited Statutory-Basis Financial Statements

Years Ended December 31, 2010 and 2009

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Report of Independent Registered Public Accounting Firm

The Board of Directors
Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

We have audited the accompanying statutory-basis balance sheets of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (the Company) as of December 31, 2010 and 2009, and the related statutory-basis statements of operations, changes in surplus, and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles also are described in Note 2. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. at December 31, 2010 and 2009, or the results of its operations or its cash flow for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. at December 31, 2010 and 2009, and the results of its operations and its cash flow for the years then ended in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance.

We have also audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Oversight Board (United States), the Company's internal control over statutory financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 25, 2011 expressed an unqualified opinion thereon.

April 25, 2011

Report of Independent Registered Public Accounting Firm

Board of Directors
Blue Cross & Blue Shield of Massachusetts HMO Blue, Inc.

We have audited Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.'s (the Company) internal control over statutory financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over statutory financial reporting, and for its assessment of the effectiveness of internal control over statutory financial reporting included in the accompanying Report of Management on the Company's Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over statutory financial reporting based on our audit.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over statutory financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over statutory financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over statutory financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance. A company's internal control over statutory financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the statutory financial statements.

Because of its inherent limitations, internal control over statutory financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over statutory financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), the statutory-basis balance sheets of Blue Cross & Blue Shield of Massachusetts HMO Blue, Inc. as of December 31, 2010 and 2009, and the related statutory-basis statements of operations, changes in surplus, and cash flow for the years then ended and our report dated April 25, 2011 expressed an unqualified opinion thereon.

April 25, 2011



MASSACHUSETTS

**Report of Management on Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.
Internal Control Over Financial Reporting**

April 25, 2011

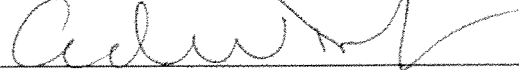
We, as members of management of Blue Cross and Blue Shield of Massachusetts HMO Blue Inc., (the Company) are responsible for establishing and maintaining effective internal control over financial reporting. Internal control is designed to provide reasonable assurance to the Company’s management and Board of Directors regarding the preparation of reliable published financial statements in conformity with accounting practices prescribed by the NAIC and or permitted by the Commonwealth of Massachusetts Division of Insurance. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of inherent limitations in any internal control, no matter how well designed, misstatements due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the Company’s internal control as of December 31, 2010 based on criteria for effective internal control over financial reporting described in “Internal Control—Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, we assert that the Company maintained effective internal control over financial reporting as of December 31, 2010 based on the COSO criteria.

Ernst & Young LLP audited the Company’s statutory financial statements and has issued an attestation report on the Company’s internal control over statutory financial reporting as of December 31, 2010. The attestation is included in our annual report.


Blue Cross and Blue Shield of Massachusetts, Inc.

by 

Andrew Dreyfus, President and Chief Executive Officer

by 

Allen Maltz, Executive Vice President and Chief Financial Officer

by 

Brett Painchaud, Senior Vice President and Controller

by 

William T. Cushing, Jr., Senior Vice President and Chief Audit Executive

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Balance Sheets

(In thousands)

	December 31	
	2010	2009
Admitted assets		
Bonds	\$ 548,231	\$ 490,603
Common stock	154,264	144,839
Properties occupied by the company	106,005	107,613
Cash, cash equivalents and short-term investments	57,026	61,885
Receivable for securities	7,685	2,061
Other invested assets	441,382	400,451
Total cash and invested assets	<u>1,314,593</u>	<u>1,207,452</u>
Accrued investment income	3,792	4,209
Premiums receivable	30,323	25,316
Data processing equipment	3,581	4,064
Health care receivables	8,903	11,637
Other receivables	1,773	3,102
Other assets	236	2,258
Total admitted assets	<u>\$ 1,363,201</u>	<u>\$ 1,258,038</u>
Liabilities and surplus		
Health care claim reserves	\$ 314,412	\$ 297,940
Accrued medical incentive pool and bonus payments	113,564	55,611
Aggregate policy reserves	46,104	27,136
Premiums received in advance	98,417	105,843
Accounts payable and accrued liabilities	21,797	22,983
Payable to affiliates	1,110	35,929
Payable for securities	9,179	6,766
Total liabilities	<u>604,583</u>	<u>552,208</u>
Surplus	<u>758,618</u>	<u>705,830</u>
Total liabilities and surplus	<u>\$ 1,363,201</u>	<u>\$ 1,258,038</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Operations

(In thousands)

	Year Ended December 31	
	2010	2009
Premiums earned	\$ 4,019,305	\$ 4,399,739
Health care benefits	3,656,348	4,052,382
Claims adjustment expenses	189,369	236,031
General and administrative expenses	200,182	220,827
Change in premium deficiency reserve	27,000	—
Total expenses	4,072,899	4,509,240
Underwriting loss	(53,594)	(109,501)
Net investment income	40,868	41,555
Net realized investment gains (losses)	20,665	(59,964)
Net income (loss)	\$ 7,939	\$ (127,910)

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Changes in Surplus

(In thousands)

	Year Ended December 31	
	2010	2009
Balance at January 1	\$ 705,830	\$ 707,040
Net income (loss)	7,939	(127,910)
Change in net unrealized gains	43,217	37,217
Change in non-admitted assets	1,632	89,483
Balance at December 31	<u>\$ 758,618</u>	<u>\$ 705,830</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Cash Flow

