

**Utah Insurance Department
Examination Division**

Report of Financial Examination

Regence BlueCross BlueShield of Utah

Examination as of December 31, 2001



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July 25, 2003

Honorable Merwin U. Stewart
Insurance Commissioner
State of Utah Insurance Department
3110 State Office Building
Salt Lake City, Utah 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2001, has been made of the financial condition and business affairs of:

REGENCE BLUECROSS BLUESHIELD OF UTAH

Salt Lake City, Utah

a nonprofit corporation providing hospital, medical-surgical, dental and other health service benefits hereinafter referred to as the "Company." The following report of examination is respectfully submitted.

Scope of Examination

Period Covered by Examination

Representatives of the State of Utah Insurance Department previously examined the Company as of December 31, 1998. This examination covers the period from January 1, 1999, through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Examination Procedures Employed

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2001. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations.

Status of Adverse Findings Disclosed by the Previous Examination

Items of significance commented on in the prior examination report were resolved during the current examination period or have been disclosed in the "Summary" section of this report.

History

General

Blue Cross of Utah was originally organized as Intermountain Hospital Service Plan, a nonprofit corporation, on December 22, 1944. Effective October 15, 1965, the name was changed to Blue Cross of Utah.

Blue Shield of Utah was organized as Medical Service Bureau of the State Medical Association, Inc., a nonprofit corporation, on February 21, 1935. The corporation was inactive until August 16, 1946. Effective September 22, 1966, the name was changed to Blue Shield of Utah.

Effective January 1, 1982, Blue Cross of Utah and Blue Shield of Utah were merged and consolidated into a nonprofit health service corporation, organized with authority to do business pursuant to Utah Code Ann. (UCA) Title 31A, Chapter 7, with the name "Blue Cross and Blue Shield of Utah."

By order of the Insurance Commissioner of the State of Utah, granted pursuant to UCA Section 31A-16-103, the Company affiliated with The Regence Group (TRG), a nonprofit holding company, effective December 22, 1997. The name of the Company was changed to Regence BlueCross BlueShield of Utah.

The Board of Directors (the Board) approved and adopted amendments to the Articles of Incorporation (the "Articles") on three separate occasions during the three years ended December 31, 2001. UCA Subsection 31A-5-219(2) states:

An amendment becomes effective when the commissioner approves the properly adopted and filed articles of amendment.

The Company failed to comply with UCA Subsection 31A-5-219(2) as follows:

- A copy of the Articles identified as "Amended and Restated Articles of Incorporation for changes adopted by the Board on March 25, 1999," was received by the Utah Insurance Department (the "Department") on October 29, 1999. Articles of Amendment, which did not accompany the filing, were requested on behalf of the Department by letter dated June 9, 2000. The Company failed to respond to this request. Subsequently the Articles were not approved.
- Articles of Amendment for the changes adopted by the Board on June 22, 2000 have not been filed with or approved by the Department.
- Articles of Amendment for the change adopted by the Board on September 14, 2000, and a copy of the Articles identified, as "Amended and Restated Articles of Incorporation," were not filed with the Department until August 2002. The Articles of Amendment reflected only the change adopted on September 14, 2002 accordingly, the amendments for changes adopted by the Board on March 25, 1999, and June 22, 2000, have not been approved by the Commissioner.

Amended and Restated Bylaws (the "Bylaws") dated March 25, 1999, June 22, 2000, and September 20, 2001, were prepared to incorporate changes adopted by the Board on March 25, 1999, March 23, 2000, June 22, 2000, and September 20, 2001. The Bylaws were not filed as required by UCA Subsection 31A-5-203(4) which, states in part:

...A copy of the bylaws, and any amendments to them, shall be filed with the commissioner within 60 days after their adoption.

Capital Stock

The Company has no capital stock.

Dividends to Stockholders

The Company has no stockholders.

Management

Pursuant to the Company's Articles of Incorporation and Bylaws, the control and management of the affairs and business of the Corporation shall be vested in a Board of Directors (the "Board") consisting of not less than twelve (12) nor more than eighteen (18) Directors. The Board shall be comprised of: the Chief Executive Officer of the Corporation; at least one (1) member of the Board of Directors of The Regence Group (TRG); and members of the public who are not Health Care Providers. A majority of the Board shall be residents of the State of Utah. The Board elects Directors for three-year terms. A majority of the Directors present at any meeting constitute a quorum. Actions by a quorum constitute the action of the Board.

Officers of the Corporation elected by the Board are: Chairman of the Board of Directors; Vice Chairman of the Board of Directors; Chief Executive Officer; President; Secretary; Treasurer; Assistant Treasurer; and Assistant Secretary. The Chief Executive Officer may, with the approval of the Board, appoint additional officer positions as deemed necessary.

Board of Directors serving as of December 31, 2001, were as follows:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Dan Lynn Chichester, M.D. Salt Lake City, Utah	Independent Practicing Physician Gynecology
George Henry Emert Logan, Utah	President Utah State University
Howard Reese Hansen, Esq. Provo, Utah	Dean and Professor of Law J. Reuben Clark Law School Brigham Young University

Gary Edward Meredith
Salt Lake City, Utah

Consultant
Evans & Sutherland

Jed H. Pitcher
Salt Lake City, Utah

Chairman of the Board of Directors of
Regence BlueCross BlueShield of Utah and
Chief Operating Officer of The Regence Group

Stephen Fred Beck
Providence, Utah

Chief Financial Officer
ICON Health & Fitness, Inc.

