



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**REGENCE BLUECROSS BLUESHIELD OF OREGON
PORTLAND, OREGON**

NAIC COMPANY CODE 54933

AS OF

DECEMBER 31, 2008

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SALUTATION

January 29, 2010

Alfred W. Gross, Commissioner
Chairman, NAIC Financial Condition (E) Committee
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, Virginia 23218

Honorable Cory Streisinger, Director
Department of Consumer and Business Services
State of Oregon
350 Winter Street NE
Salem, Oregon 97301-3883

Dear Commissioner and Director:

In accordance with your instructions and guidelines in the National Association of Insurance Commissioners (NAIC) Examiners Handbook, pursuant to ORS 731.300 and 731.302, respectively, we have examined the business affairs and financial condition of

REGENCE BLUECROSS BLUESHIELD OF OREGON
100 SW Market Street
Portland, Oregon 97201

NAIC Company Code 54933

hereinafter referred to as the “Company” or “RBCBSO.” The following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

The full scope examination of the Company was conducted as of December 31, 2008, covering the three year period then ended, and included a review of material transactions or events which occurred subsequent to the examination cut-off date and were noted during the examination.

The examination was conducted pursuant to ORS 731.300 and in accordance with the NAIC *Financial Condition Examiner Handbook*. The handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company including corporate governance, identifying and assessing inherent risks within the company and evaluating system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions in accordance with the Oregon Insurance Code.

In addition to the above, work papers were reviewed that were prepared by Deloitte & Touche LLP, the Company's independent auditors, during its audit of the Company's accounts for the year ended December 31, 2008. Portions of the auditors' work papers have been incorporated into our work papers and have been utilized in determining the scope and areas of emphasis in conducting the examination.

Scott Fitzpatrick, FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in this examination by evaluating

losses and loss adjustment expenses unpaid. The results of his analysis are found under the relevant section of this report.

Concurrent with this examination, other affiliated insurers domiciled in Oregon and Utah were examined. These companies included Regence Life and Health Insurance Company (OR), Regence HMO Oregon (OR), Regence Health Maintenance of Oregon, Inc. (OR), Regence BlueCross BlueShield of Utah (UT) and HealthWise (UT). This was part of a coordinated examination effort, whereby Oregon and Utah coordinated their efforts to examine all their domestic companies within The Regence Group as of December 31, 2008. A separate report will be issued for each company.

COMPANY HISTORY

Northwest Hospital Service (dba Blue Cross of Oregon) was incorporated under the laws of the State of Oregon October 7, 1941, and commenced business in June 1942. Oregon Physicians' Service (dba Blue Shield) was incorporated under the laws of the State of Oregon December 6, 1941, and also commenced business in June 1942. Both functioned independently as not for profit health care service contractors under individual Certificates of Authority until March 1983 when Oregon Physicians' Service merged with and into Northwest Hospital Service, the surviving corporation, and soon after the entity changed its name to Blue Cross and Blue Shield of Oregon (BCBSO).

On June 1, 1995, BCBSO became part of The Benchmark Group, a non-profit holding company located in Portland, Oregon. On April 1, 1997, The Benchmark Group changed its name to The Regence Group (TRG), and concurrently, the Company's name changed to Regence BlueCross BlueShield of Oregon.

Surplus Notes

The Company had purchased surplus notes from Regence HMO Oregon in exchange for cash on the following dates:

<u>Issue Date</u>	<u>Interest Rate</u>	<u>Par Value</u>	<u>Carrying Value</u>
June 1997	6.0%	\$21,000,000	\$21,000,000
September 1998	6.0%	19,000,000	19,000,000
March 1999	6.0%	<u>20,000,000</u>	<u>20,000,000</u>
Total		<u>\$60,000,000</u>	<u>\$60,000,000</u>

The original surplus note issued in June 1997 was for \$36,000,000. In December 2002, RHO repaid \$15 million principal and \$5 million interest on its surplus notes to the Company, after receiving approval from DCBS.

Under the terms of the surplus notes, the repayment of principal or payment of interest requires the approval of the director of the Department of Consumer and Business Services. On March 21, 2007, RHO's management submitted a request to the director for approval to pay all its outstanding surplus notes and related accumulated interest in four quarterly payments. The request was approved by the director, and the Company received the surplus note repayment and interest payments as follows:

<u>Date of Payment</u>	<u>Principal</u>	<u>Interest</u>	<u>Date Approved</u>
3/31/2007	\$15,000,000	\$8,000,000	3/26/2007
6/30/2007	15,000,000	8,000,000	6/12/2007
9/30/2007	15,000,000	8,000,000	9/18/2007
12/31/2007	15,000,000	9,040,247	12/17/2007

No surplus notes were outstanding at December 31, 2008.

CORPORATE RECORDS

Board Minutes

In general, the review of 2006 to 2009 Board meeting minutes of the Company and of TRG, as well as the various committees authorized by TRG, indicated that the minutes support the

transactions of the Company and clearly describe the actions taken by its directors and officers. A quorum, as defined by ORS 731.302, met at all of the meetings held during the period under review. Regular Board meetings are held quarterly.

TRG's Investment Committee approved investments and monitored the investment guidelines for TRG and each of its subsidiaries. Minutes of their meetings were approved by the Company's Board of Directors in accordance with ORS 733.730. TRG's Personnel and Compensation Committee approved officer salaries. The Company's Board approved the TRG Personnel and Compensation Committee's actions pursuant to ORS 732.320(3).

