

AUDITED STATUTORY-BASIS FINANCIAL
STATEMENTS AND SUPPLEMENTARY INFORMATION

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors and
Independent Registered Public Accounting Firm

Ernst & Young LLP



Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Audited Statutory-Basis Financial Statements and
Supplementary Information

Years Ended December 31, 2018 and 2017

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Report of Independent Auditors

The Board of Directors
Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

We have audited the accompanying statutory-basis financial statements of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (the Company), which comprise the balance sheet as of December 31, 2018, and the related statements of operations, changes in capital and surplus and cash flow for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance. Management also is responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2 to the statutory-basis financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, which is a basis of accounting other than U.S. generally accepted accounting principles. The effects on the financial statements of the variances between these statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company at December 31, 2018, or the results of its operations or its cash flows for the year then ended.

Opinion on Statutory-Basis of Accounting

In our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2018, and the results of its operations and its cash flows for the year then ended, on the basis of accounting described in Note 2.

Ernst + Young LLP

April 26, 2019



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Report of Independent Registered Public Accounting Firm

The Board of Directors
Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

We have audited the accompanying statutory-basis balance sheets of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. as of December 31, 2017, and the related statutory-basis statements of operations, changes in surplus and cash flow for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the statutory-basis financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles are described in Note 2. The effects on the accompanying financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. at December 31, 2017, or the results of its operations or its cash flows for the year then ended.

However, in our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. at December 31, 2017, and the results of its operations and its cash flows for the year then ended in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance.

Ernst & Young LLP

April 26, 2019

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Balance Sheets
(Dollars in Thousands)

	December 31	
	2018	2017
Admitted assets		
Bonds	\$ 891,299	\$ 948,471
Common stock	211,118	187,671
Properties occupied by the Company	88,433	90,760
Cash, cash equivalents, and short-term investments	29,154	92,766
Receivable for securities	9,154	7,888
Other invested assets	921,886	952,189
Total cash and invested assets	<u>2,151,044</u>	<u>2,279,745</u>
Accrued investment income	4,542	4,679
Premiums receivable	34,683	46,258
Reinsurance recoverable	–	1,715
Data processing equipment	6,007	7,268
Health care receivables	55,539	65,106
Other receivables	13,539	2,650
Other assets	1,108	4,284
Total admitted assets	<u>\$ 2,266,462</u>	<u>\$ 2,411,705</u>
Liabilities and surplus		
Unpaid claims liabilities	\$ 413,330	\$ 402,230
Accrued medical incentive pool and bonus payments	54,362	97,458
Aggregate policy reserves	39,246	31,962
Premiums received in advance	134,863	110,201
Accounts payable and accrued liabilities	50,135	32,950
Federal income tax payable	213	–
Borrowed money	145,161	320,250
Amounts due to parent, subsidiaries, and affiliates	11,543	18,908
Payable for securities	3,854	14,082
Total liabilities	<u>852,707</u>	<u>1,028,041</u>
Special surplus funds	–	48,717
Unassigned surplus	1,413,755	1,334,947
Total surplus	<u>1,413,755</u>	<u>1,383,664</u>
Total liabilities and surplus	<u>\$ 2,266,462</u>	<u>\$ 2,411,705</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Operations
(Dollars in Thousands)

	Year Ended December 31	
	2018	2017
Premiums earned	\$ 5,096,307	\$ 4,817,365
Health care benefits	4,466,600	4,259,338
Claims adjustment expenses	219,391	190,418
General and administrative expenses	365,144	287,876
Total expenses	5,051,135	4,737,632
Underwriting gain	45,172	79,733
Net investment income	48,372	37,111
Net realized investment gains	491	3,897
Net investment gains	48,863	41,008
Other income	179	693
Net income before federal income taxes	94,214	121,434
Federal income tax expense	213	-
Net income	\$ 94,001	\$ 121,434

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Changes in Surplus
(Dollars in Thousands)

	Unassigned Surplus	Special Surplus Funds	Total Surplus
Balance at December 31, 2016	\$ 1,207,684	\$ –	\$ 1,207,684
Net income	121,434	–	121,434
Change in net unrealized gains	59,451	–	59,451
Change in non-admitted assets	(4,905)	–	(4,905)
2018 ACA health insurer fee	(48,717)	48,717	–
Balance at December 31, 2017	1,334,947	48,717	1,383,664
2018 ACA health insurer fee	48,717	(48,717)	–
Net income	94,001	–	94,001
Change in net unrealized gains	(60,910)	–	(60,910)
Change in non-admitted assets	(3,000)	–	(3,000)
Balance at December 31, 2018	\$ 1,413,755	\$ –	\$ 1,413,755

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Statutory-Basis Statements of Cash Flow
(Dollars in Thousands)

	Year Ended December 31	
	2018	2017
Operating activities		
Premiums received	\$ 5,140,931	\$ 4,917,647
Health care benefits paid	(4,480,525)	(4,238,223)
General and claim adjustment expenses paid	(554,743)	(457,732)
Net investment income received	52,129	42,503
Net cash provided by operating activities	<u>157,791</u>	264,195
Investing activities		
Sales, maturities, and redemptions of investments	508,561	840,653
Cost of investments acquired	(517,877)	(1,095,380)
Net cash used in investing activities	<u>(9,316)</u>	(254,727)
Financing or miscellaneous activities		
Borrowed funds	(175,000)	72,500
Other cash applications, net	(37,087)	(35,212)
Net cash (used in) provided by financing or miscellaneous activities	<u>(212,087)</u>	37,288
Net (decrease) increase in cash, cash equivalents, and short-term investments	(63,612)	46,756
Cash, cash equivalents, and short-term investments:		
Beginning of year	92,766	46,010
End of year	<u>\$ 29,154</u>	<u>\$ 92,766</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (Dollars in Thousands)

December 31, 2018

1. Nature of Business

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue” or the “Company”), a wholly-controlled subsidiary of Blue Cross and Blue Shield of Massachusetts, Inc. (“BCBSMA”), is a Massachusetts nonprofit corporation organized under Chapter 180 of the Massachusetts General Laws (“M.G.L.”) and holds a health maintenance organization license pursuant to Massachusetts General Laws Chapter 176G. HMO Blue and BCBSMA (collectively, the “Companies”) operate under common management and Board of Directors control. The Company provides hospitalization, medical, and other health benefits to members through contracts with hospitals, participating physicians, skilled nursing facilities, nursing homes, and other health care providers and organizations. The Company offers a variety of HMO and other supplementary programs for the benefit of its members.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared in accordance with the National Association of Insurance Commissioners (“NAIC”) *Statements of Statutory Accounting Principles* (“SSAP”), and in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance (“DOI”), which practices differ from US generally accepted accounting principles (“GAAP”).

The more significant variances from GAAP are as follows:

Investments: Investments in bonds not backed by other loans are principally stated at amortized cost using the constant yield (interest) method. Bonds can also be stated at the lesser of amortized cost or fair value based on their NAIC designated rating. Preferred stocks are reported at lower of cost or fair value. The related net unrealized gains (losses) are reported in unassigned surplus. For GAAP, such fixed maturity investments would be designated as available-for-sale or held-for-trading and reported at fair value with unrealized investment gains and losses reported as a separate component of stockholder’s equity for available-for-sale, unless the decline is believed to be other-than-temporary, or as earnings for held-for-trading.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Fair value for statutory purposes, as with GAAP, is based on quoted market prices while the fair value of private placements and credit tenant loans is obtained from independent third-party dealers.

The Company has a process in place to identify bonds, excluding loan-backed and structured securities that could potentially have an impairment that is other-than-temporary. For statutory reporting, the Company recognizes other-than-temporary impairment losses on bonds with unrealized losses when either of the following two conditions exist: the Company either (1) has the intent to sell the debt security or (2) is more likely than not to be required to sell the debt security before its anticipated recovery. Declines in value due to credit difficulties are also considered to be other-than-temporarily impaired when the Company does not have the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in value. For statutory reporting, the entire difference between amortized cost and fair value on such bonds with credit difficulties is recognized as an impairment loss in earnings. For GAAP, an impairment loss is recognized in earnings determined as the difference between amortized cost and the net present value of the projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. The remaining difference between the net present value and the fair value is recognized as a non-credit unrealized loss in accumulated other comprehensive income for GAAP.

All single class and multi-class mortgage-backed or asset-backed securities (i.e. collateralized mortgage obligations) are adjusted for the effects of changes in prepayment assumptions on the related accretion of discounts or amortization of premiums of such securities using either the retrospective or prospective methods. The retrospective adjustment method is used to value all such securities, except principal-only and interest-only securities and such securities with NAIC designations of 3 through 6, which are valued using the prospective method. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the present value of estimated future cash flows using the original effective interest rate inherent in the security.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

For GAAP, all securities purchased or retained that represent beneficial interests in securitized assets (i.e. asset-backed securities, including collateralized mortgage obligations, collateralized bond obligations, collateralized debt obligations, collateralized loan obligations, and mortgage-backed securities) and other than high credit quality securities with fixed rates of interest are carried at fair value, and their rate of income recognition is adjusted using the prospective method when there is a change in estimated future cash flows.

If it is determined that an other-than-temporary credit impairment has occurred, the security is written down through earnings to the present value of estimated future cash flows using the original effective interest rate inherent in the security, with any further non-credit impairment recorded in the accumulated other comprehensive income to adjust the investment to its current fair value. This non-credit portion of the impairment recorded for GAAP is not recognized under NAIC guidelines. High credit quality asset-backed securities with fixed rates of interest are also carried at fair value for GAAP, but if their estimated future cash flows change, the retrospective method is used.

Investments in real estate are reported net of related obligations rather than on a gross basis. Real estate owned and occupied by the Company is included in investments rather than reported as an operating asset under GAAP, and investment income and operating expenses include rent for the Company's occupancy of those properties.

Non-admitted Assets: Certain assets designated as "non-admitted," including furniture, fixtures and equipment, leasehold improvements, non-operating system software, prepaid expenses, certain premium receivable balances, and other assets not specifically identified as an admitted asset within the SSAP, are excluded from the accompanying balance sheets and are charged directly to surplus. Under GAAP, such assets are included in the balance sheets, net of any impairment charge.

