

AUDITED STATUTORY-BASIS FINANCIAL
STATEMENTS AND SUPPLEMENTARY INFORMATION

Blue Cross and Blue Shield of Massachusetts, Inc.
Years Ended December 31, 2017 and 2016
With Report of Independent Registered
Public Accounting Firm

Ernst & Young LLP



Building a better
working world

Blue Cross and Blue Shield of Massachusetts, Inc.

Audited Statutory-Basis Financial Statements
and Supplementary Information

Years Ended December 31, 2017 and 2016

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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 2016, and the related statutory-basis statements of operations, changes in surplus and cash flow for the years 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 audits.

We conducted our audits 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 audits provide 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 and 2016, or the results of its operations or its cash flows for the years 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 2016, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance.



We also have audited, 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, the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated April 27, 2018 expressed an unqualified opinion thereon.

Ernst & Young LLP

April 27, 2018



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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 Blue Cross and Blue Shield of Massachusetts, Inc.'s (the Company) internal control over statutory financial reporting as of December 31, 2017, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). The Company's management is responsible for maintaining effective internal control over statutory financial reporting, and for its assessment of the effectiveness of internal control over statutory financial reporting included in the accompanying Report of Management on Internal Control over Statutory Financial Reporting. Our responsibility is to express an opinion on the company's internal control over statutory financial reporting 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 effective internal control over statutory financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over statutory financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over statutory financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance. A company's internal control over statutory financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of statutory-basis financial statements in accordance with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the statutory-basis financial statements.



Because of its inherent limitations, internal control over statutory financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over statutory financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, 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, the statutory-basis balance sheets of the Company as of December 31, 2017 and 2016, and the related statutory-basis statements of operations, changes in surplus and cash flow for the years then ended and our report dated April 27, 2018 expressed an unqualified opinion on those financial statements with regard to their conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance.

Ernst & Young LLP

April 27, 2018



MASSACHUSETTS

**Management’s Report on Internal Control over Statutory Financial Reporting
for Blue Cross and Blue Shield of Massachusetts, Inc.**

April 27, 2018

We, as members of management of Blue Cross and Blue Shield of Massachusetts, Inc. (the Company), are responsible for establishing and maintaining adequate internal control over statutory financial reporting. The Company's internal control over statutory financial reporting is a process designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of the statutory-basis financial statements in conformity with accounting practices prescribed or permitted by the Commonwealth of Massachusetts Division of Insurance. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are also subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an assessment of the effectiveness, as of December 31, 2017, of the Company's internal control over statutory financial reporting based on the framework established in *Internal Control–Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment under that framework, we assert that the Company maintained effective internal control over statutory financial reporting as of December 31, 2017.

Ernst & Young LLP, our independent registered public accounting firm, has issued its report on the effectiveness of the Company's internal control over statutory financial reporting as of December 31, 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

Andrew Dreyfus, President and Chief Executive Officer

Andriana Santangelo, Executive Vice President and Chief Financial Officer

Brett Painchaud, Senior Vice President and Controller

Linda Williams, Senior Vice President and Chief Risk and Audit Officer

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Balance Sheets

(Dollars in Thousands)

	December 31	
	2017	2016
Admitted assets		
Bonds	\$ 828,221	\$ 770,846
Preferred stock	—	525
Common stock	153,316	171,596
Properties occupied by the Company	102,393	104,689
Cash, cash equivalents and short-term investments	212,222	39,095
Receivable for securities	6,102	5,070
Other invested assets	538,615	559,300
Total cash and invested assets	1,840,869	1,651,121
Accrued investment income	4,031	3,919
Premiums receivable	212,372	173,606
Reinsurance recoverable	9,104	8,648
Receivables related to uninsured plans	169,860	153,683
Income tax recoverable	4,227	7,765
Net deferred tax asset	115,320	27,057
Data processing equipment	10,902	6,979
Receivable from affiliates	20,325	29,649
Health care receivables	52,850	71,305
Other receivables	44,553	47,997
Other assets	63,567	55,639
Total admitted assets	\$ 2,547,980	\$ 2,237,368
Liabilities and surplus		
Unpaid claims liabilities	\$ 299,617	\$ 285,045
Aggregate policy reserves	125,804	121,176
Premiums received in advance	97,925	74,375
Accounts payable and accrued liabilities	453,748	296,423
Pension benefit obligation	71,504	84,967
Borrowed funds	170,238	297,695
Ceded reinsurance payable	13,733	13,254
Payable for securities	11,990	7,109
Liability for amounts held under uninsured plans	408,399	329,148
Total liabilities	1,652,958	1,509,192
Special surplus funds	43,483	—
Surplus notes	285,000	100,000
Unassigned surplus	566,539	628,176
Total surplus	895,022	728,176
Total liabilities and surplus	\$ 2,547,980	\$ 2,237,368