Kay W. Lipman
Ogden, Utah

Civic Volunteer

Robert Allen Hatch
Bountiful, Utah

President
Community Banking Group
First Security Bank, N.A.

Thomas Hugh Caine, M.D.
Salt Lake City, Utah

Internal Medicine
University of Utah Medical Center

J. Michael Gwartney
Eagle, Idaho

President
Political Consultants, Ltd.

Donald Benson Holbrook
Salt Lake City, Utah

Jones, Waldo, Holbrook & McDonough
Retired

Shelley Thomas
Salt Lake City, Utah

Senior Vice President
Salt Lake Organizing Committee

Richard L. Woolworth
Lake Oswego, Oregon

Chairman and Chief Executive Officer
The Regence Group

Christopher Patrick Hill
Salt Lake City, Utah

Special Assistant to President
Director of Athletics
University of Utah

Mark R. Stoddard
Nephi, Utah

President, Rural Health Management Corp.

D. Kurt Seppi, M.D.
Twin Falls, Idaho

Physician
Private Practice

E. John Ruch
Salt Lake City, Utah

President and Chief Executive Officer of
Regence BlueCross BlueShield of Utah and
Regence BlueShield of Idaho

Officers serving as of December 31, 2001, were as follows:

Elected by the Board of Directors:

<u>Name</u>	<u>Office</u>
Jed H. Pitcher	Chairman of the Board
Robert A. Hatch	Vice Chairman of the Board
E. John Ruch	President and Chief Executive Officer
John A. Riherd	Vice President and Secretary
Thomas W. Colosimo	Vice President and Treasurer

Appointed by the Board of Directors:

<u>Name</u>	<u>Office</u>
Michael N. Mitchell	Senior Vice President and Assistant Secretary
J. Kevin Bischoff	Vice President
James Verdick	Vice-President
Robert David Shaffer	Vice-President
D. Scott Ideson	Senior Vice President
John M. Rusche, M.D.	Senior Vice President
Donald E. Smith	Senior Vice President
Robert E. Johnston	Vice President
Philip L. Bryson, M.D.	Vice President
Teresa L. Rivera	Vice President
Mark P. Stimpson	Vice President
Geoffrey S. Irvin	Vice President
Paul D. Jelenik	Vice President

Committees of the Board of Directors December 31, 2001:

Executive

Robert A. Hatch, Chairman
S. Fred Beck, Vice Chairman
H. Reese Hansen
Jed H. Pitcher
Donald B. Holbrook
Gary E. Meredith

Provider Affairs

Dan L. Chichester, M.D., Chairman
D. Kurt Seppi, M.D., Vice Chairman
Thomas H. Caine
Mark R. Stoddard
Shelley Thomas

Marketing and Communications

Shelley Thomas, Chairman
George H. Emert, Vice Chairman
J. Michael Gwartney
Christopher P. Hill
D. Kurt Seppi, M.D.
Kay W. Lipman
Jed H. Pitcher

Audit and Compliance

Gary E. Meredith, Chairman
H. Reese Hansen, Vice Chairman
George H. Emert
J. Michael Gwartney
Robert A. Hatch
Kay W. Lipman
S. Fred Beck

Compensation

Donald B. Holbrook, Chairman
S. Fred Beck, Vice Chairman
Dan L. Chichester, M.D.
Shelley Thomas
Robert A. Hatch

Nominating

Richard L. Woolworth, Chairman
Jed H. Pitcher, Vice Chairman
Howard Reese Hansen
Robert A. Hatch
Mark R. Stoddard

UCA Subsection 31A-5-410(1)(a) states: "The name of a person selected as a director or principal officer of a corporation, together with pertinent biographical and other data the commissioner requires by rule, shall be reported to the commissioner immediately after the selection."

During the three years ended December 31, 2001, seven (7) individuals were selected as a director or elected as a principal officer of the Company. Biographical affidavits from these individuals were provided to the commissioner but not immediately as required.

Conflict of Interest Procedure

Bylaws adopted by the Company, require that members of the board of directors provide annual conflict of interest statements to the company. The Code of Business Conduct adopted by the Company in 2002 extends the requirement to officers of the corporation. The Company has adopted a policy that extends the requirement to all employees. Procedures are in place for obtaining conflict of interest statements as required.

Corporate Records

Company transactions and events are approved and supported by minutes of meetings of the Board of Directors and Committees.

The directors of the Company reviewed the previous examination report.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales Through Reinsurance

Pursuant to the resolution made by the Board of Directors on March 25, 1999, the Company exchanged its interest in a life insurance agency operation. Consideration for the exchange was an 11.73 % share of the common stock of Regence Life and Health Insurance Company ("RLHIC"), a wholly owned subsidiary of Regence BlueCross BlueShield of Oregon, an affiliate of the Company. Based on an evaluation performed by the Company's independent auditor, the fair market value of the life insurance agency operation was established at \$3,328,526, as of December 31, 1999, the value, determined in accordance with instructions from the Accounting Practices and Procedures Manual of the Securities Valuation Office and National Association of Insurance Commissioners (NAIC), of the Company's investment in the shares of the common stock of RLHIC was \$2,207,523.

This transaction was not disclosed in Schedule Y, Part 2 or in the Notes To Financial Statements of the Annual Statement for the year ended December 31, 1999, as is required by the Annual Statement Instructions of the NAIC, as required by UCA 31A-4-113(1) which, provides in part:

(a) Each authorized insurer shall annually, on or before March 1, file with the commissioner a true statement of its financial condition, transactions, and affairs as of December 31 of the preceding year.

