

AUDITED STATUTORY-BASIS FINANCIAL
STATEMENTS AND SUPPLEMENTARY INFORMATION

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

We have audited the accompanying statutory-basis financial statements of Blue Cross and Blue Shield of Massachusetts, 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.



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, Inc.

We have audited the accompanying statutory-basis balance sheets of Blue Cross and Blue Shield of Massachusetts, 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, 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, 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, Inc.

Statutory-Basis Balance Sheets

(Dollars in Thousands)

	December 31	
	2018	2017
Admitted assets		
Bonds	\$ 773,529	\$ 828,221
Common stock	170,932	153,316
Properties occupied by the Company	99,723	102,393
Cash, cash equivalents and short-term investments	46,743	212,222
Receivable for securities	7,741	6,102
Other invested assets	460,181	538,615
Total cash and invested assets	1,558,849	1,840,869
Accrued investment income	3,827	4,031
Premiums receivable	209,025	212,372
Reinsurance recoverable	—	9,104
Receivables related to uninsured plans	140,482	169,860
Income tax recoverable	158,363	4,227
Net deferred tax asset	100,473	115,320
Data processing equipment	9,001	10,902
Receivable from affiliates	13,530	20,325
Health care receivables	74,502	52,850
Other receivables	58,345	44,553
Other assets	59,733	63,567
Total admitted assets	\$ 2,386,130	\$ 2,547,980
Liabilities and surplus		
Unpaid claims liabilities	\$ 330,771	\$ 299,617
Aggregate policy reserves	102,391	125,804
Premiums received in advance	92,386	97,925
Accounts payable and accrued liabilities	305,768	453,748
Pension benefit obligation	69,189	71,504
Borrowed funds	345,199	170,238
Ceded reinsurance payable	613	13,733
Payable for securities	3,962	11,990
Liability for amounts held under uninsured plans	356,553	408,399
Total liabilities	1,606,832	1,652,958
Special surplus funds	—	43,483
Surplus notes	285,000	285,000
Unassigned surplus	494,298	566,539
Total surplus	779,298	895,022
Total liabilities and surplus	\$ 2,386,130	\$ 2,547,980

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Statements of Operations
(Dollars in Thousands)

	Year Ended December 31	
	2018	2017
Premiums earned	\$ 2,899,734	\$ 2,687,810
Health care benefits	2,650,522	2,452,353
Claim adjustment expenses	165,032	146,757
General and administrative expenses	199,457	121,070
Total expenses	<u>3,015,011</u>	<u>2,720,180</u>
Underwriting loss	(115,277)	(32,370)
Net investment income	34,370	38,909
Net realized capital (loss) gains, less capital gains tax expense of \$0 and \$563 in 2018 and 2017, respectively	(13,629)	2,250
Total investment gains	<u>20,741</u>	<u>41,159</u>
Other income (expense)	6,231	(136,620)
Net loss before federal income taxes	<u>(88,305)</u>	<u>(127,831)</u>
Federal income tax (benefit) expense	(153,863)	523
Net income (loss)	<u>\$ 65,558</u>	<u>\$ (128,354)</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

	Unassigned Surplus	Special Surplus Funds	Total Surplus
Balance at December 31, 2016	\$ 728,176	\$ —	\$ 728,176
Net loss	(128,354)	—	(128,354)
Change in net unrealized gains, net of tax benefit of \$6,637	20,422	—	20,422
Change in non-admitted assets	(118,244)	—	(118,244)
Change in net deferred income taxes	242,125	—	242,125
Pension liability adjustment, net of tax expense of \$(29,738)	(34,103)	—	(34,103)
Change in surplus notes	185,000	—	185,000
2018 ACA health insurer fee	(43,483)	43,483	—
Balance at December 31, 2017	<u>851,539</u>	<u>43,483</u>	<u>895,022</u>
2018 ACA health insurer fee	43,483	(43,483)	—
Net income	65,558	—	65,558
Change in net unrealized gains, net of tax expense of \$(6,650)	43,941	—	43,941
Change in non-admitted assets	(24,224)	—	(24,224)
Change in net deferred income taxes	(148,183)	—	(148,183)
Pension liability adjustment	(52,816)	—	(52,816)
Balance at December 31, 2018	\$ 779,298	\$ —	\$ 779,298

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

	Year Ended December 31	
	2018	2017
Operating activities		
Premiums received	\$ 2,862,182	\$ 2,678,268
Health care benefits paid	(2,613,346)	(2,427,755)
General and claim adjustment expenses paid	(491,785)	(118,241)
Net investment income received	37,902	44,494
Federal income taxes received	3,196	411
Net cash (used in) provided by operating activities	<u>(201,851)</u>	<u>177,177</u>
Investing activities		
Sales, maturities and redemptions of investments	734,865	729,202
Cost of investments acquired	(775,680)	(740,459)
Other miscellaneous proceeds	432	3,937
Net cash used in investing activities	<u>(40,383)</u>	<u>(7,320)</u>
Financing or miscellaneous activities		
Surplus notes	—	185,000
Borrowed funds	175,000	(127,500)
Other applications, net	(98,245)	(54,230)
Net cash provided by financing or miscellaneous activities	<u>76,755</u>	<u>3,270</u>
Net (decrease) increase in cash, cash equivalents and short-term investments	<u>(165,478)</u>	<u>173,127</u>
Cash, cash equivalents and short-term investments:		
Beginning of year	212,222	39,095
End of year	<u>\$ 46,743</u>	<u>\$ 212,222</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

December 31, 2018

1. Nature of Business

Blue Cross and Blue Shield of Massachusetts, Inc. (“BCBSMA” or the “Company”) is a nonprofit hospital and medical service corporation in the Commonwealth of Massachusetts, subject to regulation by the Commonwealth of Massachusetts Division of Insurance (“DOI”). The Company is organized for the purpose of establishing, maintaining and operating a nonprofit hospital and medical service company to provide hospital and medical care and reimbursement for other health services to its members. Hospitalization, medical and other health benefits are provided to members through contracts with hospitals, participating physicians, skilled nursing facilities, nursing homes, and other health care organizations. The Company participates in a national arrangement to process claims for other Blue Cross and Blue Shield companies throughout the country. The Company offers a variety of group indemnity plans, preferred provider networks, non-group plans, Medicare extension, dental and other supplementary programs for the benefit of its members. The Company has a wholly-controlled subsidiary, Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc. (“HMO Blue”). BCBSMA and HMO Blue (collectively, the “Companies”) operate under common management and Board of Directors control.

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 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 are designated as available-for-sale or held-for-trading and reported at fair value with unrealized investment gains (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, 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/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 3-6, 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, 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., all 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 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 for income recognition.

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 deferred federal income taxes in excess of certain statutory limits, 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

Admissibility of Deferred Income Tax Assets: Adjusted gross deferred tax assets are admitted at an amount equal to the sum of: (a) federal income taxes paid in prior years that can be recovered through loss carry-backs for existing temporary differences that reverse in a timeframe not to exceed three years; (b) amount based on the *Realization Threshold Limitation Table* for risk-based capital (“RBC”) reporting entities, when RBC is greater than 300% of Company Action Level, which is the lesser of: (i.) the amount of adjusted gross deferred tax assets expected to be realized within three years of the balance sheet date; or (ii.) 15% of surplus excluding any net deferred tax assets, electronic data processing (“EDP”) equipment and operating software; and (c) the amount of adjusted gross deferred tax assets that can be offset against existing gross deferred tax liabilities. The remaining deferred tax assets are non-admitted.

The application of SSAP No. 101, *Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10* (“SSAP 101”) requires a company to evaluate the recoverability of deferred tax assets and to establish a valuation allowance if necessary to reduce the deferred tax asset to an amount which is more likely than not to be realized.

Under GAAP, a deferred tax asset is recorded for the amount of gross deferred tax assets expected to be realized in future years, and a valuation allowance is established for deferred tax assets not realizable.

Surplus Notes: Surplus notes issued by the Company are reported as a separate component of statutory surplus. Under GAAP, surplus notes are reported as long-term debt in the liabilities section of the balance sheet.

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.

Consolidation: Wholly-controlled subsidiaries are not consolidated for individual entity statutory reporting. Under GAAP, financial statements of wholly-controlled subsidiaries are consolidated with the parent.

Blue Cross and Blue Shield of Massachusetts, 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 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.

Preferred stock is reported at lower of cost or 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 stocks 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, 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 improvements, is recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of 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	\$ 130,007	\$ 130,216
Less accumulated depreciation	<u>(30,284)</u>	<u>(27,823)</u>
Net real estate occupied by the Company	<u>\$ 99,723</u>	<u>\$ 102,393</u>

Blue Cross and Blue Shield of Massachusetts, 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 by rentable square feet. These imputed amounts are reported as investment income and operating expense in the statements of operations reflecting that the Company had recorded annual rent of \$9,087 for the periods ended December 31, 2018 and 2017.

Furniture, Equipment, and Capitalized Software

The admitted value of the Company's electronic data processing equipment 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	\$ 64,890	\$ 61,453
Less accumulated depreciation	(55,889)	(50,551)
Net EDP equipment and operating software	\$ 9,001	\$ 10,902

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 \$27,390 and \$29,964, respectively.

Blue Cross and Blue Shield of Massachusetts, 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 as 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.

Aggregate Policy Reserves

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

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

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 sheets as premiums received in advance and subsequently credited to income as earned during the coverage period.

The definitions of the Patient Protection and Affordable Care Act (“PPACA”) 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.

For uncollected premium, after the calculation of non-admitted amounts, an evaluation is made of the remaining admitted assets in accordance with SSAP No. 5R, *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 the Company did not have any uncollectible amounts charged to income. In 2017, the amount charged to income was \$122.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

Surplus Notes

Surplus notes are instruments that have the characteristics of both debt and equity. These instruments are also referred to as surplus debentures or contribution certificates. Current statutory accounting for issuers of surplus notes is in Statement of Statutory Accounting Principles No. 41, *Surplus Notes* (“SSAP 41R”).

Surplus notes issued by a reporting entity are subject to the control and oversight of the commissioner of the insurer’s state of domicile and must be approved as to the form and content of the note in order to be reported as surplus and not as debt. The surplus note must contain contractual provisions indicating; the indebtedness is subordinated to all other obligations of the Insurer including, claimant and beneficiary claims and all other classes of creditors other than surplus note holders; and interest payments and principal repayments require mandatory prior approval by the commissioner of the state of domicile of the insurer.

