Best's Rating Report

Health Care Service Corporation

a Mutual Legal Reserve Company

A+

Ultimate Parent:
Health Care Svc Corp Mut Legal Reserve

HEALTH CARE SERVICE CORPORATION, A MUTUAL LEGAL RESERVE COMPANY
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Tel: 312-653-6000 **Fax: 312-540-0544**
AMB#: 009193 **NAIC#: 70670**
Ultimate Parent#: 009193 **FEIN#: 36-1236610**

BEST'S CREDIT RATING
Best's Financial Strength Rating: A+ **Outlook**: Stable
Best's Financial Size Category: XV

RATING RATIONALE

The following text is derived from A.M. Best's Credit Report on Health Care Service Corporation Group (AMB# 069154).

Rating Rationale: The ratings of Health Care Service Corporation (HCSC) and its health insurance lines of business/subsidiaries reflect the strength of the company's capital level, very strong underwriting and net income, as well as its well-established market presence in its primary health insurance markets and its market and product diversity. These strengths are partially offset by the high degree of regulation on its primary business line, moderate organic membership growth, competitive market pressure and earnings concentration.

HCSC has a strong level of capital in support of its business and investment risks. HCSC has a history of consistently reporting positive net income results, which have been particularly strong for the last four years. These favorable results have contributed significantly to capital and surplus expansion and to the company's favorable capital adequacy on a risk-adjusted basis. The health insurance operations of HCSC (which operates as Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma/Montana), as well as its HMO subsidiaries and lines of business, have a well-established market presence in their respective markets. The company has leading market shares in each of the five states in which it operates. HCSC offers a diverse product portfolio designed to meet the ever-changing needs of individuals and large, medium and small employer groups that also meet regulatory required benefits and benefit levels. Additionally, HCSC has a strong complementary portfolio of life and ancillary health product offerings written by its subsidiaries, which are licensed in all 50 states and the District of Columbia.

HCSC's primary line of business is health insurance, which is a highly regulated industry both on a state and federal level. The health insurance industry has been heavily impacted by the Patient Protection and Affordable Care Act. External economic and market conditions in each of the operating markets could pose a challenge for HCSC to continue to grow its businesses organically as the majority of HCSC's enrollment remains employer based. Although employment levels have somewhat stabilized, meaningful employment growth is not anticipated in the near term. Furthermore, the commercial market has been very competitive with many carriers vying for insured business. Additionally, national competitors have attained enough scale to price themselves competitively against the BlueCard program in each of HCSC's operating regions. HCSC's earnings continue to be geographically concentrated in

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the markets of Illinois and Texas. Owing to moderate medical trends and modest enrollment gains, earnings have been strong over the last four years. A.M. Best expects this level of reported earnings to remain positive, but to decline somewhat in the medium term driven by increased enrollment in individual and government business as well as competitive pressure on commercial business pricing.

Positive rating movement on the ratings could occur if HCSC continues to report strong underwriting and net income results, as well as maintains its strong capital and surplus position and its high level of risk-adjusted capital with little disruption to its operations from the new operating environment. A revision to the outlook of the ICR to stable from positive could occur if the organization is negatively affected by new business from healthcare exchanges, government business expansion, or by regulatory and operational changes required under the Patient Protection and Affordable Care Act, if it attempts to aggressively grow in non-core business lines or is unfavorably affected by regulatory changes in its primary states.

KEY FINANCIAL INDICATORS ($000)

Year	Assets	Total Capital & Surplus	Net Premiums Written	Total Revenues	Net Income
2008	10,528,728	6,104,793	16,179,722	16,269,268	742,597
2009	11,377,915	6,692,380	17,619,725	17,505,666	514,461
2010	12,718,574	7,793,536	19,722,014	19,667,777	1,092,641
2011	14,603,800	8,909,829	20,182,710	19,958,096	1,203,879
2012	15,517,614	9,553,748	20,685,942	20,714,282	1,007,066

(*) Data reflected within all tables of this report has been compiled from the company-filed statutory statement.

CORPORATE OVERVIEW

Health Care Service Corporation (HCSC) is a Mutual Legal Reserve Company that conducts business as Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma/Montana where it provides health insurance coverage to approximately 13.8 million members. HCSC's life subsidiary, Dearborn National, and its insurance subsidiaries, Dearborn National Life Insurance Company of New York and Colorado Bankers Life Insurance Company, offer individual and group life insurance and ancillary products in 50 states and the District of Columbia. With the products available through Dearborn National, HCSC can provide a complete array of health and life insurance products to both individuals and employer groups.