Articles of Incorporation

The Company's Articles of Incorporation were not amended during the period under examination. The Articles of Incorporation conformed to Oregon statutes.

Bylaws

The Company amended its corporate Bylaws twice during the period under examination; on August 7, 2006, to reflect the reduction in the number of directors, and February 4, 2008, to establish two classes of directors, to change the term of office from one year to three years, and to set a mandatory retirement age at 70. The Company shares a common Board of Directors with its two downstream insurance subsidiaries, Regence HMO Oregon and Regence Health Maintenance of Oregon, Inc.

The Bylaws conformed to Oregon statutes.

Holding Company Registration Statement

An insurance holding company registration statement was filed by the Company in accordance with the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-027-0020(1).

MANAGEMENT AND CONTROL

Board of Directors

Article II, section 3, of the Company's Amended Bylaws state that the number of Directors shall not be less than five (5) or more than seven (7). In addition, the Bylaws specify that there be two classes of directors, outside and inside. Outside directors shall be a person who is not an employee of an affiliate or of the corporation. Inside directors shall be a person who is an employee of the corporation. Only the CEO of TRG and the corporate president may be an inside director. Generally, directors shall serve one or more terms of three years, staggered so that approximately one-third are elected each year. A majority of the number of directors constitutes a quorum. The Board of Directors met all requirements of ORS 750.015.

As of December 31, 2008, the Company's Board of Directors was as follows:

<u>Name and Address</u>	<u>Principal Occupation</u>	<u>Member Since</u>
William L. Chenevich Portland, Oregon	Vice Chairman US Bancorp	2004
Peggy Y. Fowler Tigard, Oregon	CEO Portland General Electric	2005
Mark B. Ganz Portland, Oregon	CEO The Regence Group	2004
William R. Lee, MD Portland, Oregon	Physician	1995
Luis Machuca Hillsboro, Oregon	President and CEO Kryptiq Corporation	2008
J. Bart McMullan Jr. M.D. Portland, Oregon	President Regence BlueCross BlueShield of OR Regence Health Maintenance of OR Regence HMO Oregon	2004
John W. Morgan Portland, Oregon	President and CEO HemCon Medical Technologies, Inc.	2008

Dr. McMullan announced his retirement in September 2009, and was replaced by Jared L. Short.

Article IV of the Amended Bylaws state the Board shall have no standing committees. Instead, TRG authorized five different committees to assist in the management of all its subsidiaries. The committees are: 1) Organizational & Governance Committee; 2) Investment Committee; 3) Audit & Compliance Committee; 4) Personnel & Compensation Committee; and 5) Health Care Services Committee. The various committees provide direction to the Group within the area/field in which they are assigned. The committees' actions are summarized and reported to TRG's board of directors during their regular meetings. The actions and minutes of each of the committees are approved during the Company's board of director meetings.

Officers

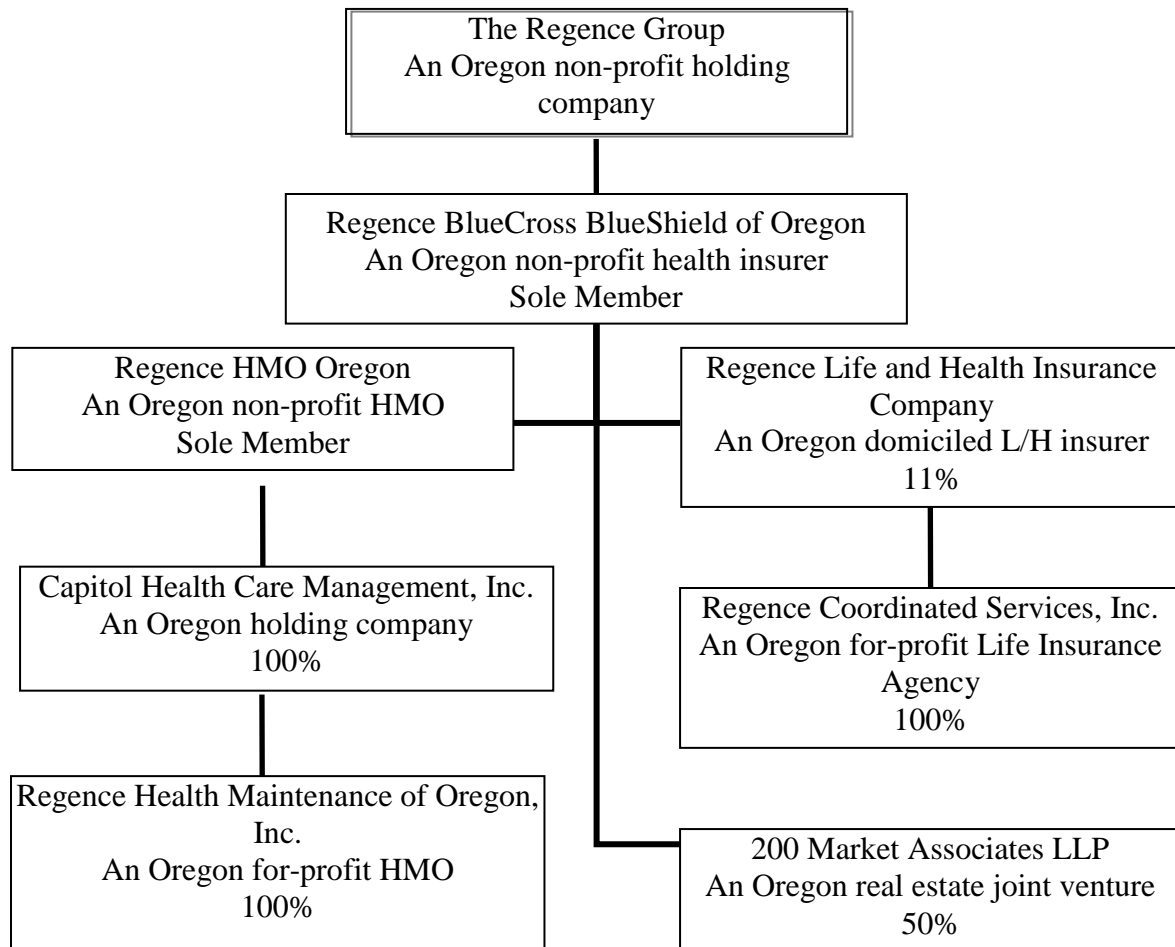
Operating management of the Company as of December 31, 2008, was under the direction of the following principal officers:

<u>Officer</u>	<u>Office</u>
John B. McMullan Jr. MD	President
Steven L. Hooker	Treasurer
Kerry E. Barnett	Secretary
Stephanie C. Dreyfuss	Vice President – Provider Services
Michael T. Mudrow	Assistant Secretary
Dorane L. Wintermeyer	Vice President – Sales

Dr. McMullan retired in September, 2009, and was replaced by Jared L. Short. Steven Hooker announced his retirement in December 2009. He was replaced by Andreas B. Ellis. Ms. Wintermeyer is no longer with Regence, and her position has not been replaced.

Affiliated Companies

The Company is part of a holding company system in which TRG is the ultimate parent. TRG is a nonprofit Oregon Corporation governed by an 11-member board of directors and is the sole member of the Company, Regence BlueShield (RBS), and Regence BlueCross BlueShield of Utah (RBCBSU). In addition, TRG manages the operations of Regence BlueShield of Idaho (RBSI) under the terms of a long-term management services agreement. The following organization chart depicts the relationship of Oregon affiliates within the Regence group.



The following is a description of the parent, affiliates and subsidiaries:

Regence HMO Oregon (RHO) is a non-profit Oregon health care service contractor federally qualified as a health maintenance organization. RHO is the immediate parent of Capitol Health Care Management, Inc. RHO ceased writing business in 2005.

Capitol Health Care Management, Inc. (CHCM) is an Oregon for-profit business corporation which functions as a down stream holding company to own all the stock of RHO subsidiaries and to consolidate the income tax results of the for-profit subsidiaries of RHO. CHCM owns 100% of the common stock of Regence Health Maintenance of Oregon, Inc., and would be considered its direct parent.

Regence Health Maintenance of Oregon, Inc. (RHMO) is a for-profit Oregon health care service contractor federally qualified as a health maintenance organization. RHMO ceased writing business in 2005.

Regence Life and Health Insurance Company (RLH) is an Oregon domiciled for-profit insurer licensed to conduct the business of life and accident and health insurance in Alaska, Idaho, Montana, Oregon, Utah, and Washington.

Regence Coordinated Services, Inc. (RCS), is a for-profit life and health insurance agency owned by RLH, and formed by the four TRG regional plans, which merged four regional insurance agency subsidiaries into RCS. In consideration of this transaction, each of the affiliated plans received shares of RLH stock (RBS – 75%, RBCBSU – 12%, RBCBSO – 11%, and RBSI – 2%).

200 Market Associates LP is a limited partnership formed by RBCBSO and Russell Development Company, each with a 50% ownership, to own and operate an office building located at 200 SW Market Street, Portland, Oregon.

INTERCOMPANY AGREEMENTS

Regence Administrative Services Agreement

Effective December 28, 2007, TRG entered into a cost-sharing agreement with each of the Regence Plans in Oregon, Utah and Washington, including their subsidiary companies. Under the terms of the agreement, TRG will provide all operational, administrative, and management services reasonably necessary to transact business. These services include managerial, legal, financial, actuarial, underwriting, accounting, human resources, billing, membership, claims adjudication, customer service, reporting, regulatory compliance, and all applicable technical, clerical and communication support, as well as all necessary equipment, materials, office space and general supplies. Reimbursement will be made using a cost allocation method describe in the contract, and it is the intent that TRG receive full compensation for the cost of their services and general overhead and taxes, and that no profit be derived from the agreement. This complies with the provisions of ORS 732.215. Reconciliations are being performed monthly, and settlement of expenses shall be made 90 days after the month end. The agreement will automatically renew each year, unless cancelled by any party upon 30 days written notice. The Insurance Division approved the agreement on February 13, 2008, in accordance with ORS 732.574(2)(d).

Management Agreement with RLH

Effective January 1, 1999, the Company entered into an agreement with RLH to perform the following services: marketing; legal, personnel services; underwriting/actuarial services; investments; accounting, cash control and payroll; data processing; accounts payable; reprographics; mail services; office space, furnishing and equipment; grievances and appeals/utilization reviews; claims adjudication, and; other services. Each month, RLH agrees to pay an amount equal to the total incurred expenses to the Company. The agreement

renews automatically each January 1, unless terminated by either party with written notice at least 30 days before renewal.