Interest is not recorded as a liability or an expense until approval for payment of such interest has been granted by the commissioner of the state of domicile. All interest, including interest in arrears, is expensed in the statement of operations when approved. Unapproved interest is not reported through operations and not added to the principal of the note. Costs of issuing surplus notes (e.g., loan fees and legal fees) shall be charged to operations when incurred.

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 24.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

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 amounts recoverable or receivable on the balance sheet. Refer to Note 16.

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.

The Company takes part in the federal risk adjustment program whereby premium adjustments are based on the risk scores of enrollees 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 now 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. Group plans were required to contribute funding, but were not eligible to receive reinsurance program distributions.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

Accordingly, insured group contributions to the reinsurance pool as well as disbursements to the U.S. Treasury covered administrative expenses of the program and were treated as an assessment payable that was charged to taxes, licenses, and fees.

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. The purpose of the risk corridor program was to provide limitations on issuer losses and gains for QHPs through additional protection against initial pricing risk. The program created a mechanism for sharing or spreading the risk for allowable costs between the federal government and the QHP issuers.

Any risk corridor payable or receivable, if applicable, were reported as a component of accounts receivable, and should have been 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 ACA’s reinsurance and risk corridors programs were temporary programs that transitioned to end effective December 31, 2016. These 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.

Administrative Services Contract (“ASC”)

ASC is referred to as uninsured business under SSAP No. 47, *Uninsured Plans*. ASC is a business where the Company pays benefits on the behalf of employers using the Company’s check stock. The Company receives an administrative fee for providing these services. Premiums and claim expenses are not included in the Company’s financial statements. The administrative fees earned are reported as a reduction to general and administrative expenses in the Company’s statements of operations.

ASC accounts are billed monthly, in arrears, for actual medical claims plus administrative fees. The remaining balance of receivables from uninsured plans, after assessment for collectability, are included in the Company’s admitted assets and liabilities, respectively. The uninsured admitted receivables are recorded net of any available deposits.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

The balance of deposits reported in the liability section represents the net balance for those customers whose deposits exceed accounts receivable balance.

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.

Income Taxes

The Company follows SSAP 101 to account for current and deferred federal income taxes and current state income taxes. SSAP 101 requires: 1) the use of the three year reversal period and 15% of surplus admission threshold; 2) changes to the recognition threshold for recording tax contingency reserves from a probable standard to a more likely than not standard and; 3) requires the disclosure of tax planning strategies.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

2. Summary of Significant Accounting Policies (continued)

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.

Medicare Part D Premium and Expenses

The Company has a Medicare Part D Inter-Plan Services Agreement to offer a Blue Cross and Blue Shield branded prescription drug plan (“PDP”) under contract with the Centers for Medicare & Medicaid Services (“CMS”). The CMS premium, the member premium, and the low-income premium subsidy represent payments for the Company’s insurance risk coverage under the Medicare Part D program and therefore are recorded as premium earned in the statement of operations. Premium revenue is earned ratably over the period in which eligible individuals are entitled to receive prescription drug benefits.

Subsidies and reinsurance payments from CMS represent cost reimbursements under the Medicare Part D program. Amounts received for these subsidies are not reflected in premiums earned, but rather are accounted for as deposits, with the related liability included in accounts payable and accrued liabilities in the balance sheets. Pharmacy benefit costs and administrative costs under the contract are expensed as incurred.

Reinsurance

The Company ceded certain premiums and benefits to other insurance companies under various reinsurance agreements to reduce overall risk, including exposure to large losses. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations.

Blue Cross and Blue Shield of Massachusetts, 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, 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

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.

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.

Blue Cross and Blue Shield of Massachusetts, 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				Total
	Level 1	Level 2	Level 3		
Bonds:					
Industrial and miscellaneous	\$ –	\$ 1,749	\$ –	\$ 1,749	
Common stock:					
Industrial and miscellaneous	117,018	–	53,644	170,662	
Parent, subs and affiliates	–	–	270	270	
Total assets at fair value	\$ 117,018	\$ 1,749	\$ 53,914	\$ 172,681	

Description	December 31, 2017				Total
	Level 1	Level 2	Level 3		
Common stock:					
Industrial and miscellaneous	\$ 101,541	\$ –	\$ 51,524	\$ 153,065	
Parent, subs and affiliates	–	–	251	251	
Total assets at fair value	\$ 101,541	\$ –	\$ 51,775	\$ 153,316	

Blue Cross and Blue Shield of Massachusetts, 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			Issuances and Settlements	Balance at December 31, 2018
				Net Realized Capital Gains	Included in and (Losses) Surplus	Total Gain Included in Purchases		
Common stock								
Industrial and miscellaneous	\$ 51,524	\$ —	\$ —	\$ (892)	\$ 1,720	\$ 1,292	\$ —	\$ 53,644
Parent, subs and affiliates	251	—	—	—	19	—	—	270
Total assets	\$ 51,775	\$ —	\$ —	\$ (892)	\$ 1,739	\$ 1,292	\$ —	\$ 53,914

	Balance at January 1, 2017	Transfers in Level 3	Transfers out Level 3	Total Gain			Issuances and Settlements	Balance at December 31, 2017
				Net Realized Capital Gains	Included in and (Losses) Surplus	Total Gain Included in Purchases		
Common stock								
Industrial and miscellaneous	\$ 50,188	\$ —	\$ —	\$ 84	\$ 1,139	\$ 197	\$ (84)	\$ 51,524
Parent, subs and affiliates	236	—	—	—	15	—	—	251
Total assets	\$ 50,424	\$ —	\$ —	\$ 84	\$ 1,154	\$ 197	\$ (84)	\$ 51,775

The table below presents the fair value by fair value hierarchy level for certain financial assets 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	\$ —	\$ 229,720	\$ —	\$ 229,720
Industrial and miscellaneous	—	257,679	—	257,679
Mortgage-backed securities	—	271,544	—	271,544
Total	\$ —	\$ 758,943	\$ —	\$ 758,943

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

Description	December 31, 2017				Total
	Level 1	Level 2	Level 3		
Bonds:					
U.S. treasury securities	\$ –	\$ 273,029	\$ –	\$ 273,029	
Industrial and miscellaneous	–	284,271	–	284,271	
Mortgage-backed securities	–	271,183	–	271,183	
Total	<u>\$ –</u>	<u>\$ 828,483</u>	<u>\$ –</u>	<u>\$ 828,483</u>	

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	\$ 46,743	\$ –	\$ –	\$ 46,743	
Bonds:					
U.S. treasury securities and agency obligations	233,125	859	(4,264)	229,720	
Industrial and miscellaneous	262,435	1,460	(6,217)	257,678	
Mortgage-backed securities	277,969	851	(7,275)	271,545	
Total bonds	<u>773,529</u>	<u>3,170</u>	<u>(17,756)</u>	<u>758,943</u>	
Common stock	150,926	25,417	(5,411)	170,932	
Total cash and investments	<u>\$ 971,198</u>	<u>\$ 28,587</u>	<u>\$ (23,167)</u>	<u>\$ 976,618</u>	

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

3. Cash and Investments (continued)

	December 31, 2017				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Cash, cash equivalents and short-term investments	\$ 212,222	\$ -	\$ -	\$ 212,222	
Bonds:					
U.S. treasury securities and agency obligations	274,348	736	(2,056)	273,028	
Industrial and miscellaneous	280,886	4,899	(1,514)	284,271	
Mortgage-backed securities	272,987	1,280	(3,083)	271,184	
Total bonds	828,221	6,915	(6,653)	828,483	
Common stock	120,790	33,452	(926)	153,316	
Total cash and investments	<u>\$ 1,161,233</u>	<u>\$ 40,367</u>	<u>\$ (7,579)</u>	<u>\$ 1,194,021</u>	

As of 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 fixed maturities and equities and length of time that individual securities have been in a continuous unrealized position.

At December 31, 2018	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	
U.S. treasury securities	\$ 32,029	\$ (268)	\$ 141,521	\$ (3,996)	\$ 173,550	\$ (4,264)	78
Industrial and miscellaneous	90,097	(1,923)	124,829	(4,294)	214,926	(6,217)	529
Mortgage-backed securities	26,181	(422)	190,457	(6,853)	216,638	(7,275)	373
Total bonds	<u>148,307</u>	<u>(2,613)</u>	<u>456,807</u>	<u>(15,143)</u>	<u>605,114</u>	<u>(17,756)</u>	<u>980</u>
Common stock	26,417	(1,974)	39,412	(3,437)	65,829	(5,411)	7
Total	<u>\$ 174,724</u>	<u>\$ (4,587)</u>	<u>\$ 496,219</u>	<u>\$ (18,580)</u>	<u>\$ 670,943</u>	<u>\$ (23,167)</u>	<u>987</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

3. Cash and Investments (continued)

	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	\$ 171,951	\$ (1,390)	\$ 40,930	\$ (666)	\$ 212,881	\$ (2,056)	90
Industrial and miscellaneous	58,183	(352)	73,245	(1,162)	131,428	(1,514)	252
Mortgage-backed securities	80,769	(578)	127,044	(2,506)	207,813	(3,084)	276
Total bonds	310,903	(2,320)	241,219	(4,334)	552,122	(6,654)	618
Common stock	3,525	(83)	12,143	(843)	15,668	(926)	3
Total	\$ 314,428	\$ (2,403)	\$ 253,362	\$ (5,177)	\$ 567,790	\$ (7,580)	621

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 \$10,206 and \$140,618, respectively, are included in cash, cash equivalents and short-term investments.

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 it is categorized as 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

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

In 2018, BCBSMA recorded other-than-temporary impairment losses for investments in joint ventures and partnerships of \$892 for Plan Liability Insurance Company ("PLIC") and \$13,500 for Zaffre Affiliated Services, LLC. ("Zaffre Affiliated"), a wholly-controlled subsidiary of the Company. The impairments were recognized based on the length of time the securities have been unrealized loss position and an outlook lacking improvement. In 2017, the Company did not record any other-than-temporary impairment losses.