HCSC's complementary group life product offerings are marketed through the distribution systems of HCSC as well as other Blue Cross and Blue Shield plans in numerous states. The life companies fulfill the product diversity goals of HCSC. Dearborn National has laid out an operating strategy that is designed to exploit the parent company's marketing position by leveraging its relationships within the Blue Cross Blue Shield system while maintaining selective distribution outside the "Blues" network. Dearborn National is in the process of aligning its core complimentary group product offerings as well as its voluntary product base with its parent's medical products in its home states.

Additionally, HCSC owns GHS Property & Casualty Insurance Company which offers a broad range of personal lines coverage, including private passenger automobile, homeowners, dwelling fire, personal umbrella, as well as short-term health policies in Texas and Oklahoma.

BUSINESS PROFILE

The following text is derived from A.M. Best's Credit Report on Health Care Service Corporation Group (AMB# 069154).

HCSC offers Blue Cross and Blue Shield branded (Blue brand) products. The company offers indemnity and preferred provider organization (PPO) products through Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma/Montana. In addition, the organization offers health maintenance organization (HMO) and point-of-service (POS) products through several subsidiaries and lines of business. For large multi-state employer groups, HCSC provides access to the national Blue Cross and Blue Shield network through its BlueCard program. Subsidiaries include GHS Health Maintenance Organization (OK) and HCSC Insurance Services Company. Lines of business are the HCSC - Illinois HMO Line of Business and HCSC - Texas HMO Line of Business. All HMOs focus on serving commercial groups of various sizes. The company also offers Blue Cross and Blue Shield branded Medicare Advantage and Medicare Part D prescription drug coverage directly or through its subsidiary, HCSC Insurance Services Company.

Scope of Operations: The company's health operations are defined by three market segments: Group, Government and Retail.

The Group market segment includes Small Group, Large Group and National Accounts. Small Group, which covers over 1.4 million members, represents employer groups with 150 or less employees in Illinois and 50 or less employees in Texas, Oklahoma and New Mexico. In all states, groups of 50 employees and under are more regulated by the state Department of Insurance than other market segments. Product offerings for this segment are standardized and include PPO, HMO, POS and indemnity, and are available only on a fully insured basis. Policyholders in this market are more price sensitive than other markets and may change carriers frequently due to price. Large Group, which covers over 8.1 million members, represents employer groups with 151 - 1,999 employees in Illinois, 51 - 1,999 employees in Texas and Oklahoma, and 51 or more employees in New Mexico. HCSC serves this segment with a cross section of products from PPO and HMO plans to multiple option product offerings (including dual and triple option plans). Self-funding is available to groups of 100 employees or more. Within the Large Group market segment HCSC manages multiple group accounts that do not fall in to the traditional group segment definition such as the Federal Employee Health Benefits Program (FEP), Illinois Labor Accounts, Illinois Municipal Accounts and Interagency Benefit Advisory Committee accounts. Over the past few years, the FEP program has shown growth and now has a membership of approximately 749,000 in the four states combined. National Accounts, which covers about 1.5 million members at December 31, 2012, represents employer groups with over 1,000 employees as well as the processing of BlueCard claims for members covered under other Blue Cross and Blue Shield plans. HCSC offers a variety of healthcare plans to national account customers, including PPO, POS, HMO and indemnity products. A majority of the national accounts covered by HCSC are self-funded.

The Government Market segment is comprised of different government plans in each state. HCSC currently participates in Medicaid programs in New Mexico and Texas, and in Medicare Part D in all four core states.

The Retail Markets segment is divided into two sub-segments: the under age 65 group and the Medicare Supplement (or over age 65). This segment covers approximately 1.4 million individuals. In the under age 65 sub-segment, the company offers a variety of individual and family plans, ranging from comprehensive plans to high-deductible catastrophic coverage. In addition, children-only coverage and temporary/transitional coverage are available in all four states. The over age 65 sub-segment offers Medicare Supplemental plans and Medicare Part D prescription drug coverage offered by its wholly owned subsidiary, HCSC Insurance Services Company (HISC). Also included in this segment are the Illinois Comprehensive Health Insurance Plan and the New Mexico Medical Insurance Plan. These plans are administered by HCSC, doing business as Blue Cross and Blue Shield of Illinois and Blue Cross and Blue Shield of New Mexico. Although the plans are administered by HCSC, the risk is assumed by the state via tax collected from all individual carriers in Illinois and all carriers in New Mexico. Furthermore, HCSC offers Health Check, a medically underwritten comprehensive healthcare product unique to the Oklahoma under 65 market.