Statements of Cash Flow: Cash, cash equivalents, and short-term investments in the statements of cash flow represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Other significant accounting practices are as follows:

Use of Estimates

The preparation of the financial statements in conformity with Statutory Accounting Principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Investments

Investments are stated at values prescribed by the NAIC, as follows:

Investments in bonds not backed by other loans are principally stated at amortized cost using the constant yield (interest) method. Bonds can also be stated at the lesser of amortized cost or fair value based on their NAIC designated rating.

Common stock is stated at fair value.

The Company has various ownership interests in limited liability partnerships and limited liability companies. The Company carries these investments based on its ownership interest in the underlying GAAP equity of the investee. These investments are included as other invested assets on the balance sheets.

Unrealized gains and losses on common stock and other invested assets are reflected directly in surplus unless there is deemed to be an other-than-temporary decline in value, in which case the loss is charged to income. Realized gains and losses on investments sold are determined using the specific identification method and are included in income.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Amortization of bond premium and accretion of bond discount are recognized on a yield-basis method. Security transactions are accounted for on a trade-date basis, with any unsettled transactions recorded as due to or from investment broker and included as payable or receivable for securities in the balance sheets.

Investment income is recognized as income when earned. Accrued investment income is defined as investment income earned as of the reporting date, but not legally due to be paid to the Company until subsequent to the reporting date.

Cash equivalents are short-term highly liquid investments with original maturities of three months or less and are principally stated at amortized cost. Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at amortized cost.

Real Estate

Land is recorded at cost, and other real estate, which includes expenditures for significant improvements, is recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life (typically 50 years).

The Companies jointly own land and buildings with 349,058 square feet of office space in Quincy, Massachusetts and 328,945 square feet of office space in Hingham, Massachusetts.

The components of the Company's real estate are summarized as follows:

	December 31	
	2018	2017
Land and buildings	\$ 115,288	\$ 115,428
Less accumulated depreciation	(26,855)	(24,668)
Net real estate occupied by the Company	<u>\$ 88,433</u>	<u>\$ 90,760</u>

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Under statutory reporting guidelines, the Companies are required to calculate imputed rental income for owner-occupied real estate. The method for calculating imputed rental income is based on estimated rental rates of like property in the same area multiplied rentable square feet. These imputed amounts are reported as net investment income and general and administrative expenses in the statements of operations reflecting that the Company had recorded annual rent of \$6,058 for December 2018 and 2017.

Furniture, Equipment, and Capitalized Software

The admitted value of the Company's electronic data processing equipment ("EDP") and operating software is limited to three percent of adjusted surplus. The Company's admitted portion is reported at cost, less accumulated depreciation.

The components of the Company's EDP and operating software are summarized as follows:

	December 31	
	2018	2017
EDP equipment and operating software	\$ 49,170	\$ 46,879
Less accumulated depreciation	(43,163)	(39,611)
Net EDP equipment and operating software	<u>\$ 6,007</u>	<u>\$ 7,268</u>

The Company calculates depreciation on furniture, equipment, and leasehold improvements and amortization of capitalized software using the straight-line method. Furniture and equipment is depreciated over its estimated useful life or ten years; leasehold improvements over the lesser of its useful life or the term of the lease; operating software over the lesser of its useful life or three years; and internally developed software over the lesser of its useful life or five years.

Depreciation and amortization expense charged to income in 2018 and 2017 was \$16,330 and \$19,784, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

The Company continually evaluates the recoverability of long-lived assets by assessing whether the carrying amount of asset balances can be recovered as measured against the future undiscounted net cash flows expected to be generated by the assets. The future undiscounted net cash flows are based on historical trends, revenue forecasts, and market trends projected over the remaining life of the long-lived assets.

If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. In 2018 and 2017, the Company did not have any impairment expenses.

Unpaid Claims Liabilities

The Company uses estimates for determining its claims incurred but not yet reported which are based on historical claim payment patterns, healthcare trends and membership, and includes a provision for adverse changes in claim frequency and severity. Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately settled.

Liabilities at any year end are continually reviewed and re-estimated as information regarding actual claims payments become known. This information is compared to the originally established year end liability.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate.

Accrued Medical Incentive Pool and Bonus Payments

Medical incentive pools and bonus accruals represent the liability for risk sharing arrangements with health care providers where the Company agrees to share savings with contracted providers.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Aggregate Policy Reserves

Aggregate policy reserves represent a reserve for unearned premium income, rate credits, experience rating refunds, ACA risk adjustment and medical loss ratio rebates.

Premium Deficiency

The Company evaluates its health care contracts to determine if it is probable that a loss will be incurred. A premium deficiency loss is recognized when it is probable that expected future paid claims, administrative expenses, and reserves will exceed existing reserves plus anticipated future premiums on existing contracts. Anticipated investment income and overhead expenses are also considered in the calculation of premium deficiency losses. As of December 31, 2018 and 2017, the Company did not have a premium deficiency reserve.

Premiums

The Company receives premium revenue from insured business. Member premiums are billed in advance of their respective coverage periods. Premium receivables are recorded when due. Premium earned is recorded during the coverage period. Aggregate policy reserves are established to cover the unexpired portion of premiums written and are computed by pro-rata methods for direct business.

Expenses incurred in connection with acquiring new insurance business, including acquisition costs such as sales commissions, are charged to administrative expenses as incurred. The premium paid by subscribers prior to the effective date is recorded in the balance sheet as premiums received in advance and subsequently credited to income as earned during the coverage period.

The provisions of the Patient Protection and Affordable Care Act (“PPACA” or “ACA”) and implementing regulations require commercial health plans with a medical loss ratio (“MLR”) on fully insured products that fall below certain targets to rebate ratable portions of their premiums annually. The Company’s management thereby regularly monitors MLR calculations by market type and records the applicable liability and expense if the MLR falls below the minimum requirements pursuant to the PPACA.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

For uncollected premium, after the calculation of non-admitted amounts, an evaluation is made of the remaining admitted assets in accordance with SSAP No. 5, *Liabilities, Contingencies and Impairment of Assets*, to determine if there is a collectability issue.

If it is probable that the balance is uncollectible, any uncollectible amount is written off and charged to income in the period the determination is made. In 2018 and 2017, the amount charged to income was \$325 and \$487, respectively.

Affordable Care Act (“ACA”)

Effective January 1, 2014, the Company adopted Statement of Statutory Accounting Principles No. 106, *Affordable Care Act Assessments* (“SSAP 106”). SSAP 106 provides accounting treatment for the assessment under Section 9010 of the Patient Protection and Affordable Care Act (ACA) of entities issuing health insurance. Refer to Note 20.

Effective January 1, 2014, the Company also adopted SSAP No. 107, *Accounting for the Risk-Sharing Provisions of the Affordable Care Act* (“SSAP 107”). The Affordable Care Act (“ACA”) imposes fees and premium stabilization provisions on health insurance issuers offering commercial health insurance. The risk-sharing provisions include three programs known as risk adjustment, reinsurance, and risk corridor. The required payments to the programs are reported as assessments and amounts distributed back to the insurance companies are presented as recoverable or receivable on the balance sheet. Refer to Note 13.

The risk adjustment program based on Section 1343 of the ACA is effective beginning in the 2014 benefit year and continues as a permanent program. The risk adjustment program includes health plans participating in the state individual or small group markets. The purpose of the risk adjustment program is to transfer funds from lower risk plans to higher risk plans in the same state in order to adjust premiums for adverse selection among carriers caused by membership shifts due to guarantee issue and community rating mandates.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

The Company takes part in the federal risk adjustment program whereby premium adjustments are based on the risk scores of enrollers rather than the actual loss experience of the insured. The risk adjustment payables and receivables are accounted for as premium adjustments subject to redetermination.

In addition to the risk adjustment amount, the federal government determines the user fee, which is treated as an assessment and recognized as an expense and liability when the premium subject to assessment is earned.

The transitional or temporary reinsurance program based on Section 1341 of the ACA was effective for plan years 2014 through 2016. Reinsurance assessments were collected and distributions have been issued during this three-year term. In general, this transitional reinsurance program provided funding to issuers in the individual market that incur high claims costs for enrollees. The program required assessments from all issuers based on a per member annual fee established by the Department of Health and Human Services (“HHS”). The reinsurance program for individual insured products was accounted for as a traditional reinsurance program with assessments reported as ceded premium and distributions received for the reimbursement of claims reflected as ceded claim benefits recovered.

The risk corridor program based on Section 1342 of the ACA was effective for benefit years 2014 through 2016. The risk corridors program applied to Qualified Health Plans (“QHPs”) in the individual and small group markets. If applicable, any risk corridor payable or receivable was reported as a component of accounts receivable, and was included in other receivables on the balance sheets. Any related expense or revenue associated with the risk corridor program was included as a component of premiums earned on the statements of operations.

The three year reinsurance and risk corridor programs ended on December 31, 2016. It was assumed that over this three year period, insurers would gain more familiarity with enrollees and would be able to price their products with greater certainty. These temporary ACA programs were intended to protect against negative effects of adverse selection and risk selection, and also work to stabilize premiums during the initial implementation years of the ACA. Any adjustments or outstanding balances related to these programs are included in the 2018 and 2017 financial results.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Health Care Receivables

The Company enters into contractual agreements with various health care providers to provide certain medical services to its members. Compensation arrangements vary by provider. Certain providers have entered into risk-sharing arrangements with the Company, whereby a settlement is calculated by comparing actual medical claims experience to a pre-approved and predetermined budgeted amount. These settlements are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. Estimated settlements for these risk-sharing arrangements are reflected in health care receivables on the Company's balance sheets.

Other amounts included in health care receivables represent pharmaceutical rebates, claims overpayments, advances to the providers and capitation arrangement receivables. Pharmaceutical rebates are arrangements with pharmaceutical companies negotiated by the Company's pharmacy benefit manager ("PBM"), in which the Company receives rebates based upon certain drug utilization of its subscribers. Claim overpayments occur as a result of several events, including, but not limited to, claim payments made in error to a provider. The Company also makes advances to providers when those advances are supported by legally enforceable contracts and are generally entered into at the request of the providers.