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	\$ 20,162	\$ 20,051
After 1 year through 5 years	299,504	294,556
After 5 years through 10 years	116,248	114,981
After 10 years	337,615	329,355
Total bonds	\$ 773,529	\$ 758,943

Blue Cross and Blue Shield of Massachusetts, 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	\$ 483,872	\$ 596,850	\$ 1,604	\$ 3,865	\$ 4,121	\$ 3,659
Common stock	—	37,297	—	2,637	892	—
Other invested assets	251,159	94,528	3,795	137	13,931	210

Gross realized investment gains and losses are as follows:

	2018	2017
Gross gains	\$ 31,110	\$ 6,694
Gross losses	(44,739)	(3,881)
Net realized investment gains	<u>\$ (13,629)</u>	<u>\$ 2,813</u>

Major categories of net investment income are summarized as follows:

	2018	2017
Income:		
Bonds	\$ 21,547	\$ 17,101
Other invested assets	11,848	23,914
Common stock	10,373	7,015
Preferred stock	—	16
Real estate	9,087	9,087
Cash, cash equivalents and short-term investments	2,069	566
Other miscellaneous	4,100	2,237
Total investment income	<u>59,024</u>	<u>59,936</u>
Less: Investment expenses	22,193	18,517
Depreciation	2,461	2,510
Net investment income	<u>\$ 34,370</u>	<u>\$ 38,909</u>

Blue Cross and Blue Shield of Massachusetts, 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	\$ 1,515	\$ 1,501	\$ 1,578	No
912828-K3-3	10,013	10,296	10,562	No
912828-NM-8	8,224	8,220	8,383	No
912828-PP-9	8,170	8,243	8,439	No
912828-QV-5	9,641	9,597	9,915	No
912828-SA-9	10,426	10,454	10,803	No
Total	\$ 47,989	\$ 48,311	\$ 49,680	

4. Restricted Assets

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

Restricted assets category	2018		2017		2018	
	Total Gross Restricted	Total Gross Restricted	Increase/Decrease	Total Admitted Restricted	Total	
Federal Home Loan Bank ("FHLB") capital stock	\$ 6,194	\$ 6,194	\$ -	\$ 6,194		
Pledged as collateral to FHLB	114,605	112,283	2,322	114,605		
Pledged as collateral to BCBSA ^(a)	157,658	172,909	(15,251)	157,658		
Other restricted assets ^(b)	4,595	6,469	(1,874)	2,928		
Total	\$ 283,052	\$ 297,855	\$ (14,803)	\$ 281,385		

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

4. Restricted Assets (continued)

- (a) At December 31, 2018 and 2017, BCBSMA had restricted securities included in cash and investments on deposit with Blue Cross Blue Shield Association (“BCBSA”) to meet certain licensure standards.
- (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 following reconciliation of the beginning and ending balances of unpaid claims liability (net of recoveries and health care receivables) and accrued medical incentive pools and bonuses:

	2018				
	Unpaid Claims Liability	Reinsurance Recoverable	Health Care Receivable	Medical Incentive Pool and Bonus	Total Health Care Benefits
Net balance at January 1	\$ 299,617	\$ (9,104)	\$ (79,062)	\$ –	\$ 211,451
Incurred related to:					
Current year	2,948,305	(86,531)	(177,999)	1,018	2,684,793
Prior years	(23,829)	(7,884)	(2,558)	–	(34,271)
Total incurred	<u>2,924,476</u>	<u>(94,415)</u>	<u>(180,557)</u>	<u>1,018</u>	<u>2,650,522</u>
Paid related to:					
Current year	2,620,775	(86,531)	(97,482)	1,018	2,437,780
Prior years	272,547	(16,988)	(79,993)	–	175,566
Total paid	<u>2,893,322</u>	<u>(103,519)</u>	<u>(177,475)</u>	<u>1,018</u>	<u>2,613,346</u>
Net balance at December 31	<u>\$ 330,771</u>	<u>\$ –</u>	<u>\$ (82,144)</u>	<u>\$ –</u>	<u>\$ 248,627</u>

Blue Cross and Blue Shield of Massachusetts, 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	\$ 285,045	\$ (8,648)	\$ (89,544)	\$ —	\$ 186,853
Incurred related to:					
Current year	2,734,041	(121,401)	(149,773)	240	2,463,107
Prior years	(11,478)	(22)	746	—	(10,754)
Total incurred	<u>2,722,563</u>	<u>(121,423)</u>	<u>(149,027)</u>	<u>240</u>	<u>2,452,353</u>
Paid related to:					
Current year	2,435,885	(112,305)	(98,358)	240	2,225,462
Prior years	272,106	(8,662)	(61,151)	—	202,293
Total paid	<u>2,707,991</u>	<u>(120,967)</u>	<u>(159,509)</u>	<u>240</u>	<u>2,427,755</u>
Net balance at December 31	<u>\$ 299,617</u>	<u>\$ (9,104)</u>	<u>\$ (79,062)</u>	<u>\$ —</u>	<u>\$ 211,451</u>

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 \$7,642 and \$26,212, respectively, which are non-admitted in accordance with SSAP No. 84, *Certain Health Care Receivables and Receivables Under Government Insured Plans*.

Estimated subrogation credits of \$4,807 and \$4,191 were taken into account in determining health care benefits reserves as of December 31, 2018 and 2017, respectively.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate at December 31, 2018 and 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

6. Pension and Other Post-Retirement Benefit Plans

All employees who have completed twelve months of employment are eligible to participate in the Retirement Income Trust Plan (“RIT”), which grants pension benefits to retired employees at various levels based on age and years of service.

The Company also provides two noncontributory retirement plans for eligible employees (“Non-Qualified Benefit Plans”), and sponsors a defined benefit plan covering medical, life and dental benefits (“Other Post-Retirement Benefit Plans”). The Company uses a December 31, measurement date for all of its plans.

As of December 31, 2018, the Company used the following Expected Mortality Assumptions:

- For annuity payments, the RP-2014 generational mortality table with post-2006 improvements backed out and then projected using MP-2018 improvement scale for preretirement mortality.
- For lump sum payments, the 2018 PPA Unisex table as required and then projected using MP-2017 improvement scale.

BCBSMA 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 accrues post-employment benefits and compensated absences in accordance with SSAP No. 11, *Post-employment Benefits and Compensation Absences*. The company has a no-carryover policy for vacation time policy.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

The BCBSMA pension plan is underfunded, as of December 31, 2018. A summary of change in benefit obligation are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2018	2017	2018	2017	2018	2017
Benefit obligation at beginning of year	\$ 896,407	\$ 808,490	\$ 152,662	\$ 143,451	\$ 1,243	\$ 2,432
Service cost	19,999	18,583	3,890	3,219	56,425	50,769
Interest cost	29,484	28,776	5,061	5,146	—	—
Plan Settlements	—	(10,047)	—	—	—	—
Actuarial gain (loss)	(46,512)	89,081	(12,517)	8,363	—	—
Benefits paid	(54,267)	(36,828)	(7,042)	(7,682)	(55,974)	(51,958)
Plan amendments	—	—	—	—	—	—
Medicare Part D reimbursement	—	—	38	165	—	—
Administrative expenses paid	(1,397)	(1,648)	—	—	—	—
Benefit obligation at end of year	<u>\$ 843,714</u>	<u>\$ 896,407</u>	<u>\$ 142,092</u>	<u>\$ 152,662</u>	<u>\$ 1,694</u>	<u>\$ 1,243</u>

A summary of change in plan assets are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2018	2017	2018	2017	2018	2017
Fair value at beginning of year	\$ 829,858	\$ 724,315	\$ 83,810	\$ 71,103	\$ —	\$ —
Actual return on plan assets	(60,565)	113,876	(6,024)	11,510	—	—
Employer contribution	62,440	40,190	8,175	8,714	—	—
Plan Settlements	—	(10,047)	—	—	—	—
Benefits paid	(54,267)	(36,828)	(7,042)	(3,245)	—	—
Medicare Part D reimbursement	—	—	38	165	—	—
401(h) benefit payments	—	—	—	(4,437)	—	—
Administrative fees paid	(1,397)	(1,648)	—	—	—	—
Fair value at end of year	<u>\$ 776,069</u>	<u>\$ 829,858</u>	<u>\$ 78,957</u>	<u>\$ 83,810</u>	<u>\$ —</u>	<u>\$ —</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

A summary of funded status are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2018	2017	2018	2017
Accrued benefit costs	\$ 11,745	\$ 10,744	\$ 49,848	\$ 53,153
Liability for pension benefits	55,901	55,805	13,287	15,699
Total liabilities recognized	67,646	66,549	63,135	68,852
Unrecognized liabilities	—	—	—	—

A summary of components of net periodic benefit cost are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2018	2017	2018	2017	2018	2017
Service cost	\$ 19,999	\$ 18,583	\$ 3,890	\$ 3,219	\$ 56,425	\$ 50,769
Interest cost	29,484	28,777	5,061	5,147	—	—
Expected return on plan assets	(64,418)	(54,712)	(6,467)	(5,531)	—	—
Amortization of unrecognized transitional obligation	430	430	—	—	—	—
Recognized actuarial loss	22,886	22,462	—	—	—	—
Amortization of prior service cost	(72)	(72)	2,387	2,387	—	—
Gain or loss recognized due to settlement curtailment	—	2,728	—	—	—	—
Total net periodic benefit cost	\$ 8,309	\$ 18,196	\$ 4,871	\$ 5,222	\$ 56,425	\$ 50,769

The pension and other postretirement benefit plans are sponsored by BCBSMA and the associated costs are shared by the Companies. BCBSMA allocates amounts to HMO Blue and wholly-owned subsidiaries based on salary ratios. The Company's share of net expense for the qualified pension plan was \$5,951 and \$12,061 for 2018 and 2017, respectively and for other postretirement benefit plans was \$3,501 and \$3,428 for 2018 and 2017, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

Amounts in unassigned funds (surplus) recognized as components of net periodic benefit costs:

	Pension Benefits		Post-Retirement Benefits	
	2018	2017	2018	2017
Items not yet recognized as a component of net periodic benefit cost – prior year	\$ 343,340	\$ 338,972	\$ 15,700	\$ 15,703
Net transition asset or obligation recognized	(430)	(430)	–	–
Net prior service cost or credit arising during the period	–	–	–	–
Net prior service cost or credit recognized	72	72	(2,387)	(2,387)
Net gain and loss arising during the period	78,472	29,916	(26)	2,384
Net gain and loss recognized	(22,885)	(25,190)	–	–
Item not yet recognized as a component of net periodic cost – current year	\$ 398,569	\$ 343,340	\$ 13,287	\$ 15,700

