

REPORT ON EXAMINATION

OF

BCBSD, INC.

AS OF

DECEMBER 31, 2008

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2008 of the

BCBSD, INC.

is a true and correct copy of the document filed with this Department.

Attest By: *Sonia C. Harris*

Date: 25 October 2010



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 25th day of June 2010.

A thick, black, handwritten signature scribble.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
OF THE
BCBSD, INC.
AS OF
DECEMBER 31, 2008

The above-captioned Report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 25th day of October, 2010

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December 7, 2009

Honorable Karen Weldin Stewart, CIR-ML
Insurance Commissioner
State of Delaware Insurance Department
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09-020, an examination has been made of the affairs, financial condition and management of the

BCBSD, INC.

hereinafter referred to as “BCBSD”, or “the Company”, incorporated under the laws of the State of Delaware. The main administrative office of the Company is located at 800 Delaware Avenue, Wilmington, Delaware 19801, which is also the location of the primary accounts and records of the Company.

The report of such examination is respectfully submitted herewith.

SCOPE OF EXAMINATION

The last examination of BCBSD was conducted as of December 31, 2005. This examination covered the period from January 1, 2006 through December 31, 2008. This report is presented on the exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. The text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed the rules established by the National Association of Insurance Commissioners' (NAIC) Committee Risk Surveillance Handbook, and generally accepted statutory insurance examination standards.

In addition to items hereinafter incorporated as part of the written report, the following were checked and made part of the workpapers of this examination:

- Fidelity Bond & Other Insurance
- Legal Actions
- Conflict of Interest Statements
- Officers and Employees Welfare/Benefits
- All Asset and Liability items not mentioned

The December 31, 2008 examination was conducted by the Delaware Insurance Department in accordance with the examination guidelines established by the National Association of Insurance Commissioners. Due to the fact that BCBSD is not a nationally significant company, an Association Examination was not called. Therefore, no states in addition to the State of Delaware participated in the examination.

HISTORY

BCBSD, Inc. was originally incorporated under the name of Group Hospital Service, Incorporated, by the filing of a Certificate of Incorporation with the Secretary of State on August 16, 1935. Up until March 1996, the Company's legal title was Blue Cross Blue Shield of Delaware, Inc., and the Company still does business under this title. The Company is operated as a private not-for-profit corporation that does not have the authority to issue capital stock.

The purpose of the Company is to develop, market and underwrite all types of health insurance and other employee benefit programs at reasonable costs; to promote policies and programs which foster effective health care cost containment; to act as underwriter or administrator for the administration of governmental health care programs; to provide all types of health services; to assist individuals in defraying the costs of all types of health services; to do all things in any way related to or connected with these purposes and to engage in any lawful act for which corporations may be organized under the General Corporate Law of the State of Delaware. On March 22, 2000, BCBSD entered into a business affiliation with CareFirst, Inc. (CFI), the parent corporation of Blue Cross Blue Shield of Maryland and Blue Cross Blue Shield of the National Capital area. On September 21, 2006, BCBSD and CFI terminated their structure affiliation. BCBSD is no longer controlled by CFI and is an independent licensee of the BlueCross and BlueShield Association.

During the examination period, BCBSD consolidated its operations from several locations in New Castle County to a single location on 800 Delaware Avenue in Wilmington.

CORPORATE RECORDS

As stated above, BCBSD, Inc. was originally incorporated under the name of Group Hospital Service, Incorporated, by the filing of a Certificate of Incorporation with the Secretary of State on August 16, 1935.

Since the disaffiliation with CareFirst in 2006, BCBSD became an independent Company and is the holding company for its subsidiaries, The Gateway Group Limited (Gateway) and NCIA Insurance Agency – Delaware, Inc. (NCIA).