Management Agreement with RHO and RHMO

Under separate agreements entered into and effective January 1, 1999, the Company agrees to perform certain functions for RHO and RHMO, including the use of the Company's employees for performing the operations of the two HMO subsidiaries. Some of the functions under the management agreement include: accounting, data processing, marketing, financial reporting, budgeting, provider contracting and policy services. In return for these services, RHO and RHMO agree to pay all costs and expenses that are directly attributable to its operations. Indirect expenses are paid to the Company using a written cost allocation plan. The allocation method appeared to be reasonable and therefore meets the provisions of ORS 732.574(1)(b).

Insolvency Agreement

Effective August 1, 1991, the Company entered into an agreement with RHO and RHMO whereby the Company agrees, in the event of insolvency of either or both the subsidiary HMO insurers, to make payments to policyholders for covered services.

Consolidated Federal Income Tax Agreement

Effective January 1, 1997, and signed on December 20, 2000, the Company became party to a tax allocation agreement with TRG. Under the terms of the agreement, TRG and each of its taxable subsidiaries owned 90% or more, directly or indirectly, will calculate their federal tax liability on a stand-alone basis, including any liability for alternative minimum tax. TRG shall pay each member with tax credits or tax losses its share of amounts allocated to other members. Payments of estimated installments shall be due within 30 days of notice, and

final settlements are due within 30 days of filing the consolidated tax return. The allocation method and terms of this agreement appear fair and reasonable.

CONFLICT OF INTEREST

The Company's Code of Business Conduct provides for conflict of interest disclosure in the form of a questionnaire that is completed annually by the Company's Board of Directors, officers, and employees. All personnel performed due diligence in completing the questionnaire. From a review of the questionnaires of board members and senior management, there were no material conflicts of interest reported.

FIDELITY BOND AND OTHER INSURANCE

A review of the adequacy of limits and retentions and the solvency of the insurers providing the insurance was considered during the examination of the Company's insurance coverage. TRG purchased insurance covering itself and all its subsidiaries. A fidelity bond covered losses up to \$15,000,000 per occurrence, net of a \$50,000 deductible, caused by employees' dishonesty and fraud. This coverage exceeded the minimum coverage recommended by the NAIC *Financial Condition Examiners Handbook*. Executive liability risks and D&O risks are covered up to \$50,000,000 per loss occurrence net of a \$250,000 deductible. Other insurance coverages in force at December 31, 2008, included property, commercial general and excess liability, automobile liability, umbrella liability, fiduciary liability, computer crime liability, and workers' compensation. All insurance limits and deductibles appeared adequate as of December 31, 2008.

PENSION PLANS AND OTHER EMPLOYEE BENEFITS

The Company does not have its own employees, but does contribute to the pension and other employee benefits assessed for employees performing work for it.

Employee Retirement Plan

The Company participates in a defined-benefit pension plan sponsored by TRG that covers substantially all regular employees having one or more years of service. Benefits are based upon years of service and the employee's final average compensation. The Company also participates in a supplemental executive retirement plan sponsored by TRG to cover key employees meeting specific eligibility requirements. The Company's practice is to reimburse TRG for employee retirement plan obligations and to record such amounts as employment related expenses. The Company has no legal obligation for benefits under these plans; the obligation is carried by TRG. As sponsor of the plan, however, TRG is legally required to fund the plans regardless of amounts paid to TRG by the Company. The Company's share of net expenses for the retirement plans was \$7,761,000 and \$12,486,000 in 2008 and 2007, respectively.

Effective December 31, 2009, the defined-benefit pension plan was frozen. Subsequent to the freeze date, there will be no new participants enrolled in the plan, and no pension benefits will be earned after that date. Benefits-eligible employees who have not yet met plan eligibility criteria were immediately eligible and non-vested plan participants became fully vested.

Employee 401(k) Savings Plan

The Company participates in an employee savings plan sponsored by TRG in which the Company will match employee contributions up to 50% of the first 6% of salary for each pay period in which the employee makes a contribution. Beginning January 1, 2010, this employee match will increase up to 100% of the first 6% of salary for each pay period in which the employee makes a contribution. In addition, a discretionary contribution of up to 5% of eligible earnings for eligible employees will be added, subject to annual review and

board approval. Expense is allocated to the Company based on the portion of the employees' functional activities that relate to the Company. The Company has no legal obligation for benefits under this plan; the obligation is carried by TRG. The Company contributed \$2,623,000 and \$2,529,000 for 2008 and 2007, respectively.

Post-retirement Benefits Plan

The Company participates in a post-retirement health and welfare plan sponsored by TRG for retired employees, subject to certain eligibility rules based on age and years of service at retirement date. Employees hired after January 1, 2004, are not eligible for benefits. Expenses are allocated to the Company monthly, based on relative employee count. The Company has no legal obligation for benefits under this plan; the obligation is carried by TRG. As sponsor of the plan, however, TRG is legally required to fund the plan regardless of amounts paid to TRG by the Company. The Company's share of net expenses for the postretirement benefit was \$717,000 and \$705,000 for 2008 and 2007, respectively.

Coverage for eligible participants who retire on or after January 2, 2010, will terminate the date the participant or beneficiary attains Medicare eligibility on the basis of age or disability, regardless of whether the participant or beneficiary becomes entitled to Medicare.

Eligible participants who retire on or after January 2, 2010, and already are eligible for Medicare on the basis of age or disability, will not be eligible to enroll in the plan. Retirees must be enrolled as a participant in the active employee health and welfare plan immediately prior to retirement in order to be eligible to enroll in the plan, except for those individuals retiring between October 1, 2009, and January 1, 2010.