Advances to the providers under a capitation arrangement are usually made in anticipation of future services, and used in connection with some managed care contracts, when a physician or other medical provider is paid a flat amount.

Fair Value of Financial Instruments

The fair value of investment securities is estimated based on quoted prices for those or similar investment securities. The carrying amounts of cash, cash equivalents and short-term investments approximate fair value because of the short maturity of these instruments.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In March 2017, the NAIC made substantive revisions to SSAP No. 69 – *Statement of Cash Flow* to adopt ASU 2016-15 *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments* as issued by the FASB, without modifications. The revisions clarified the classification of eight specific cash flow issues with the objective of reducing diversity in practice. The amendment is to be applied retrospectively, effective for fiscal years beginning after December 15, 2018 and interim periods within those years. Early adoption is permitted. The Company will adopt the amendment in 2019 and is currently assessing the impact of these revisions on its financial statements.

In August 2017, the NAIC adopted non-substantive revisions to SSAP No. 69 – *Statement of Cash Flow* to adopt ASU 2016-18 *Statement of Cash Flows: Restricted Cash* as issued by the FASB. The revision clarifies that restricted cash and cash equivalents shall not be reported as operating, investing or financing activities, but shall be reported with cash and cash equivalents when reconciling beginning and ending amounts on the cash flow statement. A consequential change was incorporated in SSAP No. 1 – *Accounting Policies, Risks & Uncertainties and Other Disclosures* to ensure information on restricted cash, cash equivalents and short-term investments is reported in the restricted asset disclosure. The revision is effective December 31, 2019, to be adopted retrospectively to allow for comparative cash flow statements. Early adoption is permitted. The Company will adopt the amendment in 2019 and is currently assessing the impact of these revisions on its financial statements.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

3. Cash and Investments

Included in various investment related line items in the financial statements are certain financial instruments carried at fair value. Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated by incorporating current market inputs for similar financial instruments. In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models, and assumptions that management believes market participants would use to determine a current transaction price.

The Company's statutory-basis financial assets have been classified, for disclosure purposes, based on a hierarchy defined by SSAP No. 100R, *Fair Value Measurement* ("SSAP 100R"). The levels of the fair value hierarchy are as follows:

Level 1 – Values are unadjusted quoted prices for identical assets in active markets accessible at the measurement date.

Level 2 – Inputs include quoted prices for similar assets in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads, and yield curves.

Level 3 – Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset at the reporting date.

Investments in mutual funds are carried at estimated fair value based on quoted market prices and are recorded in the statutory-basis balance sheets as common stock. These assets include primarily actively-traded exchange-listed mutual funds identified as common stock. Unadjusted quoted prices for these securities are provided to the Company by independent pricing services.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

Level 2 assets consist primarily of bonds, including U.S. government, industrial, and miscellaneous, mortgage backed securities, and preferred stocks which are valued using pricing models with observable market inputs.

Level 3 investments include holdings in real estate investment trusts (“REITs”) and other privately issued stock holdings. Fair values of the REIT holdings are provided to the Company by the trust manager either monthly or quarterly and are derived from limited observable inputs as a result of low transaction volume. The Company also holds privately issued common stocks that experience similarly low transaction volume. The Company obtains prices for these investments quarterly and considers these prices to approximate fair value.

The Company reviews the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets. Such reclassifications are reported as transfers in and out of Level 3, or between other levels, at the ending fair value for the reporting period in which the changes occur. There were no significant transfers between levels for the year ended December 31, 2018.

Investments in partnerships and similar investments are recorded in the statutory-basis balance sheets as other invested assets. Other invested asset investments in subsidiary, controlled, and affiliated entities are recorded using the statutory equity method. These investments are not included within the scope of SSAP 100R.

As of December 31, 2018 and 2017, included in the Company’s Other Invested Assets is an investment in a surplus note, issued by BCBSMA with a carrying value of \$280,749 and \$285,000, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

The following table presents the Company's financial assets that are measured and reported at fair value in the balance sheets by fair value hierarchy level at December 31, 2018 and 2017:

Description	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Bonds:				
Industrial and miscellaneous	\$ –	\$ 2,405	\$ –	\$ 2,405
Common stock:				
Industrial and miscellaneous	143,572	–	67,276	210,848
Parent, subs, and affiliates	–	–	270	270
Total assets at fair value	\$ 143,572	\$ 2,405	\$ 67,546	\$ 213,523

Description	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Common stock:				
Industrial and miscellaneous	\$ 124,959	\$ –	\$ 62,461	\$ 187,420
Parent, subs, and affiliates	–	–	251	251
Total assets at fair value	\$ 124,959	\$ –	\$ 62,712	\$ 187,671

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

Fair Value Measurements in Level 3:

	Balance at January 1, 2018	Transfers in Level 3	Transfers out Level 3	Total Gain Included in Net Realized Capital Gains and (Losses)	Total (Losses) Included in Surplus	Purchases	Sales	Issuances and Settlements	Balance at December 31, 2018
Common stock									
Industrial and miscellaneous Parent, subs, and affiliates	\$ 62,461	\$ –	\$ –	\$ –	\$ 2,927	\$ 1,888	\$ –	\$ –	\$ 67,276
	251	–	–	–	19	–	–	–	270
Total assets	\$ 62,712	\$ –	\$ –	\$ –	\$ 2,946	\$ 1,888	\$ –	\$ –	\$ 67,546

	Balance at January 1, 2017	Transfers in Level 3	Transfers out Level 3	Total Gain Included in Net Realized Capital Gains and (Losses)	Total (Losses) Included in Surplus	Purchases	Sales	Issuances and Settlements	Balance at December 31, 2017
Common stock									
Industrial and miscellaneous Parent, subs, and affiliates	\$ 60,485	\$ –	\$ –	\$ 161	\$ 1,701	\$ 275	\$ (161)	\$ –	\$ 62,461
	236	–	–	–	15	–	–	–	251
Total assets	\$ 60,721	\$ –	\$ –	\$ 161	\$ 1,716	\$ 275	\$ (161)	\$ –	\$ 62,712

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

The table below presents the fair value by hierarchy level for certain financial assets that are not reported at fair value in the balance sheets:

Description	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Bonds:				
U.S. treasury securities	\$ –	\$ 257,815	\$ –	\$ 257,815
Industrial and miscellaneous	–	312,548	–	312,548
Mortgage-backed securities	–	304,192	–	304,192
Total	\$ –	\$ 874,555	\$ –	\$ 874,555

Description	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Bonds:				
U.S. treasury securities	\$ –	\$ 305,404	\$ –	\$ 305,404
Industrial and miscellaneous	–	343,199	–	343,199
Mortgage-backed securities	–	300,178	–	300,178
Total	\$ –	\$ 948,781	\$ –	\$ 948,781

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and fair value of cash and investments are as follows:

	December 31, 2018			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash, cash equivalents, and short-term investments	\$ 29,154	\$ –	\$ –	\$ 29,154
Bonds:				
U.S. treasury securities and agency obligations	261,586	865	(4,636)	257,815
Industrial and miscellaneous	318,336	1,680	(7,468)	312,548
Mortgage-backed securities	311,377	951	(8,136)	304,192
Total bonds	891,299	3,496	(20,240)	874,555
Common stock	187,455	27,209	(3,546)	211,118
Total cash and investments	\$ 1,107,908	\$ 30,705	\$ (23,786)	\$ 1,114,827

	December 31, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash, cash equivalents, and short-term investments	\$ 92,766	\$ –	\$ –	\$ 92,766
Bonds:				
U.S. treasury securities and agency obligations	306,872	909	(2,377)	305,404
Industrial and miscellaneous	339,319	5,713	(1,833)	343,199
Mortgage-backed securities	302,280	1,344	(3,446)	300,178
Total bonds	948,471	7,966	(7,656)	948,781
Common stock	150,826	36,916	(71)	187,671
Total cash and investments	\$ 1,192,063	\$ 44,882	\$ (7,727)	\$ 1,229,218

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

At December 31, 2018 and 2017, there are no bonds that are non-admitted due to a default or near default status.

The following tables show gross unrealized losses and fair values of bonds and equities and length of time that individual securities have been in a continuous unrealized position.

	Less than 12 Months		12 Months or More		Total		Number of Securities
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	
At December 31, 2018							
U.S. treasury securities	\$ 34,669	\$ (318)	\$ 160,510	\$ (4,318)	\$ 195,179	\$ (4,636)	78
Industrial and miscellaneous	106,074	(2,194)	155,573	(5,274)	261,647	(7,468)	552
Mortgage-backed securities	25,332	(325)	213,690	(7,811)	239,022	(8,136)	369
Total Bonds	166,075	(2,837)	529,773	(17,403)	695,848	(20,240)	999
Common stock	29,126	(2,314)	15,045	(1,232)	44,171	(3,546)	3
Total	\$ 195,201	\$ (5,151)	\$ 544,818	\$ (18,635)	\$ 740,019	\$ (23,786)	1,002

	Less than 12 Months		12 Months or More		Total		Number of Securities
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	
At December 31, 2017							
U.S. treasury securities	\$ 209,391	\$ (1,684)	\$ 41,999	\$ (694)	\$ 251,390	\$ (2,378)	89
Industrial and miscellaneous	65,643	(388)	94,957	(1,444)	160,600	(1,832)	260
Mortgage-backed securities	84,919	(569)	143,804	(2,877)	228,723	(3,446)	389
Total Bonds	359,953	(2,641)	280,760	(5,015)	640,713	(7,656)	738
Common stock	1,122	(71)	-	-	1,122	(71)	3
Total	\$ 361,075	\$ (2,712)	\$ 280,760	\$ (5,015)	\$ 641,835	\$ (7,727)	741

In accordance with SSAP No. 2R—*Cash, Cash Equivalents, Drafts, and Short-Term Investments*, all money-market mutual funds (“MMMF’s”) are classified as cash equivalents effective December 31, 2017, and on a prospective basis. As of December 31, 2018 and 2017, the Company’s investments in MMMF’s of \$18,124 and \$22,083, respectively, are included in cash, cash equivalents and short-term investments.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

Management regularly reviews the fair value of the Company's investments. If the fair value of any investment falls below its cost basis, the decline is analyzed to determine whether the decline in value is other-than-temporary. To make this determination for each security, the following is considered:

- The length of time and the extent to which the fair value has been below cost;
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earnings potential;
- Volatility inherent in the asset class to which the investment belongs;
- Management's intent and ability to hold the respective securities long enough for it to recover its value.

