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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AMB#: 09193 **NAIC#: 70670**
Ultimate Parent#: 09193 **FEIN#: 36-1236610**

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 seven years, excluding a one-time charge in 2002 and was more than $700 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 2007 and is considered below industry average. Debt service coverage was strong at more than 30 times at year-end 2007.

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

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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.

Best's Rating: A+ g **Outlook: Stable**

KEY FINANCIAL INDICATORS ($000)

Year	Assets	Total Capital & Surplus	Net Premiums Written	Total Revenues	Net Income
2002	4,552,815	1,552,388	8,116,100	8,121,804	232,748
2003	5,399,704	2,283,527	9,148,929	9,148,992	661,528
2004	6,412,523	3,101,301	10,791,834	10,844,798	1,049,970
2005	7,783,445	4,268,276	11,873,718	11,985,762	1,147,838
2006	9,173,484	5,262,751	13,080,209	13,317,862	1,119,941
2007	10,007,660	6,095,693	14,206,862	14,629,927	865,686

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 12 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.

In addition to acquisitions of health insurance companies, HCSC has acquired supplemental business as well. In June 2008, HCSC announced that it was acquiring MEDecision, a provider of healthcare management solutions. This follows investments in prior years in Prime Therapeutics, a pharmacy benefit management company, and a joint venture between an HCSC and HCSC's subsidiary, THIN, an electronic claims and information network, and Availaity, an advanced internet based e-health exchange.

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) and GHS Health Maintenance Organization (OK). Lines of business are the HCSC - Illinois HMO Line of Business and HCSC HMO-Texas. All HMOs, except BCI HMO, focus on serving commercial groups of various sizes. 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 60% of HCSC's total enrollment and has a market share of 46.6%. The Texas plan has over 3.7 million members and has a market share of 28.2%. The New Mexico plan has 271,000 members and has a market share of 32.4%. The Oklahoma plan has reported over 570,000 members and a 25.3% 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 4.5 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 3.7 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 1.2 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.

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THE CONSUMER 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 1.1 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 is available in all four states. The over age 65 segment offers Medicare Advantage plans, including Medicare Part D, prescription drug coverage. 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 and represents approximately 1.1 million members. 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 670,000 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 2008.

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 three 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).

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 has exceeded $850 million for the past four years supported by strong net investment income earnings. Underwriting gains have declined in 2007 as a result of the company pricing closer to cost trend. 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 continues to price closer to actual trend. In addition, A.M. Best expects volatility in the financial markets to have an effect on near term investment income returns, however the capital at HCSC is sufficient to absorb near term losses should they occur and negatively impact overall earnings.

The primary driver of HCSC's earnings is the Illinois health care operation, which represents over 60% 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.

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However, A.M. Best acknowledges that New Mexico represents only 2% of HCSC's total business.

The Texas Blue Cross and Blue Shield health care operations performed well in 2007 with all segments reporting positive results. Additionally, the Texas HMO operations experienced growth in underwriting and net gains for the past four years. The significant improvement in the health care expense ratio is the result of rating actions implemented and renegotiated contracts with hospital providers.

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.

HCSC Insurance Services Company (HISC) has contributed additional profitability to the consolidated entity since offerings of Medicare Advantage (MA) products began in 2006. The primary earnings source for HISC is derived from the MA Part D, prescription drug, business.

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 2007 was 7%, 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 (32%), stocks (18%), real estate (5%), cash and short-term (45%). Bonds are distributed between U.S. Government, Industrial/Miscellaneous, Special Revenue, and Utilities with 99% ranked NAIC class 1 bonds. Approximately 55% of common stock is investments in affiliates.

OFFICERS

Chief Executive Officer, Raymond F. McCaskey; President and Chief Operating Officer, Patricia A. Hemingway Hall; Presidents, Paul S. Boulis (Illinois Division), Martin G. Foster (Texas Division), Larry J. Newsom (Life and Subsidiary Operations), Elizabeth A. Watrin (New Mexico Division); Executive Vice Presidents, Raymond A. Angeli, Gail K. Boudreaux; Senior Vice President and Chief Financial Officer, Denise A. Bujak; Senior Vice President and Chief Information Officer, John A. Oborn; Senior Vice President and Chief Legal Officer, Deborah L. Dorman-Rodriguez; Senior Vice President and Treasurer, Brian A. Kennedy (Divisional); Senior Vice President and Actuary, Kenneth S. Avner (Divisional); Senior Vice Presidents, Karen A. Chesrown, Tara D. Gurber, Patrick F. O'Connor, Austin J. Waldron.

DIRECTORS

Juliann S. Bluitt, 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)

	12/31/2007
*Total bonds	$ 2,180,890
*Total preferred stocks	22,181
*Total common stocks	1,167,502
Real estate	322,013
Cash & short-term inv	3,000,187
Health care recvble	275,048
Prems and consids due	749,987
Accrued invest income	44,920
Uninsured A&H plans	1,862,653
Other assets	382,278
Assets	$10,007,660

Liabilities ($000)

Claims payable	1,297,328
Unpaid claims adj	406,454
Accrued med incent pool	119,246
Comm taxes expenses	543,062
Unallocated items	464,924
Borrowed money	418,875
Health policy reserves	444,067
Other liabilities	218,012
Total Liabilities	$ 3,911,967
Unassigned surplus	6,094,058
Other surplus	1,634
Total	$10,007,660

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

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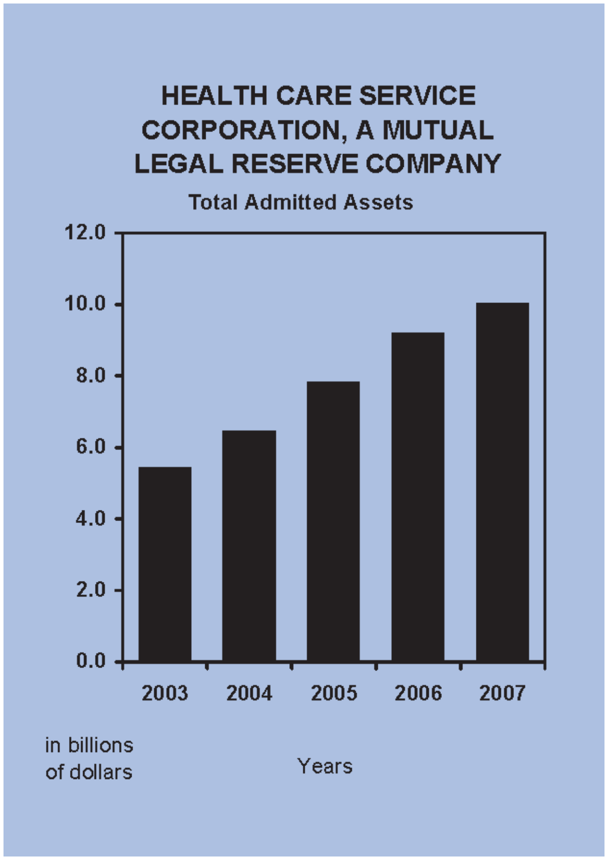

FINANCIAL SUMMARY ($000) as of 12/31/2007

Capital & Surplus	$ 6,095,693
Net Premiums Written	$14,206,862
Assets	$10,007,660
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
D	Poor
E	Under Regulatory Supervision
F	In Liquidation
S	Rating Suspended

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