Health insurance products are sold through several distribution channels. They include general agents, brokers and consultants. In Illinois, the company utilizes general agents to sell to the individual market and small group employers markets. Brokers market to employer groups of more than 50 lives. In Texas and New Mexico, brokers are the primary distribution channel for all market segments, although some direct sales are made through a telesales unit, which has expanded its direct sales capability by administering online applications and the first month's premium payment. Oklahoma utilizes appointed producers; consulting firms; an in-house General Agency, GHS, Inc.; and direct sales to distribute insurance products. In all states, consultants market to the national accounts.

HCSC recognizes the competitive advantages and operating efficiencies that can be achieved through maintaining state-of-the-art technology infrastructure and systems. The company utilizes several systems for functions such as paying claims, identifying fraudulent claims and maintaining membership. These systems allow the company to better manage its resources and evaluate data. Blue Chip is the company's claim adjudication system that processes all health claims for Illinois, New Mexico, Texas and Oklahoma. The Blue Chip system works with other systems within the organization to generate specific utilization and cost information reports. In addition, the company scans all incoming claim documents, which allows a digitized image of the document to be immediately available in any claims office. Scanning of the claim documents also allows for a more effectively controlled claim inventory process.

The company also recognizes the importance of using the Internet to communicate information about its products and services. Members can access information about pending health claims, receive an electronic explanation of benefits, search for providers and view the drug formulary. Group administrators can view information about HCSC products online and self-funded accounts can utilize online billing. Brokers can complete an application online as well as monitor the status of submitted cases. Key small group producers are able to obtain an online proposal and quote.

Territory: The company is licensed in the District of Columbia, AK, AZ, AR, CO, CT, DE, FL, ID, IL, IN, KY, ME, MD, MA, MI, MN, MO, MT, NE, NJ, NM, OH, OK, OR, PA, SC, TX, UT, VA, WV and WI.

Business Trends: HCSC's strategy for growth relies equally on organic growth as well as on business combinations. The December 1998 merger with Blue Cross and Blue Shield of Texas was the first major step in HCSC's strategic expansion. This transaction provided the combined entity with a significant market presence in the Texas market, while adding needed scale to the overall healthcare operation. In July 2001, HCSC acquired the assets of Blue Cross and Blue Shield of New Mexico, which provided further access to expand into new markets. The company has maintained a strong local presence in sales, marketing, provider relations and contracting offices. Administrative functions are centrally integrated. In November 2005, HCSC and Blue Cross and Blue Shield of Oklahoma completed the merger with Group Health Service of Oklahoma, d.b.a. Blue Cross and Blue Shield of Oklahoma. In 2007, HCSC merged its line of business, HCSC HMO-New Mexico, into Blue Cross Blue Shield of New Mexico. On October 28, 2009, HCSC announced a membership transition agreement with WellPoint, Inc., and its UniCare subsidiaries' commercial membership from the Illinois and Texas markets. Under the agreement, HCSC offered guaranteed replacement coverage for individual and group members in those states. The membership transfers were offered on December 31, 2009, and HCSC achieved membership transfers of over 200,000 in 2010. In September 2013, HCSC completed an affiliation with Blue Cross and Blue Shield of Montana; this transaction added approximately 239,000 members to the HCSC organization as well as further diversified its business geographically. In November 2013, HCSC announced its intention to acquire Lovelace Health Plan, a provider owned health plan in New Mexico with approximately 110,000 commercial and government program members.