BCBSD's bylaws were amended as of September, 2006 to reflect the changes from the disaffiliation from CareFirst. The Company shall be a membership corporation, operated as a private not-for-profit corporation, and shall not have the authority to issue capital stock. The bylaws provide that there shall be both a Chairman and a Vice Chairman of the Board. The registered office of the Company is 800 Delaware Avenue, Wilmington, DE. The business and affairs of the Corporation shall be managed under the direction of the Board of Directors.

No conflicts between the bylaws, the Articles of Incorporation or any other corporate documentation were noted.

HOLDING COMPANY SYSTEM

As stated above, the BCBSD is a Health Services Corporation and is a membership company and an independent company. As of the December 31, 2008 examination date the Company has two non-material subsidiaries. The ownership line of the Company (including its subsidiaries) is as follows:

BCBSD, Inc.
The Gateway Group, Ltd.
NCIA Insurance Agency-Delaware, Inc.

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements:

| Year | Admitted Assets | Surplus | Net Premium Income | Net Underwriting Gain/(Loss) | Net Income |
|-------------|------------------------|----------------|---------------------------|-------------------------------------|-------------------|
| 2005 | \$246,288,616 | \$132,714,867 | \$370,057,002 | \$6,447,894 | \$14,649,582 |
| 2006 | 263,249,126 | 159,662,713 | 421,469,872 | 21,428,520 | 24,261,784 |
| 2007 | 274,858,271 | 160,001,826 | 457,669,805 | 4,860,151 | 15,524,753 |
| 2008 | 245,310,403 | 120,807,157 | 477,182,765 | (20,074,350) | (16,749,008) |
| | | | | | |

The following is noted with regards to the Growth of the Company during the period under examination:

| | | |
|-------------------------------|------------------|--------|
| Net Admitted Assets decreased | \$ 978,213 or | .40% |
| Surplus decreased | \$ 11,907,719 or | 8.97% |
| Net Premium Income increased | \$107,125,763 or | 28.95% |

As shown above, while admitted assets decreased by .40% during the examination period, there was a significant decrease of \$29,547,868 or 10% between 2007 and 2008. This decrease was the result of a decrease in cash and short-term investments attributed to funding operations and a decrease in stocks and bonds attributed to the other than temporary impairment of stocks and bonds. There was also a decrease in deferred tax receivable.

The Company was generally profitable until 2008, when surplus decreased by \$39,194,669. As indicated above, BCBSD reported a Net Underwriting Loss of \$20,074,350 for 2008. An analysis of this underwriting loss noted three major components:

- Underwriting gain on the Company’s risk or underwritten business \$8,448,000
- Loss incurred processing the Company’s non-underwritten business (17,028,000)
- One time charge for the Company’s early retirement program (11,515,000)

The remaining approximately \$20,650 was made up of several reconciling items.

Also contributing to the decrease in surplus in 2008 were \$13,068,000 for the write-down of impaired securities and \$9,362,000 in additional funding for the Company’s pension plan.

The Company’s premium income increased steadily during the examination period. Note that only the Company’s underwritten business is reported in Net Premium Income. The examination noted that BCBSD continues to incur losses on its non-underwritten or “cost-plus” business. The Company does not receive adequate reimbursement to offset its fully allocated costs of processing this business. Approximately two-thirds of the claims processed by BCBSD are for non-underwritten business.

MANAGEMENT AND CONTROL

The business and affairs of the Company shall be managed under the direction of the Board of Directors. The Board of Directors shall have the sole authority to determine, from time to time, the exact number of Directors but in no event shall the number of Directors be less than three.