(b) The statement required by Subsection (1)(a) shall be:

- (i) verified by the oaths of at least two of the insurer's principal officers; and
- (ii) in the general form and provide the information as prescribed by the commissioner by rule.

Utah Administrative Code (UAC) R590-147-4. (1) provides:

All insurers shall file their annual statement with the department on the form adopted by the National Association of Insurance Commissioners ("NAIC"). The statement shall be prepared in accordance with the latest edition of the annual statement instructions, and the accounting practices and procedures manual published by the NAIC. Annual statement filings are not complete until all supplemental schedules; exhibits and documents are filed as required by the instructions or as otherwise indicated by this rule.

Surplus Debentures

The Company has not issued surplus debentures.

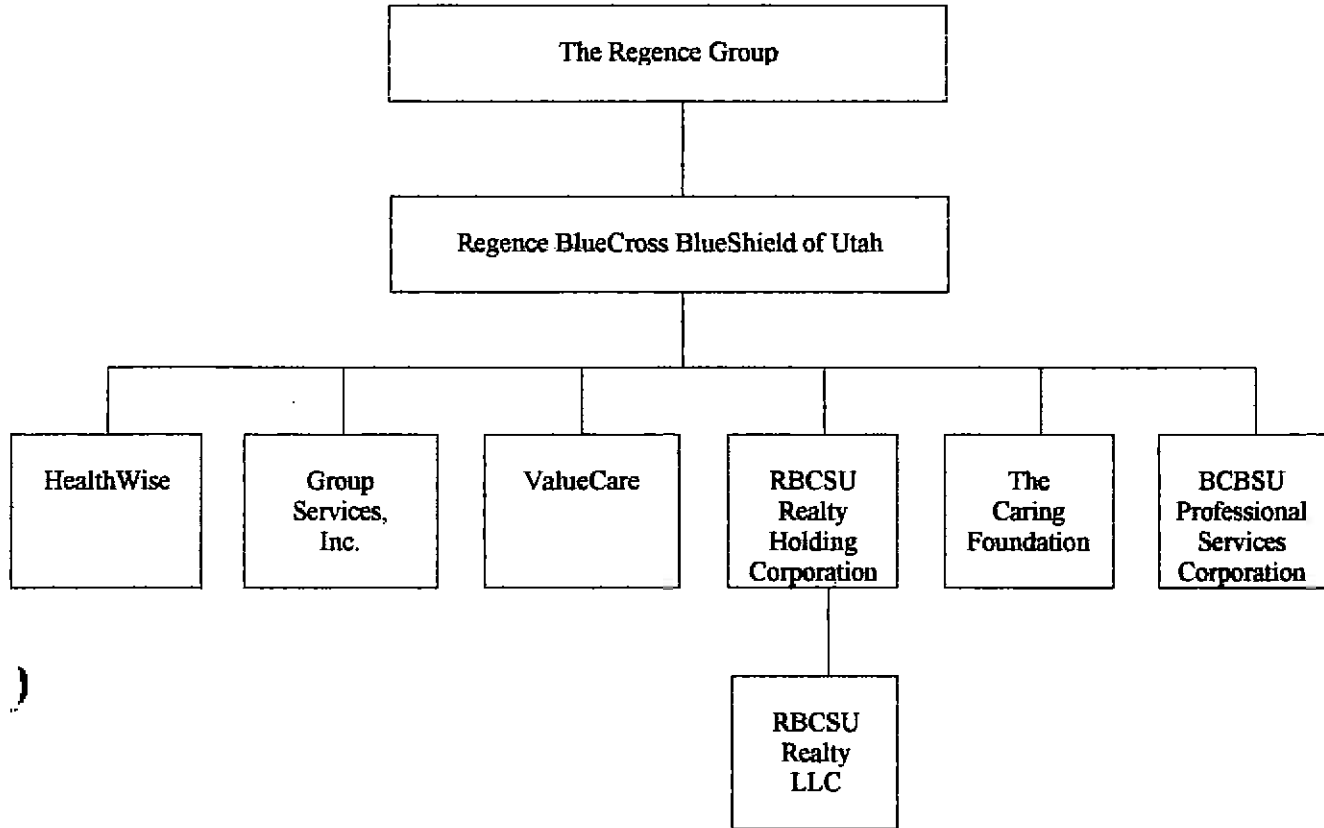
Affiliated Companies

By order of the Insurance Commissioner of the State of Utah, granted pursuant to UCA Section 31A-16-103 and effective December 22, 1997, the Company was allowed to affiliate with The Regence Group (TRG), a nonprofit holding company organized as a nonprofit corporation in the State of Oregon. Regence BlueCross BlueShield of Oregon ("RCBSO"), Regence BlueShield ("RBS") and Regence BlueShield of Idaho, Inc. ("RBSI") are members of TRG. TRG is the sole member of the Company, RCBSO, and RBS pursuant to a Plan and Agreement of Affiliation, effective July 28, 1997, and has a long-term management services agreement with RBSI.

As discussed above under the caption "Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales Through Reinsurance" The Company holds shares of the common stock of RLHIC, a subsidiary of RBCSO.

As "sole member", TRG has authority to approve or disapprove elections to the governing board of the Company and to discharge members of its governing board at any time, with or without cause. Further, the "sole member" has approval authority over actions of the board going to such fundamental matters as merger, dissolution, or sales not in the ordinary course of business.