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

Statutory-Basis Statements of Operations

(Dollars in Thousands)

	Year Ended December 31	
	2017	2016
Premiums earned	\$ 2,687,810	\$ 2,522,351
Health care benefits	2,452,353	2,284,473
Claim adjustment expenses	146,757	123,868
General and administrative expenses	121,070	140,216
Total expenses	2,720,180	2,548,557
Underwriting loss	(32,370)	(26,206)
Net investment income	38,909	22,809
Net realized capital gains, less capital gains tax expense of \$563 and \$840 in 2017 and 2016, respectively	2,250	3,360
Total investment gains	41,159	26,169
Other (expense) income	(136,620)	1,897
Net (loss) income before federal income taxes	(127,831)	1,860
Federal income tax expense (benefit)	523	(2,055)
Net income	\$ (128,354)	\$ 3,915

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 January 1, 2016	\$ 579,328	\$ 39,338	\$ 618,666
2016 ACA health insurer fee	39,338	(39,338)	–
Net income	3,915	–	3,915
Change in net unrealized gains, net of tax expense of \$4,709	10,526	–	10,526
Change in non-admitted assets	24,822	–	24,822
Change in net deferred income taxes	(576)	–	(576)
Pension liability adjustment, net of tax expense of \$(10,247)	(29,177)	–	(29,177)
Change in surplus notes	100,000	–	100,000
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	\$ 851,539	\$ 43,483	\$ 895,022

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

	Year Ended December 31	
	2017	2016
Operating activities		
Premiums received	\$ 2,678,268	\$ 2,550,484
Health care benefits paid	(2,427,755)	(2,307,891)
General and claim adjustment expenses paid	(118,241)	(206,703)
Net investment income received	44,494	30,080
Federal income taxes received (paid)	411	(955)
Net cash provided by operating activities	<u>177,177</u>	<u>65,015</u>
Investing activities		
Sales, maturities and redemptions of investments	729,202	830,688
Cost of investments acquired	(740,459)	(1,013,940)
Other miscellaneous proceeds (applications)	3,937	26,698
Net cash used in investing activities	<u>(7,320)</u>	<u>(156,554)</u>
Financing or miscellaneous activities		
Surplus notes	185,000	100,000
Borrowed funds	(127,500)	85,000
Other applications, net	(54,230)	(96,571)
Net cash provided by financing or miscellaneous activities	<u>3,270</u>	<u>88,429</u>
Net increase (decrease) in cash, cash equivalents and short-term investments	<u>173,127</u>	<u>(3,110)</u>
Cash, cash equivalents and short-term investments:		
Beginning of year	39,095	42,205
End of year	<u>\$ 212,222</u>	<u>\$ 39,095</u>

See accompanying notes.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

December 31, 2017

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.

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)

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.

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,	
	2017	2016
Land and buildings	\$ 130,216	\$ 130,003
Less accumulated depreciation	(27,823)	(25,314)
Net real estate occupied by the Company	<u>\$ 102,393</u>	<u>\$ 104,689</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 and \$8,259 for the periods ended December 2017 and 2016.

