

Best's Rating Report

Health Care Service Corporation

a Mutual Legal Reserve Company



A+

Health Care Service Corp
HEALTH CARE SERVICE
CORPORATION, A MUTUAL LEGAL
RESERVE COMPANY

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BEST'S RATING

Based on our opinion of the consolidated Financial Strength of the life/health members of Health Care Service Corp., which operate under a group structure, this group member is assigned a Best's Rating of A+ (Superior). The company is assigned the Financial Size Category of Class XV which is the Financial Size Category of the parent.

RATING RATIONALE

Rating Rationale: The ratings of Health Care Service Corporation (HCSC) and its health insurance subsidiaries reflect the company's established market presence in its selected health insurance markets, sound financial and operating discipline, market and product diversity as well as solid capitalization. These strengths are partially offset by the low enrollment growth in New Mexico and the integration risks associated with merging Group Health Service of Oklahoma (d/b/a Blue Cross and Blue Shield of Oklahoma) into HCSC.

The health insurance operations of HCSC (which operates as Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma) as well as its HMO subsidiaries and lines of business, have an established

market presence in their respective markets. Market shares reported for Illinois, Texas, New Mexico and Oklahoma are 46%, 26%, 29% and 23%, respectively. A diverse product portfolio designed to meet the needs of individuals and large, medium and small employer groups has contributed to the strong market share. Additionally, HCSC has a growing business of life product offerings through its subsidiaries that are licensed in 50 states and the District of Columbia. Regional diversity minimizes geographic and regulatory risk. Net income has exceeded \$300 million for the past six years, excluding a one-time charge in 2002 and was more than \$900 million for the past three years. HCSC is well capitalized. Historically strong earnings have contributed significantly to consistent surplus growth and to favorable capital adequacy on a risk-adjusted basis. HCSC's debt to capital ratio was under 10% at year-end 2006 and is considered below industry average. Debt service coverage was strong at more than 30 times at year-end 2006.

Enrollment at the New Mexico plan has marginally improved over the past two years, after declining in 2004. The decline in enrollment in 2004 was attributable to the loss of a national account. However, the New Mexico market is extremely competitive with HMO's owned by medical delivery systems as the major competitors. A.M. Best expects the growth of the New Mexico segment to remain challenged in the near term due to competitive pressures. However, A.M. Best recognizes that the New Mexico segment represents only 2% of HCSC's net premium written and membership. Additionally, there are business risks associated with the merger of Group Health Service of Oklahoma, particularly when system integration is impacted. However, A.M. Best recognizes that HCSC has successfully integrated both the Texas and New Mexico plans in the past, both of which included system migrations.

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Best's Rating: A+ g

Outlook: Stable

KEY FINANCIAL INDICATORS (\$000)

Year	Assets	Total	Net	Total	Net
		Capital & Surplus	Premiums Written	Revenues	Income
2001	3,913,120	1,283,573	6,712,606	6,766,821	399,514
2002	4,540,794	1,552,388	8,050,938	8,056,088	229,098
2003	5,392,652	2,286,982	9,062,155	9,061,771	659,507
2004	6,401,252	3,101,301	10,700,103	10,752,605	1,051,016
2005	7,770,387	4,268,276	11,772,425	11,883,927	1,145,599
2006	9,162,657	5,262,751	12,991,761	13,228,546	1,115,440

BUSINESS REVIEW

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 where it provides health insurance coverage to over 11 million members. HCSC's life subsidiaries, collectively known as the Preferred Financial Group (PFG) offer individual and group life insurance products in 50 states and the District of Columbia. With the products available through PFG, HCSC can provide a complete array of health and life insurance products to both individuals and employer groups.

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. A.M. Best believes that HCSC will continue to seek opportunities for strategic combinations with other Blue Cross and Blue Shield plans.