The holding company organization chart, modified to exclude the entities: Regence BlueCross BlueShield of Oregon, Regence BlueShield and Regence BlueShield of Idaho, Inc., and the respective wholly owned subsidiaries and affiliates of each, is set forth below.



The Company pays expenses on behalf of TRG, its subsidiaries and affiliates. Administrative costs allocated to TRG were \$3,430,000 for the year ended December 31, 2001. Administrative costs incurred by TRG are allocated to the Company. TRG pays expenses on behalf of the Company, its subsidiaries and affiliates. Amounts allocated from TRG were \$33,303,000, for the year ended December 31, 2001.

These transactions were conducted pursuant to agreements between the parties, however they were not disclosed in Schedule Y, Part 2 of the Annual Statement for the year ended December 31, 2001, as is required by the Annual Statement Instructions of the NAIC.

TRG has instituted a program for the development of software for systems to be implemented by its affiliates for operating purposes. These systems will be owned jointly by the affiliated Plans. Development costs allocated to and paid by the Company during the years ended December 31, 1999, 2000, and 2001 were \$395,000, \$2,952,000, and \$14,688,000, respectively.

These transactions, were approved by the Company's Board of Directors, however they were not disclosed in Schedule Y, Part 2 of the Annual Statements for the years ended December 31, 1999, 2000, and 2001, as is required by the Annual Statement Instructions of the NAIC.

The Company pays expenses in behalf of its subsidiaries. The Company allocated \$5,677,000 in operating expense to Healthwise and \$929,000 to its other subsidiaries during the year ended December 31, 2001. These transactions were pursuant to agreements between the parties.

Fidelity Bond And Other Insurance

As of December 31, 2001, the Company's insurance program included \$5,000,000 of fidelity bond coverage, which is in excess of the minimum amount suggested by the National Association of Insurance Commissioners. In addition the program provides coverage for the risk of loss to its property or liability from operations.

Pension, Stock Ownership, and Insurance Plans

The Company participates in The Regence Group's Choices Benefits Program (The "Choices Program"). The Choice Program, a cafeteria plan qualified under Internal Revenue Service rules, provides employees with benefits for medical and dental, employee and family life insurance with AD&D, short-term and long-term disability, medical reimbursement accounts, and legal and financial services. Regular full-time employees, part-time employees regularly scheduled to work at least 20 hours per week, and eligible family members are eligible to enroll. The Choice Program benefits are typically 40% of an employee's total compensation. Cost of benefit elections in excess of benefit dollars provided are deducted from the employee's pre-tax compensation. Programs for leave of absence, paid time off, extended illness, and severance pay are available.

The Company participates in The Regence Group Retirement Plan (the "Plan"). The Plan is a defined benefit pension plan funded by the Company. All employees, including new employees who work at least 1,000 hours during the first calendar year of employment, are covered. The Company accrues in accordance with actuarially determined amounts.

The Company provides postretirement health care and life insurance for retired employees. Individuals may continue medical and dental coverage for themselves and eligible family members when retiring immediately from the Company at age 55 or older and having at least 10 years of continuous employment during the period ending on the last date of active service. Premiums for health care are based on plan costs. The Company shares the cost of retiree health coverage based on the retiree's age and years of service at retirement. Life insurance coverage is provided in the amount of \$10,000 with premiums paid by the Company.

The Company provides a supplemental retirement plan to cover key employees meeting certain eligibility requirements. The Company has not funded the plan.

The Company provides an Employee Savings Plan 401(k) in which the Company will match employee contributions up to 50% of the first 6% of salary.

The Company offers a non-qualified deferred compensation program to certain key employee whereby the employee may defer a portion of compensation. The Company has also adopted a Directors' Deferred Compensation Plan, which permits non-employee directors to receive their fees and retainers as members of the Board of Directors and committees of the Board in form other than as direct payments.

Provision for obligations of the Company under such plans was included in the financial statements.

Statutory Deposit

Utah Code Ann. (UCA) Section 31A-4-105 requires that domestic insurers maintain a deposit under Section 31A-2-206 in the amount of the insurer's, in this case, permanent surplus. Permanent surplus requirements are included in Section 31A-5-211. The Company's required deposit is \$400,000. As of December 31, 2001, the Company reported that securities having statement value of \$567,587 were on deposit with the Utah Insurance Department (Department). The securities on deposit as of the same date, as reflected by the records of the Department, fulfilled the minimum required amount but were substantially different in content and amount. The differences occurred as a result of the issue discussed below.

On March 8, 1990, the Company, Wells Fargo Bank (the "Bank"), and the Insurance Commissioner for the State of Utah, jointly executed a State of Utah Insurance Department Tri-Party Agreement designating the Bank as custodian (the "Agreement"). During the period under examination, the Company and the Bank failed to comply with the terms of the Agreement as well as the requirements of Subsections 31A-2-206(6) and (10) related to depositing or withdrawing securities. It is recommended that the Company implement appropriate procedures that will insure compliance with the terms of the Agreement and statutory requirements.

Insurance Products and Related Practices

Policy Forms and Underwriting

The Company makes a variety of policy forms available to subscribers. The policy forms vary in terms, benefits, deductibles, co-payment amounts and exclusions. The majority of the forms are in the comprehensive major medical product line that can be tailored to meet the requirements of the subscribing employer. Forms are available for other product lines, but the subscriber must choose from the forms offered rather than have the program tailored to meet the subscriber's requirements. In addition, forms are available for dental coverage. Product lines are set forth below.