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	
	2017	2016
EDP equipment and operating software	\$ 61,453	\$ 50,191
Less accumulated depreciation	<u>(50,551)</u>	<u>(43,212)</u>
Net EDP equipment and operating software	<u>\$ 10,902</u>	<u>\$ 6,979</u>

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

Depreciation and amortization expense charged to income in 2017 and 2016, was \$29,964 and \$28,448, 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 2017, the Company did not have any impairment expenses. In 2016, the Company recognized \$2,653 in impairment expenses related to internally developed software systems.

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, 2017 and 2016, 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 2017 and 2016, the amount charged to income was \$122 and \$294, 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)

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 41”).

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.

In 2016, the NAIC adopted substantive revisions to SSAP No. 41R, *Surplus Notes* (“SSAP 41R”) to change the measurement method, clarify the guidance for non-admittance, and to incorporate impairment guidance for surplus note investments. The Company has adopted the new guidance for its surplus notes effective January 1, 2017.

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 Commonwealth of Massachusetts terminated its risk adjustment program effective December 31, 2016. Commencing January 1, 2017, the Company takes part in the federal risk adjustment program whereby premium adjustments are based on the risk scores of enrollers rather than the actual loss experience of the insured. The risk adjustment payables and receivables are accounted for as premium adjustments subject to redetermination. In addition to the risk adjustment amount, the federal government 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 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.

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.

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 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.

Reclassification

Certain 2016 amounts in the Company's financial statements have been reclassified to conform to the 2017 financial statement presentation.

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

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

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

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

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

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

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

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, 2017.

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 100.

As of December 31, 2017, the Company did not record an intercompany loan receivable. As of December 31, 2016, an intercompany loan receivable of \$70,000 is included in Other Invested Assets. Refer to Note 12.

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, 2017 and 2016:

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

Description	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Common stock:				
Industrial and miscellaneous	\$ 121,172	\$ –	\$ 50,188	\$ 171,360
Parent, subs and affiliates	–	–	236	236
Preferred stock	–	525	–	525
Total assets at fair value	<u>\$ 121,172</u>	<u>\$ 525</u>	<u>\$ 50,424</u>	<u>\$ 172,121</u>

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

	Balance at January 1, 2016	Transfers in Level 3	Transfers out Level 3	Total Gain Included in Net Realized Capital Gains and (Losses)	Total Gain and (Losses) Included in Surplus	Purchases	Sales	Issuances and Settlements	Balance at December 31, 2016
Common stock									
Industrial and miscellaneous	\$ 49,114	\$ -	\$ -	\$ -	\$ 702	\$ 372	\$ -	\$ -	\$ 50,188
Parent, subs and affiliates	230	-	-	-	6	-	-	-	236
Total assets	<u>\$ 49,344</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 708</u>	<u>\$ 372</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 50,424</u>

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, 2017			
	Level 1	Level 2	Level 3	Total
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>

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, 2016			
	Level 1	Level 2	Level 3	Total
Bonds:				
U.S. treasury securities	\$ -	\$ 256,925	\$ -	\$ 256,925
Industrial and miscellaneous	-	258,669	-	258,669
Mortgage-backed securities	-	252,277	-	252,277
Total	\$ -	\$ 767,871	\$ -	\$ 767,871

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

	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	\$ 1,161,233	\$ 40,367	\$ (7,579)	\$ 1,194,021

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, 2016			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash, cash equivalents and short-term investments	\$ 39,095	\$ -	\$ -	\$ 39,095
Bonds:				
U.S. treasury securities and agency obligations	260,569	627	(4,271)	256,925
Industrial and miscellaneous	257,476	3,823	(2,630)	258,669
Mortgage-backed securities	252,801	1,821	(2,345)	252,277
Total bonds	770,846	6,271	(9,246)	767,871
Common stock	145,968	26,635	(1,007)	171,596
Preferred stock	500	25	-	525
Total cash and investments	\$ 956,409	\$ 32,931	\$ (10,253)	\$ 979,087

At December 31, 2017 and 2016, 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.