(In thousands)

	Year Ended December 31	
	2010	2009
Operating activities		
Premiums received	\$ 3,999,179	\$ 4,404,990
Health care benefits paid	(3,581,004)	(4,098,412)
General and claim adjustment expenses paid	(377,901)	(417,965)
Net investment income received	46,522	43,819
Net cash provided by (used in) operating activities	<u>86,796</u>	<u>(67,568)</u>
Investing activities		
Sales, maturities and redemptions of investments	824,362	267,210
Cost of investments acquired	(872,269)	(232,210)
Other miscellaneous (applications) proceeds	(2,974)	3,092
Net cash (used in) provided by investing activities	<u>(50,881)</u>	<u>38,092</u>
Financing or miscellaneous activities		
Other applications, net	(40,774)	5,442
Net cash used in financing or miscellaneous activities	<u>(40,774)</u>	<u>5,442</u>
Net decrease in cash, cash equivalents and short-term investments	(4,859)	(24,034)
Cash, cash equivalents and short-term investments:		
Beginning of year	61,885	85,919
End of year	<u>\$ 57,026</u>	<u>\$ 61,885</u>
Supplemental disclosure of cash flow information for non cash transaction in investing activities		
Transfer of certain assets associated with a software system to Core Administrative Systems, LLC II in exchange for a notes receivable	<u>\$ 1,206</u>	<u>\$ 67,279</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements

December 31, 2010

(Dollars in thousands)

1. Nature of Business

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue” or the “Company”), a wholly-controlled subsidiary of Blue Cross Blue Shield of Massachusetts, Inc. (“BCBSMA”), is a Massachusetts nonprofit corporation organized under Chapter 180 of the Massachusetts General Laws and holds a health maintenance organization license pursuant to Massachusetts General Laws Chapter 176G. HMO Blue and BCBSMA (collectively, the “Companies”) operate under common management and Board of Directors control. The Company provides hospitalization, medical and other health benefits to members through contracts with hospitals, participating physicians, skilled nursing facilities, nursing homes, and other health care providers and organizations. The Company offers a variety of HMO and other supplementary programs for the benefit of its members.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statement has been prepared in accordance with the National Association of Insurance Commissioners (“NAIC”) *Statements of Statutory Accounting Principles* (“SSAP”), and in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance (“DOI”), which practices differ from accounting principles generally accepted in the United States (“GAAP”).

The more significant variances from GAAP are as follows:

Investments: Investments in bonds and preferred stock are reported at amortized cost or fair value based on their NAIC rating; for GAAP, such fixed maturity investments are designated at purchase as trading and reported at fair value, with unrealized holding gains and losses reported in operations. Fair value for statutory purposes, as with GAAP, is based on quoted market prices while the fair value of private placements and credit tenant loans is obtained from independent third party dealers.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Effective September 30, 2009, the Company adopted SSAP No. 43R, *Loan-Backed and Structure Securities Revised*, superseding SSAP No. 98, *Treatment of Cash Flows When Qualifying Changes in Valuation and Impairments*. This revised guidance provides information on accounting for structured securities and beneficial interests with the primary impact related to other-than-temporary-impairments (“OTTI”). It requires the bifurcation of impairment losses into interest and noninterest related portions. The noninterest portion is the difference between the present value of cash flows expected to be collected from the security and the amortized cost basis of the security. The interest portion is the difference between the present value of cash flows expected to be collected from the security and its fair value at the balance sheet date.

If there is no intent to sell and the Company has the intent and the ability to retain the investment to recovery, then only the noninterest loss is recognized through earnings. However, if there is intent to sell or the Company does not have the intent and ability to hold the investment for a period of time sufficient to recover the amortized cost basis, the security must be written down to fair value and the loss recognized through earnings. The implementation of SSAP 43R did not have a material impact on the Company’s statutory basis financial statements.

For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., CMO, CBO, CDO, CLO, MBS and ABS securities), other than high credit quality securities, are adjusted using the prospective method when there is a change in estimated future cash flows. If it is determined that an other-than-temporary credit impairment has occurred, the amortized cost basis of the security is written down to the present value of estimated future cash flows using the original effective interest rate inherent in the security. If it is determined that a decline in fair value is other than temporary, the cost basis of the security is written down to fair value. If high credit quality securities are adjusted, the retrospective method is used.

Fair value of certain investments in bonds and stocks are based on values specified by the NAIC rather than on actual or estimated market values, and therefore, are not stated in accordance with GAAP.

Investments in real estate are reported net of related obligations rather than on a gross basis. Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset under GAAP, and investment income and operating expenses include rent for the Company’s occupancy of those properties.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Accrued investment income is defined as investment income earned as of the reporting date, but not contractually due to be paid to the Company until subsequent to the reporting date.

Non-admitted Assets: Certain assets designated as “non-admitted,” including furniture, fixtures and equipment, leasehold improvements, non-operating system software, prepaid expenses, certain premium receivable balances, and, other assets not specifically identified as an admitted asset within the SSAP, are excluded from the accompanying balance sheet and are charged directly to surplus. Under GAAP, such assets are included in the balance sheet.