The following persons were serving on the Board of Directors at December 31, 2008:

| <u>Name</u> | <u>Principal Occupation</u> |
|-----------------------------|--|
| Max S. Bell, Jr. – Chairman | Retired - Richards, Layton & Finger (law firm) |

| | |
|-------------------------------------|--|
| Ben Corballis, M.D. – Vice Chairman | Chairman Emeritus, Department of Emergency Medicine at Christiana Care Health System; Retired – President and Chairman, Doctors for Emergency Services of Wilmington |
| Thomas E. Archie | Retired – Business Manager, Laborers International Union of North America, Local 199 |
| Bernard J. Daney, CPA | Business Consultant |
| Robert F. Rider | Chairman and CEO, O. A. Newton & Son Company |
| David P. Roselle, Ph.D. | Executive Director, Winterthur Museum and Country Estate |
| Frances M. West., Esq. | Retired – Secretary of Community Affairs; Past President of Better Business Bureau of Delaware, Inc. |
| William H. Willis, Jr. | President, Willis Chevrolet, Inc. and Willis Ford, Inc. |

The following officers were elected and serving as of December 31, 2008:

| <u>Name</u> | <u>Principal Occupation</u> |
|----------------------------|--|
| Timothy J. Constantine | President and CEO |
| William E. Kirk, III, Esq. | Vice President, General Counsel and Corporate Secretary |
| Christine L. Alrich | Vice President, Corporate Marketing |
| George H. English, Jr. | Vice President, Operations and Compliance Officer |
| William B. Jones | Vice President, Chief Information Officer |
| Lauren C. O'Brien | Vice President, Chief Financial Officer |
| Phillip A. Carter | Assistant Vice President, Corporate Controller and Treasurer |
| Paul A. Kaplan, MD | Vice President, Chief Medical Officer |
| Darelle L. Riabov | Assistant Vice President, Corporate Communications |

P. Scott Fad

Assistant Vice President, Planning and Corporate
Projects

Subsequent to year end December 31, 2008, the following senior managers left the Company: George H. English, Jr., Joseph Klimchak (Chief Reporting Actuary) and Lauren O'Brien.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to solicit business as a Health Services Corporation in the State of Delaware only. A portion of the Company's business is "non-underwritten", meaning there is no insurance risk to BCBSD. For large, self-insured accounts, the Company processes claim payments and receives reimbursement for claims and expenses fees from the account. The examination noted that BCBSD continues to incur losses on its non-underwritten or "cost-plus" business. The Company does not receive adequate reimbursement to offset its fully allocated costs of processing this business. In an effort to reduce costs, BCBSD has downsized staff by approximately 5% in late 2008. The Company has also sought an affiliation with another Blue Cross Blue Shield plan or group of plans in order to access state of the art processing system technologies, and gain economies of scale. This is further described in the Subsequent Events section.

A summary of the Company's revenue for 2008 is as follows:

| | |
|------------------------------------|------------------------------|
| Underwritten Business | \$ 397,999,844 |
| FEP* | 79,182,921 |
| Fees for Non-Underwritten Business | <u>55,958,436</u> |
| Total | <u>\$ 533,141,201</u> |

* = Federal Employees Health Benefits Plan.

When the fees for processing non-underwritten business of \$55,958,436 are backed out of the amounts shown above, the net underwritten business totals \$477,182,765 which ties to the Company's December 31, 2008 Net Premium Income.

The total for underwritten business and FEP business is broken down by the following lines of business:

| | |
|------------------------------------|------------------------------|
| Comprehensive (medical & hospital) | \$ 379,442,051 |
| Medicare Supplement | 10,927,921 |
| Dental Only | 2,759,323 |
| Vision Only | 69,667 |
| FEP | 79,182,921 |
| Title XVIII – Medicare Part D | <u>4,800,882</u> |
| Total Underwritten Business | <u>\$ 477,182,765</u> |

Note: The FEP Business is actually non-underwritten business; however, the NAIC Annual Statement has certain reporting requirements with regards to FEP business on certain schedules within the Annual Statement. As a result, the Company must include the FEP business on the Statutory Balance Sheet so that the Balance Sheet will tie to the supporting schedules of the Annual Statement.

As indicated above, BCBSD does not write a significant amount of Medicare Part D business. One reason for the Company seeking an affiliation partner is to access the systems and resources needed to effectively participate in governmental programs.