Amount in unassigned funds (surplus) expected to be recognized in the next fiscal year as components of net periodic benefit cost:

	Post-	
	Pension Benefits	Retirement Benefits
	2018	2018
Net transition asset or obligation	\$ (430)	\$ –
Net prior service cost or credit	72	(2,387)
Net recognized gains and losses	(28,129)	–
Total expected to be recognized	\$ (28,487)	\$ (2,387)

Amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost:

	Pension Benefits		Post-Retirement Benefits	
	2018	2017	2018	2017
Net transition asset or obligation	\$ 860	\$ 1,291	\$ –	\$ –
Net prior service cost or credit	(304)	(377)	\$ 5,181	\$ 7,569
Net recognized gains and losses	398,013	342,426	8,106	8,131
Total have yet been recognized	\$ 398,569	\$ 343,340	\$ 13,287	\$ 15,700

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

Weighted-average assumptions to determine net periodic benefits as of December 31, 2018 and 2017, are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2018	2017	2018	2017
Discount rate				
Benefit obligation	3.33%-3.75%	1.58%-4.37%	3.80%	4.42%
Service cost	3.36%-3.70%	3.80%-4.26%	3.96%	4.75%
Interest cost	3.08%-3.36%	1.58%-3.69%	3.41%	3.70%
Expected return on plan assets	7.50%	7.50%	7.50%	7.50%
Salary scale	Varies	Varies	N/A	N/A

Weighted-average assumptions to determine projected obligations as of December 31, 2018 and 2017, are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2018	2017	2018	2017
Discount rate used for benefit cost	4.44%-4.11%	3.33%-3.75%	4.44%	3.80%
Rate of compensation increase	Varies	Varies	N/A	N/A

The amount of accumulated benefit obligation for the RIT defined benefit plan was \$809,325 and \$860,979 as of December 31, 2018 and 2017, respectively. The amount of accumulated benefit obligation for the Non-Qualified Benefit Plans was \$23,325 and \$21,352 as of December 31, 2018 and 2017, respectively.

For benefit costs measurement purposes, the rate of increase in the per capita cost of covered health care benefits was assumed to be 6.3% (Pre-65) and 7.3% (Post-65) for 2018. The rate is assumed to decrease gradually to 4.5% over the next 18 years and remain at that level thereafter.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage-point change in assumed health care cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
(Decrease) in total of service and interest cost components	\$ (58)	\$ (16)
(Decrease) in post-retirement benefit obligation	(963)	(134)

The Company's weighted-average asset allocations at December 31, 2018 and 2017, by asset category, are as follows:

	Pension Benefits		Post-Retirement Benefits		Range
	2018	2017	2018	2017	
Asset category:					
Equity securities	45%	49%	45%	49%	40-50%
Debt securities	24	23	24	23	18-28
Real estate	8	7	8	7	4-10
Absolute return	23	21	23	21	17-23
Private debt/equity	—	—	—	—	0-8%
Total	100%	100%	100%	100%	

The Companies portfolio is managed within ERISA guidelines to ensure adequate funding of the pension obligation and to maximize returns. The asset allocation has been structured to provide a 7.5% return target on the assets. The targets and ranges were established based on the results of an asset liability study. The Company considered the historical returns and future expectations of returns for each asset class, as well as the target allocation of the portfolio to develop the expected long-term rate of return on assets assumption. This resulted in the selection of the 7.5% long-term rate of return on assets assumption.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

The fair value of BCBSMA's pension and post retirement plan assets at December 31, 2018 and 2017, by asset category are as follows:

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Plan assets				
Money market funds	\$ 9,563	\$ —	\$ —	\$ 9,563
Common collective trusts	—	439,576		439,576
Partnership/joint venture interests	—	73,926	66,243	140,169
Registered investment companies	241,307	—	—	241,307
Common stocks:				
Domestic	22,772	—	—	22,772
International	1,638	—	—	1,638
Total investments	<u>\$ 275,280</u>	<u>\$ 513,502</u>	<u>\$ 66,243</u>	<u>\$ 855,025</u>
Less: investments related to 401(h) account				(78,956)
Total investments at fair value				<u>\$ 776,069</u>

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Plan assets				
Money market funds	\$ 11,565	\$ —	\$ —	\$ 11,565
Common collective trusts	—	431,337	—	431,337
Partnership/joint venture interests	—	110,265	61,920	172,185
Registered investment companies	270,521	—	—	270,521
Common stocks:				
Domestic	26,687	—	—	26,687
International	1,373	—	—	1,373
Total investments	<u>\$ 310,146</u>	<u>\$ 541,602</u>	<u>\$ 61,920</u>	<u>\$ 913,668</u>
Less: investments related to 401(h) account				(83,810)
Total investments at fair value				<u>\$ 829,858</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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

To determine the expected long-term rate of return for BCBSMA Retirement Income Trust, BCBSMA's investment consultant begins with their annual asset class assumptions. Asset class assumptions are developed based on a combination of historic data and forward-looking analysis.

Historical data is used to frame the range of returns over the long term. As such, the historical data is most important in developing volatility assumptions, and secondly, correlation assumptions among the various asset classes.

Forward-looking analysis is used in developing assumptions for expected returns. Return assumptions are based on current market pricing and a "building blocks" approach utilizing a variety of factors. Our investment consultants incorporate existing inflation, yields, credit spreads, dividends, and various ratios to estimate the return that is expected by investors across asset classes over 5–7 years and 30 years.

BCBSMA's expected return is then calculated using the plan's target allocations and the return, volatility and correlation assumptions for each asset class in a mean-variance optimization software model.

The Company's fair value hierarchy levels under SSAP 100R are defined in Note 3.

The Company's 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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

At December 31, 2018, the Company's projected benefit payments and Medicare Subsidy receipts are as follows:

	Pension Benefits	Post-Retirement Benefits	Medicare Subsidy
2019	\$ 38,255	\$ 8,050	\$ 707
2020	42,580	8,126	772
2021	47,288	8,220	845
2022	51,304	8,304	917
2023	52,068	8,350	992
Next five years	287,692	42,836	6,378

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.

The Company and its actuarial advisors determined that benefits provided by the post-retirement benefit plan as of the date of the enactment of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") were at least actuarially equivalent to Medicare Part D, and accordingly, the Company is entitled to the federal subsidy.

The Company determined that the aggregate effect of the federal subsidy on the service cost, interest cost, and amortization of the actuarial experience gains is a reduction in annual net periodic post-retirement benefit cost of \$2,228 and \$2,032 in 2018 and 2017, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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

The accumulated post-retirement benefit obligation decreased by \$23,349 and \$25,444 at December 31, 2018 and 2017, respectively, due to the effect of the Act. The calculation excludes non-vested employees costs per Interpretation 04-17, *Impact of Medicare Modernization Act on Post-retirement Benefits* (“INT 04-17”).

The Company also has a 401(k) savings plan for eligible employees. Under the employee savings plan, the Company contributes an amount equal to 100% of employee contributions, up to a maximum of 4% of each employee’s compensation, subject to Internal Revenue Code limit of \$55 and \$54 for 2018 and 2017, respectively. Contributions are maintained in investment funds established under the employee savings plan.

The Company’s contributions charged to income were \$11,634 and \$11,738 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 pretax Internal Revenue Code limit.

7. Income Taxes

On December 22, 2017, the federal government enacted tax bill H.R.1 - 115th Congress (2017-2018), *An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, or the Tax Cuts and Jobs Act*. The Tax Cuts and Jobs Act (“TCJA”) contains significant changes to corporate taxation, including, but not limited to, reducing the U.S. federal corporate income tax rate from 35% to 21% and modifying or limiting certain business deductions. Under the TCJA, the corporate AMT is repealed effective for taxable years beginning after December 31, 2017.

The Company’s 2018 federal income tax rate is less than the regular tax rate of 21% for corporations, due to the utilization of the special deduction available to the Blue Cross and Blue Shield Plans under Internal Revenue Code (“IRC”) section 833.

Under the asset and liability method, the Company’s temporary differences represent the estimated future tax effects attributable to future taxable or deductible temporary differences between amounts recognized in the financial statements and income tax returns.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

7. Income Taxes (continued)

The components of net deferred tax assets (“DTA”) and deferred tax liabilities (“DTL”) recognized in the Company’s assets, liabilities and surplus as of December 31, are as follows:

	2018			2017			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Gross deferred tax assets	\$ 264,509	\$ 5,726	\$ 270,235	\$ 410,551	\$ 3,311	\$ 413,862	\$ (146,042)	\$ 2,415	\$ (143,627)
b. Statutory valuation allowance adjustments	114,619	5,726	120,345	106,726	3,311	110,037	7,893	2,415	10,308
c. Adjusted gross deferred tax assets (1a-1b)	149,890	—	149,890	303,825	—	303,825	(153,935)	—	(153,935)
d. Deferred tax assets non-admitted	33,916	—	33,916	160,603	—	160,603	(126,687)	—	(126,687)
e. Subtotal net admitted deferred tax asset (1c-1d)	115,974	—	115,974	143,222	—	143,222	(27,248)	—	(27,248)
f. Gross deferred tax liabilities	108	15,393	15,501	103	27,799	27,902	5	(12,406)	(12,401)
g. Net admitted DTA/DTL (1e-1f)	<u>\$ 115,866</u>	<u>\$ (15,393)</u>	<u>\$ 100,473</u>	<u>\$ 143,119</u>	<u>\$ (27,799)</u>	<u>\$ 115,320</u>	<u>\$ (27,253)</u>	<u>\$ 12,406</u>	<u>\$ (14,847)</u>

The components of the DTA/DTL and admission calculation are as follows:

	2018			2017			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Federal income taxes paid in prior years recoverable through loss carrybacks	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
b. Adjusted gross deferred tax assets expected to be realized (excluding the amount of deferred tax assets from 2a above) after application of the threshold limitation (The lesser of 2b1 and 2b2 below)	100,473	—	100,473	115,320	—	115,320	(14,847)	—	(14,847)
b1. Adjusted gross deferred tax assets expected to be realized following the balance sheet date	149,890	—	149,890	265,847	—	265,847	(115,956)	—	(115,956)
b2. Adjusted gross deferred tax assets allowed per limitation threshold	N/A	N/A	100,473	N/A	N/A	115,320	N/A	N/A	(14,846)
c. Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from 2a and 2b above) offset by gross deferred tax liabilities	15,501	—	15,501	27,902	—	27,902	(12,401)	—	(12,401)
d. Deferred tax assets admitted as the result of application of SSAP No. 101 total (2a + 2b + 2c)	<u>\$ 115,974</u>	<u>\$ —</u>	<u>\$ 115,974</u>	<u>\$ 143,222</u>	<u>\$ —</u>	<u>\$ 143,222</u>	<u>\$ (27,248)</u>	<u>\$ —</u>	<u>\$ (27,248)</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

	2018	2017
Applicable ratio for realization limitation threshold table	504%	584%
Adjusted capital and surplus used to determine recovery period	\$ 678,824	\$ 779,702

The Company does not employ tax planning strategies. There are no temporary differences for which a DTL has not been established.