TERRITORY AND PLAN OF OPERATION

The Company is authorized to conduct business as a health care service contractor in Oregon and Washington. The Company operates as a Blue Cross and Blue Shield plan subject to operational and performance standards established by the national Blue Cross and Blue Shield Association.

The Company provides group and individual prepayment plans for hospital, medical and surgical benefits and group-only plans for dental, prescription drug, vision care and other benefits. These include a capitation dental plan and a preferred provider organization (PPO) plan in the Portland area.

The Company provides benefits toward expenses of physicians, hospital and related services required for sickness or injury of persons insured under group and individual policies. Member providers contract to accept the Company's allowances as full payment for covered services. For nonmember providers used by the insured, only established fee schedules are allowed and the insured is responsible for any higher fee.

The majority of the Company's subscribers are enrolled through employer groups. The Company also manages Administrative Service Only (ASO) and Administrative Services Contract (ASC) plans, whereby the Company acts as a claims administrator for self-insured groups but assumes no liabilities as a result of claims incurred by the groups.

The Company's group and individual business is produced through marketing representatives in conjunction with licensed independent agents and brokers.

GROWTH OF THE COMPANY

Growth of the Company over the past five years is reflected in the following schedule. Amounts were derived from Company's filed annual statements, except in those years where a report of examination was published by the Oregon Insurance Division.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Net Income (Loss)</u>
2004	\$ 762,187,227	\$ 395,750,403	\$ 366,436,824	\$ 39,814,306
2005 *	904,571,297	437,710,825	466,860,469	108,653,535
2006	965,767,778	432,224,353	533,543,425	79,849,176
2007	1,034,489,182	482,301,046	552,188,131	20,851,464
2008 *	905,394,008	419,269,770	486,124,238	25,093,568

*Per examination

LOSS EXPERIENCE

The following exhibit reflects the annual underwriting results of the Company over the last five years. The amounts were compiled from copies of the Company's filed annual statements and, where indicated, from the examination reports.

<u>Year</u>	<u>(1) Total Revenues</u>	<u>(2) Total Hospital and Medical</u>	<u>(3) CAE and General Expenses</u>	<u>(2)+(3)/(1) Combined Loss Ratio</u>
2004	\$ 1,730,848,226	\$ 1,508,512,440	\$ 195,060,297	98.4%
2005 *	1,894,190,702	1,618,063,477	198,672,497	95.9%
2006	2,092,665,946	1,821,698,952	249,791,823	99.0%
2007	2,282,451,997	2,024,410,967	314,060,007	102.5%
2008 *	2,595,653,513	2,335,370,649	289,582,474	101.1%

*Per examination

A combined loss incurred and expense to premium ratio of more than 100% indicates an underwriting loss.

REINSURANCE

Ceded

The Company cedes 100% of individual accidental death and dismemberment insurance premiums written to Regence Life & Health Insurance Company (RLH). Total amounts ceded were \$1.3 million out of total \$2.6 billion total net premium written during 2008.

Assumed

Under the terms of a 100% quota share agreement with RLH, the Company assumes all of the premiums and liabilities for RLH's individual and group health policies. During 2008, the Company assumed approximately \$68.6 million of premiums from RLH under this agreement.

Under the terms of two excess of loss assumption agreements with RHO and RHMO, the Company assumed 100% of losses related to the HMO commercial institutional fund benefits and Medicaid business above \$200,000. Institutional fund benefits include inpatient hospital, emergency room, skilled nursing facilities, emergency room out of area, ambulance, home health, outpatient hospital and hospice. Under the same contracts, the Company covered all Medicare product losses in excess of \$100,000. In accordance with the terms of the agreements, RHO and RHMO agreed to pay the Company a premium on a per member per month basis for this reinsurance coverage. No premiums were paid to the Company under these treaties since the two subsidiary HMOs ceased writing business in 2005.

All the above reinsurance agreements contained a proper insolvency clause in accordance with ORS 731.508(3) as required to take reserve credits for reinsurance ceded. In addition, the Company does not retain risk on any one subject of insurance in an amount exceeding 10% of its surplus pursuant to the provisions of ORS 731.504.

ACCOUNTS AND RECORDS

In general, the Company's records and source documentation adequately supported the amounts presented in the Company's December 31, 2008, annual statement and were maintained in a manner by which the financial condition was readily verifiable pursuant to the provisions of ORS 733.170. From a review of the Company's disaster recovery plan, it was determined that the current information system possessed the physical and internal controls as prescribed by the NAIC.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company has taken corrective action with respect to seven of the eight recommendations made in the 2005 report of examination. A follow-up report was prepared on July 14, 2008.

The one item that was deemed to be out of compliance dealt with the ability to conduct completeness testing on the amount of direct claims reported in process of adjustment. The Company did not maintain claims records in sufficient detail to verify the balances reported at year-end 2005. It was determined that most of these records were on older legacy claims systems that are being quickly phased out with the adoption of FACETS.

SUBSEQUENT EVENTS

The Oregon Public Employees Benefits Board (PEBB) met on April 21, 2009, and elected to end its longstanding relationship with RBCBSO by becoming self-insured. It selected another Oregon domiciled health plan to administer coverage for approximately 102,500 of its members effective January 1, 2010. This follows a similar decision by the Oregon Educators Benefits Board (OEBB) made on April 24, 2008, to move approximately 145,000 enrollees from RBCBSO to other carriers.