In addition to acquisitions of health insurance companies, HCSC has acquired supplemental business as well. On August 15, 2008, HCSC acquired MEDecision, a provider of healthcare information technology for case, disease and utilization management, and has developed secure health information access and exchange capabilities. Additionally, on October 31, 2008, HCSC acquired TMG Health, a leading provider of business provider outsourcing for Medicare, Medicaid, and group retiree health plans. This follows investments in prior years in Prime Therapeutics, a pharmacy benefit management company, and a joint venture between HCSC's subsidiary, THIN, an electronic claims and information network, which, effective June 2009, was merged into Availity, LLC, an advanced Internet-based e-health exchange. HCSC along with WellPoint, Inc. and Blue Cross Blue Shield of Michigan made equal investments in Bloom Health. This joint effort is intended to enable the offering of a nationwide private exchange and defined contribution platform for employers to manage their employee health benefit offerings.

Market Share/Market Presence: HCSC is the market leader in all four Blue branded states. The Illinois plan has 7.4 million members, who comprise over one half of HCSC's total enrollment. The Texas plan

has over 4.8 million members and primarily serves the large local market segment. The New Mexico plan has nearly 300,000 members as of December 31, 2012. The Oklahoma plan has reported approximately 720,000 members at year-end 2012. Nearly 94% of total membership is enrolled in a managed care plan (PPO/POS/HMO). Large group business still accounts for over 60% of HCSC's business. HCSC large group accounts include over one half of Fortune 500 employers in HCSC home states. HCSC also participates with the Blue Cross Blue Shield Association National BlueCard program which makes up another 16% of HCSC's combined enrollment. Although individual business makes up a smaller portion of HCSC's overall enrollment, HCSC has one of the largest individual membership base in the country.

OPERATING PERFORMANCE

The following text is derived from A.M. Best's Credit Report on Health Care Service Corporation Group (AMB# 069154).

Operating Results: HCSC has reported strong earnings over the past three years, with net income of $1.0 billion in 2012, $1.2 billion in 2011 and $1.0 billion in 2010. Operating results in 2013 are likely to tracking to meet 2012 net income. The high level of earnings has been achieved by modest premium growth, repricing efforts to improve operating margins on certain lines of business and a moderate medical trend. Operating margins compressed somewhat in 2012 mainly due to an increased medical loss ratio in the company's commercial business. This is due the institution of minimum loss ratios under healthcare reform legislature and competitive pricing pressure. Prior to 2010, earnings had gradually trended downward from 2007 through year-end 2009, which was partially due to the deliberate strategy to reduce surplus growth through margin reduction. The strong results over the last three years has mainly been due to favorable underwriting results as net investment income remains significantly lower than historic levels due partly due to write downs taken on affiliated subsidiaries. While A.M. Best believes that HCSC will continue to report favorable earnings based on its margins, continued economic pressure on employer groups may negatively affect medium-term results. Furthermore, margins will continue to be pressured due to strategic investments in operational changes required due to healthcare exchanges under the Patient Protection and Affordable Care Act. Additionally, A.M. Best expects the low interest rate environment to continue to affect investment income returns.

The primary driver of HCSC's earnings continues to be the Illinois healthcare operation, which represents over one-half of total membership and operating earnings.

The Texas Blue Cross and Blue Shield healthcare operations have significantly improved over the past few years despite local market pricing challenges. Operating earnings growth in 2012 is due to repricing select products in markets where margins had declined as well as a lower level of utilization. Results for 2010 included additional membership which had transferred from WellPoint/UniCare of Texas Health plan. The impact from the transfer of membership favorably added to earnings in 2010. Additionally, the Texas health maintenance organization (HMO) operations experienced favorable underwriting results for the past five years.

Blue Cross and Blue Shield of Oklahoma's operations have performed well since it merged with HCSC in 2005, and more recently, the company has experienced growth in its administrative service only fee business. Effective January 1, 2009, HCSC entered into an assumption reinsurance agreement with GHS HMO, Inc. (GHS), and any operating gains or losses are excluded from consolidated HCSC reported results. The Oklahoma plan's operations represent 9% of total operating gains for the year-ended December 31, 2012.

The New Mexico operations, which were acquired in 2001, have been challenged to grow earnings due to the competitive environment, A.M. Best acknowledges that New Mexico represents 2% of HCSC's total business.

The primary earnings source for HCSC Insurance Services Company (HISC) is derived from the Medicare Advantage Part D prescription drug business. HISC is the third largest provider of Medicare Advantage Part D benefits within the Blues organization. HISC reported favorable underwriting and net income for 2012.

BALANCE SHEET STRENGTH

The following text is derived from A.M. Best's Credit Report on Health Care Service Corporation Group (AMB# 069154).