Subscriber	Medical	HMO	Dental
Large Group (51 and over)	Blue Cross Blue Shield of Utah ValueCare Blue Net HealthPoint	Healthwise HMO Blue	Blue Cross Blue Shield of Utah ValueCare DentalWise
Small Group (1-50)	Blue Cross Blue Shield of Utah ValueCare Blue Net HealthPoint	Healthwise HMO Blue	Blue Cross Blue Shield of Utah ValueCare DentalWise
Individual	Blue Cross Blues Shield of Utah (Qualifier) ValueCare (250/500 deductible) ValueCare Premier Interim Plus Medicare Supplement		
Uninsurable	Health Insurance Pool		
Federal	Federal Employees Program		
Medicare	Process Medicare Claims		

HealthWise, a wholly owned subsidiary of the Company is a federally qualified health maintenance organization, providing managed care on a fee-for-service basis. HMOBlue, a separate line of business under HealthWise, currently provides managed care on a fee-for-service basis, but ultimately on a capitation basis. ValueCare, a wholly owned subsidiary of the Company, is a preferred provider organization. BlueNet is a managed care plan developed specifically for a single employer. HealthPoint is a point of service product with a swing out option. InterimPlus is a limited benefit, short-term policy for use by employees during enrollment waiting periods. DentalWise is a fully capitated dental maintenance organization.

The Company, acting as administrator, performs administrative services for self-funded health plans. The self-funded plans may be entirely uninsured or partially insured. The plan sponsor bears all of the insurance risk for the uninsured plan. A partially insured allows the plan sponsor to shift excess losses to the administrator. The plan is an Administrative Services Contract (ASC) plan. Under an ASC plan, the administrator pays claims from its own bank accounts, and only subsequently receives reimbursement from the plan sponsor. For statutory financial reporting, the Company excludes the assets and liabilities related to uninsured plans and the plan sponsors share of partially insured self-funded plans and treats administrative fees as a reduction of administrative expenses.

Separate rates apply for large groups, small groups, individuals and self-funded partially insured plans.

The Company retains the first \$300,000 of a loss or losses incurred on any member. The excess, subject to maximums, is reinsured. The reinsurance program is discussed in more detail under the caption "Reinsurance."

Territory and Plan of Operation

The Company holds a certificate of authority, which allows it to transact nonprofit health service insurance in the State of Utah and has the authority to conduct administrative services in the State of Idaho.

The Company acquires the majority of its group and individual business using the agency system. The agency force consists of employees licensed as agents and independent, non-employee agents. Sales by employee agents are conducted from facilities at the home office and at three district offices.

Advertising and Sales Material

The advertising campaign and development of sales material are under the direction of the Company. An advertising agency produces the advertising program. Current advertising files are maintained at the Company. Historical files are maintained at the advertising agency. The Company advertises on local television and in local newspapers as well as other media.

Treatment of Policyholders

The Company maintains a consumer complaints register and claims appeal register on a consolidated basis with HealthWise, a wholly owned subsidiary. Complaints filed with the Utah Insurance Department were reviewed with no exceptions noted. Appeals of claims were resolved timely and in accordance with procedures contained in the Appeals Procedure manual.

Reinsurance and Risk Transfer

The Company assumes risk from Healthwise, a wholly owned subsidiary. Risk assumed provides benefit coverage (excluding dental) for a member's aggregate claims for incurred services exceeding \$50,000 per calendar year.

As of December 31, 2001, a reinsurance treaty between the Company and Employer's Reinsurance Corporation ("ERC") was in effect. The Company's retention, ERC's lifetime limit, and the reinsurance premium rates are as follows:

Group	Retention	Lifetime Limit	Premium Per Subscriber
Healthwise HMO Option	\$300,000	\$1,700,000	\$1.49
Kennecott Holdings Corp	500,000	1,500,000	.74
Administration Service Contract Only Stop-Loss Business	300,000	700,000	1.37
All Other Plans	300,000	700,000	1.37

Paragraph 17 of Statement of Statutory Accounting Principles ("SSAP") No. 61, contained in the Accounting Practices and Procedures Manual, published by the National Association of Insurance Commissioners provides in part: "Reinsurance agreements must transfer risk from the ceding company to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement. If the terms of the agreement violate the risk transfer criteria contained herein, (i.e., limits or diminishes the transfer of risk by the ceding company to the reinsure), the agreement shall follow the guidance for Deposit Accounting."

Pursuant to the terms of the reinsurance treaty, ERC's liability, for any contract year, is limited to 90 percent of the reinsurance premium paid by the Company for that year. As a result, risk is not transferred from the Company to ERC. The Company does not claim credit for reinsurance as a reduction of liability for unpaid claims and in general has followed the guidance for Deposit Accounting in reporting transactions resulting from the reinsurance treaty with ERC.

Accounts and Records

The Company utilizes an electronic data processing and information system for purposes of recording data related to contractual obligations and financial transactions. This data provides the basis from which the various reports needed for operations are developed. Journals, registers, statistical records and other reports summarizing the financial transactions from operations are prepared daily as a function of recording data. After review, the summary amounts from the journals, registers and reports are recorded on a general ledger by journal entry. General ledger account balances are reconciled to supporting data monthly. The general ledger provides the basic elements required for financial reporting.