FINANCIAL STATEMENTS

The following examination financial statements show the financial conditions of Regence BlueCross BlueShield of Oregon as of December 31, 2008:

Statement of Assets

Statement of Liabilities, Capital and Surplus

Statement of Revenues and Expenses

Reconciliation of Surplus Since the last Examination

REGENCE BLUECROSS BLUESHIELD OF OREGON
STATEMENT OF ASSETS
As of December 31, 2008

	Balance per Company	Examination Adjustment	Balance per Exam	Note
Assets				
Bonds	\$ 546,529,877	\$ -	\$ 546,529,877	1
Stocks				
Preferred stocks	829,172	-	829,172	
Common stocks	153,190,119	-	153,190,119	1
Real estate				
Properties occupied by the company	23,745,458	-	23,745,458	
Cash, cash equivalents and short-term investments	(18,932,601)	-	(18,932,601)	1
Other invested assets (Schedule BA)	22,199,511	-	22,199,511	
Receivable for securities	50,139	-	50,139	
Aggregate write-ins for invested assets	-	-	-	
Subtotal, cash and invested assets	\$ 727,611,675	\$ -	\$ 727,611,675	
Investment income due and accrued	8,740,175	-	8,740,175	
Premiums and considerations:				
Uncollected premiums and agent's balances in the course of collection	80,421,053	-	80,421,053	
Accrued retrospective premiums	5,386,268	-	5,386,268	
Reinsurance				
Amounts recoverable from reinsurers	111,859	-	111,859	
Amounts receivable relating to uninsured plans	27,591,189	-	27,591,189	
Current FIT recoverable and interest thereon	7,034,645	-	7,034,645	
Net deferred tax asset	8,229,819	-	8,229,819	
EDP equipment and software	973	-	973	
Receivables from parent, subsidiaries, and affiliates	28,849,643	-	28,849,643	
Health care and other amounts receivable	5,233,885	-	5,233,885	
Aggregate write-ins for other than invested assets	6,182,824	-	6,182,824	
Total Assets	<u>\$ 905,394,008</u>	<u>\$ -</u>	<u>\$ 905,394,008</u>	

REGENCE BLUECROSS BLUESHIELD OF OREGON
STATEMENT OF LIABILITIES, CAPITAL AND SURPLUS
As of December 31, 2008

	Balance per Company	Examination Adjustment	Balance per Exam	Note
Liabilities, Capital and Surplus				
Claims unpaid	\$ 265,132,654	\$ -	\$ 265,132,654	2
Accrued medical incentive pool and bonus amounts	4,059	-	4,059	2
Unpaid claims adjustment expense	6,945,397	-	6,945,397	2
Aggregate health policy reserves	32,308,035	-	32,308,035	2
Premiums received in advance	27,865,832	-	27,865,832	
General expenses due or accrued	18,230,572	-	18,230,572	
Current FIT payable and interest thereon	740,644	-	740,644	
Ceded reinsurance premiums payable	92,343	-	92,343	
Amounts withheld or retained for the account of others	7,601,147	-	7,601,147	
Remittances and items not allocated	8,095,401	-	8,095,401	
Borrowed money and interest thereon	101,195	-	101,195	
Amounts due to parent, subsidiaries, and affiliates	13,970,718	-	13,970,718	
Payable for securities	1,827,064	-	1,827,064	
Liability for amounts held under uninsured plans	8,480,758	-	8,480,758	
Aggregate write-ins for other liabilities	27,873,951	-	27,873,951	
Total Liabilities	<u>\$ 419,269,770</u>	<u>\$ -</u>	<u>\$ 419,269,770</u>	
Common capital stock	-	-	-	
Gross paid in and contributed surplus	-	-	-	
Surplus notes	-	-	-	
Aggregate write-ins for other than special surplus funds	-	-	-	
Unassigned funds (surplus)	486,124,238	-	486,124,238	
Total capital and surplus	<u>486,124,238</u>	<u>-</u>	<u>486,124,238</u>	
Total liabilities, capital and surplus	<u>\$ 905,394,008</u>	<u>\$ -</u>	<u>\$ 905,394,008</u>	

REGENCE BLUECROSS BLUESHIELD OF OREGON
STATEMENT OF REVENUE AND EXPENSES
For the Year Ended December 31, 2008

	Balance per Company	Examination Adjustment	Balance per Exam	Note
Net premium income	\$ 2,589,064,998	\$ -	\$ 2,589,064,998	
Change in unearned premium reserves	6,588,515	-	6,588,515	
Total Revenues	<u>2,595,653,513</u>	<u>-</u>	<u>2,595,653,513</u>	
Hospital and Medical:				
Hospital/medical benefits	1,140,719,626	-	1,140,719,626	
Other professional services	809,122,996	-	809,122,996	
Outside referrals	25,015,960	-	25,015,960	
Emergency room and out-of-area	62,780,893	-	62,780,893	
Prescription drugs	227,640,127	-	227,640,127	
Incentive pool, withhold adjustments and bonus amounts	<u>197,108</u>	<u>-</u>	<u>197,108</u>	
Subtotal:	2,265,476,710	-	2,265,476,710	
Less:				
Net reinsurance recoveries	<u>(69,893,939)</u>	<u>-</u>	<u>(69,893,939)</u>	
Total medical and hospital	2,335,370,649	-	2,335,370,649	
Non-health claims	-	-	-	
Claim adjustment expenses	123,820,274	-	123,820,274	
General administrative expenses	165,762,200	-	165,762,200	
Increase in reserves for life and accident and health contracts	<u>-</u>	<u>-</u>	<u>-</u>	
Total underwriting deductions	<u>2,624,953,123</u>	<u>-</u>	<u>2,624,953,123</u>	
Net underwriting gain or loss	<u>(29,299,610)</u>	<u>-</u>	<u>(29,299,610)</u>	
Net investment income earned	81,612,497	-	81,612,497	
Net realized capital gains or (losses)	<u>(26,790,948)</u>	<u>-</u>	<u>(26,790,948)</u>	
Net investment gains or (losses)	54,821,549	-	54,821,549	
Net gain (loss) from agents' or premium balances charged off	(402,103)	-	(402,103)	
Aggregate write-ins for other income or expense	<u>2,620,132</u>	<u>-</u>	<u>2,620,132</u>	
Net income or (loss) before federal income taxes	27,739,968	-	28,142,071	
Federal and foreign income taxes incurred	<u>2,646,400</u>	<u>-</u>	<u>2,646,400</u>	
Net Income (loss)	<u>\$ 25,093,568</u>	<u>\$ -</u>	<u>\$ 25,093,568</u>	