Statement of Cash Flow: Cash, cash equivalents, and short-term investments in the statement of cash flow represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Use of Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statement and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Investments

Bonds not backed by loans are stated at amortized cost, with amortization calculated based on the scientific method, using lower of yield to call or yield to maturity. Prepayment assumptions for mortgage-backed securities and structured securities were obtained from broker-dealer survey values. These assumptions are consistent with the current interest rate and economic environment. The retrospective adjustment method is used to value all mortgage-backed securities.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Common stock is stated at fair values as determined by the NAIC Securities Valuation Office (“SVO”). The Company has various ownership interests in limited liability partnerships and limited liability companies. The Company carries these investments based on its ownership interest in the underlying GAAP equity of the investee. These investments are included as other invested assets on the balance sheets.

Unrealized gains and losses on common stock and other invested assets are reflected directly in surplus unless there is deemed to be an other-than-temporary decline in value, in which case the loss is charged to income. Realized gains and losses on investments sold are determined using the specific identification method and are included in income.

Amortization of bond premium and accretion of bond discount are recognized on a yield-basis method. Security transactions are accounted for on a trade-date basis, with any unsettled transactions recorded as due to or from investment broker and included as payable or receivable for securities in the Company’s admitted assets and liabilities, respectively.

Investment income is recognized as income when earned. The Company periodically reviews the portfolio of securities to determine whether an other-than-temporary impairment has occurred. Any identified other-than-temporary impairment is recorded as part of net realized investment gains or losses. Accrued investment income is defined as investment income earned as of the reporting date, but not legally due to be paid to the Company until subsequent to the reporting date.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less and are principally stated at amortized cost. Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at amortized cost.

Real Estate

Land is recorded at cost, and other real estate, which includes expenditures for significant improvements, is recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life (typically 50 years).

HMO Blue and BCBSMA jointly own land and buildings with 349,058 square feet of office space in Quincy, Massachusetts and 328,945 square feet of office space in Hingham, Massachusetts.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The components of the Company's real estate are summarized as follows:

	<u>2010</u>	<u>2009</u>
Land and buildings	\$ 115,218	\$ 114,692
Less accumulated depreciation	(9,213)	(7,079)
Net real estate occupied by the Company	<u>\$ 106,005</u>	<u>\$ 107,613</u>

Under statutory reporting guidelines, the Companies are required to calculate imputed rental income for owner-occupied real estate. The method for calculating imputed rental income is based on estimated rental rates of like property in the same area times rentable square feet. These imputed amounts are reported as net investment income and operating expense in the statements of income reflecting that the Company had recorded annual rent of \$6,062 in 2010 and \$6,917 in 2009.

Furniture, Equipment and Capitalized Software

The admitted value of the Company's electronic data processing equipment ("EDP") and operating software is limited to three percent of adjusted surplus. The Company's admitted portion is reported at cost, less accumulated depreciation.

The components of the Company's EDP and operating software are summarized as follows:

	<u>2010</u>	<u>2009</u>
EDP equipment and operating software	\$ 34,525	\$ 32,149
Less accumulated depreciation	(30,944)	(28,085)
Net EDP equipment and operating software	<u>\$ 3,581</u>	<u>\$ 4,064</u>

The Company calculates depreciation on furniture, equipment, and leasehold improvements and amortization of capitalized software using the straight-line method. Furniture and equipment is depreciated over the lesser of its useful life or ten years; leasehold improvements over the lesser of its useful life or the term of the lease; operating software over the lesser of its useful life or three years; and internally developed software over the lesser of its useful life or five years.

Depreciation and amortization expense charged to income in 2010 and 2009 was \$20,805 and \$30,058, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The Company continually evaluates the recoverability of long-lived assets by assessing whether the carrying amount of asset balances can be recovered as measured against the future undiscounted net cash flows expected to be generated by the assets. The future undiscounted net cash flows are based on historical trends, revenue forecasts, and market trends projected over the remaining life of the long-lived assets.

If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. HMO Blue did not have any impairment expense in 2010. The Company recorded \$17,637 of impairment expense in 2009 related to internally developed software.

Health Care Claim Reserves

The Company uses estimates for determining its claims incurred but not yet reported which are based on historical claim payment patterns, healthcare trends and membership, and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

Liabilities at any year end are continually reviewed and re-estimated as information regarding actual claims payments become known. This information is compared to the originally established year end liability.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate.

Accrued Medical Incentive Pool and Bonus Payments

Medical incentive pool and bonus accruals represent the liability for arrangements with health care providers and other risk sharing arrangements where the Company agrees to share savings with contracted providers.

Aggregate Policy Reserves

Aggregate policy reserves represent a reserve for unearned premium income, a reserve for rate credits, experience rating refunds and premium deficiency reserve.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Premium Deficiency

The Company evaluates its health care contracts to determine if it is probable that a loss will be incurred. A premium deficiency loss is recognized when it is probable that expected future paid claims, administrative expenses, and reserves will exceed existing reserves plus anticipated future premiums on existing contracts. Anticipated investment income and overhead expenses are also considered in the calculation of premium deficiency losses.

In early 2010, the Massachusetts DOI rejected the majority of the individual and small group premium rate increases filed by HMO Blue. An agreement was subsequently reached between DOI and the Company for the second, third and fourth quarters of 2010, which required the Company to accept rates lower than originally filed.

As of December 31, 2010, due to these deficient rates, HMO Blue recorded a \$27,000 premium deficiency reserve, which is included in aggregate policy reserves on the balance sheet. The Company did not record any premium deficiency reserves in 2009.