As a result of financial examination conducted, by the Utah Insurance Department, of a wholly owned subsidiary, the Company was made aware of a deficiency in its accounting system. Because of the deficiency certain amounts of premium, collected by the Company in behalf of the subsidiary, had not been remitted to the subsidiary. Based on the Company's estimate, this resulted in generating an additional amount due the subsidiary of approximately \$1,600,000 as of December 31, 2001. The adjustment for this does not impact the Company's surplus. Accordingly, the change was not made for purposes of the current examination.

The Company utilizes Mellon Bank, N.A. ("Mellon") and Wells Fargo Bank Northwest, N.A. (formerly First Security Bank of Utah, N.A.) ("Wells Fargo") as custodian of any investment securities not held in the Company's own name or issued in bearer form. In addition to custodial duties, Mellon tracks and accounts for the securities it holds as well as the securities held by Wells Fargo. Investment transactions are recorded to the general ledger from monthly reports provided by Mellon and reconciled by the Company. Investment data required for quarterly and annual reporting purposes is downloaded from Mellon.

Seven agreements with subscribers for the provision of health benefits were randomly selected for review. The subscriber had not signed five of the seven agreements. It was

) determined that, in most cases, agreements are not signed and returned to the company. It is noted that the Company, as described in Internal Audit Report dated July 2001, does not have a system for tracking the return.

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Financial Statements

The following financial statements were prepared from the Company's accounting records and the valuations and determinations made during the examination:

Balance Sheet as of December 31, 2001

Statement of Revenue and Expenses for the Twelve Months Ended December 31, 2001

Statement of Capital and Surplus for the Three Years Ended December 31, 2001

The accompanying Notes to Financial Statements are an integral part of the Financial Statements.

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The Regence BlueCross BlueShield of Utah
 Balance Sheet
 As of December 31, 2001

	<u>Assets</u>	<u>Notes</u>
Bonds	\$ 58,420,878	(1)
Stocks:		
Preferred	1,308,887	
Common	78,758,280	
Real estate, net of encumbrances	10,777,962	
Cash	5,045,902	(2)
Short-term investments	11,790,502	
Other long-term investments	9,767,515	
Receivable for securities	89,757	
Subsidiary equity in investment pool	<u>(6,126,363)</u>	
Total cash and invested assets	169,833,320	
Accident and health premiums due and unpaid	46,482,399	
Investment income due and accrued	1,228,880	(3)
Amounts due from affiliates	737,850	
Amounts receivable relating to uninsured accident and health plans	10,955,264	
Federal income tax recoverable	5,862,673	(4)
Electronic data processing equipment and software	1,608,408	(5)
Other assets	<u>426,484</u>	(6)
Total assets	<u>\$ 237,135,278</u>	

The Regence BlueCross BlueShield of Utah
 Balance Sheet
 As of December 31, 2001

Liabilities

		<u>Notes</u>
Claims unpaid	\$ 66,002,459	(7)
Unpaid claims adjustment expenses	2,345,000	
Aggregate policy reserves	229,514	
Premiums received in advance	11,835,477	
General expenses due or accrued	7,572,653	
Federal income tax payable	2,976,659	
Amounts withheld or retained for the for the account of others	6,989,436	(8)
Amounts due to parent, subsidiaries and affiliates	1,725,977	
Payable for Securities	178,480	
Funds held under reinsurance treaties with authorized reinsurers	139,767	
Postretirement benefits	13,814,358	
Experience Rating Refunds	21,166,613	
Capital lease obligations	2,358,337	
Deposits	1,141,492	
Retrospective premiums	<u>123,551</u>	
 Total liabilities	 138,599,773	

Capital And Surplus

Unassigned funds (surplus)	<u>98,535,505</u>	(9), (10)
 Total liabilities, capital and surplus	 <u>\$ 237,135,278</u>	

The Regence BlueCross BlueShield of Utah
Statement of Revenue and Expenses
For the Twelve Months Ended December 31, 2001

Member Months		2,899,841
		<hr/>
Premium Revenue	\$	452,091,668
		<hr/>
Underwriting Deductions:		
Medical and Hospital Benefits		371,750,465
Claims Adjustment Expenses		17,564,741
General and Administrative Expenses		52,307,149
		<hr/>
Total Expenses		441,622,355
		<hr/>
Underwriting Income		10,469,313
Investment Income (Loss):		
Net Investment Income		10,187,343
Net Realized Capital Gain (Loss)		(1,252,097)
		<hr/>
Total Investment Income (Loss)		8,935,246
		<hr/>
Other Income (Expense)		240,745
		<hr/>
Net Income or (Loss) Before Federal Income Taxes Incurred		19,645,304
		<hr/>
Federal Income Taxes Incurred		3,998,817
		<hr/>
Net Income	\$	15,646,487
		<hr/> <hr/>

The Regence BlueCross BlueShield of Utah
Statement of Capital and Surplus
For the Three Years Ended December 31,

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Reported by the Company:			
Balance prior year	\$ 71,068,913	\$ 71,077,116	\$ 85,944,195
Net income or (loss)	2,069,832	16,761,098	15,646,487
Net unrealized capital gain (loss)	1,713,679	(7,036,945)	(4,320,020)
Change in net deferred income tax			1,256,284
Change in nonadmitted assets	(3,240,944)	3,466,596	(11,322,926)
Change in allowance for federal income tax on unrealized capital gains and losses	(534,364)	1,676,330	
Cumulative effect of changes in accounting principles			<u>12,688,101</u>
Net Increase (Decrease)	<u>8,203</u>	<u>14,867,079</u>	<u>13,947,926</u>
Balance Current Year	<u>\$ 71,077,116</u>	<u>\$ 85,944,195</u>	99,892,121
Increase (decrease) from examination adjustments:			
Reduction of assets:			
Bonds			(1,208,616)
Electronic data processing equipment and software			<u>(148,000)</u>
Total			(1,356,616)
Balance per examination			<u>\$ 98,535,505</u>

Notes to Financial Statements

1. Bonds

\$58,420,878

This item is \$1,208,618 less than the amount reported by the Company as of December 31, 2001. The change is made to reduce the value of certain securities that were not valued and reported as required by the Utah Insurance Code.