REGENCE BLUECROSS BLUESHIELD OF OREGON
RECONCILIATION OF SURPLUS SINCE THE LAST EXAMINATION
For the Year Ended December 31

	2008	2007	2006
Capital and surplus, December 31, previous year	\$ 552,188,131	\$ 533,543,424	\$ 466,860,469
Net income	25,093,568	20,851,464	79,849,176
Change in net unrealized capital gains (losses)	(66,373,063)	978,526	(8,052,933)
Change in net unrealized foreign exchange capital gain or (loss)	(1,715,662)	850,358	-
Change in net deferred income tax	10,946,978	12,772,155	27,944,115
Change in nonadmitted assets	(27,792,002)	(16,807,796)	(30,749,807)
Change in unauthorized reinsurance	-	-	-
Change in surplus notes	-	-	-
Cumulative effects of changes in accounting principles	-	-	-
Capital changes:	-	-	-
Paid in	-	-	-
Transferred from surplus (Stock Dividend)	-	-	-
Transferred to surplus	-	-	-
Surplus adjustments:	-	-	-
Paid in	-	-	-
Transferred to capital (Stock Dividend)	-	-	-
Transferred from capital	-	-	-
Dividends to stockholders (cash)	-	-	-
Examination adjustment	-	-	-
Aggregate write-ins for gains and losses in surplus (1)	(6,223,712)	-	(2,307,596)
Change in surplus as regards policyholders for the year	(66,063,893)	18,644,707	66,682,955
Surplus as regards policyholders, December 31, current year	\$ 486,124,238	\$ 552,188,131	\$ 533,543,424

NOTES TO FINANCIAL STATEMENTS

Note 1 – Invested Assets

At year-end 2008, most of the Company's long-term bond investments were in US government obligations, US agency bonds, municipals, public utilities and miscellaneous industrial bonds. The Company did have exposure to mortgaged-backed and asset-backed securities. All MBS/ABS issues were investment rated at year-end 2007, but the book carrying value of \$212.5 million comprised nearly 39% of the total long-term bond portfolio. An additional \$66.5 million was invested in banks and financial institutions. Cash and short-term deposits consisted of cash on deposit, three long-term bonds purchased within one year of maturity, and five short-term money market funds. A comparison of the investments over the past five years is as follows:

<u>Year</u>	<u>A</u> <u>Bonds</u>	<u>B</u> <u>Common</u> <u>Stock</u>	<u>C</u> <u>Cash and</u> <u>Short-term</u>	<u>Ratio</u> <u>A/</u> <u>Total Assets</u>	<u>Ratio</u> <u>B/</u> <u>Total Assets</u>	<u>Ratio</u> <u>C/</u> <u>Total Assets</u>
2004	282,986,736	148,942,852	40,122,515	37.1%	19.5%	5.3%
2005 *	448,292,824	167,083,354	20,222,415	49.6%	18.5%	2.2%
2006	504,751,251	185,366,186	(21,410,940)	52.3%	19.2%	(2.2)%
2007	587,447,448	213,439,037	3,489,511	56.8%	20.6%	0.3%
2008 *	546,529,877	153,190,119	(18,932,601)	60.4%	16.9%	(2.1)%

*Per examination

The minutes indicated that the Board reviews and approves investments in accordance with the provisions of ORS 733.730 and ORS 733.740. As of December 31, 2008 invested assets with a reported book value of approximately \$58.7 million, representing 8.1% of the total invested assets, were invested in amply secured obligations of the United States, Oregon municipal bonds, or FDIC insured cash deposits, which exceeded the required capitalization amount required by ORS 733.580.

Effective December 29, 2005, the Company entered into an amended and restated custodial agreement with Mellon Bank, NA. The agreement appears to contain all of the relevant protections described in OAR 836-027-0200(4)(a) through (l).