Premium

The Company receives premium revenue from insured business. Member premiums are billed in advance of their respective coverage periods. Premium receivables are recorded when due. Premium earned is recorded during the coverage period. Aggregate policy reserves are established to cover the unexpired portion of premiums written and are computed by pro-rata methods for direct business. Expenses incurred in connection with acquiring new insurance business, including acquisition costs such as sales commissions, are charged to administrative expenses as incurred. The premium paid by subscribers prior to the effective date is recorded in the balance sheet as premiums received in advance and subsequently credited to income as earned during the coverage period.

For uncollected premium, after the calculation of non-admitted amounts, an evaluation is made of the remaining admitted assets in accordance with SSAP No. 5, *Liabilities, Contingencies and Impairment of Assets*, to determine if there is a collectability issue. If it is probable that the balance is uncollectible, any uncollectible amount is written off and charged to income in the period the determination is made. In 2010 and 2009, the amount charged to income was \$3,329 and \$4,917, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Health Care Receivables

The Company enters into contractual agreements with various health care providers to provide certain medical services to its members. Compensation arrangements vary by provider. Certain providers have entered into risk-sharing arrangements with the Company, whereby a settlement is calculated by comparing actual medical claims experience to a pre-approved and predetermined budgeted amount. These settlements are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. Estimated settlements for these risk-sharing arrangements are reflected in health care receivables on the balance sheets.

Other amounts included in health care receivables represent pharmaceutical rebates, claims overpayments, advances to the providers and capitation arrangement receivables. Pharmaceutical rebates are arrangements with pharmaceutical companies negotiated by the Company's pharmacy benefit manager ("PBM"), in which the Company receives rebates based upon certain drug utilization of its subscribers. Claim overpayments occur as a result of several events, including, but not limited to, claim payments paid in error to a provider. The Company also makes advances to providers when those advances are supported by legally enforceable contracts and are generally entered into at the request of the providers. Advances to the providers under a capitation arrangement are usually made in anticipation of the future services, and used in connection with some managed care contracts, when a physician or other medical provider is paid a flat amount.

Fair Value of Financial Instruments

The fair value of investment securities is estimated based on NAIC quoted prices for those or similar investment securities. The carrying amounts of cash, cash equivalents and short-term investments approximate fair value because of the short maturity of these instruments.

Reclassification

Certain amounts for the year ended December 31, 2009 have been reclassified to be consistent with the presentation of the amounts for the year ended December 31, 2010.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments

Included in various investment related line items in the financial statements are certain financial instruments carried at statutory-basis NAIC fair value. NAIC fair values are based on quoted market prices when available. When market prices are not available, NAIC fair value is generally estimated by incorporating current market inputs for similar financial instruments. In instances where there is little or no market activity for the same or similar instruments, the Company estimates NAIC fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price.

The Company's statutory-basis financial assets and liabilities carried at NAIC fair value have been classified, for disclosure purposes, based on a hierarchy defined by SSAP No. 100, *Fair Value Measurement* ("SSAP 100"). The levels of the fair value hierarchy are as follows:

Level 1 – Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 – Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 – Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Investments in mutual funds are carried at estimated fair value based on quoted market prices and are recorded in the statutory-basis balance sheets as common stock. These assets include primarily actively-traded exchange-listed mutual funds identified as common stock. Unadjusted quoted prices for these securities are provided to the Company by independent pricing services. These investments are included within the scope of SSAP 100.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Level 3 recurring investments include holdings in real estate investment trusts (“REITs”) and other privately issued stock holdings. Fair values of the REIT holdings are provided to the Company by the trust manager either monthly or quarterly and are derived from limited observable inputs as a result of low transaction volume. The Company also holds privately issued common stocks that experience similarly low transaction volume. The Company obtains SVO prices for these investments quarterly and considers these prices to approximate of fair value.

Investments in partnerships and similar investments are recorded in the statutory-basis balance sheets as other invested assets. Other invested asset investments in subsidiary, controlled and affiliated entities are recorded using the statutory equity method. These investments are not included within the scope of SSAP 100.

Fair value measurements at December 31, 2010 and 2009:

Description	December 31, 2010			
	Level 1	Level 2	Level 3	Total
Assets at fair value				
Common stock - unaffiliated	\$ 137,120	\$ –	\$ 17,109	\$ 154,229
Common stock - affiliate	–	–	35	35
Total assets at fair value	\$ 137,120	\$ –	\$ 17,144	\$ 154,264

Description	December 31, 2009			
	Level 1	Level 2	Level 3	Total
Assets at fair value				
Common stock - unaffiliated	\$ 132,723	\$ –	\$ 12,101	\$ 144,824
Common stock - affiliate	–	–	15	15
Total assets at fair value	\$ 132,723	\$ –	\$ 12,116	\$ 144,839

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

Fair Value Measurements in Level 3:

	Balance at 01/01/2010	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2010
Common Stock	\$12,116	\$ -	\$ -	\$ -	\$ 4,886	\$ 142	\$ 17,144
Total	\$12,116	\$ -	\$ -	\$ -	\$ 4,886	\$ 142	\$ 17,144

	Balance at 01/01/2009	Transfers in (Level 3)	Transfers out (Level 3)	Total gain and (losses) included in Net income	Total gain and (losses) included in Surplus	Purchases, issuances, sales and settlements	Balance at 12/31/2009
Common Stock	\$ 30,928	\$ -	\$ -	\$ -	\$ (19,257)	\$ 445	\$ 12,116
Total	\$ 30,928	\$ -	\$ -	\$ -	\$ (19,257)	\$ 445	\$ 12,116