At December 31, 2018 and 2017, included in the Company's investments are unrealized losses deemed to be temporary. These investments reflect a range of industries, and the Company determined the current market volatility is temporary.

In 2018 and 2017, the Company did not record any other-than-temporary impairments.

The amortized cost and fair value of bonds at December 31, 2018, by stated maturity, are shown below. Fixed maturities subject to early or unscheduled prepayments have been included based upon their stated maturity dates. Actual maturities may differ from stated maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Cost or Amortized Cost	Fair Value
Within 1 year	\$ 24,367	\$ 24,236
After 1 year through 5 years	296,158	290,970
After 5 years through 10 years	171,982	169,984
After 10 years	398,792	389,365
Total bonds	<u>\$ 891,299</u>	<u>\$ 874,555</u>

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

Proceeds, realized gains and losses from investment securities sales are as follows:

Description	Proceeds from Sales		Realized Gains		Realized Losses	
	2018	2017	2018	2017	2018	2017
Bonds	\$ 447,588	\$ 644,789	\$ 1,511	\$ 4,058	\$ (4,042)	\$ (3,848)
Common stock	–	37,200	–	2,714	–	–
Other invested assets	60,808	155,207	3,916	1,433	(836)	(526)

Gross realized investment gains and losses are as follows:

	2018	2017
Gross gains	\$ 5,455	\$ 8,278
Gross losses	(4,964)	(4,381)
Net realized investment gains	\$ 491	\$ 3,897

Major categories of net investment income are summarized as follows:

	2018	2017
Income:		
Bonds	\$ 24,308	\$ 19,912
Other invested assets	20,045	14,470
Common stock	10,984	8,633
Preferred stock	–	23
Real estate	6,058	6,058
Cash, cash equivalents and short-term investments	1,465	1,243
Other miscellaneous	606	3,043
Total investment income	63,466	53,382
Less: investment expenses	12,907	14,051
Depreciation	2,187	2,220
Net investment income	\$ 48,372	\$ 37,111

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

3. Cash and Investments (continued)

As of December 31, 2018, the Company had the following structured notes:

CUSIP Identification	Actual Cost	Fair Value	Book/Adjusted Carrying Value	Mortgage-Referenced Security (Yes/No)
912810-RF-7	\$ 1,767	\$ 1,747	\$ 1,839	No
912828-K3-3	9,875	10,144	10,406	No
912828-NM-8	8,134	8,128	8,290	No
912828-PP-9	8,277	8,343	8,543	No
912828-QV-5	9,411	9,369	9,679	No
912828-SA-9	10,193	10,221	10,562	No
Total	\$ 47,657	\$ 47,952	\$ 49,319	

4. Restricted Assets

The Company's restricted assets and pledged collateral are summarized in the table as follows:

	2018 Total Gross Restricted	2017 Total Gross Restricted	Increase/ Decrease	2018 Total Admitted Restricted
Restricted assets category				
Federal Home Loan Bank ("FHLB") capital stock	\$ 6,375	\$ 6,375	\$ -	\$ 6,375
Pledged as collateral to FHLB	114,190	112,150	2,040	114,190
On deposit with states ^(a)	1,143	1,142	1	1,143
Other restricted assets ^(b)	8,967	6,333	2,634	760
Total	\$ 130,675	\$ 126,000	\$ 4,675	\$ 122,468

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

4. Restricted Assets (continued)

- (a) At December 31, 2018 and 2017, HMO Blue had restricted securities, included in bonds, and on deposit with the Commonwealth of Massachusetts as required by M.G.L. c.176G, section 26.
- (b) At December 31, 2018 and 2017, BCBSMA had Commonwealth of Massachusetts Tax Credits as restricted assets included in other assets on the statutory-basis balance sheets.

5. Health Care Benefits, Net of Reinsurance

The Company's health care benefits are summarized in the reconciliation of the beginning and ending balances of the unpaid claims liability, net of recoveries, health care receivables and accrued medical incentive pool and bonus payments are as follows:

	2018				
	Unpaid Claims Liability	Reinsurance Recoverable	Health Care Receivable	Medical Incentive Pool and Bonus	Total Health Care Benefits
Net balance at January 1	\$ 402,230	\$ (1,715)	\$ (82,526)	\$ 97,458	\$ 415,447
Incurred related to:					
Current year	4,516,375	–	(136,252)	152,598	4,532,721
Prior years	(36,216)	(1,101)	(26,051)	(2,753)	(66,121)
Total incurred	4,480,159	(1,101)	(162,303)	149,845	4,466,600
Paid related to:					
Current year	4,110,014	–	(78,199)	106,166	4,137,981
Prior years	359,045	(2,816)	(100,460)	86,775	342,544
Total paid	4,469,059	(2,816)	(178,659)	192,941	4,480,525
Net balance at December 31	\$ 413,330	\$ –	\$ (66,170)	\$ 54,362	\$ 401,522

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

5. Health Care Benefits, Net of Reinsurance (continued)

	2017				
	Unpaid Claims Liability	Reinsurance Recoverable	Health Care Receivable	Medical Incentive Pool and Bonus	Total Health Care Benefits
Net balance at January 1	\$ 381,169	\$ (13,611)	\$ (47,178)	\$ 73,953	\$ 394,333
Incurred related to:					
Current year	4,308,739	–	(153,989)	182,021	4,336,771
Prior years	(27,767)	(6,432)	(20,627)	(22,607)	(77,433)
Total incurred	4,280,972	(6,432)	(174,616)	159,414	4,259,338
Paid related to:					
Current year	3,919,347	–	(86,086)	88,763	3,922,024
Prior years	340,564	(18,328)	(53,182)	47,146	316,200
Total paid	4,259,911	(18,328)	(139,268)	135,909	4,238,224
Net balance at December 31	\$ 402,230	\$ (1,715)	\$ (82,526)	\$ 97,458	\$ 415,447

Negative amounts reported for incurred related to prior years result from claims being settled for amounts less than originally estimated. The favorable development in medical claims payables for the years ended December 31, 2018 and 2017, is primarily attributable to actual claim payment patterns and cost trends differing from those assumed at the time the liability was established.

At December 31, 2018 and 2017, health care receivables include \$10,631 and \$17,420, respectively, of amounts that are non-admitted in accordance with SSAP No. 84, *Certain Health Care Receivables and Receivables Under Government Insured Plans*.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate at December 31, 2018 and 2017. Estimated subrogation credits of \$7,022 and \$6,111 were taken into account in determining health care benefits reserves as of December 31, 2018 and 2017, respectively.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

6. Pension and Other Post-Retirement Benefit Plans

The pension and other post-retirement benefit plans (“Plans”) are sponsored by BCBSMA and the associated costs are shared by the Companies. BCBSMA allocates amounts to the Company and wholly owned subsidiaries based on salary ratios. All employees who have completed twelve months of employment are eligible to participate in BCBSMA’s Retirement Income Trust Plan (“RIT”), which grants benefits to retired employees at various levels based on age and years of service. BCBSMA also participates in two noncontributory retirement plans for eligible employees. BCBSMA uses a December 31 measurement date for all of its plans. The Company is an active participating employer of the Plans.

Since 2016, HMO Blue uses a spot rate approach to determine service cost and interest cost. BCBSMA’s actuarial basis for discount rate determination is the Mercer Select 100 Yield Curve.

The Company’s share of the net expenses for the years ended December 31, 2018 and 2017, are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2018	2017	2018	2017	2018	2017
Service cost	\$ 4,700	\$ 6,004	\$ 1,094	\$ 1,106	\$ 20,313	\$ 17,769
Interest cost	6,650	9,180	1,423	1,766	–	–
Expected return on plan assets	(14,320)	(17,382)	(1,819)	(1,899)	–	–
Amortization of unrecognized transitional obligation	159	162	–	–	–	–
Recognized actuarial loss	5,184	7,167	–	–	–	–
Amortization of prior service cost	(16)	(23)	672	820	–	–
Amount of loss recognized due to settlement	–	1,027	–	–	–	–
Total net periodic benefit cost	\$ 2,357	\$ 6,135	\$ 1,370	\$ 1,793	\$ 20,313	\$ 17,769

The Companies do not have any regulatory contribution requirements for 2019. However, the Companies currently intend to make voluntary contributions of \$45,000 to its defined benefit pension plan and \$4,909 to its post-retirement benefit plan in 2019.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

6. Pension and Other Post-Retirement Benefit Plans (continued)

The Companies other post-retirement benefit plan includes medical, dental, and life benefits for retired employees. The plan is funded by a 401(h) account. The Companies made a contribution into this account of \$5,308 and \$5,634 in 2018 and 2017, respectively. Total employer contributions to the post-retirement benefit plan were \$8,175 and \$8,714 in 2018 and 2017, respectively.

BCBSMA also has a 401(k) savings plan for eligible employees. Under the employee savings plan, BCBSMA contributes an amount equal to 100% of employee contributions, up to a maximum of 4% of each employee's compensation, subject to Internal Revenue Service limits of \$55 and \$54 for 2018 and 2017, respectively. The Company's allocated costs for the 401(k) plan were \$6,833 and \$6,603 in 2018 and 2017, respectively. In 2018, the Company continued to make an additional core contribution of 2% of base pay for all associates subject to the Internal Revenue Code limit.

7. Income Taxes

The Company is reporting as an organization exempt from federal income taxes under Internal Revenue Code Section 501(c)(4), and is exempt from Massachusetts state income taxes.

The Company would be required to adopt Accounting Standards Codification No. 740-10, Income Taxes ("ASC 740"), Accounting for Uncertainty in Income Taxes, if it prepared GAAP-basis financial statements for the years ended December 31, 2018 and 2017. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Similar guidance has not been adopted by the NAIC. If the Company were to adopt ASC 740 for statutory reporting purposes, it would have no impact on the financial statements.