As a member of the National BlueCross and BlueShield Association (BCBSA), BCBSD routinely processes benefits for members of other BCBS plans when treatment occurs in Delaware. Conversely, when the Company's members require treatment outside of Delaware, the local BCBS plan provides the benefits. This type of business, which is primarily non-underwritten, is termed "National Accounts" by BCBSD. The payments to other BCBS plans by

BCBSD for services for the Company's members, and the receipt of payments by BCBSD for services to other BCBS plan members, is coordinated by the BCBSA.

REINSURANCE

For the year ended December 31, 2008, the Company reported the following premium distribution for its underwritten business:

| | |
|---------|------------------|
| Direct | \$ 483,788,636 |
| Assumed | -0- |
| Ceded | <u>6,605,871</u> |

Net Premium Income \$ 477,182,765

Effective January 1, 2006, the Company entered into a reinsurance agreement with FirstCare Inc. The agreement relates to all Medicare D insurance policies written by FirstCare for individuals living in the BCBSD's service area for which the Company assumes the risk. As of December 31, 2008, the Company has terminated the agreement with FirstCare and no assumed premiums were reported in 2008.

BCBSD entered into an agreement with Highmark Life Insurance Company (Highmark Life) that applied to all BCBSD policies classified as Specific Medical Stop Loss Insurance written or renewed on or after July 1, 2004. Highmark Life is responsible for 100% of the Company's paid claims in excess of the original specific employer's self insured retention of \$200,000 per covered person, per policy year, up to a maximum of \$1,000,000 for a covered person's lifetime. As of December 31, 2008, the Company has terminated the reinsurance agreement with Highmark Life.

ACCOUNTS AND RECORDS

The Company is neither a publicly traded company nor subject to Sarbanes Oxley (404) SEC requirements. However, BCBSD has taken the steps to be Model Audit Rule compliant and hired a firm, Interactive Solutions, LLC, to assist the Company in this endeavor.

The Company's books and records are audited, on an annual basis, by the firm of Ernst & Young, LLP, Certified Public Accountants. Selected workpapers of the accounting firm's December 31, 2007 and 2008 audit were obtained by the examination and utilized to the fullest extent possible.

Subsequent to year end 2008, a revised Annual Statement for 2008 was filed with the Delaware Insurance Department. It was determined that an adjustment for Minimum Pension Liability under SSAP 89 had not been properly recorded. The Company has taken action with its pension consultants to mitigate the control weakness, and therefore no examination recommendation will be noted in this report.

During the examination review of the Company's Claims Unpaid liability, BCBSD took approximately seven weeks to provide two reconciliations of paid claim data. This delay caused the examination to be extended. Therefore, the following recommendation will be made:

It is recommended that the Company provide information in a timely manner.

BCBSD contracts with outside vendors to administer the Company's prescription drug program. As per 18 Del Admin 1406, in cases where an administrator provides benefits for more than one hundred certificate holders on behalf of an insurer, the insurer shall, at least semiannually, conduct a review of the operations of the administrator. At least one such review

shall be an on-site audit of the operations of the administrator. The Company has not conducted reviews of its third party administrators during the examination period. Therefore, the following recommendation is noted:

It is recommended that the Company conduct an annual on-site audit of its third party administrators in accordance with Regulation 1406 of the Delaware Insurance Code.

Per the 2008 NAIC Annual Statement Instructions, the Company is instructed to categorize bonds in accordance with section: Schedule D Part 1 - Long Term Bonds owned December 31 of Current Year. From the examination review, the Company is reporting commercial backed securities per Schedule D Part 1, but is not categorizing them properly. Therefore, the following recommendation is noted:

It is recommended that the Company comply with the NAIC Annual Statement Instructions when categorizing bonds.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of BCBSD, Inc. as determined by this examination, as of December 31, 2008.