The cost or amortized cost, gross unrealized gains (losses), and NAIC fair value of cash and investments are as follows:

	December 31, 2010			NAIC Fair Value
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Cash, cash equivalents and short-term investments	\$ 57,026	\$ -	\$ -	\$ 57,026
Bonds:				
U.S. Government securities	168,647	3,409	(1,556)	170,500
Industrial and miscellaneous	183,483	6,829	(929)	189,383
Mortgage-backed securities	196,219	5,339	(1,028)	200,530
Total bonds	548,349	15,577	(3,513)	560,413
Common stock	150,161	7,800	(3,697)	154,264
Total cash and investments	\$ 755,536	\$ 23,377	\$ (7,210)	\$ 771,703

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

	December 31, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
Cash, cash equivalents and short-term investments	\$ 61,885	\$ –	\$ –	\$ 61,885
Bonds:				
U.S. Government securities	184,407	3,480	(644)	187,243
Industrial and miscellaneous	118,661	7,508	(432)	125,737
Mortgage-backed securities	187,713	6,270	(281)	193,702
Total bonds	490,781	17,258	(1,357)	506,682
Common stock	149,128	3,348	(7,637)	144,839
Total cash and investments	\$ 701,794	\$ 20,606	\$ (8,994)	\$ 713,406

At December 31, 2010 and 2009, the total cost or amortized cost includes \$118 and \$178 of bonds that are non-admitted due to a default or near default status.

Bonds include \$1,022 at December 31, 2010 and 2009, of securities which the Company had on deposit with regulatory agencies as required by M.G.L. c.176G, section 26.

The following tables show gross unrealized losses and fair values of fixed maturities and equities and length of time that individual securities have been in a continuous unrealized position.

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>		<u>Number of Securities</u>
	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>NAIC Fair Value</u>	<u>Gross Unrealized Losses</u>	
At December 31, 2010							
Bonds	\$ 161,244	\$ (3,226)	\$ 18,851	\$ (287)	\$ 180,095	\$(3,513)	258
Common stock	93,807	(3,568)	1,026	(129)	94,833	(3,697)	4
Total	\$ 255,051	\$(6,794)	\$ 19,877	\$ (416)	\$ 274,928	\$(7,210)	262

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

At December 31, 2009	Less than 12 months		12 months or more		Total		Number of Securities
	NAIC Fair Value	Gross Unrealized Losses	NAIC Fair Value	Gross Unrealized Losses	NAIC Fair Value	Gross Unrealized Losses	
Bonds	\$ 1,140	\$ (57)	\$ 102,490	\$ (1,300)	\$ 103,630	\$ (1,357)	127
Common stock	15,172	(1,143)	82,173	(6,494)	97,345	(7,637)	4
Total	<u>\$ 16,312</u>	<u>\$ (1,200)</u>	<u>\$ 184,663</u>	<u>\$ (7,794)</u>	<u>\$ 200,975</u>	<u>\$ (8,994)</u>	<u>131</u>

Management regularly reviews the fair value of the Company's investments. If the fair value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. To make this determination for each security, the following is considered:

- The length of time and the extent to which the fair value has been below cost.
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential.
- Volatility inherent in the asset class to which the investment belongs.
- Management's intent and ability to hold the respective fixed maturity security long enough for it to recover its value.

At December 31, 2010 and 2009, included in the Company's investments are unrealized losses deemed to be temporary. These investments reflect a range of industries, and the Company deems the current market volatility as temporary.

In 2010, there were no other-than-temporary impairment write downs. In 2009, there was a write-down of \$2,079 for preferred stock, \$26,452 for common stock and \$21,619 for other invested assets for declines in fair value determined by management to be other-than-temporary.

The amortized cost and NAIC fair value of debt securities at December 31, 2010, by stated maturity, are shown below. Fixed maturities subject to early or unscheduled prepayments have been included based upon their stated maturity dates. Actual maturities may differ from stated maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

3. Cash and Investments (continued)

	Cost or Amortized Cost	NAIC Fair Value
Within 1 year	\$ 21,095	\$ 21,952
After 1 year through 5 years	184,191	188,240
After 5 years through 10 years	122,836	124,963
After 10 years	220,227	225,258
Total bonds	<u>\$ 548,349</u>	<u>\$ 560,413</u>

Proceeds from the sale of debt securities were approximately \$688,351 and \$113,154 with realized gains on sales of \$16,653 and \$1,914 and realized losses of \$1,639 and \$8,436 for the years ended December 31, 2010 and 2009, respectively.

Major categories of net investment income are summarized as follows:

	Year ended December 31	
	2010	2009
Income:		
Bonds	\$ 19,390	\$ 20,432
Other invested assets	14,199	12,988
Common stock	10,338	9,482
Preferred stock	-	12
Real estate	6,062	6,917
Short-term investments and cash	188	223
Other miscellaneous	434	190
Total investment income	<u>50,611</u>	50,244
Less: Investment expenses	7,609	6,555
Depreciation	2,134	2,134
Net investment income	<u>\$ 40,868</u>	<u>\$ 41,555</u>

Gross realized investment gains and losses are as follows:

	2010	2009
Gross gains	\$ 22,950	\$ 3,195
Gross losses	(2,285)	(63,159)
Net realized investment gains (losses)	<u>\$ 20,665</u>	<u>\$ (59,964)</u>