The current provision for incurred federal income taxes on earnings for the years ended December 31, consist of the following major components:

	2018	2017
Current federal income tax (benefit) expense	\$ (153,863)	\$ (2,443)
Tax expense on realized capital gains	–	563
Other, including prior year under accrual (over accrual)	–	2,966
Federal income taxes incurred	<u>\$ (153,863)</u>	<u>\$ 1,086</u>

The tax effect of temporary differences that give rise to significant portions of the DTAs and DTLs as of December 31, are as follows:

	2018	2017	Change
DTAs resulting from book/tax differences in Ordinary:			
Discounting of unpaid losses and LAE	\$ 1,253	\$ 558	\$ 695
Investments	–	28,980	(28,980)
Fixed assets	1,266	2,137	(871)
Compensation and benefit accruals	9,830	10,085	(255)
Pension accruals	24,950	26,178	(1,228)
Non-admitted assets	501	469	32
Intangible asset	15,175	15,352	(177)
Net operating loss carry-forward	48,042	4,041	44,001
Tax credit carry-forward	149,890	303,825	(153,935)
Other	13,602	18,927	(5,325)
Subtotal – gross ordinary DTAs	<u>264,509</u>	<u>410,552</u>	<u>(146,043)</u>
Statutory valuation adjustment – ordinary	114,619	106,727	7,892
Non-admitted ordinary DTAs	33,916	160,603	(126,687)
Admitted ordinary DTAs	<u>115,974</u>	<u>143,222</u>	<u>(27,248)</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

	2018	2017	Change
Capital:			
Investments	\$ 5,726	\$ 3,311	\$ 2,415
Net capital loss carry/forward	—	—	—
Gross capital DTAs	5,726	3,311	2,415
Statutory valuation adjustment – capital	5,726	3,311	2,415
Non-admitted capital DTAs	—	—	—
Admitted capital DTAs	—	—	—
Admitted DTAs	\$ 115,974	\$ 143,222	\$ (27,248)
DTLs resulting from book/tax differences in Ordinary DTLs:			
Other	\$ 108	\$ 103	\$ 5
Capital DTLs:			
Investments	—	—	—
Total DTLs	15,393	27,799	(12,406)
Net DTA	15,501	27,902	(12,401)
	\$ 100,473	\$ 115,320	\$ (14,847)

As of December 31, the change in net deferred income taxes is comprised of the following:

	2018	2017	Change
Total DTAs	\$ 270,236	\$ 413,862	\$ (143,626)
Total DTLs	(15,501)	(27,902)	12,401
Net DTAs/DTLs	254,735	385,960	(131,225)
Statutory Valuation Allowance adjustment	(120,345)	(110,037)	10,308
Net DTAs/DTLs after SVAs	134,390	275,923	(141,533)
Tax effect of unrealized gains	—	—	(6,650)
Change in net deferred income tax benefit			\$ (148,183)

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

The Company's provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate of 35% to net gain from operations before taxes. The significant items causing these differences are as follows:

	Statutory Rate Tax Effect
Income before taxes (including all realized capital gains)	\$ (18,561)
ACA Health Insurer Fee	9,465
162(m)(6) adjustment	3,173
Non-deductible expenses	456
Dividends received deduction	(323)
Rabbi Trust CSV build-up over cost	576
Change in non-admitted assets	(5,924)
Statutory valuation allowance adjustment	10,308
Other	(4,850)
Total	<u><u>\$ (5,680)</u></u>
Federal income taxes incurred	\$ (153,863)
Change in net deferred income tax	<u><u>148,183</u></u>
Total statutory income taxes	<u><u>\$ (5,680)</u></u>

At December 31, 2018 the Company had net operating loss carry-forwards of \$228,769 of which \$37,346 expire after 2037, and \$191,423 expire after 2038. The AMT credit carry forward as of January 1, 2018 was \$303,825. Due to the 2017 tax year loss carryback, this 2018 beginning balance decreased by \$4,044.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

As of December 31, 2018, the Company had \$149,890 of AMT credits available to offset future regular tax. These AMT credits do not expire under the current provisions of the Internal Revenue Code ("IRC").

- The AMT credit carryforward is recognized as a deferred tax asset.
- The AMT credit carryforward as of January 1, 2018 was \$303,825 and due to the 2017 tax-year loss carryback, the 2018 beginning balance decreased by \$4,044.
- The AMT credit balance recovered during 2018 is \$149,890.
- The ending balance of \$149,890 is not reduced by sequestration and is fully admitted.

The Company does not expect the liability related to any federal tax loss contingencies to significantly increase in the next 12 months.

The Company has no protective deposits under Section 6603.

The Company files income tax returns in the US federal jurisdiction. The Company's open tax years are 2015 through 2018.

The Company did not have any amounts for federal income taxes incurred and available for recoupment in the event of future net losses for the periods ended December 31, 2018 and 2017.

BCBSMA files a consolidated tax return with Zaffre Affiliated and Zaffre Investments. For 2018, Zaffre Affiliated had a tax benefit of \$768 and Zaffre Investments had a tax benefit of \$2,408. As of December 31, 2018, the net tax-related balance due to these companies was \$1,213. Taxes are allocated among members of the consolidated tax return under the terms of a written tax sharing agreement.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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 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 \$25,494 and \$20,562, respectively. Gains and losses on tax credits are recorded as other income in the statements of operations. As of December 31, 2018 and 2017, the Company did not have any unused Massachusetts tax credits.

9. Surplus

M.G.L. Chapter 160 of the Acts of 1988 requires that the Company maintain surplus of not less than 5% of all expenses and insured claims incurred in each year. At December 31, 2018 and 2017, the Company’s surplus was in excess of the regulatory Chapter 160 requirements.

In addition, the NAIC has imposed regulatory 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

9. Surplus (continued)

In December 2017, the Company issued a surplus note in the amount of \$285,000 to HMO Blue 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. 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 and no principal or interest was paid in 2017. As of December 31, 2018 and 2017 there were no unapproved interest or principal payments.

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.

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

11. Federal Employees Program

The Company participates in the Federal Employee Health Benefits Program (“FEHBP”) with other BlueCross BlueShield plans (“Plans”). This program includes a fully-insured experience-rated contract, commonly known as the Federal Employee Program (“FEP”), between the Office of Personnel Management (“OPM”) and the BCBSA, which acts as an agent for the participating Plans. In addition, each participating Plan, including the Company, executes a contract with BCBSA which obligates each participating Plan to underwrite FEP benefits in its service area.

Premium rates are developed by BCBSA and negotiated with OPM annually. These rates determine the funds that will be available to the participating Plans to provide insurance to Federal employees that enroll in FEP. The excess of gross premiums for the life of the program over the charges for the life of the program on an accrual basis is accounted for as a rate stabilization reserve (commonly referred to as the special reserve), as required by the contract between OPM and BCBSA. Any premiums that remain in the rate stabilization reserve upon termination of the BCBSA contract after the claims run-out and reimbursement of allowable administrative expenses would be returned to OPM for the benefit of the FEHBP. The FEP contract renews automatically each year unless written notice of termination is given by either party.

The Company has recorded its allocable share of the special reserve funds held in the U.S. Treasury as an admitted asset, with an equivalent amount recorded as a rate stabilization reserve. These amounts were \$96,555 and \$108,841 as of December 31, 2018 and 2017, respectively, and are included in premium receivables and aggregate policy reserves in the accompanying balance sheets.

12. Related-Party Transactions

BCBSMA has two wholly-controlled subsidiaries: HMO Blue and Zaffre Affiliated. Zaffre Affiliated has one wholly-controlled subsidiary: Zaffre Investments. In addition, the Company has two other affiliated companies: BlueCross BlueShield Venture Partners, L.P. (“BCBS Venture”) and BlueCross BlueShield Venture Partners II, L.P. (“BCBS Venture II”).

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

HMO Blue provides hospitalization, medical and other health benefits as a licensed health maintenance organization.

The general business of Zaffre Affiliated is to act as a holding company for Zaffre Investments. Zaffre Investments, with Zaffre Affiliated as its sole member, is engaged in certain strategic investments that provide services to wide array of businesses in the healthcare industry.

The Company is the sole corporate member of the Blue Cross Blue Shield of Massachusetts Foundation, Inc. for Expanding Healthcare Access (“BCBSF”), and as such, has a variety of powers, including appointment and approval of board members. The mission of BCBSF is to promote and support programs, research and policies that will help to expand access to high quality, affordable health care for Massachusetts residents. BCBSMA provided financial support to BCBSF in the amount of \$1,355 and \$858 in 2018 and 2017, respectively.

During 2018, BCBSMA made additional contributions to its Subsidiaries, Controlled, and Affiliated Entities (SCA) as follows:

SCA Entity	Contribution Amount
Zaffre Investments, LLC	\$ 32,000
Zaffre Affiliated Services, LLC	3,737
BlueCross BlueShield Venture Partners, L.P.	26
BlueCross BlueShield Venture Partners II, L.P.	1,031

As of December 31, 2018 Zaffre Affiliated had one wholly-controlled subsidiary, Zaffre Investments. Zaffre Investments had five wholly-controlled subsidiaries, twelve affiliated companies, and held four convertible notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

The five subsidiaries of Zaffre Investments are; Core Administrative System I (“CASI”), Indigo Insurance Services, LLC (“Indigo”), Massachusetts Benefit Administrators, LLC (“MBA”), HealthBox II, LLC (“HealthBox II”) and QCentive, LLC (“QCentive”).