In the course of the examination, the examiners noted three instances of bond ratings that differed from the rating given by the NAIC Securities Valuation Office (SVO). All three bonds were given a rating of NAIC-2 on Schedule D – Part 1, but were in fact rated NAIC-3. No adjustment to surplus is necessary, however, **I recommend the Company report all bonds with the proper NAIC SVO designation, pursuant to SSAP No. 26, paragraph 7 and the NAIC Annual Statement Instructions for Health manual.**

Note 2 - Claims Unpaid and Claims Adjustment Expenses

Scott L. Fitzpatrick, FSA, MAAA, life and health actuary for the Oregon Insurance Division, reviewed the loss and loss adjustment expenses in the Company's filed financial statements as of December 31, 2008. The purpose of his review was to determine, in general, if the Company's liabilities were reasonably stated. In his opinion, he concluded:

	My Estimate	Company Estimate
Claims Unpaid	\$215,790,043	\$265,132,654
Accrued Medical Incentive Pool and Bonus Payments	4,059	4,059
Unpaid Claims Adjustment Expenses	6,473,701	6,945,397
Aggregate Health Policy Reserves	32,308,035	32,308,035
Aggregate Health Claim Reserves	0	0
Experience Rated Refunds	5,784,480	5,784,480
Any Other Actuarial Liabilities	0	0

My calculation of the unpaid claims estimate is simply an accumulation of the payments incurred before year-end 2008 that were paid after the end of 2008 through November 30, 2009, which totaled \$196,172,767 for medical claims and dental claims, plus \$0 using lag completion factor methodology (claims considered 100% complete after eleven months of runout), with 10% added for conservatism. The final estimate was \$215,790,043; \$49,342,611 less than Mr. Thoen's (the Company's consulting actuary) estimate.

The company's estimate for Unpaid Claims Adjustment Expenses amounts to 2.62% of Claims Unpaid. This is slightly less than what I am used to seeing since 4% is average for our domestic companies. Normally, I prefer a slightly higher estimate using 5%. Since my IBNR Reserve estimate includes 10% margin and the claims have been fully run out, I used the percentage of 3%. Multiplying my unpaid claim liability of \$215,790,043 by 3% produced the value of \$6,473,701.

My total estimate for actuarial liabilities is less than the company's estimate by \$49,814,306. Therefore, the statement of the actuarial liabilities at year-end for the annual statement was appropriate and adequate.

Note 3 - Financial Derivatives

The Company responded in the 2008 Annual Statement Notes to Financial Statement No. 1C(9), that the Company does not invest in derivatives with the exception of foreign currency hedges which are stated at fair value.

The Company did not prepare a Derivative Use Plan (DUP) to measure the appropriateness or effectiveness of the hedging technique, which conflicts with SSAP No. 86, paragraph 34, which requires a formal documentation of the hedging relationship and the entity's risk management objective and strategy, including a signature of approval, for each instrument, by an authorized person. The Company responded it discontinued investments in derivatives in April, 2008, however, the examiners noted the investment guidelines approved by its Board of Directors continue to allow investments in derivatives.

I recommend the Company prepare a DUP prior to entering into any future derivative transaction to measure the appropriateness or effectiveness of the hedging technique by SSAP No. 86 paragraph 34 which requires a formal documentation of the hedging relationship and the entity's risk management objective and strategy, including a signature of approval for each instrument by an authorized person.

I also recommend that the Company provide documentation required in SSAP 86, paragraph 35, which requires documentation for all derivatives terminated, expired, or exercised during the year, specifically noting the effectiveness of the hedging strategy.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

There were two comments or recommendations made as a result of this examination, as follows:

Page

- 26 I recommend the Company report all bonds with the proper NAIC SVO designation, pursuant to SSAP No. 26, paragraph 7 and the NAIC Annual Statement Instructions for Health manual.
- 27 I recommend the Company prepare a DUP prior to entering into any future derivative transaction to measure the appropriateness or effectiveness of the hedging technique by SSAP No. 86 paragraph 34 which requires a formal documentation of the hedging relationship and the entity's risk management objective and strategy, including a signature of approval for each instrument by an authorized person.
- 28 I also recommend that the Company provide documentation required in SSAP 86, paragraph 35, which requires documentation for all derivatives terminated, expired, or exercised during the year, specifically noting the effectiveness of the hedging strategy.

CONCLUSION

During the period covered by this examination, the capital and surplus of the Company has increased from \$466,860,469 as presented in the December 31, 2005, report of examination to \$486,124,238 as shown in this report of examination. The comparative assets and liabilities are shown below:

	<u>2008</u>	<u>December 31,</u> <u>2005</u>	<u>Change</u>
Assets	\$905,394,008	\$904,571,297	\$ 822,714
Liabilities	<u>419,269,770</u>	<u>437,710,825</u>	<u>(18,441,055)</u>
Surplus	<u>\$486,124,238</u>	<u>\$466,860,469</u>	<u>\$19,263,769</u>

ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Company during the examination process are gratefully acknowledged.

In addition to the undersigned, Raymond W. Anderson, CFE, Mark A. Giffin, CFE, and Ellen Quale, CPA, AFE, insurance examiners, and Scott Fitzpatrick, FSA, MAAA, Life and Health Actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination. David L. Daulton, CFE, of the firm Huff, Thomas and Company, and Aaron Phillips, examiner for the Utah Department of Insurance, also participated in this examination, both representing the State of Utah.

Respectfully submitted,

Greg A. Lathrop, CFE
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Greg A. Lathrop, CFE, being duly sworn, states as follows:

1. I have authority to represent the state of Oregon in the examination of Regence BlueCross BlueShield of Oregon.

2. The Insurance Division of the Department of Consumer and Business Services of the state of Oregon is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of Regence BlueCross BlueShield of Oregon was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

Greg A. Lathrop, CFE
Supervising Financial Examiner
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to me this _____ day of _____, 2010.

Notary Public for the State of Oregon

My Commission Expires: _____