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

4. Health Care Benefits

The Company's health care benefits, net of recoveries, is summarized in the reconciliation of the beginning and ending balances of claims payable, claims incurred but not yet reported and health care receivables as follows:

	<u>2010</u>	<u>2009</u>
Net balance at January 1	\$ 277,986	\$ 328,241
Incurred related to:		
Current year	3,546,807	4,014,456
Prior years	(16,014)	(29,170)
Total incurred	<u>3,530,793</u>	<u>3,985,286</u>
Paid related to:		
Current year	3,250,929	3,730,661
Prior years	262,473	304,880
Total paid	<u>3,513,402</u>	<u>4,035,541</u>
Net balance at December 31	<u>\$ 295,377</u>	<u>\$ 277,986</u>

Negative amounts reported for incurred related to prior years result from claims being settled for amounts less than originally estimated. The favorable development in medical claims payable for the years ended December 31, 2010 and 2009 is primarily attributable to actual claim payment patterns and cost trends differing from those assumed at the time the liability was established.

At December 31, 2010 and 2009, health care receivables include \$10,132 and \$8,317, respectively, of amounts that are non-admitted in accordance with SSAP No. 84, *Certain Health Care Receivables and Receivables Under Government Insured Plans*.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate at December 31, 2010 and 2009.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

4. Health Care Benefits (continued)

A reconciliation of incurred claims reported above to health care benefits in the Company's statements of income is as follows:

	December 31	
	2010	2009
Total incurred benefits per above	\$ 3,530,793	\$ 3,985,286
Medical incentive pool and bonus payments incurred	125,555	67,096
Health care benefits	<u>\$ 3,656,348</u>	<u>\$ 4,052,382</u>

Estimated subrogation credits of \$3,219 and \$2,946 were taken into account in determining health care benefits reserves as of December 31, 2010 and 2009, respectively.

5. Pension and Other Post-Retirement Benefit Plans

The pension and other post-retirement benefit plans ("Plans") are sponsored by BCBSMA and the associated costs are shared by the Companies. All employees are eligible to participate in BCBSMA's Retirement Income Trust Plan ("RIT"), which grants benefits to retired employees at various levels based on age and years of service. The plan was amended to provide employees hired after June 30, 2010 with a cash balance benefit. The December 31, 2010 obligations were not affected by this change, since there is a one year waiting period for plan participation. BCBSMA also participates in two noncontributory retirement plans for eligible employees. BCBSMA uses a December 31 measurement date for all of its plans. The Company is an active participating employer of the Plans. The Company's share of the net expense for the pension plan was \$10,156 and \$14,712 for 2010 and 2009, respectively and for other post-retirement benefits plans was \$3,632 and \$4,698 for 2010 and 2009, respectively.

BCBSMA also sponsors a defined benefit plan covering medical, life and dental benefits. The 401(h) account was instituted by BCBSMA in December 2003. The Companies made a 401(h) contribution of \$3,300 and \$14,000 in 2010 and 2009, respectively. BCBSMA also has a savings 401(k) plan for eligible employees. Under the employee savings plan, BCBSMA contributes an amount equal to 100% of employee contributions, up to a maximum of 4% of each employee's compensation, subject to pretax Internal Revenue Service limits. The Company's allocated costs for the 401(k) plan were \$3,100 and \$3,175 in 2010 and 2009, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

6. Income Taxes

The Company is reporting as an organization exempt from federal income taxes under Internal Revenue Code Section 501(c)(4), and is exempt from Massachusetts state income taxes. The Company is subject to tax on any income unrelated to its operations as a tax-exempt health maintenance organization. The amount of unrelated business income tax for the Company for both 2010 and 2009 was immaterial.

The Company would be required to adopt Accounting Standards Codification No. 740-10, *Income Taxes* (“ASC 740”, formerly FIN No. 48), *Accounting for Uncertainty in Income Taxes*, if it prepared GAAP-basis financial statements for the year ended December 31, 2010. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Similar guidance has not yet been adopted by the NAIC. If the Company were to adopt the guidance for statutory reporting purposes, it would have no impact on the financial statements.

The Company files income tax returns in the US federal jurisdiction. The Company’s open tax years are 2006 through 2010. The Company would recognize any interest and penalties resulting from ASC 740 in general and administrative expenses.

7. State Transferable Tax Credits

The General Laws of the Commonwealth of Massachusetts (the “Commonwealth”) provide film tax credits that apply to Massachusetts income and excise taxes relating to expenditures making motion pictures in the Commonwealth. These film tax credits are transferable and are, therefore, available through purchase to any taxpayer in the Commonwealth.

The Company estimates the utilization of any remaining unused state tax credits by projecting the annual premium tax liability taking into account policy growth and rate changes, projecting future premium tax liability based on projected premium, tax rates and tax credits, and comparing projected future tax liability to the availability of remaining tax credits.

As of December 31, 2010 and 2009 the carrying value of the Massachusetts tax credits gross of any related tax liabilities was \$7,617 and \$2,994, respectively. The Company did not have any unused Massachusetts tax credits as of December 31, 2010 and 2009.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

8. Surplus

The NAIC has imposed regulatory RBC requirements on health insurance companies, including the Company. The RBC calculation serves as a benchmark for the regulation of health insurance companies' solvency by state insurance regulators. At December 31, 2010 and 2009, the Company's total adjusted capital is in excess of the regulatory RBC requirements.