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. As of December 31, 2018, BCBSMA 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, BCBSMA 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

In September 2018, BCBSMA transferred 100% ownership in Zaffre Investments to Zaffre Affiliated to streamline the Company organizational structure. At the BCBSMA reporting level, this transfer of ownership was treated as a non-economic transaction since BCBSMA continued its involvement in those same investments. Using the appropriate valuation method for non-economic transactions between related parties and affiliates, BCBSMA recorded \$65,828 in assets transferred at the lower of existing book value or fair value of Zaffre Investments at the date of transaction. This non-economic transaction between the Company and its investment holding subsidiaries had no impact on BCBSMA surplus.

In September 2018, Zaffre Affiliated completed the withdrawal of its membership from Life and Specialty Ventures, LLC (LSV). As a part of the settlement agreement LSV delivered a promissory note (the LSV Note) to Zaffre Affiliated in the amount of \$123,631. On September 28, 2018 and in accordance with the terms and conditions of the LSV Note, the entire outstanding principal and accrued interest of \$1,937 was paid.

As of December 31, 2018, Zaffre Affiliated had a book value of \$214,674 which has been non-admitted as it is unaudited and does not meet the criteria of SSAP No. 97 – Investments in Subsidiary, Controlled, and Affiliated Entities to utilize the look-through approach.

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 borrowing transactions between BCBSMA and HMO Blue.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

As of December 31, 2018, BCBSMA's intercompany receivable balances were as follows:

	2018	2017
HMO Blue	\$ 11,543	\$ 18,908
BCBSF	608	551
Indigo	521	479
MBA	70	81
Zaffre Affiliated	657	45
Zaffre Investments	131	261
Totals	\$ 13,530	\$ 20,325

HMO Blue and BCBSMA operate under common Board of Directors management and control.

The Company participates in a bilateral intercompany agreement with HMO Blue 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.

As a condition of granting a health maintenance organization ("HMO") license to HMO Blue, the DOI required the Companies to enter into an agreement granting the DOI discretionary authority that requires a surplus note to be issued from one company to the other, if either company's health Risk-Based Capital ("RBC") is more than seventy five percentage points higher than the other company's RBC.

Under the terms of its license with the 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.

As required by the "*Blue Cross Blue Shield Controlled Affiliate License*," BCBSMA guarantees, to full extent of its assets, all of the contractual and financial obligations of MBA.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

BCBSMA and HMO Blue 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.

Those 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.

With respect to individuals solely employed by BCBSMA, the pro-rata portion of compensation, benefits and administrative expenses attributable to 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 set up for payroll and payroll related benefits. An agency arrangement has been established for payment of claims and operating expenses and receipt of funds.

HMO Blue is a participating employer in BCBSMA sponsored employee benefit plans which include, but are not limited to, retirement, healthcare and life insurance benefits. The associated costs are shared by BCBSMA and HMO Blue. BCBSMA is financially responsible for the administration of the benefit plans. The Company charges HMO Blue as participating employer of the benefit plans, a fee based on HMO Blue’s allocated share of the benefit plans’ expenses. Additionally, under the Common Paymaster Agreement, BCBSMA administers payroll, payroll taxes and benefits on behalf of subsidiaries.

BCBSMA, HMO Blue and Indigo have a Tri-party Employment Agreement which covers the terms and conditions upon which BCBSMA, HMO Blue and Indigo will concurrently employ employees (“Tri-party Associates”) who provide sales, account relations and sale related administrative services for all three entities. The compensation, benefits and related administrative expenses of the Tri-party Associates attributable to the sales services are charged to each company in accordance with the provision of the services provided to each company.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

In accordance with the General Service Agreement, Zaffre Affiliated provides BCBSMA, HMO Blue, MBA, and Indigo the services of Zaffre Affiliated's employees. The Company compensates Zaffre Affiliated by paying a management fee. Zaffre Investments employs its own employees.

BCBSMA provides core, non-core and routine administrative support services including personnel, office space, equipment, computer processing, office and professional services, and other services under the Administrative Services Agreement with Indigo, MBA, Zaffre Affiliated and Zaffre Investments. Each of the subsidiaries pay monthly administrative fees to BCBSMA for these services or any other special requests at cost or cost plus a mark-up depending on the nature of services and costs.

BCBSMA has a Leased Employees Agreement with Indigo and QCentive. In accordance with this agreement, Indigo and QCentive receive services and support from BCBSMA employees in the areas of sales, solicitation, negotiation of insurance coverage and products, forecast and contract modeling, and quality analysis reporting. Indigo and QCentive pay a monthly leased employee services fee to BCBSMA for compensation, benefits and related administrative expenses attributable to these services.

BCBSMA has senior management agreements with both Indigo and MBA where each subsidiary engages BCBSMA as its non-exclusive manager to manage, supervise and administer the business of Indigo or MBA through BCBSMA's senior management in accordance with all applicable federal, state and local laws and regulations.

As compensation in full for the senior management service, Indigo and MBA pay BCBSMA a senior management fee.

BCBSMA has a Management and Administrative Services Agreement with QCentive where the Company provides certain financial and tax services to QCentive.

All administrative support, management fees and employees expenses associated with services provided to each subsidiary and paid by BCBSMA on their behalf are settled within 90 days.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

Because of the significant related-party transactions with HMO Blue, the Company's financial condition and the results of operations may not necessarily be indicative of the financial condition or results of operations that would have occurred if the Company had been operated as an unaffiliated company.

13. Third Party Administrators

The Company has a Medicare Part D Inter-Plan Services Agreement to offer a Blue Cross and Blue Shield branded prescription drug plan ("PDP") with Anthem Blue Cross Blue Shield, Blue Cross and Blue Shield of Rhode Island, and Blue Cross and Blue Shield of Vermont ("The Plans"). The Plans have collectively have a contract with the Centers for Medicare Services to offer a branded PDP in Region 2, based on the regulations contained with the Medicare Modernization Act of 2003. CVS Caremark is acting as a third party administrator to process premiums and claims under the PDP.

Profits and losses associated with the direct pay Blue Cross Blue Shield branded PDP are pooled and allocated amongst the Plans based upon membership in the applicable branded area and reported as other expense of \$1,468 and \$426 in 2018 and 2017, respectively.

The Company has an agreement with Health Reinsurance Management Partnership ("HRMP") for stop loss third party claims administrative services. HRMP acts, in effect, as the accident and health reinsurance department of London Reinsurance Group, managing excess medical reinsurance for the group. It is also a fully licensed third party administrator.

Name and Address of Third Party Administrator	FEIN Number	Exclusive Contract	Type of Business Written	Type of Authority Granted	Total Direct Premium Written
CVS Caremark, Inc. One CVS Drive, Woonsocket RI 02895 Health Reinsurance Management Partnership 300 Rosewood Drive, Suite 250, Danvers, MA 01923	33-1113587 51-0397873	No	Medicare Part D Stop loss	Admin Services Admin Services	\$ 195,650 \$ 52,771

Blue Cross and Blue Shield of Massachusetts, Inc.

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

14. Reinsurance

Since 2010, the Company had dental reinsurance and administrative services transfer agreements with USAble Life, Inc. (“USAble Life”), a wholly-owned insurance subsidiary of LSV. The proportional share dental reinsurance agreement between BCBSMA (“reinsured”) and USAble Life (“reinsurer”) transfers 51% of dental insurance risk to USAble Life.

The difference between the amount arrived at by subtracting the aggregate value of claims incurred plus the ceded commission from the reinsurance premiums was invoiced monthly and settled between the parties within 45 days. On September 28, 2018, the Company terminated the Agreements with USAble Life, Inc. Refer to footnote 22.

At December 31, 2018, the Company has reported in its operations, the result of the commutation of the Dental Reinsurance Agreement with the company listed below, amounts are reflected as:

Losses incurred	\$ (93,151)
Loss adjustment expenses incurred	(9,552)
Premiums earned	123,760
Other	—

<u>Company</u>	<u>Amount</u>
USAble Life, Inc.	\$ 21,057

In 2018 and 2017, dental premiums earned have been reduced for the amounts ceded of \$123,760 and \$150,653, respectively. Healthcare benefits incurred have been reduced by the recovery amounts of \$83,416 and \$113,484 in 2018 and 2017, respectively, related to individuals with excess claims.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

14. Reinsurance (continued)

The Company has Specific Excess of Loss Reinsurance agreement with Navigators Insurance Company (“Navigators”) to provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources.

Neither BCBSMA nor any of its related parties control, directly or indirectly, any reinsurers with whom the Company conducts business. No policies issued by BCBSMA have been reinsured with a foreign company, which is controlled, either directly or indirectly, by a party not primarily engaged in the business of insurance.

BCBSMA does not have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel the agreement. At December 31, 2018, there was no reinsurance agreements in effect such that the amount of losses paid or accrued exceed the total direct premium collected.

BCBSMA also has a Specific and Aggregate Excess of Loss Reinsurance agreement with Gerber Life Insurance Company. This assumed reinsurance agreement provides the Company with the ability to expand into the National Stop Loss market.

Premiums earned have been increased for the amounts assumed of \$6,353 and \$6,103 in 2018 and 2017, respectively. Healthcare benefits incurred have been increased for the amount assumed of \$5,739 and \$6,037 in 2018 and 2017, respectively.

The net amount of increase in surplus if all reinsurance agreements were cancelled would be \$2,710 and \$31,219 as of December 31, 2018 and 2017, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

15. Retrospectively Rated Contracts and Contracts Subject to Redetermination

The Company estimates accrued retrospective premium adjustments for its retrospectively rated business through a mathematical approach consistent with the Company's underwriting rules and experience rating practices. BCBSMA records accrued retrospective premium as an adjustment to earned premium.

The amount of net premiums written by the Company that are subject to retrospective rating features was \$195,650 and \$183,046 for the years ended December 31, 2018 and 2017, respectively, which represents approximately 7% and 6% of the Company's written premiums for both 2018 and 2017, respectively. No other premiums written by the Company are subject to retrospective rating features.