HEALTH INSURANCE OPERATIONS: The HCSC organization offers Blue Cross and Blue Shield branded (Blue brand) products. The BlueCard PPO network provides value to the Blue brand by providing access to the national Blue Cross and Blue Shield network for serving multi-state employers. The company offers indemnity and preferred provider organization (PPO) through Blue Cross and Blue Shield of Illinois/Texas/New Mexico/Oklahoma. In addition, the organization offers health maintenance organization (HMO) and point-of-service (POS) products through several subsidiaries and lines of business. Subsidiaries are: BCI HMO, Inc. (IL), HMO New Mexico, Inc. and GHS Health Maintenance Organization (OK). Lines of business are the HMOs of Blue Cross and Blue Shield of Illinois and HCSC HMO-Texas. All HMOs, except BCI HMO, focus on serving commercial groups of various sizes. The membership at BCI HMO consists of direct pay conversion policies in Illinois. Additionally, the company offers Blue Cross and Blue Shield branded Medicare Advantage and Medicare Part D, prescription drug, coverage through its subsidiary, HCSC Insurance Services Company.

HCSC is a strong player in all four states. The Illinois plan has over 62% of HCSC's total enrollment and has a market share of 45.7%. The

Texas plan has over 3 million members and has a market share of 26.3%. The New Mexico plan has 255,000 members and has a market share of 29.2%. The Oklahoma plan has reported over 500,000 members and a 23.2% market share. Nearly 93% of total membership is enrolled in a managed care plan (PPO/POS/HMO). The companies' large membership base has permitted the creation of the most extensive statewide managed care networks in each of the four states, contracting with a total of over 900 hospitals and 60,000 providers in the four states.

The membership growth and strong market share is attributable to HCSC's product innovation and offering of more affordable health benefit designs. Products introduced include consumer directed health plans (CDHP) in Illinois, Texas and New Mexico; a value-based network option in Illinois which is available to individuals and groups; and a high-performance network, BlueChoice Solutions, in Texas. Individuals in Illinois and Texas can also select a benefit design with a Health Savings Account (HSA) option.

The company's health operations are defined by five segments: national accounts, large group, small group, individual/direct market and government programs.

NATIONAL ACCOUNTS, which covers about 4.3 million members, 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 health care plans to national account customers, including PPO, POS, HMO and indemnity products. The majority of the national accounts covered by HCSC are self-funded. State based national account market share is 20% in Illinois and 15% in Texas. **LARGE GROUP**, which covers over 3.6 million members, represents employer groups with 100 - 1,000 employees in Illinois, 51 - 2,000 employees in Texas and 51 or more employees in New Mexico and Oklahoma. 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. The company has a very strong position in the Illinois municipal account segment, particularly in the Chicago metro area.

SMALL GROUP, which covers over 1.1 million members, represents employer groups with less than 150 employees in Illinois and 50 or less employees in Texas, New Mexico and Oklahoma. 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 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.

THE CONSUMER MARKETS segment is divided into two sub-segments: the under age 65 group and the Medicare Supplement (or over age 65). [approximately 1.1 million] 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 is available in all four states. The over age 65 segment offers Medicare Advantage plans, which is the renamed "Medicare +Choice" plan standardized by the federal government in the

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Medicare Modernization Act of 2003. HCSC offers other standardized plans, however the availability by product type varies by state. 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 a 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.

THE GOVERNMENT PROGRAMS market segment is comprised of different government plans in each state [approximately 1.1 million]. In all four states, the segment consists of the Federal Employee Health Benefits Program (FEP) as well as state government contracts. The FEP membership has grown steadily over the past few years to over 650,000 members in the four states combined. In addition, HCSC has a significant presence in state government plans. In Illinois, the government market includes the State of Illinois which utilizes only the HMO network. Blue Cross and Blue Shield of Illinois has an 18% market share of the State of Illinois plan, of which almost 80% reside in the Chicago metropolitan area. In Texas, the government market consists of the State of Texas Employees Retirement System (ERS), Teachers Retirement System, University of Texas, Texas A&M University, City of Houston and the Texas Health Insurance Risk Pool. In New Mexico, the government segment consists of the Indian Health Services/Contract Health Services, Medicaid Utilization Review and the New Mexico Medical Insurance Plan, a high risk pool.

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 on-line applications and 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 and Texas. 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. Oklahoma is targeted to be fully integrated into HCSC's key systems within the next year.

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.