Chapter 141, which applies requirements of unfair insurance competition under Chapter 176D to HMOs and HMOs operated as a line of business, requires an HMO to have adjusted net worth of \$1,500 when initially licensed. Thereafter, an HMO must maintain a minimum adjusted net worth in an amount determined by the DOI based initially on a sliding scale over a seven-year phase-in period effective December 31, 2004. HMOs must maintain a minimum deposit of at least \$1,000 with a trustee acceptable to the DOI. The Company exceeded all regulatory Chapter 141 requirements at December 31, 2010 and 2009.

9. Permitted Statutory Accounting Practices

State insurance laws and regulations prescribe accounting practices for determining statutory net income and surplus for insurance companies. In addition, state regulators may permit statutory accounting practices that differ from prescribed practices. The Company had no permitted practices that would have an effect on statutory surplus at December 31, 2010 and 2009.

10. Related Party Transactions

HMO Blue and BCBSMA operate under common Board of Directors management and control. The Company participates in a bilateral inter-company agreement with BCBSMA to settle any claims, fees, administrative cost expense allocation and pass-through cash and expenses paid by one company on behalf of the other company.

As a condition of granting an HMO license to HMO Blue, the DOI required the Companies to enter into an agreement with the DOI granting the DOI discretionary authority to require either company to issue a surplus note to the other company if either of the company's health risk-based capital ("RBC") is significantly higher than the other company's RBC. Under the terms of its license with Blue Cross and Blue Shield Association, BCBSMA has also entered into a unilateral agreement with HMO Blue to guarantee all current and future financial obligations of HMO Blue.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

10. Related Party Transactions (continued)

Both BCBSMA and HMO Blue have an undivided interest in what had been BCBSMA's property and equipment. The initial basis of the property and equipment were systematically allocated to each company. Ongoing depreciation expenses are charged to each company based on utilization.

Existing employees of the Companies (the "Associates") are either concurrently employed by both BCBSMA and HMO Blue or solely employed by BCBSMA. Those individuals solely employed by BCBSMA include senior level management ("SLM"). The compensation, benefits and administrative expenses of the concurrently employed Associates are charged to BCBSMA and HMO Blue in accordance with their provision of services to each company.

With respect to individuals solely employed by BCBSMA, the pro rata portion of compensation, benefits and administrative expenses attributable to services provided to HMO Blue is charged to HMO Blue on an arm's length basis, including a mark-up. A common paymaster arrangement has been established for payroll and payroll related benefits. An agency arrangement has been established for payment of claims and operating expenses and receipt of funds.

The Companies' pension and post-retirement benefits plans (benefit plans) continue to be sponsored by BCBSMA and BCBSMA will continue to be liable for the benefit plans. BCBSMA charges HMO Blue, as a participating employer of the benefit plans, a fee based on HMO Blue's allocated share of the benefit plans' expenses.

The Company had a payable to BCBSMA of \$1,110 and \$35,929 as of December 31, 2010 and 2009, respectively.

Because of the significant related-party transactions with BCBSMA, the Company's financial condition and the results of operations may not necessarily be indicative of the financial condition or results of operations that would have occurred if the Company had been operated as an unaffiliated company.

In 2009, BCBSMA and HMO Blue management decided to manage the operation of the Blue Core administrative system ("Blue Core") by maintaining it in separate limited liability corporations named Core Administrative System I, LLC ("CASI") and Core Administrative System II, LLC ("CASII"). Given that Blue Core is jointly owned by BCBSMA and HMO Blue, a new separate wholly-owned and controlled LLC was created for each company.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

10. Related Party Transactions (continued)

On June 1, 2009, BCBSMA and HMO Blue each transferred its respective share of Blue Core to CASI and CASII in exchange for a 10-year note receivable in the amount of the net book value at the date of transfer. Each note accrues interest at a rate of four percent (4%) per year compounded daily and paid monthly. On the same date, BCBSMA and HMO Blue each entered into arms-length 10-year service agreements with CASI and CASII, respectively, for access to use of Blue Core.

On June 1, 2010, BCBSMA and HMO Blue each transferred its additional share of Blue Core to CASI and CASII in exchange for a 9-year note receivable in the amount of \$1,360 and \$1,206, respectively. Each note accrues interest at a rate of four percent (4%) per year compounded daily and paid monthly. On the same date, BCBSMA and HMO Blue each entered into additional arms-length 9-year service agreements with CASI and CASII, respectively, for access to use of the additional Blue Core assets.

In December, 2010, the Company recognized \$384 impairment write-offs of its investment in CASII, related to expired access and use of specific software modules. The Company's total service agreement payments to CASII were \$8,987 and \$5,186 in 2010 and 2009, respectively.

In 2008, BCBSMA and HMO Blue committed to invest \$20,000 in BlueCross BlueShield Ventures, Inc. (the "General Partner") and BlueCross BlueShield Venture Partners, L.P. (the "Partnership"), in form of purchase of 20 Class A shares of the General Partner and 17% limited interest in the Partnership in accordance with the Assignment and Assumption Agreement. BlueCross BlueShield Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield plans to invest in emerging companies that will bring greater innovation, efficiency, consumer-focus and transparency to healthcare. HMO Blue has contributed \$2,687; \$1,493 and \$575 in 2010, 2009 and 2008, respectively, to the Partnership. At December 31, 2010 and 2009, the Company had an outstanding contingent commitment for additional funding of \$5,145 and \$7,832, respectively, related to the future equity contributions in the Partnership.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

11. Retrospectively Rated Contracts and Contracts Subject to Redetermination

The Company receives premium payments from the Centers for Medicare & Medicaid Services (“CMS”) on monthly basis to provide comprehensive healthcare benefits for the Company’s insured Medicare members. Premiums are fixed during the contract period, however, are subject to retroactive risk adjustments based on submitted diagnosis data accepted by CMS throughout the year. The Company estimates retroactive risk adjustment revenue based on accepted data and its adjusted risk scores. This revenue is recognized when the amounts become determinable and collectivity is reasonably assured.