Capitalization: HCSC is well capitalized in support of its business and financial risks. Consistently favorable earnings have contributed to steady surplus growth and to favorable capital adequacy on a risk-adjusted basis. HCSC's exposure to investment impairments has been minimal over the past year.

HCSC has used its capital strength to support its subsidiaries over the last three year. Capital infusions were made to Dearborn National Life Insurance Company of $85 million in 2009 and an additional $23 million in 2010 as well as $5.0 million to GHS Property & Casualty Insurance Company in 2010 and an additional $10 million in 2012. Contributions of $1.5 million in 2011 and $10 million in 2012 were made to Colorado Bankers Life Insurance Company.

Risk-based capital has improved in 2012 driven by strong earnings from its core health operations. A.M. Best notes that the overall organization's high level of risk-adjusted capital and its strong core operating results within Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma, particularly the Illinois plan, provide HCSC and its affiliates with adequate financial flexibility to support its operations.

Subsequent to the Texas HMO purchases from NYLCare, the company issued a $400 million debt offering in June 2001, which paid down $267 million of commercial bank debt. In January 2011, HCSC issued $500 million of senior unsecured notes. The January 2011 issuance proceeds were primarily used to repay the $400 million senior notes that matured on June 15, 2011 and the remainder used for general corporate purposes.

HCSC's debt-to-capital ratio as of December 31, 2012, was approximately 4%, and is well below the industry norm. Earnings before interest and tax (EBIT) coverage is strong at approximately 53 times earnings at year-end 2012. The debt-to-capital ratio is expected to remain stable in the near term. Furthermore, the low leverage combined

with strong earnings should result in maintenance of very favorable coverage ratios.

The following text is derived from A.M. Best's Credit Report on Health Care Service Corporation Group (AMB# 069154).

Liquidity: HCSC maintains a very liquid, high quality and well-diversified portfolio with cash and cash equivalents comprising over one-third of invested assets. HCSC's investment strategy is to match short-term maturities with its ongoing obligations. The management of HCSC believes that the fundamental principle of investment is to match uses of funds to sources of funds. The company's long-term perspective is to maintain a highly liquid, low risk short-term balance sheet.

The investment portfolio is conservatively managed and provides adequate liquidity. A majority of assets held are fixed and of the highest quality. HCSC has a fairly limited exposure to the public equity markets and diversifies the portfolio across numerous funds, which are managed by outside vendors; there are also some investment functions performed in-house.

On October 25, 2011, HCSC closed on a five year credit facility for $400 million. There was no balances outstanding against the facility at year end 2012.

MANAGEMENT

Officers: President and Chief Executive Officer, Patricia A. Hemingway Hall; Presidents, Karen M. Atwood (Illinois Division), Ted Haynes (Oklahoma Division), Mike Malouf (Life and Subsidiary Operations), Bert E. Marshall (Texas Division), Kurt B. Shipley (New Mexico Division), Jeffery R. Tikkanen (Retail Markets); Executive Vice Presidents, Martin G. Foster (Plan Operations), Colleen F. Reitan (Financial Services and Internal Operations), Paula A. Steiner (Markets, Retail and Strategy); Senior Vice President and Chief Financial Officer, Kenneth S. Avner; Senior Vice President and Chief Information Officer, Brian R. Hedberg; Senior Vice President and Chief Marketing Officer, J. Darren Rogers; Senior Vice President and Treasurer, Jerry Mallen; Senior Vice President and Chief Actuary, Janice Knight; Senior Vice President and Chief Legal Officer, Deborah L. Dorman-Rodriguez; Senior Vice President and Chief Medical Officer, Stephen Ondra; Senior Vice Presidents, Gary S. Brantz (Analytics and Information Management), Carolyn Dawson (Health Care Management), James Kadela (Finance and Strategic Support and Optimization), Teresa Kline (Health Care Management), Thomas C. Lubben (Compliance and Audit), Nazneen Razi (H/R), Austin J. Waldron (Claims / Customer Service).

Directors: Timothy L. Burke, Milton Carroll, Robert T. Clarke, Michelle L. Collins, James R. Corrigan, Tieman H. Dippel, Jr., Dennis J. Gannon, Dianne B. Gasbarra, M.D., Patricia A. Hemingway Hall, Thomas R. Hix, M. Ray Perryman, Ph.D., Waneta C. Tuttle, Ph.D.