LIFE INSURANCE OPERATIONS: HCSC has two life insurance subsidiaries that market products under the name of The Preferred Financial Group (PFG). PFG includes the following insurance companies: Fort Dearborn Life Insurance Company (FDL), Fort Dearborn Life Insurance Company of New York and Colorado Bankers Life Insurance Company (CBL). Effective December 31, 2004, the legal entity and business of Medical Life Insurance Company, was merged into FDL. In addition, on October 1, 2006 Member Service Life Insurance Company (Member Service Life) was also merged into FDL.

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 PFG companies fulfill the product diversity goals of HCSC. PFG has laid out an operating strategy that is designed to exploit the parent company's marketing position by leveraging its relationships within the BCBS system while developing selective distribution outside the "Blues" network. In order to solidify its purpose, PFG will align and merge life companies as appropriate and will continue to pursue a growth strategy through mergers and acquisitions. In addition to the structural changes, PFG is in the process of growing its core group products and is selectively expanding its voluntary product base.

EARNINGS

Health Care Service Corporation's (HCSC) strong earnings are the result of the organizations' consistent pricing discipline. Net income exceeded \$1.0 billion in 2006 and was the sixth consecutive year in excess of \$300 million, excluding a one-time charge in 2002. In 2002, net income included a \$124.6 million one time settlement charge which was part of an agreement between the Illinois Attorney General's Office and HCSC to establish a foundation to address the health care needs of children in Illinois. Underwriting income was over \$1.1 billion in 2006 compared with \$140 million in 2000. HCSC's earnings have remained strong despite the goodwill write-downs from the Texas HMO acquisition that ended in 2004 and the one time settlement charge that occurred in 2002. While A.M. Best believes that HCSC will continue to report strong earnings, results may decline somewhat in the near term due to competitive pressures and as the company prices closer to actual trend.

The primary driver of Health Care Service Corporation's (HCSC) earnings are the Illinois health care operation, which represents over 62% of the membership. The New Mexico operations, which were acquired in 2001, have been challenged to grow earnings due to the competitive environment and the loss of a large hospital system in New Mexico's provider network. However, A.M. Best acknowledges that New Mexico represents only 2% of HCSC's total business.

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The Texas Blue Cross and Blue Shield health care operations performed well in 2006 with all segments reporting positive results. Additionally, the Texas HMO operations experienced growth in underwriting and net gains for the past three years. The significant improvement in the health care expense ratio is the result of rating actions implemented and renegotiated contracts with hospital providers. A.M. Best recognizes that while the Texas HMO operations are strategic to HCSC, it only represents a small portion of the total business.

Blue Cross Blue Shield of Oklahoma has shown favorable underwriting earnings growth since it merged with HCSC in 2005, and more recently, the company has experienced growth in its administrative service only fee business. The plan had contributed over 5% of total underwriting earnings in 2006.

CAPITALIZATION

Health Care Service Corporation (HCSC) is well capitalized in support of its business and financial risks. Historically strong earnings have contributed significantly to consistent surplus growth and to favorable capital adequacy on a risk-adjusted basis.

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. HCSC's debt to capital ratio for 2006 was 8%, which is well below industry norm. Interest coverage is strong at over 30 times. In addition, A.M. Best notes that the overall organization's 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.

INVESTMENTS AND LIQUIDITY

Health Care Service Corporation (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 on-going obligations. The management of HCSC believes that the fundamental principle of investment is to match uses of funds to sources of funds.

The investment portfolio is conservatively managed and provides adequate liquidity. HCSC's invested assets portfolio includes bonds (36%), stocks (17%), real estate (4%), cash and short-term (42%). Bonds are distributed between U.S. Government, Industrial/Miscellaneous, Special Revenue, and Utilities with 96% ranked NAIC class 1 bonds. Approximately 60% of common stock is investments in affiliates.