	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

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, 2016							
U.S. treasury securities	\$ 132,439	\$ (3,820)	\$ 29,844	\$ (451)	\$ 162,283	\$ (4,271)	86
Industrial and miscellaneous	83,355	(1,902)	57,437	(728)	140,792	(2,630)	283
Mortgage-backed securities	66,657	(1,033)	101,891	(1,312)	168,548	(2,345)	216
Total bonds	282,451	(6,755)	189,172	(2,491)	471,623	(9,246)	585
Common stock	7,345	(192)	12,516	(815)	19,861	(1,007)	5
Total	\$ 289,796	\$ (6,947)	\$ 201,688	\$ (3,306)	\$ 491,484	\$ (10,253)	590

Effective December 31, 2017, and on a prospective basis, all money market mutual funds are classified as cash equivalents. The change is due to revisions in SSAP No. 2R—*Cash, Cash Equivalents, Drafts, and Short-Term Investments*. As of December 31, 2017, the Company's \$140,618 investment in money market mutual funds were 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.

At December 31, 2017 and 2016, included in the Company's investments are unrealized losses deemed to be temporary. These investments reflect a range of industries, and the Company determined the current market volatility is temporary.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

In 2017, the Company did not record any other-than-temporary-impairment losses. In 2016, the Company recorded other-than-temporary-impairment losses of \$2,200 related to Other Invested Assets. Declines in the fair value of investments are evaluated and determined by management to be other-than-temporary.

The amortized cost and fair value of bonds at December 31, 2017, by stated maturity, are shown below. Fixed maturities subject to early or unscheduled prepayments have been included based upon their stated maturity dates. Actual maturities may differ from stated maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Cost or Amortized Cost	Fair Value
Within 1 year	\$ 24,174	\$ 24,170
After 1 year through 5 years	319,804	318,674
After 5 years through 10 years	143,042	143,462
After 10 years	341,201	342,177
Total bonds	<u>\$ 828,221</u>	<u>\$ 828,483</u>

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

Description	Proceeds from Sales		Realized Gains		Realized (Losses)	
	2017	2016	2017	2016	2017	2016
Bonds	\$ 596,850	\$ 742,326	\$ 3,865	\$ 7,859	\$ 3,659	\$ 4,150
Common stock	37,297	47,047	2,637	2,702	-	11
Other invested assets	94,528	41,311	137	-	210	-

Blue Cross and Blue Shield of Massachusetts, Inc.

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

3. Cash and Investments (continued)

Gross realized investment gains and losses, including impairments, are as follows:

	<u>2017</u>	<u>2016</u>
Gross gains	\$ 6,694	\$ 10,561
Gross losses	(3,881)	(6,361)
Net realized investment gains	<u>\$ 2,813</u>	<u>\$ 4,200</u>

Major categories of net investment income are summarized as follows:

	<u>2017</u>	<u>2016</u>
Income:		
Bonds	\$ 17,101	\$ 14,984
Other invested assets	23,914	11,006
Common stock	7,015	5,998
Preferred stock	16	26
Real estate	9,087	8,259
Cash, cash equivalents and short-term investments	566	197
Other miscellaneous	2,237	1,506
Total investment income	<u>59,936</u>	41,976
Less: Investment expenses	18,517	16,683
Depreciation	2,510	2,484
Net investment income	<u>\$ 38,909</u>	<u>\$ 22,809</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, 2017, 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	\$ 1,525	\$ 1,649	\$ 1,558	No
912810-RL-4	350	421	368	No
912828-C9-9	9,629	9,974	9,994	No
912828-K3-3	14,155	14,519	14,649	No
912828-LA-6	3,706	3,571	3,577	No
912828-MF-4	7,320	7,294	7,340	No
912828-NM-8	7,958	8,030	8,015	No
912828-PP-9	7,905	8,052	8,052	No
912828-QV-5	9,333	9,339	9,458	No
912828-S5-0	1,258	1,257	1,286	No
912828-SA-9	9,864	9,896	10,031	No
Total	\$ 73,003	\$ 74,002	\$ 74,328	