The Company files income tax returns in the US federal jurisdiction. The Company's open tax years are 2015 through 2018. The Company would recognize any interest and penalties resulting from ASC 740 in general and administrative expenses.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

7. Income Taxes (continued)

The Tax Cuts and Jobs Act (“TCJA”) was enacted on December 22, 2017. For tax-exempt entities, the TCJA requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis and other provisions. The provision for these taxes at December 31, 2018 is \$213.

8. State Transferable Tax Credits

The General Laws of the Commonwealth of Massachusetts (the “Commonwealth”) provide film tax credits that apply to Massachusetts income and excise taxes relating to expenditures incurred while making motion pictures in the Commonwealth. These film tax credits are transferable and are, therefore, available through purchase to any taxpayer in the Commonwealth.

The Company estimates the utilization of any remaining unused state tax credits by projecting the annual premium tax liability taking into account policy growth and rate changes, projecting future premium tax liability based on projected premium, tax rates and tax credits, and comparing projected future tax liability to the availability of remaining tax credits.

All of the Company’s state tax credits are classified under Massachusetts law as transferable tax credits. All of the tax credits during 2018 were utilized against Massachusetts tax liabilities and are, therefore, admitted.

As of December 31, 2018 and 2017, the carrying value of the Massachusetts tax credits applied to related tax liabilities was \$2,231 and \$19,880, respectively. As of December 31, 2018 the Company did not have any unapplied Massachusetts tax credits. As of December 31, 2017 the Company had unapplied Massachusetts tax credits of \$3,933.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

9. Surplus

The NAIC has imposed regulatory risk-based capital (“RBC”) requirements on health insurance companies, including the Company. The RBC calculation serves as a benchmark for the regulation of health insurance companies’ solvency by state insurance regulators. At December 31, 2018 and 2017, the Company’s total adjusted capital is in excess of the regulatory RBC requirements.

M.G.L. Chapter 141, which applies requirements of unfair insurance competition under Chapter 176D to HMOs and HMOs operated as a line of business, requires an HMO to have adjusted net worth of \$1,500 when initially licensed. Thereafter, an HMO must maintain a minimum adjusted net worth in an amount determined by the DOI based initially on a sliding scale over a seven-year phase-in period effective December 31, 2004. HMOs must maintain a minimum deposit of at least \$1,000 with a trustee acceptable to the DOI. The Company exceeded all regulatory Chapter 141 requirements at December 31, 2018 and 2017.

As a condition of granting an HMO license to HMO Blue, the DOI required the Companies to enter into an agreement with the DOI granting the DOI discretionary authority to require either company to issue a surplus note to the other company if either of the company’s health RBC is significantly higher than the other company’s RBC.

In December 2017, the Company invested in a surplus note in the amount of \$285,000 that was issued by BCBSMA in exchange for cash. The term of the note is 10 years at an interest rate of 2.95% and pays interest annually, commencing on September 30, 2018.

Each payment of interest and principal of the surplus notes may be made after obtaining prior written approval of the Massachusetts Commissioner of Insurance. Subject to payment restrictions, the note may be prepaid in whole at any time, or in part from time to time, without penalty and with interest due on the date of payment.

During September 2018, and after receiving approval from the Commissioner of the Massachusetts Division of Insurance, BCBSMA paid HMO Blue \$6,609 in accrued interest on the surplus note. No principal payments were processed during 2018. As of December 31, 2018 and 2017 there were no unapproved interest or principal payments.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

9. Surplus (continued)

The indebtedness is subordinated to all other obligations of the Company, including but not limited to, claims of members, members' beneficiaries, providers and all other claims, including claims for indebtedness issued, incurred or guaranteed by the Company. This surplus note is not registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

10. Permitted Statutory Accounting Practices

State insurance laws and regulations prescribe accounting practices for determining statutory net income and surplus for insurance companies. In addition, state regulators may permit statutory accounting practices that differ from prescribed practices. The Company had no permitted practices that would have an effect on statutory surplus at December 31, 2018 and 2017.

11. Related-Party Transactions

BCBSMA and HMO Blue (the "Companies") have an intercompany loan agreement which allows borrowings between the companies not to exceed the lesser of 3% of HMO Blue's admitted assets on a statutory basis or 25% of HMO Blue's net worth on a statutory basis calculated as of the previous year-end or if loans exceed the maximum amount per the calculation, by obtaining permission from the Massachusetts Insurance Commissioner of the Company's intent to exceed the limits. These loans bear interest based on the overnight LIBOR rate plus a spread or a fixed rate as agreed to by the Companies. During 2018, there were no intercompany borrowings between HMO Blue and BCBSMA.

As of December 31, 2018 and 2017, the Company had payables with BCBSMA of \$11,543 and \$18,908, respectively.

In 2008, BCBSMA and HMO Blue each committed to invest \$10,000 in BlueCross BlueShield Ventures, Inc. (the "General Partner") and BlueCross BlueShield Venture Partners, L.P. (the "Partnership"), in the form of 20 Class A shares of the General Partner and 17.1% limited interest in the Partnership. BCBS Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield plans to invest in emerging companies that will bring greater innovation, efficiency, consumer-focus and transparency to healthcare.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

11. Related-Party Transactions (continued)

As of December 31, 2018, HMO Blue has contributed \$9,465 to the Partnership and \$100 to the General Partner. As of December 31, 2018, the Company had an outstanding contingent commitment for additional funding of \$435 related to the future equity contributions in the Partnership. As of December 31, 2018 and 2017, the admitted book values of the company's investment in BCBS Venture were \$7,484 and \$7,129, respectively.

In 2011, the Companies each committed to invest \$10,000 in BlueCross BlueShield Ventures II, Inc. (the "General Partner II") and BlueCross BlueShield Venture Partners II, L.P. (the "Partnership II"), in the form of 200 Class A shares of the General Partner II and 10.5% limited interest in the Partnership II. BCBS Venture II is a strategic corporate venture fund formed by twenty Blue Cross and Blue Shield plans to primarily make equity investments in emerging companies of strategic interest to Blue Plans while pursuing positive financial returns.

As of December 31, 2018, HMO Blue has contributed \$8,468 to the Partnership II and \$100 to the General Partner II. As of December 31, 2018, the Company had an outstanding contingent commitment for additional funding of \$1,432 related to the future equity contributions in the Partnership II. As of December 31, 2018 and 2017, the admitted book values of the company's investment in BCBS Venture II were \$7,136 and \$7,293, respectively.

There were no non-admitted assets related to the Company's investments in Subsidiary, Controlled, and Affiliated Entities as of December 31, 2018 and 2017.

HMO Blue and BCBSMA operate under common Board of Directors management and control. The Company participates in a bilateral intercompany agreement with BCBSMA to settle any claims, fees, administrative cost expense allocation, and pass-through cash and expenses paid by one company on behalf of the other company.

Under the terms of its license with Blue Cross and Blue Shield Association, BCBSMA has also entered into a unilateral agreement with HMO Blue to guarantee all current and future financial obligations of HMO Blue.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

11. Related-Party Transactions (continued)

HMO Blue and BCBSMA have an undivided interest in property and equipment. The apportionment of fixed assets is allocated to each company based on a rolling five-year average of pro-rata administrative expenses. Depreciation expenses are charged to each company based on utilization.

Employees of the Companies (the “Associates”) are either: concurrently employed by the Companies or solely employed by BCBSMA or employed under a Tri-Party Agreement between BCBSMA, HMO Blue and Indigo Insurance Services, LLC. (“Indigo”) a subsidiary of Zaffre Investments, LLC.

Individuals solely employed by BCBSMA include senior level management (“SLM”) and non SLM individuals who provide routine services that benefit specific products, programs, and subsidiaries of BCBSMA. The compensation, benefits and administrative expenses of the concurrently employed Associates are charged to the Companies in accordance with their provision of services to each company.

For the individuals solely employed by BCBSMA, the pro-rata portion of compensation, benefits and administrative expenses attributable to the services provided to HMO Blue is charged to HMO Blue on an arm’s length basis, including a mark-up. A common paymaster arrangement has been established for payroll and payroll related benefits. An agency arrangement has been established for payment of claims and operating expenses and receipt of funds. The Companies’ pension and post-retirement benefits plans (“Benefit Plans”) are sponsored by BCBSMA and BCBSMA is liable for the Benefit Plans. BCBSMA charges HMO Blue, as a participating employer of the Benefit Plans, a fee based on HMO Blue’s allocated share of the Benefit Plans’ expenses.

12. Retrospectively Rated Contracts and Contracts Subject to Redetermination

The Company receives premium payments from the Centers for Medicare & Medicaid Services (“CMS”) on a monthly basis to provide comprehensive healthcare benefits for the Company’s insured Medicare members. Premiums are fixed during the contract period, however, are subject to retroactive risk adjustments based on submitted diagnosis data accepted by CMS throughout the year. The Company estimates retroactive risk adjustment revenue based on accepted data and its adjusted risk scores. This revenue is recognized when the amounts become determinable and collectability is reasonably assured.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

12. Retrospectively Rated Contracts and Contracts Subject to Redetermination (continued)

The total amount of net premiums written by the Company that are subject to retrospective rating features was \$505,537 and \$486,156 for the years ended December 31, 2018 and 2017, respectively, which represents approximately 10%, respectively, of Company's written premiums for both 2018 and 2017. No other premiums written by the Company are subject to retrospective rating features.