OFFICERS

President and Chief Executive Officer, Raymond F. McCaskey; Presidents, Paul S. Boullis (Illinois Division), Martin G. Foster (Texas Division), Charles W. Kidd (Oklahoma Division), Larry J. Newsom (Life and Subsidiary Operations), Elizabeth A. Watrin (New Mexico Division); Executive Vice Presidents, Gail K. Boudreaux (External Operations), Patricia A. Hemingway Hall (Internal Operations); Senior Vice President and Chief Financial Officer, Denise A. Bujak; Senior Vice President and Chief Information Officer, John A. Oborn; Senior Vice President, Secretary and Chief Legal Officer, Hugo Tagli, Jr.; Senior Vice President and Treasurer, Brian A. Kennedy (Divisional);

Senior Vice President and Actuary, Kenneth S. Avner (Divisional); Senior Vice Presidents, Raymond A. Angeli, Karen A. Chesrown, Tara D. Gurber, Patrick F. O'Connor.

DIRECTORS

Juliann S. Bluit, D.D.S., Timothy L. Burke, Milton Carroll, Robert T. Clarke, James R. Corrigan, William H. Dailey, Tieman H. Dippel, Jr., Dennis J. Gannon, Dianne B. Gasbarra, M.D., Jack A. Griggs, Thomas R. Hix, Ronald F. King, Raymond F. McCaskey, Alejandro Perez-Tamayo, M.D., M. Ray Perryman, Kenneth J. Rudnick, Wanetta C. Tuttle.

TERRITORY

The company is licensed in the District of Columbia, AK, AZ, AR, CO, CT, DE, FL, GA, ID, IL, KY, ME, MD, MA, MN, MO, MT, NE, NV, NM, NC, OH, OK, OR, PA, TN, TX, UT, WV and WI.

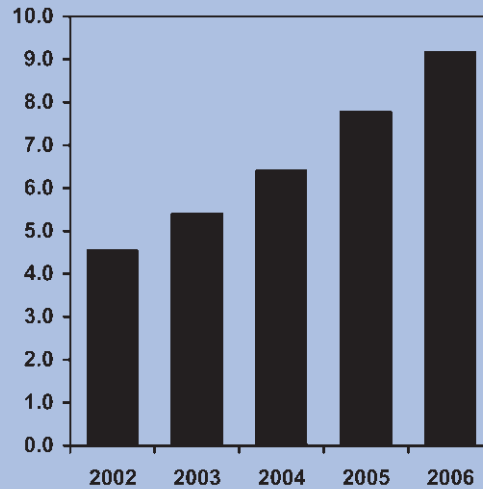
Balance Sheet	
Assets (\$000)	
	12/31/2006
*Total bonds	\$2,221,958
*Total preferred stocks	1,782
*Total common stocks	1,048,228
Real estate	254,800
Cash & short-term inv	2,589,005
Health care rcvble	318,456
Premis and consids due	855,947
Accrued invest income	41,923
Uninsured A&H plans	1,565,985
Other assets	264,571
Assets	\$9,162,657
Liabilities (\$000)	
Claims payable	1,199,379
Unpaid claims adj	340,811
Accrued med incent pool	88,185
Comm taxes expenses	496,156
Unallocated items	492,432
Borrowed money	418,663
Health policy reserves	599,711
Other liabilities	264,569
Total Liabilities	\$3,899,906
Unassigned surplus	5,261,198
Other surplus	1,552
Total	\$9,162,657

*Securities are reported on the bases prescribed by the National Association of Insurance Commissioners.

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HEALTH CARE SERVICE CORPORATION, A MUTUAL LEGAL RESERVE COMPANY

Total Admitted Assets



in billions
of dollars

Years

FINANCIAL SUMMARY (\$000) as of 12/31/2006

Capital & Surplus	\$	5,262,751
Net Premiums Written	\$	12,991,761
Assets	\$	9,162,657
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. Best's Ratings represent the current and independent **opinion** of a company's financial strength and ability to meet obligations to policyholders. Best's Ratings are **not a warranty** of an insurer's current or future ability to meet obligations to policyholders, nor are they a recommendation of a specific policy form, contract, rate, or claim practice.

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 Rating is assigned after an extensive quantitative and qualitative evaluation of a company's financial strength, operating performance and market profile.

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

Secure Best's Ratings

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

Vulnerable Best's Ratings

B and B-Fair
C++ and C+Marginal
C and C-Weak
DPoor
EUnder Regulatory Supervision
FIn Liquidation
SRating Suspended

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