Analysis of Assets
Liabilities, Surplus and Other Funds
Statement of Revenues & Expenses
Capital and Surplus Accounts
Examination and Surplus Changes

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding.

Analysis of Assets
December 31, 2008

| | <u>Ledger</u> | <u>Assets Not</u> | <u>Net Admitted</u> | <u>Note</u> |
|--|-----------------------|----------------------|-----------------------------|-------------|
| | <u>Assets</u> | <u>Admitted</u> | <u>Assets</u> | |
| Bonds | \$ 166,989,150 | | \$ 166,989,150 | 1 |
| Preferred stock | 1,436,335 | | 1,436,335 | |
| Common stock | 18,016,270 | \$1,356,455 | 16,659,815 | |
| Mortgage loans (first liens) | 223,482 | | 223,482 | |
| Cash, cash equivalents & short-term investments | 6,410,579 | | 6,410,579 | |
| Other invested assets | 337,355 | 337,355 | | |
| Investment income due and accrued | 1,709,085 | | 1,709,085 | |
| Accident & health premiums due & unpaid | 11,012,284 | | 11,012,284 | |
| Amounts receivable relating to uninsured accident & health plans | 21,342,051 | | 21,342,051 | |
| FIT recoverable | 6,013,047 | | 6,013,047 | |
| Net deferred tax asset | 19,083,442 | 10,535,279 | 8,548,163 | |
| EDP equipment | 4,246,500 | 704,135 | 3,542,365 | |
| Furniture and equipment | 15,293,599 | 15,293,599 | | |
| Receivables from parents, subsidiaries and affiliates | 6,137 | | 6,137 | |
| Health care receivables | 17,168,453 | 15,750,543 | 1,417,910 | |
| Aggregate write-ins for other than invested assets | <u>27,648,183</u> | <u>27,648,183</u> | <u> </u> | |
| Total Assets | <u>\$ 316,935,952</u> | <u>\$ 71,625,549</u> | <u>\$ 245,310,403</u> | |

Liabilities, Surplus and Other Funds
December 31, 2008

| | | <u>Note</u> |
|--|---------------------------|-------------|
| Claims unpaid | \$ 41,690,000 | 2 |
| Unpaid claims adjustment expenses | 2,946,000 | |
| Aggregate health policy reserves | 240,000 | |
| Premiums received in advance | 11,667,673 | |
| General expenses due and accrued | 19,035,128 | |
| Amounts withheld or retained for the account of others | 3,605,239 | |
| Remittance and items not allocated | 1,703,712 | |
| Amounts due to affiliates | 1,519 | |
| Liability for amounts held under uninsured accident & health plans | 1,726,814 | |
| Aggregate write-ins for liabilities | <u>41,887,161</u> | |
| Total liabilities | <u>\$ 124,503,246</u> | |
| Unassigned funds (Surplus) | <u>\$ 120,807,157</u> | |
| Total Capital and Surplus | <u>\$ 120,807,157</u> | |
| Total liabilities and surplus | <u>\$ 245,310,403</u> | |

Statement of Revenues and Expenses
December 31, 2008

| | |
|---|------------------------|
| Income: | |
| Net premium income | <u>\$ 477,182,765</u> |
| Expenses: | |
| Hospital/medical benefits | \$ 308,738,974 |
| Other professional services | 33,503,966 |
| Emergency room and out-of-area | 8,359,121 |
| Prescription drugs | <u>76,799,222</u> |
| Subtotal | <u>427,401,283</u> |
| Claims adjustment expenses | 22,336,033 |
| General administrative expenses | <u>47,519,799</u> |
| Total underwriting deductions | <u>\$ 497,257,115</u> |
| Net underwriting gain / (loss) | <u>\$ (20,074,350)</u> |
| Net investment income earned | \$ 9,677,651 |
| Net realized capital gains/(loss) | \$ (11,005,121) |
| Net investment gain/(loss) | <u>(1,327,470)</u> |
| Aggregate write-ins for other income or (expenses) | <u>424,385</u> |
| Net income or (loss) after capital gains tax and before other FIT | \$ (20,977,435) |
| Federal income taxes incurred | <u>4,228,427</u> |
| Net income/(loss) | <u>\$ (16,749,008)</u> |