Balance Sheet
Assets ($000)

	12/31/2012
Total bonds	$ 5,024,021
Total preferred stocks	10,076
Total common stocks	1,239,202
Real estate	1,068,744
Cash & short-term inv	2,809,740
Health care recvble	413,309
Net deferred tax asset	322,017
Prems and consids due	1,669,652
Accrued invest income	36,858
Uninsured A&H plans	2,685,183
Other assets	238,813
Assets	$15,517,614

Liabilities ($000)

Claims payable	$ 1,664,341
Unpaid claims adj	74,744
Accrued med incent pool	152,777
Advance premiums	202,454
Comm taxes expenses	1,289,905
Unallocated items	554,415
Borrowed money	509,577
Health policy reserves	1,364,582
Other liabilities	151,070
Total Liabilities	$ 5,963,865
Unassigned surplus	9,552,591
Other surplus	1,158
Total	$15,517,614

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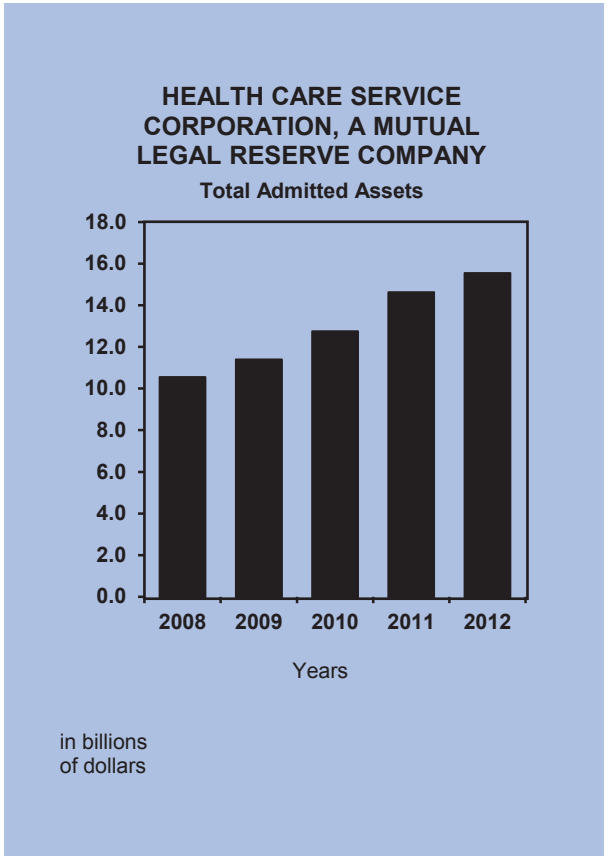

FINANCIAL SUMMARY ($000) as of 12/31/2012

Capital & Surplus	$	9,553,748
Net Premiums Written	$	20,685,942
Assets	$	15,517,614
Total Life Insurance Issued	$	...
Total Life Insurance In Force	$	...

Best's Rating Report

Why is this *Best's® Rating Report* important to you?

A Rating Report from the A.M. Best Company represents an independent opinion from the leading provider of insurer ratings of a company's financial strength and ability to meet its obligations to policyholders.

The A.M. Best Company is the oldest, most experienced rating agency in the world and has been reporting on the financial condition of insurance companies since 1899. The Best's Financial Strength Rating **opinion** addresses the relative ability of an insurer to meet its ongoing insurance obligations. The rating is not assigned to specific insurance policies or contracts and does not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of an insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Best's Financial Strength Rating is **not a recommendation** to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser.

The company information appearing in this pamphlet is an extract from the complete company report prepared by the A.M. Best Company.

A Best's Financial Strength Rating is assigned after a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile.

Best's Financial Strength Ratings are assigned according to the following scale:

Secure Best's Financial Strength Ratings

A++ and A+ . . . . . Superior
A and A- . . . . . Excellent
B++ and B+ . . . . . Good

Vulnerable Best's Financial Strength Ratings

B and B- . . . . . Fair
C++ and C+ . . . . . Marginal
C and C- . . . . . Weak
D. . . . . Poor
E. . . . . Under Regulatory Supervision
F . . . . . In Liquidation
S . . . . . Rating Suspended

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