4. Restricted Assets

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

	2017	2016		2017
	Total Gross Restricted	Total Gross Restricted	Increase/Decrease	Total Admitted Restricted
Restricted assets category				
Federal Home Loan Bank ("FHLB") capital stock	\$ 6,194	\$ 5,997	\$ 197	\$ 6,194
Pledged as collateral to FHLB	112,283	110,772	1,512	112,283
Pledged as collateral to BCBSA ^(a)	172,909	167,155	5,754	172,909
Other restricted assets ^(b)	6,469	8,267	(1,798)	2,762
Total	\$ 297,855	\$ 292,191	\$ 5,665	\$ 294,148

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, 2017 and 2016, 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, 2017 and 2016, 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, net of recoveries, are summarized in the reconciliation of the beginning and ending balances of claims payable, claims incurred but not yet reported, reinsurance recoverable, and health care receivables as follows:

	<u>2017</u>	<u>2016</u>
Net balance at January 1	\$ 186,853	\$ 210,272
Incurred related to:		
Current year	2,463,107	2,308,492
Prior years	(10,754)	(24,019)
Total incurred	<u>2,452,353</u>	<u>2,284,473</u>
Paid related to:		
Current year	2,225,462	2,115,830
Prior years	202,293	192,062
Total paid	<u>2,427,755</u>	<u>2,307,892</u>
Net balance at December 31	<u>\$ 211,451</u>	<u>\$ 186,853</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, 2017 and 2016, is primarily attributable to actual claim payment patterns and cost trends differing from those assumed at the time the liability was established.

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)

At December 31, 2017 and 2016, health care receivables include \$26,212 and \$18,240, 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 \$4,191 and \$3,757 were taken into account in determining health care benefits reserves as of December 31, 2017 and 2016, respectively.

Management believes its methodologies for reserving for unpaid claims are appropriate and represent its best estimate at December 31, 2017 and 2016.

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.

In 2015, the Company adopted the separate annuitant and non-annuitant RP-2014 mortality tables. For the development of mortality assumptions in 2017, BCBSMA will use the updated mortality table required by Internal Revenue Code (“IRC”) section 417(e) for lump sum payments using the MP-2017 mortality improvement scale. For all other purposes, the RP-2014 generational mortality table will be used with post-2006 improvements backed out and then using the MP-2017 mortality improvement scale.

Effective January 1, 2016 BCBSMA adopted a spot rate approach to determine service cost and interest cost. Effective December 31, 2016 BCBSMA updated the actuarial basis for discount rate determination to be 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*. Effective December 31, 2016 the company implemented a no-carryover policy for vacation time, resulting in the December 2016 removal of accruals for earned but unused vacation time.

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, 2017. A summary of change in benefit obligation are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2017	2016	2017	2016	2017	2016
Benefit obligation at beginning of year	\$ 808,490	\$ 774,823	\$ 143,451	\$ 135,833	\$ 2,432	\$ 8,593
Service cost	18,583	17,657	3,219	3,046	50,769	43,203
Interest cost	28,776	29,321	5,146	5,115	–	–
Plan Settlements	(10,047)	(5,676)	–	–	–	–
Actuarial gain (loss)	89,081	33,024	8,363	6,381	–	–
Benefits paid	(36,828)	(38,992)	(7,682)	(7,604)	(51,958)	(49,364)
Plan amendments	–	–	–	–	–	–
Medicare Part D reimbursement	–	–	165	680	–	–
Administrative expenses paid	(1,648)	(1,667)	–	–	–	–
Benefit obligation at end of year	\$ 896,407	\$ 808,490	\$ 152,662	\$ 143,451	\$ 1,243	\$ 2,432

A summary of change in plan assets are as follows:

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2017	2016	2017	2016	2017	2016
Fair value at beginning of year	\$ 724,315	\$ 655,489	\$ 71,103	\$ 67,693	\$ –	\$ –
Actual return on plan assets	113,876	49,346	11,510	5,006	–	–
Employer contribution	40,190	65,815	8,714	5,328	–	–
Plan Settlements	(10,047)	(5,676)	–	–	–	–
Benefits paid	(36,828)	(38,992)	(3,245)	(3,304)	–	–
Medicare Part D reimbursement	–	–	165	680	–	–
401(h) benefit payments	–	–	(4,437)	(4,300)	–	–
Administrative fees paid	(1,648)	(1,667)	–	–	–	–
Fair value at end of year	\$ 829,858	\$ 724,315	\$ 83,810	\$ 71,103	\$ –	\$ –