The ACA of 2010 amended section 1857(e) of the Social Security Act requiring Medicare Part D plans to meet a minimum MLR of 85%. The Company's medical loss ratio rebates required pursuant to the Public Health Service Act as of December 31, 2018 and 2017 are as follows:

	Individual	Small Group	Large Group	Medicare Part D	Total
<u>2017 Reporting Year</u>					
MLR rebates unpaid, January 1	\$ —	\$ —	\$ —	\$ 8,393	\$ 8,393
MLR rebates incurred	—	—	—	(6,395)	(6,395)
MLR rebates paid	—	—	—	—	—
MLR rebates unpaid, December 31	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,998</u>	<u>\$ 1,998</u>
<u>2018 Reporting Year</u>					
MLR rebates unpaid, January 1	\$ —	\$ —	\$ —	\$ 1,998	\$ 1,998
MLR rebates incurred	—	—	—	—	—
MLR rebates paid	—	—	—	1,998	1,998
MLR rebates unpaid, December 31	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

16. 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 years, and were as follows:

	December 31, 2018		2018			Ref ⁽¹⁾
	Receivable	(Payable)	Income	(Expense)		
a. Permanent ACA Risk Adjustment Program						
Premium adjustments	\$ –	\$ (500)	\$ (574)	\$ –	a)	
Risk adjustment user fees	–	(4)	(5)	–	f)	
Subtotal ACA Permanent Risk Adjustment Program	–	(504)	(579)	–	–	
b. Transitional ACA Reinsurance Program						
Claims paid	–	–	5	–	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	–	–	5	–	–	
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	\$ –	\$ (504)	\$ (574)	\$ –	–	

Ref ⁽¹⁾:

- a) There were no admitted receivables at December 31, 2018.
- b) This recoverable has been admitted.
- c) There were no reinsurance contributions (not reported as ceded premium) at December 31, 2018.
- d) There was no expense recorded within administrative expenses for 2018.
- e) There were no ceded reinsurance premiums paid in 2018.
- f) No balances or premium was excluded from the ACA Risk Adjustment Program.
- g) No balances or premium was excluded from the Transitional ACA Reinsurance Program.
- h) No balances or premium was excluded from the Temporary ACA Risk Corridor Program.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

	December 31, 2017		2017			Ref ⁽¹⁾
	Receivable	(Payable)	Income	(Expense)		
e. Permanent ACA Risk Adjustment Program						
Premium adjustments	\$ –	\$ (800)	\$ (967)	\$ –	–	a)
Risk adjustment user fees	–	(5)	(9)	–	–	f)
Subtotal ACA Permanent Risk Adjustment Program	–	(805)	(976)	–	–	–
f. Transitional ACA Reinsurance Program						
Claims paid	8	–	22	–	–	b)
Claims unpaid	–	–	(8)	–	–	g)
Related to uninsured plans	–	–	–	–	–	g)
Contributions – not reported as ceded premium	–	–	–	–	–	c) d)
Ceded reinsurance premiums	–	–	–	–	–	e)
Subtotal ACA Transitional reinsurance Program	8	–	14	–	–	–
g. Temporary ACA Risk Corridor Program						
Accrued retrospective premium	–	–	–	–	–	h)
Reserve for rate credits or policy experience rating refunds	–	–	–	–	–	h)
Subtotal ACA Risk Corridors Program	–	–	–	–	–	–
h. Total for ACA Risk Sharing Provisions	\$ 8	\$ (805)	\$ (962)	\$ –	–	–

Ref ⁽¹⁾:

- a) There were no admitted receivables at December 31, 2017.
- b) This recoverable has been admitted.
- c) There were no reinsurance contributions (not reported as ceded premium) at December 31, 2017.
- d) There was no expense recorded within administrative expenses for 2017.
- e) There were no ceded reinsurance premiums paid in 2017.
- f) No balances or premium was excluded from the ACA Risk Adjustment Program.
- g) No balances or premium was excluded from the Transitional ACA Reinsurance Program.
- h) No balances or premium was excluded from the Temporary ACA Risk Corridor Program.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

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

	Roll-forward of Prior Year ACA Risk Sharing Balances										
	Accrued		Rec/Paid		Differences		Adjustments		Unsettled		
	Rec	(Pay)	Rec	(Pay)	Rec	(Pay)	Rec	(Pay)	Ref ⁽³⁾	Rec	(Pay)
a. Permanent ACA risk adjustment											
Premium adjustments receivable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	(a)	\$ -	\$ -
Premium adjustments (payable)	-	(800)	-	(874)	-	74	-	(74)	(b)	-	-
Subtotal ACA permanent risk adjustment program	-	(800)	-	(874)	-	74	-	(74)		-	-
b. Transitional ACA reinsurance											
Claims paid	8	-	13	-	(5)	-	5	-	(c)	-	-
Claims unpaid	-	-	-	-	-	-	-	-	(d)	-	-
Related to uninsured plans	-	-	-	-	-	-	-	-		-	-
Contributions – not reported as ceded premium	-	-	-	-	-	-	-	-		-	-
Ceded reinsurance premiums	-	-	-	-	-	-	-	-		-	-
Subtotal ACA transitional reinsurance program	8	-	13	-	(5)	-	5	-		-	-
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	\$ 8	\$ (800)	\$ 13	\$ (874)	\$ (5)	\$ 74	\$ 5	\$ (74)		\$ -	\$ -

Ref ⁽³⁾:

- a) Adjustments to the prior benefit year ACA Risk Adjustment program as of December 31, 2018 were \$0 (gross of non-admitted) and were based on the reconsideration settlement notice received.
- b) Adjustments to the prior benefit year ACA Risk Adjustment program as of December 31, 2018 was \$(74).
- c) The adjustment for amounts recoverable for claims paid under the Transitional ACA Reinsurance Program was \$5 and reflects the differences between previously estimated amounts and the final settlement notice received in September 2017 for the year ended December 31, 2018.
- 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 in September 2017 for the year ended December 31, 2018.

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, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

17. 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	Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Billed or Otherwise Confirmed	Actual Rebates Collected Within 90 Days	Actual Rebates Collected Within 91 to 180 Days	Actual Rebates Collected in More Than 180 Days
12/31/2018	\$ 24,702	\$ 26,942	\$ 7,893	\$ —	\$ —
9/30/2018	24,649	28,128	7,656	—	—
6/30/2018	24,396	24,002	9,558	13,820	—
3/31/2018	22,578	22,043	6,861	13,856	5,447
12/31/2017	18,404	40,254	6,997	15,082	1,965
9/30/2017	18,146	25,388	5,027	13,510	2,352
6/30/2017	23,578	32,386	5,074	15,207	3,218
3/31/2017	22,254	26,477	—	16,489	5,890
12/31/2016	21,383	49,511	5,790	7,812	7,446
9/30/2016	22,786	41,660	—	14,497	8,022
6/30/2016	20,808	32,862	—	6,881	14,317
3/31/2016	20,520	21,443	—	6,693	15,008

Blue Cross and Blue Shield of Massachusetts, Inc.

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

18. ASC Business

The Company provides certain claim administration services for its uninsured customers through ASC arrangements. The net loss from operations related to these contracts is as follows at December 31, 2018 and 2017:

	ASC Uninsured Plans	
	2018	2017
Gross reimbursement for medical cost incurred	\$ 8,225,653	\$ 8,031,999
Gross administrative fees accrued	375,377	371,663
Gross expenses incurred (claims and administrative)	(8,697,942)	(8,469,568)
Net loss from operations	\$ (96,912)	\$ (65,906)

At December 31, 2018 and 2017, the Company had admitted assets of \$140,482 and \$169,860, respectively, in net accounts receivable for uninsured plans and amounts due from agents. The Company routinely assesses the collectability of its receivables.

At December 31, 2018 and 2017, the Company recorded gross ASC administrative fees accrued and not billed of \$22,640 and \$23,486, respectively.

19. 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

19. Leases (continued)

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.

In October 2018 the Companies entered into an additional non-cancelable sublease 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 \$11,454 and \$10,903 respectively, of which, \$11,290 and \$10,744 were 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	\$ 12,535
2020	12,634
2021	12,741
2022	12,771
2023	12,803
Thereafter	82,367

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 \$9,648 to \$6,018 per year from 2019 through 2021.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

20. Debt

At December 31, 2018, the Company does not have any outstanding capital note obligations.

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 and the third facility for \$50,000 matured in October 2018 was renewed until October 2019. At December 31, 2018 the Company had outstanding principal and accrued interest of \$200,000 and \$18, respectively and no accrued fees.

During 2018 and 2017, the Company paid interest of \$2,010 and \$1,358 and fees of \$242 and \$121, 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 1.00. 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 are 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, BCBSMA paid principal of \$15,000 and interest of \$494. At December 31, 2018, BCBSMA has a carrying value of \$12,500 outstanding and accrued interest of \$1. As of December 31, 2018, there were no violations of the debt terms and covenants reported.

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, BCBSMA paid principal of \$10,000 and interest of \$1,078. At December 31, 2018, BCBSMA 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

20. Debt (continued)

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

<u>Debt - Long-Term Borrowings</u>	<u>BCBSMA, Inc.</u>
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	145,000

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

21. 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.

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

As a requirement of the FHLB membership, the Company has \$1,862 and \$1,694 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%. At December 31, 2018 and 2017, the Company recorded \$4,000 and \$4,500 of FHLB Activity Stock, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

21. FHLB Agreements (continued)

At December 31, 2018, the Company had an outstanding borrowing of \$50,000 for a 5-year term at a rate of 2.09% 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 2018 and 2017, the Company paid annual interest expense of \$2,099. At December 31, 2018 and 2017, the Company has an outstanding principal balance of \$100,000 and accrued interest of \$178.

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.

At December 31, 2018 and 2017, the total collateral pledged against these borrowings had a fair value of \$112,363 and \$111,302, respectively, and a carrying value of \$114,605 and \$112,283, respectively.

At December 31, 2018 and 2017, the maximum amount pledged during the reporting period had a fair value of \$112,925 and \$112,845, respectively, and a carrying value of \$115,786 and \$113,405, respectively. The Company has no prepayment obligations with the FHLB.

22. Commitments and Contingencies

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

22. Commitments and Contingencies (continued)

At 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.	2,780
Park Square Capital Credit Opp II Feeder, L.P.	6,247
Comvest Capital IV, L.P.	10,040
Park Square Capital Credit Opp III Feeder, L.P.	16,659
New Mountain Net Lease L.P.	8,834
Zaffre Affiliated Services, LLC.	<u>7,417</u>
Total Commitments	<u><u>\$ 57,146</u></u>

Also, within Zaffre Affiliated is a commitment for \$940 to Long River Ventures III, L.P. a non-affiliated investment fund.