Capital and Surplus Account
December 31, 2007 to December 31, 2008

| | | |
|---|---------------------|-----------------------|
| Capital & surplus, December 31, 2007 | | \$160,001,826 |
| Net income/(loss) | | (16,749,008) |
| <u>Additions:</u> | | |
| Change in net deferred income tax | <u>\$10,348,103</u> | |
| Total additions | | 10,348,103 |
| <u>Deductions:</u> | | |
| Net unrealized capital gains/(losses) | \$4,031,470 | |
| Change in non-admitted assets | 19,400,105 | |
| Subsequent adjustment-pension contribution | <u>9,362,189</u> | |
| Total deductions | | <u>(32,793,764)</u> |
| Change in Capital and Surplus during the year | | <u>(\$39,194,669)</u> |
| Capital and Surplus, December 31, 2008 | | <u>\$120,807,157</u> |

SCHEDULE OF EXAMINATION CHANGES

This examination will propose no financial adjustments.

NOTES TO THE FINANCIAL STATEMENTS**1. Bonds****\$166,989,150**

The reported values for Bonds as shown on the December 31, 2008 Annual Statement will be accepted as reported for the purpose of this examination. The Company continues to invest primarily in Bonds with ratings of “1” or “2” per the NAIC SVO Manual. The Company’s Bond portfolio accounted for 67.38% of total admitted assets. The Bond portfolio as of the December 31, 2008 examination date consisted of the following:

| <u>NAIC Designation</u> | <u>12/31/2008</u> |
|-------------------------|-------------------|
| 1 | 89.15% |
| 2 | 10.02% |
| 3 | < 1% |
| 4 - 6 | < 1% |

The Company uses a third party consultant to review investments, make recommendations, and ensure that the investment managers stay within the investment guidelines. The Company wrote down to market value \$13,068,000 in impaired securities during 2008.

2. Claims Unpaid**\$ 41,690,000**

The amount shown above is equal to the amount reported on the Company’s 2008 Balance Sheet. As previously discussed, the Company provides services for both “underwritten” and “non-underwritten” business. A summary of those products is discussed below:

Underwritten - is traditional insurance. The policyholder pays a premium and BCBSD is responsible for all benefits and expenses under these products. The examination tested the claims unpaid and unpaid claims adjustment expenses liabilities in the following ways:

BCBSD's claim payment system was reviewed through data validity and inclusion tests. The examination received assistance from INS Consultants, Inc. (INS) in selecting random samples for the tests that were used to test the validity of the Company's claims data and the inclusion of reported claims. INS monitored the development of the Company's December 31, 2008 reserve through April 30, 2009. In summary, INS concluded the Company's reserves at December 31, 2008 were fairly stated.

Non-Underwritten - For most non-underwritten products, BCBSD is acting as a third party administrator and is reimbursed by the policyholder for benefit payments plus fees to process the claims and administer the insurance program. These products are called "cost plus" or "administrative services only" contracts. For some accounts, BCBSD is only reimbursed by the policyholder for benefit payments up to a stated specific limit. BCBSD is responsible for payments over that limit. In order to mitigate this exposure, BCBSD has purchased reinsurance to cover benefit amounts exceeding the policyholders' responsibility. This coverage was provided by Highmark Life Insurance Company as was discussed in detail in the Reinsurance Section of this Report. Going forward, BCBSD will retain all the exposure for these claims.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The examination reviewed the 2005 Report on Examination along with BCBSD's compliance with the prior examination recommendations, comments and concerns. Based on

that review, BCBSD appears to have complied with all applicable prior Report on Examination recommendations, comments and concerns.