13. Risk-Sharing Provisions of the ACA

As discussed in Note 2, the Company wrote accident and health insurance premium that is subject to the ACA risk-sharing provisions. The ACA risk-sharing provisions had an impact on admitted assets, liabilities, and revenue for the current and prior year, and were as follows:

	December 31, 2018		2018		Ref ⁽¹⁾
	Receivable	(Payable)	Income	(Expense)	
a. Permanent ACA risk adjustment program					
Premium adjustments	\$ 200	\$ (9,500)	\$ -	\$ (20,284)	(a)
Risk adjustment user fees	-	(400)	-	(726)	(f)
Subtotal ACA permanent risk adjustment program	200	(9,900)		(21,010)	
b. Transitional ACA reinsurance program					
Claims paid	-	-	1,101	-	(b)
Claims unpaid	-	-	-	-	(g)
Related to uninsured plans	-	-	-	-	(g)
Contributions – not reported as ceded premium	-	-	-	-	(c) (d)
Ceded reinsurance premiums	-	-	-	-	(e)
Subtotal ACA transitional reinsurance program	-	-	1,101	-	
c. Temporary ACA risk corridor program					
Accrued retrospective premium	-	-	-	-	(h)
Reserve for rate credits or policy experience rating refunds	-	-	-	-	(h)
Subtotal ACA risk corridors program	-	-	-	-	
d. Total for ACA risk sharing provisions	\$ 200	\$ (9,900)	\$ 1,101	\$ (21,010)	

Ref ⁽¹⁾:

- (a) This receivable has been admitted.
- (b) This recoverable has been admitted.
- (c) There were no reinsurance contributions (not reported as ceded premium) as of December 31, 2018.
- (d) This expense was recorded within administrative expenses.
- (e) There were no ceded reinsurance premiums paid in 2018.
- (f) At December 31, 2018, risk adjustment user fee payable adjustments were \$(400) and \$(326) related to benefit years 2016 and 2017, respectively, and were based on most recent CMS notice received in 2018.
- (g) No balances or premium was excluded from the ACA Reinsurance Program.
- (h) No balances or premium was excluded from the ACA Risk Corridor Program.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

13. Risk-Sharing Provisions of the ACA (continued)

	December 31, 2017		2017		Ref ⁽¹⁾
	Receivable	(Payable)	Income	(Expense)	
a. Permanent ACA risk adjustment program					
Premium adjustments	\$ 14,550	\$ –	\$ –	\$ (11,044)	(a)
Risk adjustment user fees	–	(245)	–	(486)	(f)
Subtotal ACA permanent risk adjustment program	14,550	(245)	–	(11,530)	
b. Transitional ACA reinsurance program					
Claims paid	1,715	–	5,002	–	(b)
Claims unpaid	–	–	–	–	(g)
Related to uninsured plans	–	–	–	–	(g)
Contributions – not reported as ceded premium	–	–	–	–	(c) (d)
Ceded reinsurance premiums	–	–	–	–	(e)
Subtotal ACA transitional reinsurance program	1,715	–	5,002	–	
c. Temporary ACA risk corridor program					
Accrued retrospective premium	–	–	–	–	(h)
Reserve for rate credits or policy experience rating refunds	–	–	–	–	(h)
Subtotal ACA risk corridors program	–	–	–	–	
d. Total for ACA risk sharing provisions	<u>\$ 16,265</u>	<u>\$ (245)</u>	<u>\$ 5,002</u>	<u>\$ (11,530)</u>	

Ref ⁽¹⁾:

- (a) This receivable has been admitted.
- (b) This recoverable has been admitted.
- (c) There were no reinsurance contributions (not reported as ceded premium) as of December 31, 2017.
- (d) This expense was recorded within administrative expenses.
- (e) There were no ceded reinsurance premiums paid in 2017.
- (f) At December 31, 2017, risk adjustment user fee payable adjustments were \$(245) and \$(241) related to benefit years 2016 and 2015, respectively, and were based on most recent CMS notice received in 2017.
- (g) No balances or premium was excluded from the ACA Reinsurance Program.
- (h) No balances or premium was excluded from the ACA Risk Corridor Program.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

13. Risk-Sharing Provisions of the ACA (continued)

	Roll-Forward of Prior Year ACA Risk Sharing Balances										
	Accrued		Received/Paid		Differences		Adjustments		Unsettled		
	Rec	(Pay)	Rec	(Pay)	Rec	(Pay)	Rec	(Pay)	Ref ⁽³⁾	Rec (Pay)	
a. Permanent ACA risk adjustment											
Premium adjustments receivable	\$ 14,550	\$ –	\$ 3,566	\$ –	\$ 10,984	\$ –	\$ –	\$ (10,784)	(a)	\$ 200	\$ –
Premium adjustments (payable)	–	–	–	–	–	–	–	–	(b)	–	–
Subtotal ACA permanent risk adjustment program	14,550	–	3,566	–	10,984	–	–	(10,784)		200	–
b. Transitional ACA reinsurance											
Claims paid	1,715	–	2,816	–	(1,101)	–	–	1,101	(c)	–	–
Claims unpaid	–	–	–	–	–	–	–	–	(d)	–	–
Related to uninsured plans	–	–	–	–	–	–	–	–		–	–
Contributions – not reported as ceded premium	–	–	–	–	–	–	–	–		–	–
Ceded reinsurance premiums	–	–	–	–	–	–	–	–		–	–
Subtotal ACA transitional reinsurance program	1,715	–	2,816	–	(1,101)	–	–	1,101		–	–
c. Temporary ACA risk corridor											
Accrued retrospective premium	–	–	–	–	–	–	–	–		–	–
Reserve for rate credits or policy experience	–	–	–	–	–	–	–	–		–	–
rating refunds	–	–	–	–	–	–	–	–		–	–
Subtotal ACA risk corridors program	–	–	–	–	–	–	–	–		–	–
d. Total for ACA risk sharing provisions	\$ 16,265	\$ –	\$ 6,382	\$ –	\$ 9,883	\$ –	\$ –	\$ (9,683)		\$ 200	\$ –

Ref⁽³⁾:

- (a) Adjustments to the prior benefit year ACA Risk Adjustment received in 2018 were \$10,784 (gross of non-admitted) and were based on the reconsideration settlement notice from the Commonwealth of Massachusetts Health Insurance Connector Authority.
- (b) Adjustments to the prior benefit year ACA Risk Adjustment payable in 2018 was \$0.
- (c) The adjustment for amounts recoverable for claims paid under the Transitional ACA Reinsurance Program was \$1,101 and reflects the differences between previously estimated amounts and the final settlement notice received.
- (d) The adjustment for amounts recoverable for claims unpaid under the Transitional ACA Reinsurance Program was \$0 and reflects the differences between previously estimated amounts and the final settlement notice received.

As of December 31, 2018 and 2017, the Company did not report any risk-sharing provisions related to the temporary ACA Risk Corridor Program. Therefore, no risk-corridor related asset or liability balances were either accrued, impaired or non-admitted.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

14. Health Care Receivables

Amounts receivable for pharmaceutical rebates are estimated based on a per script calculation. Rebate amounts are typically paid on a quarterly basis 150 days after the end of each quarter. The Company's pharmacy rebate receivable balances are as follows:

Quarter	Estimated Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Billed or Otherwise Confirmed	Actual Rebates Received Within 90 Days	Actual Rebates Received Within 91 to 180 days	Actual Rebates Received Within More Than 180 Days
12/31/2018	\$ 4,658	\$ 4,490	\$ —	\$ —	\$ —
9/30/2018	4,656	4,388	—	—	—
6/30/2018	4,380	4,133	—	4,355	—
3/31/2018	4,568	3,568	—	4,062	57
12/31/2017	3,657	3,628	—	3,505	89
9/30/2017	3,715	3,579	—	3,435	259
6/30/2017	2,900	2,902	—	3,514	102
3/31/2017	2,408	2,384	—	3,325	60
12/31/2016	2,384	2,487	—	2,790	50
9/30/2016	2,433	2,305	—	2,792	89
6/30/2016	2,598	2,616	—	2,739	47
3/31/2016	2,383	1,150	—	2,757	210

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

14. Health Care Receivables (continued)

The Company's risk sharing receivable balances are as follows:

Year	Evaluation Period Year Ending	Risk Sharing Receivable as Estimated in the Prior Year	Risk Sharing Receivable as Estimated in the Current Year	Risk Sharing Receivable Billed	Risk Sharing Receivable Not Yet Billed	Actual Risk Sharing Amounts Received in Year Billed	Actual Risk Sharing Amounts Received in First Year After	Actual Risk Sharing Amounts Received in Second Year After	Actual Risk Sharing Amounts Received – All Other
2018	2018	\$ 33,695	\$ 19,158	\$ 15,610	\$ 3,548	\$ 15,610	\$ –	\$ –	\$ –
	2019	–	6,831	35	6,796	35	–	–	–
2017	2017	8,621	12,779	9,878	–	9,878	2,901	–	–
	2018	N/A	33,695	93	36,602	–	–	–	–
2016	2016	17,351	56,332	47,395	8,936	19,952	18,507	–	–
	2017	N/A	8,621	N/A	N/A	N/A	N/A	N/A	N/A

15. Leases

The Companies jointly have a long-term operating lease agreement for 347,618 square feet for its corporate headquarters on Huntington Avenue in Boston, Massachusetts. Occupancy and rental expense commenced April 2015 and will continue for 15 years 2 months, with options to extend for up to 10 years thereafter. Additionally, the Companies jointly occupy space through three smaller, long-term, non-cancelable, operating lease agreements for office and data center facilities, which extend through various dates through 2024.

The Companies sublease a portion of its headquarters through a December 2016 – May 2020 non-cancelable sublease agreement for 34,417 square feet of space, for which \$1,566 of rental payments were received in 2018, with additional monthly installments of \$130 to be received through April 2020.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

15. Leases (continued)

In October 2018 the Companies entered into an additional non-cancelable sublease agreement extending through April 2030 for 43,598 square feet. Occupancy and monthly rental payments of \$185, increasing annually, will commence in 2019. The aggregate future minimum rentals to be received from these agreements is \$28,944. The Companies also sublease approximately 9,300 square feet of space through various smaller, primarily month-to-month, arrangements.

For 2018 and 2017, the Company recorded rental expenses of \$5,925 and \$5,891, respectively, of which, \$5,816 and \$5,785 were related to office space rental expenses, respectively.

At December 31, 2018, allocated minimum rental commitments on significant non-cancelable operating leases for the Company are as follows:

2019	\$	6,477
2020		6,511
2021		6,564
2022		6,579
2023		6,595
Thereafter		42,431

In addition, the Company has agreements with outside vendors to provide certain information technology services for a significant portion of the Company's business operations. The Company's minimum commitments under these agreements vary annually, with amounts ranging from \$6,432 to \$4,012 per year from 2019 through 2021.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

16. Debt

The Company does not have any outstanding capital note obligations in its financial statements as of December 31, 2018.

The Companies jointly entered into three revolving credit agreements. Borrowings under these unsecured lines of credit bear interest on a fixed or floating interest rate basis.