By execution of the SVO Certification accompanying the Annual Statement, the Company certified that "All securities previously valued by the insurer and identified by a Z suffix have now been submitted to the SVO for a valuation or disposed of by sale or otherwise with the result that all prices and NAIC Designations reported in this statement have been provided by the SVO, except for new purchases identified in Schedule D and DA with a Z suffix or items submitted not yet processed by the SVO." However, Schedule D included sixteen (16) separate issues of securities, with purchase dates ranging from April of 1998 through August of 2001 and which had been reported previously as of September 30, 2002, identified with a Z suffix. It was determined that five (5) of the securities were identified with the Z suffix in error of which two (2) were not assigned a proper value. The remaining eleven securities were properly identified by the Z suffix, however the Company failed to assign the correct NAIC quality designation or the correct value resulting in the adjustment.

Paragraph 7 of Statement of Statutory Accounting Principles ("SSAP") No. 26, contained in the Accounting Practices and Procedures Manual, published by the National Association of Insurance Commissioners provides in part: "Bonds shall be valued and reported in accordance with the NAIC Valuations of Securities manual prepared by the Securities Valuation Office".

Part Four, Section 1 (a), "Obligation to Report" of The Purposes and Procedures of the Securities Valuation Office of the National Association of Insurance Commissioners" as of December 2001 ("SVO"), provides:

"Insurance companies domiciled in any state of the United States, or any of its territories or possessions, and required by law of their domiciliary state of territory to report NAIC Association Values for their investments in the NAIC Financial Statement Blank, shall report purchases of securities or any other relevant transaction to the SVO."

SVO requires an insurance company to file all securities purchased, except those that are: 1) "Provisionally Exempt" and 2) those that are already listed, with the SVO within 120 days of purchase. Issues of bond securities not reported to the SVO by an insurer as required, and subsequently not listed, may be reported on the insurer's quarterly and annual statement at values determined analytically by the insurance company. Securities so valued must be designated with a Z suffix attached to the quality designation assigned and reported by the Company. Securities held for more than one year and that continue to be not listed by the SVO must be assigned NAIC's lowest quality designation and valued at zero.

An issue related to the deficiency in compliance, similar to that described above, existed and was commented upon in the Report of Examination for the three years ended December 31, 1998.

2. Cash \$ 5,045,902

This asset is the same as the amount reported by the Company. However, the information provided in Schedule E – Part 1 of the Annual Statement for the year ended December 31, 2001, was not in compliance with the reporting and disclosure requirements of UCA Subsection 31A-4-113(1), UAC Section R590-147-4(1), and the Annual Statement Instructions

3. Investment Income Due and Accrued \$ 1,228,880

This item is \$328,829 more than was reported by the Company. The change is the result of reclassifying \$328,829 of accrued interest from the item "Other Assets."

4. Federal Income Tax Recoverable \$5,862,673

This amount includes net deferred tax credits of \$5,862,673.

5. Electronic Data Processing Equipment and Software \$1,608,408

As discussed below, this item is \$148,000 less than was reported by the Company.

For the three years ended December 31, 2001, capitalized cost for Electronic Data Processing Equipment and Software (EDP) increased by \$20,942,619 to \$37,338,752. Capital costs for EDP, net of amortization and depreciation, increased by \$14,094,081 to \$23,753,077 for the period. Net capital costs allowed as an admitted asset decreased by \$1,809,985 to \$1,756,408. The amount charged to surplus as nonadmitted increased by \$15,904,786 to \$21,996,669.

Approximately \$15,900,000 of the increase is the Company's share of the costs associated with a systems enhancement program, instituted by its affiliate TRG; to be implemented by all affiliate Plans. For the nine months ended September 30, 2002, the Company recorded \$10,756,000 of additional capital cost for this project. The project is to be completed during the year 2004 with additional cost to the Company estimated to be approximately \$24,000,000. Statutory accounting principles, require the product generated by the program to be classified as non-operating software, and as a result, the capital cost is treated as a nonadmitted asset and charged to surplus.

The cost of nonoperating software is to be depreciated over the lesser of its useful life or five years. For purposes of depreciation for the year ended December 31, 2001, lives of longer duration than those prescribed were assigned to substantial amounts of the cost of data process equipment, operating software and nonoperating software. As a result, depreciation of the admitted amount of this asset was understated approximately \$148,000.

6. Other Assets

\$ 426,484

This item is \$328,829 less than was reported by the Company. The change is the result of reclassifying \$328,829 of accrued interest to the item "Investment Income Due and Accrued."

7. Unpaid Claims

\$ 66,002,459

This liability is \$13,670,459 more than that reported by the Company. The increase is the result of reclassifying amounts payable on claims that were reported under the classification "Amounts Withheld or Retained for the Account of Others."