SUMMARY OF RECOMMENDATIONS

It is recommended that the Company provide information in a timely manner. (p. 11)

It is recommended that the Company conduct an annual on-site audit of its third party administrators in accordance with Regulation 1406 of the Delaware Insurance Code. (p. 12)

It is recommended that the Company comply with the NAIC Annual Statement Instructions when categorizing bonds. (p. 12)

SUBSEQUENT EVENTS

The examination learned that BCBSD was actively seeking an affiliation with another Blue Cross Blue Shield plan or a group of Blue Cross Blue Shield plans. The reasons for seeking the affiliation were subsequently discussed with senior management of Company. BCBSD held serious affiliation talks with several parties. On August 20, 2010, BCBSD announced that they had signed an affiliation agreement with Pennsylvania based Highmark, Inc. The affiliation will require review and approval by the Delaware Department of Insurance before it becomes effective.

During the current examination period, BCBSD consolidated its operations from several locations in New Castle County to a single location on Delaware Avenue in Wilmington. In the process, the Company down-sized its staff by about 5% in 2008. Management has indicated that BCBSD needs to reduce its operating expenses in order to maintain its competitive position. The

examination has noted that the Company is currently short-staffed in some areas, including the actuarial department.

The following senior management staff has left the Company subsequent to December 31, 2008:

George English, Vice President Operations, Chief Compliance Officer. P. Scott Fad (Vice President, Client Services and Business Development) has replaced Mr. English with respect to Operations.

Lauren O'Brien, Vice President, Chief Financial Officer. James Hynek has replaced Ms. O'Brien as Vice President, Chief Financial Officer.

Joe Klimchak, Chief Actuary. The Company has engaged Lake Consulting, Inc. to review and assist the Company's actuarial functions.

SUMMARY COMMENTS

During the examination period, the Company was generally profitable until 2008, when surplus decreased by \$39,194,669. BCBSD reported a Net Underwriting Loss of \$20,074,350 for 2008. An analysis of this underwriting loss noted three major components:

- Underwriting gain on the Company's risk or underwritten business \$8,448,000
- Loss incurred processing the Company's non-underwritten business (17,028,000)
- One time charge for the Company's early retirement program (11,515,000)

The remaining approximately \$20,650 was made up of several reconciling items.

Also contributing to the decrease in surplus in 2008 were \$13,068,000 for the write-down of impaired securities and \$9,362,000 additional funding for the Company's pension plan.

The Company's premium income increased steadily during the examination period. Only the Company's underwritten business is reported in Net Premium Income. The examination noted that BCBSD continues to incur losses on its non-underwritten or "cost-plus" business. The

Company does not receive adequate reimbursement to offset its costs of processing this business. Approximately two-thirds of the claims processed by BCBSD are for non-underwritten business.

CONCLUSION

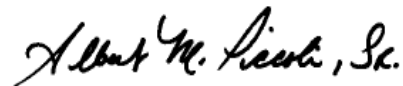
As a result of this examination, the financial condition of BCBSD, Inc. as of December 31, 2008 was determined to be as follows:

| | <u>Current Examination</u> | <u>12/31/05 Examination</u> | <u>Changes – Increases/ (Decreases)</u> |
|-------------------|----------------------------|-----------------------------|---|
| Total Assets | \$245,310,403 | \$246,288,616 | (\$978,213) |
| Total Liabilities | \$124,503,246 | \$113,573,749 | \$10,929,497 |
| Total Surplus | \$120,807,157 | \$132,714,867 | (\$11,907,719) |

In addition to the undersigned, Ann Pruett, CFE, participated in the examination along with actuarial services provided by Frank G. Edwards Jr., ASA, MAAA of INS Consultants, Inc.

James J. Blair CFE, CPA, served as the examination supervisor.

Respectfully submitted,



Albert M. Piccoli, CFE
Examiner-in-Charge
Department of Insurance
State of Delaware