The first facility for \$200,000 matured in June 2018 and was renewed until June 2019. The second facility for \$50,000 matured in June 2018 and was renewed until June 2019. The third facility for \$50,000 matured in October 2018 and was renewed until October 2019.

At December 31, 2018 the Company had no principal or accrued interest outstanding and accrued fees of \$1. At December 31, 2017, the Company had \$150,000 in outstanding principal under these facilities which was paid in 2018. During 2018 and 2017, the Company paid interest of \$642 and \$47 and fees of \$274 and \$244, respectively on these facilities. As a covenant of the first facility, the borrowers are required to certify compliance on an annual basis of a minimum Risk-Based Capital level of 300% of Company Action Level and are required to certify compliance on a quarterly basis that the Cash Reserve Ratio is not less than 1.25 to 1.0. As a covenant of the second and third facilities, the borrowers are required to maintain at all times a combined liquidity of not less than \$1,250,000. As of December 31, 2018, there were no violations of the debt terms and covenants reported.

In October 2014, the Companies jointly entered into a \$150,000 5-year unsecured term loan which amortizes monthly and has a fixed interest rate of 2.35%. The Companies are required to certify compliance on an annual basis of a minimum Risk-Based Capital level of 300% of Company Action Level and a Cash Reserve Ratio is not less than 1.25 to 1.00. The Companies each received proceeds from the term loan of \$75,000. In 2018, HMO Blue paid principal of \$15,000 and interest of \$494. At December 31, 2018, HMO Blue has a carrying value outstanding of \$12,500 and accrued interest of \$1. As of December 31, 2018, there were no violations of the debt terms and covenants reported.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

16. Debt (continued)

In March 2017, the Companies jointly entered into a \$100,000 5-year unsecured term loan which amortizes monthly and has a fixed interest rate of 2.79%. The Companies are required to certify compliance on an annual basis of a minimum Risk-Based Capital level of 350% of Company Action Level and a Cash Reserve Ratio is not less than 1.25 to 1.00. The Companies each received proceeds from the term loan of \$50,000. In 2018, HMO Blue paid principal of \$10,000 and interest of \$1,078. At December 31, 2018, HMO Blue has a carrying value of \$32,500 outstanding and accrued interest of \$3. As of December 31, 2018, there were no violations of the debt terms and covenants reported.

As of December 31, 2018, the combined aggregate amount of long-term borrowing maturities for each of the next five years are as follows:

Debt - Long-Term Borrowings	HMO Blue
Maturing in 2019	22,500
Maturing in 2020 ^(a)	110,000
Maturing in 2021	10,000
Maturing in 2022	2,500
Maturing in 2023	—
Total Maturities	<u>145,000</u>

^(a) Includes \$100,000 in five-year term borrowings from FHLB.

17. FHLB Agreements

The Company is a member of the FHLB of Boston. Through its membership, the Company has conducted business activity (borrowings) with the FHLB. It is part of the Company's strategy to utilize these funds as back-up liquidity and to ensure sufficient capital and credit to meet operational needs and provide financial flexibility to respond to strategic opportunities in the marketplace.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

17. FHLB Agreements (continued)

The Company has determined the actual maximum borrowing capacity as \$100,000. The Company based this amount on anticipated borrowing needs of the Company.

As a requirement of the FHLB membership, the Company has \$2,101 and \$1,875 of FHLB Class B Membership Stock at December 31, 2018 and 2017, respectively. The Class B Membership Stock is not eligible for redemption. In addition, the Company is required to purchase FHLB Activity Stock up to 4.0% of the value of principal borrowed which was reduced from 4.5% as of December 31, 2017. At December 31, 2018 and 2017, the Company recorded \$4,000 and \$4,500 of FHLB Activity Stock, respectively.

At December 31, 2018, the Company had outstanding borrowings of \$50,000 for a 5-year term at a rate of 1.60% which matures in 2020 and a second outstanding borrowing of \$50,000 for a 5-year term at a rate of 2.05% which matures in 2020. During the 2018 and 2017 periods, the Company paid \$1,850 in interest expense. At December 31, 2018 and 2017, the Company had outstanding principal of \$100,000 and accrued interest of \$157.

The Company is required to pledge collateral for all outstanding borrowings with the FHLB which consists of U.S. Government backed securities which are valued at 96% for maturities under 3 years and 94% for maturities over 3 years and FNMA & FHLMC mortgage-backed securities which are valued at 92% of current market value.

The total collateral pledged against these borrowings had a fair value as of December 31, 2018 and 2017, of \$112,388 and \$111,418, respectively, and a carrying value of \$114,191 and \$112,150, respectively. The maximum amounts pledged during the 2018 and 2017 reporting periods had a fair value of \$113,622 and \$112,542 and a carrying value of \$115,490 and \$112,802, respectively. The Company has no prepayment obligations with the FHLB.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

18. Commitments and Contingencies

As of December 31, 2018, the Company's remaining commitments, pursuant to the terms of the investment agreements, are as follows:

Blue Cross Blue Shield Venture Partners, L.P.	\$	435
Blue Cross Blue Shield Venture Partners II, L.P.		1,432
Blue Cross Blue Shield Venture Partners III, LLC.		1,637
Hancock Capital Partners V, L.P.		1,665
Comvest Capital III, L.P.		4,002
Park Square Capital Credit Opp II Feeder, L.P.		6,194
Comvest Capital IV, L.P.		13,431
New Mountain Net Lease, LP.		8,834
Park Square Capital Credit Opp III Feeder, L.P.		16,659
Total Commitments	\$	<u>54,289</u>

The Company is involved in pending and threatened litigation of the character incidental to its business or arising out of its insurance operations, and is, from time to time, involved as a party in various governmental and administrative proceedings. Management continues to monitor these matters, and believes the Company has accrued adequate reserves against potential liabilities.

The Company and all other Blue Plans have been named as defendants in antitrust class-action complaints that have been brought against the Blue Plans and the Blue Cross and Blue Shield Association ("BCBSA"); these cases have been consolidated in a multidistrict litigation pending in Federal Court in Alabama. The plaintiffs, who include both providers and Plan subscribers, assert that they have been damaged as a result of alleged anticompetitive conduct. Their claims focus on, among other things, BCBSA's 'exclusive service area' requirement, 'best efforts' rules (limiting revenue from non-Blue business), alleged restrictions on Plans' ability to transfer ownership interests, and rules governing the BlueCard program. The Company is vigorously defending against these claims, as are BCBSA and the other Blue Plans. The court has not yet set dates for any trials.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued) (Dollars in Thousands)

18. Commitments and Contingencies (continued)

Given the status of the litigation, an ultimate outcome cannot be presently determined or predicted by the Company. As of December 31, 2018, the date of the financial statements, the chance of future events confirming the fact of the loss or incurrence of a liability is reasonably possible and the Company has not accrued a contingent loss related to the litigation. The Company continues to vigorously defend these class actions.

19. State Assessments

In 2018, BCBSMA and HMO were obligated to pay three major assessments. The first is with the Commonwealth of Massachusetts' "*Center for Health Information and Analysis*" ("CHIA"). This is an administrative-type surcharge to cover state operating expenses. In the first quarter of 2018, the second of two HMO Blue payments of \$1,021 was made for the CHIA FY2018 assessment. HMO Blue's assessment to cover CHIA's FY2019 operations was \$1,849, which was paid in two installments during the fourth quarter of 2018.

The second is the Commonwealth of Massachusetts Health Policy Commission's assessment pursuant to Section 958 Chapter 9.04, "*Assessment on Certain Health Care Provider and Surcharge Payors*". This amount is based on the assessment percentage of the Company and the annual legislatively approved budget of the Health Policy Commission for FY2019. HMO Blue's portion of the FY2019 assessment is \$586. The first installment of \$295 was paid in December 2018 and the second payment of \$290 will be paid February 2019.

The third is the Commonwealth of Massachusetts' DOI "*Health Care Assess Bureau*" ("HCAB") assessment to pay for HCAB expenses. This assessment is based on the Company's portion of health premiums as reported to the HCAB. During the first quarter of 2018, HMO Blue paid \$308 to the HCAB for the FY2015 assessment which was based on FY2013 reported premium data. During the second quarter of 2018, HMO Blue paid \$428 to the HCAB for the FY2018 assessment which was based on FY2016 reported premium data.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)
(Dollars in Thousands)

20. ACA Insurer Fee

The Company is subject to an annual health insurance industry fee under section 9010 of the federal ACA. The ACA fee is allocated to individual health insurers based on the ratio of the entity's net premiums written to the amount of health insurance for any U.S. health risk that is written during the preceding calendar year. A health insurance entity's portion of the annual fee becomes payable once the entity provides health insurance for any U.S. health risk for each calendar year beginning on or after January 1 of the year the fee is due.

The Consolidated Appropriations Act of 2016, Title II, § 201, Moratorium on Annual Fee on Health Insurance Providers ("HIPF"), has suspended collection of the HIPF or ACA fee for the 2017 calendar year. Therefore, there was no payment in the 2017 fee year.

As of December 31, 2017, the Company had written health insurance that was subject to the ACA and expected to conduct health insurance business in 2018. The Company's portion of the annual fee for the 2017 data year was \$47,969 and was paid in September 2018. This amount was reflected in the December 2017 special surplus and would have had a 23% impact on the Company's 2017 risk based capital ("RBC") and would not have triggered an RBC action level.

Enacted on January 22, 2018, along with continuing resolution legislation, H.R. 195, Division D – *Suspension of Certain Health-Related Taxes, § 4003*, suspends collection of the fee for the 2019 calendar year only. As of December 31, 2018 the Company did not have an annual health insurance industry fee reflected in special surplus and no payment will be due in the 2019 fee year based on the 2018 data year.

	2018	2017
ACA fee assessment payable for the upcoming year	\$ –	\$ 48,717
ACA fee assessment paid	47,969	–
Premium written subject to ACA 9010 assessment	5,085,434	4,808,793
Total adjusted capital before surplus adjustment	1,413,755	1,383,664
Total adjusted capital after surplus adjustment	1,413,755	1,334,947
Authorized control level after surplus adjustment	225,530	213,071

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

21. Subsequent Events

The Company's management evaluated subsequent events through April 26, 2019, the date the financial statements were available to be issued.