The amount of net premium written that is subject to retrospective rating features was \$361,433 and \$436,756 for the years ended December 31, 2010 and 2009, respectively, which represents approximately 9% of total premiums in each year. No other premiums written by the Company are subject to retrospective rating features.

12. Health Care Receivables

Amounts receivable for pharmaceutical rebates are estimated based on a per script calculation. Rebate amounts are typically paid on a quarterly basis 150 days after the end of each quarter. The Company’s pharmacy rebate receivable balances are as follows:

Quarter	Estimated Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Billed or Otherwise Confirmed	Actual Rebates Received within 90 days	Actual Rebates Received within 91 to 180 days	Actual Rebates Received within more than 180 days
12/31/2010	\$ 440	\$ 440	\$ –	\$ –	\$ –
9/30/2010	427	427	–	–	–
6/30/2010	641	534	–	474	46
3/31/2010	569	621	–	543	78
12/31/2009	464	725	–	674	51
9/30/2009	493	719	–	698	21
6/30/2009	529	701	–	623	78
3/31/2009	482	684	–	628	56
12/31/2008	451	428	–	428	–
9/30/2008	453	418	–	418	–
6/30/2008	464	446	–	446	–
3/31/2008	455	563	–	553	10

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

12. Health Care Receivables (continued)

The Company's risk sharing receivable balances are as follows:

Year	Evaluation Period Year Ending	Risk Sharing Receivable as Estimated in the Prior Year	Risk Sharing Receivable as Estimated in the Current Year	Risk Sharing Receivable Billed	Risk Sharing Receivable Not Yet Billed	Actual Risk Sharing Amounts Received in Year Billed	Actual Risk Sharing Amounts Received in First Year After	Actual Risk Sharing Amounts Received in Second Year After	Actual Risk Sharing Amounts Received – All Other
2010	2010	\$ 2,937	\$ 9,933	\$ 9,933	\$ –	\$ 9,767	\$ –	\$ –	\$ –
	2011	N/A	1,348	N/A	N/A	N/A	N/A	N/A	N/A
2009	2009	3,498	4,271	4,271	–	2,258	1,578	–	–
	2010	N/A	2,937	N/A	N/A	N/A	N/A	N/A	N/A
2008	2008	3,088	4,015	4,015	–	4,015	–	–	–
	2009	N/A	3,498	N/A	N/A	N/A	N/A	N/A	N/A

13. Leases

The Company and BCBSMA jointly have a long-term operating lease agreement for approximately 500,000 square feet of office space for its corporate headquarters. The term of the lease is 15 years, commencing in May 2000, with an option to extend for one period of four years and eleven months.

The Company and BCBSMA jointly entered into several other long-term, non-cancelable operating lease agreements for office space and equipment that expire at various dates through 2016. The Company recorded rental expense of approximately \$13,226 and \$10,799 for 2010 and 2009, respectively.

At December 31, 2010, allocated minimum rental commitments on significant non-cancelable operating leases for the Company are as follows:

2011	\$ 13,837
2012	9,082
2013	8,442
2014	7,974
2015	3,412
Thereafter	167

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

13. Leases (continued)

The Companies have an agreement with an outside vendor to provide certain information technology (“IT”) services for a significant portion of the Companies’ business operations. The Companies’ minimum commitments under this agreement are approximately \$75,885 with the amount decreasing each year until completion of the contract in September 2015.

In 2009, the Companies’ management decided to change the IT services provider. As of December 31, 2009, in accordance with SSAP 5, HMO Blue recorded a \$9,250 contingency reserve related to the termination fees of the agreement with its current vendor. In 2010, the Company transferred its IT services to the new provider, paid termination fees of \$8,639 to the old vendor and reversed the remainder of the contingency reserve.

14. Revolving Line of Credit

The Companies jointly entered into two revolving credit agreements. Borrowings under these lines of credit bear interest on a fixed or floating interest rate basis. These facilities are unsecured and one facility for \$100,000, which matured in June, 2010, has been renewed until June, 2011 and the second facility, which matured in October, 2010, has been renewed for \$50,000 until June, 2011.

At December 31, 2010, the Company had no principal amounts outstanding under these facilities, accrued interest of \$2 calculated at 2.24% and accrued fees of \$8 calculated at 0.12%. During the year the Company incurred \$533 of interest on these facilities. There were no amounts outstanding under these facilities at December 31, 2009.

15. Commitments and Contingencies

The Company is involved in pending and threatened litigation of the character incidental to its business or arising out of its insurance operations, and is, from time to time, involved as a party in various governmental and administrative proceedings. Management continues to monitor these matters, and believes the Company has accrued adequate reserves against potential liabilities.

16. Subsequent Events

The Company’s management evaluated the subsequent events through April 25, 2011, the date the financial statements were available to be issued.