In December 2017, the Companies Board of Directors approved management's decision to terminate the Dental Reinsurance and Administrative Services Agreements (the "Agreements") with USAble Life, Inc. ("USAble") including the withdrawal of Zaffre Affiliated as a member of Life and Specialty Ventures, LLC ("LSV"). On December 29, 2017, BCBSMA executed a binding Memorandum of Understanding ("MOU") to terminate the Agreements and the withdrawal of Zaffre Affiliated. At December 31, 2017, BCBSMA established a contingent loss reserve of \$138,000 as a result of the signed MOU. This amount is included in other income or expenses on the 2017 income statement.

In September 2018, BCBSMA completed the settlement to terminate the Agreements by issuing to USAble, a promissory note (the "Note") for the aggregate amount of \$135,443 which included the make-whole-amount of \$108,000 and the tax-gross-up-amount of \$27,443. The Note was fully paid in accordance with the Agreement on September 28, 2018.

The remaining contingent loss reserve of \$2,557 was adjusted and included in other income or expenses in the Company's 2018 income statement. As of December 31, 2018, the Company did not have a contingent loss reserve balance.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

22. Commitments and Contingencies (continued)

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 our fellow Plans. The discovery phase of the litigation commenced in 2012. In January 2018, the court suspended certain procedural and pretrial deadlines; no dates have been set for any pretrial conferences or trials.

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 an estimate of the possible loss or range of loss cannot be made. Therefore, the Company has not accrued a contingent loss related to the litigation. The Company continues to vigorously defend these class actions.

23. 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 BCBSMA payments of \$2,591 was made for the CHIA FY2018 assessment. BCBSMA’s assessment to cover CHIA’s FY2019 operations was \$4,799 which was paid in two installments during 2018.

The second is the Commonwealth of Massachusetts Health Policy Commission assessment pursuant to Section 958 Chapter 9.04, “*Assessment on Certain Health Care Provider and Surcharge Payors*”. The amount is based on the assessment percentage of the Company and the annual legislatively approved budget of the Health Policy Commission for FY2019. BCBSMA’s FY2019 assessment is \$1,521, the first of two installments of \$768 was paid in 2018 and the second payment of \$753 was paid in February 2019.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

23. State Assessments (continued)

The third is the Commonwealth of Massachusetts Division of Insurance “*The Health Care Assess Bureau*” (“HCAB”) assessed BCBSMA to pay for HCAB expenses. The assessment is based on the Company’s share of health premiums as reported to the HCAB. During 2018, BCBSMA paid \$175 to the HCAB.

24. ACA Insurer Fee

The Company is subject to an annual health insurance industry fee under section 9010 of the federal Patient Protection and Affordable Care Act (“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 United States health risks written during the preceding calendar year. A health insurer’s portion of the 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 \$45,098 and was paid in September 2018. This amount was reflected in the December 2017 special surplus and would have had a 33% impact on the Company’s 2017 risk based capital (“RBC”) which 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	\$ –	\$ 43,483
ACA fee assessment paid	45,098	–
Premium written subject to ACA 9010 assessment	2,350,403	2,259,254
Total adjusted capital before surplus adjustment	779,298	895,022
Total adjusted capital after surplus adjustment	779,298	851,539
Authorized control level after surplus adjustment	134,607	133,485

Blue Cross and Blue Shield of Massachusetts, Inc.

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

25. 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, 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, 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.



April 26, 2019

Blue Cross and Blue Shield of Massachusetts, Inc.

Investment Risk Interrogatories – Statutory Basis
(Dollars in Thousands)

December 31, 2018

1. Blue Cross and Blue Shield of Massachusetts, Inc.'s total admitted assets as reported on page 2 of its annual statement are \$2,386,130.
2. Following are the ten largest exposures to a single issuer/borrower/investment, excluding: (i) 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, (ii) property occupied by Blue Cross and Blue Shield of Massachusetts, Inc. and (iii) policy loans:

Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
Primus HY Bond Fund LP	Other invested asset	\$ 67,496	2.829%
Lazard Asset Management Fund	Other invested asset	57,869	2.425
Pimco All Asset Instl Fund	Other invested asset	50,466	2.115
Bluerock Market Neutral Fund	Other invested asset	45,540	1.909
RREEF America II Core REIT Fund	Common Stock	41,658	1.746
Putnam Total Return Fund LLC	Other invested asset	41,041	1.721
Newton Global Equity Income	Common Stock	37,238	1.561
Clarion Lion Prop Core RE Fund	Other invested asset	34,133	1.430
Parametric Portfolio Associate LLC	Other invested asset	31,416	1.317
Beachpoint HY Bond Fund L.P.	Other invested asset	30,295	1.270

3. Blue Cross and Blue Shield of Massachusetts, Inc.'s total admitted assets held in bonds 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	\$ 715,122	29.970%	P/RP-1	\$ —	%
NAIC-2	58,741	2.462	P/RP-2	—	
NAIC-3	1,749	0.073	P/RP-3	—	
NAIC-4	—	P/RP-4		—	
NAIC-5	—	P/RP-5		—	
NAIC-6	—	P/RP-6		—	
	<u><u>\$ 775,612</u></u>			<u><u>\$ —</u></u>	

Blue Cross and Blue Shield of Massachusetts, Inc.

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

4. Assets held in foreign investments:

Assets	Amount	Percentage of Total Admitted Assets
Admitted assets held in foreign investments	\$ 83,552	3.502%

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

NAIC Sovereign Rating	Amount	Percentage of Total Admitted Assets
Countries rated NAIC-1	\$ 47,120	1.975%
Countries rated NAIC-2	10,790	0.452
Countries rated NAIC-3 or below	25,642	1.075

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

NAIC Sovereign Rating	Amount	Percentage of Total Admitted Assets
Countries rated NAIC-1:		
Cayman Islands	\$ 17,974	0.753%
United Kingdom	6,178	0.259
Countries rated NAIC-2:		
Ireland	2,694	0.113
Netherlands	1,842	0.077
Countries rated NAIC-3 or below:		
Guernsey	25,642	1.075

Blue Cross and Blue Shield of Massachusetts, 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-governmental) foreign issues:

Issuer	NAIC Rating	Amount	Percentage of Total Admitted Assets
Park Square Capital Opportunity II Fund	OIA	\$ 19,813	0.830%
Park Square Capital Opportunity III Fund	OIA	5,829	0.244
HSBC HLDGS PLC	1FE	2,694	0.113
UBS Group Fdg Switzland AG	1FE	2,217	0.093
Sumimotot Mitsu Finl Group Inc.	1FE	2,157	0.090
GE CapItalyL International Fdg	1FE	1,991	0.083
Sparebank 1 boligkreditt 144a	1FE	1,949	0.082
Stadshypotek AB 144A	1FE	1,945	0.082
Carlyle Global MA 4A 144A	1FE	1,900	0.080
AMMC CLO 21 LTD 144A	1FE	1,843	0.077

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

Blue Cross and Blue Shield of Massachusetts, 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
Primus HY Bond Fund LP	\$ 67,496	2.829%
Lazard Asset Management Fund	57,869	2.425
Pimco All Asset Instl Fund	50,466	2.115
Bluerock Market Neutral Fund	45,540	1.909
RREEF America II Core REIT Fund	41,658	1.746
Putnam Total Return Fund LLC	41,041	1.721
Newton Global Equity Income	37,238	1.561
Clarion Lion Prop Core RE Fund	34,133	1.430
Parametric Portfolio Associate LLC	31,416	1.317
Beachpoint HY Bond Fund L.P.	30,295	1.270

14. The Company has no assets held in nonaffiliated, privately placed equities that are greater than 2.5% of the Company's total admitted assets.
15. The Company has no assets held in general partnership interests that are 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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

18. The Company has no assets held in real estate reported that are greater than 2.5% of the Company's total admitted assets, excluding home office properties.
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 had no securities lending or repurchase agreements during 2018.
21. The Company had no warrants not attached to other financial instruments, options, caps, and floors during 2018.
22. The Company had 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, 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	\$ 200,066	11.281%	\$ 200,066	12.834%
U.S. governmental agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	33,059	1.864	33,059	2.121
Issued by U.S. government sponsored agencies	315	0.018	315	0.020
Non U.S. government (including Canada, excluding mortgage-backed securities)	3,318	0.187	3,318	0.213
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
States, territories and possessions general obligations	793	0.045	793	0.051
Political subdivisions of states, territories and possessions general obligations	807	0.045	807	0.052
Revenue and assessment obligations	2,315	0.131	2,315	0.148
Industrial development and similar obligations	—	—	—	—
Mortgage-backed securities (includes RMBS and MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	31,894	1.798	31,894	2.046
Issued or guaranteed by FHMA and FHLMC	158,646	8.945	158,646	10.177
All other	—	—	—	—
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	59,557	3.358	59,557	3.821
Issued by non-U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies	81	0.005	81	0.005
All other	27,792	1.567	27,792	1.783
Other debt and other fixed income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	192,814	10.872	192,814	12.369
Unaffiliated Non-U.S. securities (including Canada)	62,074	3.500	62,074	3.982
Affiliated securities	—	—	—	—

Blue Cross and Blue Shield of Massachusetts, 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	\$ 158,675	8.947%	\$ 158,675	10.179%
Preferred stock:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Publicly traded equity securities (excluding preferred stock):				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Other equity securities:				
Affiliated	270	0.015	270	0.017
Unaffiliated	11,987	0.676	11,987	0.769
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	99,723	5.623	99,723	6.397
Property held for production of income (including \$0 of property acquired in satisfaction of debt)	—	—	—	—
Property held for sale (including \$0 property acquired in satisfaction of debt)	—	—	—	—
Contract loans	—	—	—	—
Receivable for securities	7,741	0.436	7,741	0.497
Securities for lending	—	—	—	—
Cash, cash equivalents and short term investments	46,743	2.636	46,743	2.999
Other invested assets	674,855	38.052	460,181	29.521
Total invested assets	\$ 1,773,523	100.000%	\$ 1,558,849	100.000%

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

Blue Cross and Blue Shield of Massachusetts, Inc.

Note to Supplemental Investment Disclosure

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, Inc.'s 2018 Statutory Annual Statement as filed with the Commonwealth of Massachusetts Division of Insurance.

About EY

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