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	
	2017	2016	2017	2016
Accrued benefit costs	\$ 10,744	\$ 14,911	\$ 53,153	\$ 56,645
Liability for pension benefits	55,805	69,264	15,699	15,703
Total liabilities recognized	66,549	84,175	68,852	72,348
Unrecognized liabilities	–	–	–	–

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

	Pension Benefits		Post-Retirement Benefits		Postemployment and Compensated Absences	
	2017	2016	2017	2016	2017	2016
Service cost	\$ 18,583	\$ 17,657	\$ 3,219	\$ 3,046	\$ 50,769	\$ 43,203
Interest cost	28,777	29,321	5,147	5,115	–	–
Expected return on plan assets	(54,712)	(52,980)	(5,531)	(5,444)	–	–
Amortization of unrecognized transitional obligation	430	430	–	–	–	–
Recognized actuarial loss	22,462	20,830	–	–	–	–
Amortization of prior service cost	(72)	(500)	2,387	2,387	–	–
Gain or loss recognized due to settlement curtailment	2,728	1,399	–	–	–	–
Total net periodic benefit cost	\$ 18,196	\$ 16,157	\$ 5,222	\$ 5,104	\$ 50,769	\$ 43,203

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 \$12,061 and \$10,575 for 2017 and 2016, respectively and for other postretirement benefit plans was \$3,428 and \$5,038 for 2017 and 2016, 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	
	2017	2016	2017	2016
Items not yet recognized as a component of net periodic benefit cost – prior year	\$ 338,972	\$ 324,473	\$ 15,703	\$ 11,272
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	500	(2,387)	(2,388)
Net gain and loss arising during the period	29,916	36,658	2,384	6,819
Net gain and loss recognized	(25,190)	(22,229)	–	–
Item not yet recognized as a component of net periodic cost – current year	\$ 343,340	\$ 338,972	\$ 15,700	\$ 15,703

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

	Pension Benefits	Post-Retirement Benefits
	2017	2017
Net transition asset or obligation	\$ (430)	\$ –
Net prior service cost or credit	72	(2,387)
Net recognized gains and losses	(22,429)	–
Total expected to be recognized	\$ (22,787)	\$ (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	
	2017	2016	2017	2016
Net transition asset or obligation	\$ 1,291	\$ 1,721	\$ –	\$ –
Net prior service cost or credit	(377)	(449)	7,569	9,955
Net recognized gains and losses	342,426	337,700	8,131	5,748
Total have yet been recognized	\$ 343,340	\$ 338,972	\$ 15,700	\$ 15,703

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, 2017 and 2016, are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2017	2016	2017	2016
Discount rate				
Benefit obligation	1.58%-4.37%	4.71%	4.42%	4.71%
Service cost	3.80%-4.26%	4.14%-4.62%	4.75%	4.99%
Interest cost	1.58%-3.69%	1.18%-3.92%	3.70%	3.89%
Expected return on plan assets	7.50%	8.00%	7.50%	8.00%
Salary scale	Varies	Varies	N/A	N/A

Weighted-average assumptions to determine projected obligations as of December 31, 2017 and 2016, are as follows:

	Pension Benefits		Post-Retirement Benefits	
	2017	2016	2017	2016
Discount rate used for benefit cost	3.33%-3.75%	1.58%-4.37%	3.80%	4.42%
Rate of compensation increase	Varies	Varies	N/A	N/A

The amount of accumulated benefit obligation for the RIT defined benefit plan was \$860,979 and \$764,288 as of December 31, 2017 and 2016, respectively. The amount of accumulated benefit obligation for the Non-Qualified Benefit Plans was \$21,352 and \$24,905 as of December 31, 2017 and 2016, respectively.