Supplementary Information



Report of Independent Auditors on Supplementary Information

The Board of Directors
Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

We have audited, in accordance with auditing standards generally accepted in the United States, the statutory-basis financial statements of Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. as of December 31, 2018, and for the year then ended, and have issued an adverse opinion with respect to conformity with U.S. generally accepted accounting principles and an unmodified opinion with respect to conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance thereon dated April 26, 2019. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplemental investment disclosures are presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the statutory-basis financial statements as a whole.

This report is intended solely for the information and use of the Company and state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

April 26, 2019

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Investment Risk Interrogatories – Statutory-Basis
(Dollars in Thousands)

December 31, 2018

- Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.’s total admitted assets as reported on page two of its Annual Statement are \$2,266,462.
- Following are the ten largest exposures to a single issuer/borrower/investment, excluding:
 - U.S. government, U.S. government agency securities and those U.S. government money market funds listed in the Appendix to the SVO Practices and Procedures Manual as exempt,
 - property occupied by Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. and
 - policy loans:

Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
BCBSMA Surplus Note	Other invested asset	\$ 280,749	12.387%
PIMCO All Asset Institutional Fund	Common stock	127,283	5.616
Lazard Asset Management Fund	Other invested asset	83,934	3.703
Primus HY Bond Fund	Other invested asset	73,874	3.259
BlueRock Market Neutral Fund LP	Other invested asset	64,591	2.850
RREEFF II Core REIT	Common Stock	60,902	2.687
Putnam Total Return Fund LLC	Other invested asset	59,404	2.621
Newton Global Equity Income Fund	Other invested asset	57,083	2.519
Beachpoint HY Bond Offshore Fund	Other invested asset	52,541	2.318
Parametric Portfolio Assoc LLC	Other Invested asset	48,281	2.130

- Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.’s total admitted assets held in bonds, short-term investments and preferred stock, by NAIC rating, are:

Bonds and Short-Term Investments			Preferred Stock		
NAIC Rating	Amount	Percentage of Total Admitted Assets	NAIC Rating	Amount	Percentage of Total Admitted Assets
NAIC-1	\$ 821,840	36.261%	P/RP-1	\$ –	%
NAIC-2	74,430	3.284	P/RP-2	–	–
NAIC-3	2,404	0.106	P/RP-3	–	–
NAIC-4	–	–	P/RP-4	–	–
NAIC-5	–	–	P/RP-5	–	–
NAIC-6	–	–	P/RP-6	–	–
	<u>\$ 898,674</u>			<u>\$ –</u>	

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Investment Risk Interrogatories – Statutory-Basis (continued)
(Dollars in Thousands)

4. Assets held in foreign investments:

	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
Total admitted assets held in foreign investments	\$ 98,341	4.339%

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:

<u>NAIC Sovereign Rating</u>	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
Countries rated NAIC-1	\$ 62,845	2.773%
Countries rated NAIC-2	9,862	0.435
Countries rated NAIC 3 or below	25,634	1.131

6. Largest foreign investment exposure by country, categorized by the country's NAIC sovereign rating:

<u>NAIC Sovereign Rating</u>	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
Countries rated NAIC-1:		
United Kingdom	\$ 6,699	0.296%
Cayman Islands	24,377	1.076
Countries rated NAIC-2:		
United Kingdom	1,946	0.086
France	2,305	0.102
Countries rated NAIC-3:		
Guernsey	25,634	1.131

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Investment Risk Interrogatories – Statutory-Basis (continued)
(Dollars in Thousands)

7. The Company has no unhedged foreign currency exposure.
8. The Company has no aggregate unhedged foreign currency exposure.
9. The Company has no unhedged foreign currency exposures to a single country.
10. Ten largest non-sovereign (i.e., non-government) foreign issues:

Issuer	NAIC Rating	Amount	Percentage of Total Admitted Assets
Park Square Cap Credit Oppty II Feeder	OIA	\$ 19,813	0.874%
Park Square Cap Credit Oppty III Feeder	OIA	5,821	0.257
HSBC HLDGS PLC	1FE	2,750	0.121
Sparebank 1 Boligkreditt 144A	1FE	2,664	0.118
UBS Group FDG Switz AG	1FE	2,582	0.114
Carlyle Global M 4a a1rr 144a	1FE	2,360	0.104
Sumitomo Mitsui Finl Group INC	1FE	2,347	0.104
AMMC CLO XI LTD 2012-11R2	1FE	2,343	0.103
GE Capital International FDG	1FE	2,291	0.101
Stadshypotek AB 144A	1FE	2,285	0.101

11. The Company has no assets held in Canadian investments greater than 2.5% of the Company's total admitted assets.
12. The Company has no assets held in investments with contractual sales restrictions.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Investment Risk Interrogatories – Statutory-Basis (continued)
(Dollars in Thousands)

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

Name of Issuer	Amount	Percentage of Total Admitted Assets
BCBSMA Surplus Note	\$ 280,749	12.387%
PIMCO All Asset Institutional Fund	127,284	5.616
Lazard Asset Management Fund	83,934	3.703
Primus High Yield Bond Fund	73,874	3.259
Blue Rock Market Neutral Fund LP	64,591	2.850
RREEFF III Core REIT	60,902	2.687
Putnam Total Return Fund LLC	59,404	2.621
Newton Global Equity Income Fund	57,083	2.519
Beachpoint High Yield Offshore Fund	52,541	2.318
Parametric Defensive Equity Fund	48,281	2.130

14. The Company has no assets held in nonaffiliated, privately placed equities greater than 2.5% of the Company's total admitted assets.
15. The Company has no assets held in general partnership interests greater than 2.5% of the Company's total admitted assets.
16. The Company has no mortgage loans greater than 2.5% of the Company's total admitted assets.
17. The Company has no aggregate mortgage loans that are greater than 2.5% of the Company's total admitted assets.
18. The Company has no assets held in real estate reported greater than 2.5% of the Company's total admitted assets, excluding home office properties.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Investment Risk Interrogatories – Statutory-Basis (continued)

(Dollars in Thousands)

19. The Company has no assets held in investments held in mezzanine real estate loans greater than 2.5% of the Company's total admitted assets.
20. The Company has no securities lending or repurchase agreements during 2018.
21. The Company has no warrants not attached to other financial instruments, options, caps, and floors during 2018.
22. The Company has no potential exposure for collars, swaps, and forwards during 2018.
23. The Company had no potential exposure for future contracts during 2018.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Summary of Investment Schedule – Statutory-Basis
(Dollars in Thousands)

December 31, 2018

Investment Categories	Gross Investment Holdings*		Admitted Assets as Reported in Annual Statement	
	Amount	Percentage	Amount	Percentage
Bonds:				
U.S. treasury securities	\$ 227,719	10.586%	\$ 227,719	10.586%
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	33,866	1.574	33,866	1.574
Issued by U.S. government-sponsored agencies	333	0.015	333	0.015
Non-US government (including Canada, excluding mortgage backed securities)	3,275	0.152	3,275	0.152
Securities issued by states, territories, and possessions and their political subdivisions in the U.S.:				
State, territory and possessions – general obligations	788	0.037	788	0.037
Political subdivisions of states, territories, and possessions – general obligations	812	0.038	812	0.038
Revenue and assessment obligations	2,322	0.108	2,322	0.108
Industrial development and similar obligations				
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	34,106	1.586	34,106	1.586
Issued or guaranteed by FNMA and FHLMC	181,640	8.444	181,640	8.444
All other	–	–	–	–
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC ,or VA	59,649	2.773	59,649	2.773
Issued by non-U.S. Government issuers and collateralized by MBS issued or guaranteed by GNMA, FMNA, FHLMC, or VA	106	0.005	106	0.005
All other	35,877	1.668	35,877	1.668
Other debt and other fixed income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	233,042	10.834	233,042	10.834
Unaffiliated Non- U.S. (including Canada)	77,764	3.615	77,764	3.615
Affiliated securities	–	–	–	–

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Summary of Investment Schedule – Statutory-Basis (continued)
(Dollars in Thousands)

Investment Categories	Gross Investment Holdings*		Admitted Assets as Reported in Annual Statement	
	Amount	Percentage	Amount	Percentage
Equity interests:				
Investments in mutual funds	\$ 204,473	9.506%	\$ 204,473	9.506%
Preferred stock:				
Affiliated	–	–	–	–
Unaffiliated	–	–	–	–
Publicly traded equity securities (excluding preferred stock):				
Affiliated	–	–	–	–
Unaffiliated	–	–	–	–
Other equity securities:				
Affiliated	270	0.013	270	0.013
Unaffiliated	6,375	0.296	6,375	0.296
Other equity interests including tangible personal property under lease:				
Affiliated	–	–	–	–
Unaffiliated	–	–	–	–
Mortgage loans:				
Construction and land development	–	–	–	–
Agricultural	–	–	–	–
Single family residential properties	–	–	–	–
Multifamily residential properties	–	–	–	–
Commercial loans	–	–	–	–
Mezzanine real estate loans	–	–	–	–
Real estate investments:				
Property occupied by company	88,433	4.111	88,433	4.111
Property held for production of income (includes \$0 of property acquired in satisfaction of debt)	–	–	–	–
Property held for sale (includes \$0 of property acquired in satisfaction of debt)	–	–	–	–
Contract loans	–	–	–	–
Receivables for securities	9,154	0.426	9,154	0.426
Securities lending	–	–	–	–
Cash, cash equivalents and short-term investments	29,154	1.355	29,154	1.355
Other invested assets	921,886	42.858	921,886	42.858
Total invested assets	\$ 2,151,044	100.000%	\$ 2,151,044	100.000%

*Gross investment holdings as valued in compliance with NAIC Accounting Practices and Procedures Manual.

Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.

Note to Supplemental Investment Disclosures

December 31, 2018

Note—Basis of Presentation

The accompanying supplemental schedules present selected investment disclosures as of December 31, 2018, and for the year then ended for purposes of complying with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and agree to or are included in the amounts reported in the Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.'s 2018 Statutory Annual Statement as filed with the Commonwealth of Massachusetts Division of Insurance.

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