8. Amounts Withheld or Retained For The Account of Others

\$ 6,989,436

This liability is \$13,670,459 less than that reported by the Company. The decrease is the result of reclassifying amounts payable on claims to the classification "Unpaid Claims."

9. Nonadmitted Assets

\$ -0-

The ability of an insurer to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. For purposes of statutory accounting, an asset is defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. Assets having economic value other than those which can be used to fulfill policyholder obligations are to be reported as nonadmitted assets and are not, therefore, recognized on the balance sheet.

Nonadmitted assets increased from \$39,079,071 to \$50,176,345, during the three years ended December 31, 2001 and to \$70,510,307, during the subsequent nine months ended September 30, 2002. Generally, assets which are considered nonadmitted today, will over time, either be converted to those that can be used to fulfill policyholder obligations (Type 1); or be eliminated by periodic charges to operations for depreciation (Type 2). Transactions, which do not give rise to assets qualifying, as either Type 1 or Type 2, should be charged to operations in the period the transactions occur.

At December 31, 2001 and as of September 30, 2002, assets reported as nonadmitted, included transactions related to the funding of The Regence Group Defined Benefit Plan of \$1,077,000 and \$7,428,138, respectively and which represent contributions in excess of the Company's allocated share of the funding requirements. Evidence supporting the economic value of this asset was not made available and as a result, the transactions should have been charged to operations as they occurred.

10. Unassigned Funds

\$98,535,505

This item is \$1,356,616 less than was reported by the Company. The change is the result of reducing the value reported by the Company in balance sheet accounts "Bonds" and "Electronic Data Processing Equipment and Software" by \$1,208,616 and \$148,000, respectively.

The Company is required to maintain permanent surplus in the amount of \$400,000, pursuant to UCA Section 31A-5-211. UCA Chapter 17, Part VI requires that the Company prepare and submit, to the commissioner annually, a report of its Risk-Based Capital ("RBC") levels as of the end of the most recent calendar year, in a form and containing the information as is required by the RBC instructions adopted by the NAIC. The RBC levels are used as benchmarks to be compared with the Company's unassigned surplus. UCA Chapter 17, Part VI provides the actions required of the commissioner and the Company should events cause unassigned surplus to be less than the RBC levels provided by the report. As of December 31, 2001, as reported by the Company, its authorized control level risk based capital was \$15,049,547.

Summary

Items of significance or of special interest contained in this report are summarized below:

- 1) The Company failed to comply with UCA Title 31A as follows:
 - a) Articles of amendment to the articles of incorporation adopted by the board of directors were not timely filed or in some cases not filed with the Commissioner, as required by Subsection 31A-5-219(2). (History/General)
 - b) Amended Bylaws were not filed with the Commissioner, as required by Subsection 31A-5-203(4). (History/General)
 - c) Biographical affidavits of individuals elected as a director or appointed as an officer were not filed immediately, as required by Subsection 31A-5-410(1)(a). (History/Management)
 - d) The deposit of securities required by Section 31A-5-104, was not administered as required by Subsections 31A-2-206(6) and (10). (Statutory Deposit)
 - e) Reporting and disclosure requirements of UCA by UCA 31A-4-113(1), UAC R590-147-4. (1), and the Annual Statement Instructions were not complied with as follows:
 - i) The exchange of assets between the Company and the wholly owned subsidiary of an affiliated Plan. (History/Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales Through Reinsurance)
 - ii) The payment of expenses by the Company on behalf of TRG, its subsidiaries, and affiliates, and the allocation of expenses from TRG, an affiliate, to the Company. (Affiliated Companies)
 - iii) The payment of software development costs from the Company to TRG an affiliate. (Affiliated Companies)
 - iv) Insufficient information provided in the annual statement. (Notes to Financial Statements/Cash)
- 2) The Company failed to comply with guidelines provided by statutory accounting principles as follows:
 - a) For the valuation of bonds as of December 31, 2001. (Notes to Financial Statement/Note No. 1)
 - b) For depreciation of the cost of electronic data processing equipment and software. (Notes to Financial Statement/Note No. 3)
- 3) Deficiencies in records were noted. (Accounts and Records)

- 4) The Company is required to maintain minimum permanent surplus in the amount of \$400,000 pursuant to UCA Section 31A-5-211. The Company's total adjusted capital is \$98,535,507. UCA Chapter 17, Part VI requires that the Company maintain prescribed levels of Risk-Based Capital ("RBC") and provides the actions required of the commissioner and the Company should events cause unassigned surplus to be less than the RBC levels provided by the report. As of December 31, 2001, as reported by the Company, its authorized control level risk based capital was \$15,049,547. (Notes to Financial Statements/ Unassigned Funds)

Deficiencies similar to those described by 1.a, 1.c, 1.d, and 1.e above were encountered and brought to the attention of Company during the preceding examination for the three years ended December 31, 1998.

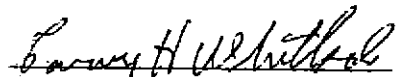
It is recommended that the Company take immediate steps to implement procedures that will eliminate these deficiencies for future operations.

Conclusion

The assistance and cooperation extended during the course of the examination by officers and employees of the Company is acknowledged.

In addition to the undersigned, Mr. Faanu Laufiso, Examiner, and Mr. Donald Catmull, examiners representing the Insurance Commissioner of the State of Utah, participated in this examination.

Respectfully Submitted,



Larry H. Whitlock, CPA, CFE

Audit Manager

State of Utah Insurance Department