For benefit costs measurement purposes, the rate of increase in the per capita cost of covered health care benefits was assumed to be 6.1% (Pre-65) and 7.1% (Post-65) for 2017. The rate is assumed to decrease gradually to 4.4% 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	\$ (55)	\$ (11)
(Decrease) in post-retirement benefit obligation	(795)	(533)

The Company's weighted-average asset allocations at December 31, 2017 and 2016, by asset category, are as follows:

	Pension Benefits		Post-Retirement Benefits		
	2017	2016	2017	2016	Range
Asset category:					
Equity securities	49%	45%	49%	45%	40-50%
Debt securities	23	25	23	25	18-28
Real estate	7	7	7	7	4-10
Absolute return	21	23	21	23	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, 2017 and 2016, by asset category are as follows:

	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>

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Plan assets				
Money market funds	\$ 7,346	\$ -	\$ -	\$ 7,346
Common collective trusts	-	390,156	-	390,156
Partnership/joint venture interests	-	67,512	54,295	121,807
Registered investment companies	251,600	-	-	251,600
Common stocks:				
Domestic	23,050	-	-	23,050
International	1,459	-	-	1,459
Total investments	<u>\$ 283,455</u>	<u>\$ 457,668</u>	<u>\$ 54,295</u>	<u>795,418</u>
Less: investments related to 401(h) account				(71,103)
Total investments at fair value				<u>\$ 724,315</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)

Fair value measurement in Level 3:

	Balance at January 1, 2017	Transfers in Level 3	Transfers out Level 3	Total Gain (Losses)	Purchases, Issuances, Sales and Settlements	Balance at December 31, 2017
Partnership/joint venture interests	\$ 54,295	\$ –	\$ –	\$ 1,257	\$ 6,368	\$ 61,920
Total	\$ 54,295	\$ –	\$ –	\$ 1,257	\$ 6,368	\$ 61,920

	Balance at January 1, 2016	Transfers in Level 3	Transfers out Level 3	Total Gain (Losses)	Purchases, Issuances, Sales and Settlements	Balance at December 31, 2016
Partnership/joint venture interests	\$ 43,907	\$ –	\$ –	\$ 1,496	\$ 8,892	\$ 54,295
Total	\$ 43,907	\$ –	\$ –	\$ 1,496	\$ 8,892	\$ 54,295

To determine the expected long-term rate of return for BCBSMA Retirement Income Trust, our 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 100 are defined in Note 3.

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 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 \$5,634 and \$2,704 in 2017 and 2016, respectively. Total employer contributions to the post-retirement benefit plan were \$8,714 and \$5,328 in 2017 and 2016, respectively.

At December 31, 2017, the Company's projected benefit payments and Medicare Subsidy receipts are as follows:

	Pension Benefits	Post- Retirement Benefits	Medicare Subsidy
2017	\$ 46,819	\$ 8,785	\$ 686
2018	47,700	8,854	747
2019	51,324	8,982	819
2020	55,212	9,128	894
2021	56,437	9,246	972
Next five years	303,622	48,314	6,222

The Companies do not have any regulatory contribution requirements for 2018. However, the Companies currently intend to make voluntary contributions of \$60,000 to its defined benefit pension plan and \$5,308 to its post-retirement benefit plan in 2018.

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 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 \$2,032 and \$1,573 in 2017 and 2016, 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 \$25,444 and \$23,979 at December 31, 2017 and 2016, 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 \$54 and \$53 for 2017 and 2016, respectively. Contributions are maintained in investment funds established under the employee savings plan.

The Company’s contributions charged to income amounted to \$11,738 and \$11,305 in 2017 and 2016, respectively. In 2017, 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

The Company’s 2017 federal income tax rate is less than the regular tax rate of 35% for corporations due to the utilization of the special deduction available to Blue Cross and Blue Shield Plans under Internal Revenue Code section 833. The special deduction subjects the Company to the Alternative Minimum Tax (AMT) provisions. The AMT provisions tax income at a rate of 20% and limits utilization of net operating loss carry-forwards to 90% of taxable income.

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.

On December 22, 2017, the federal government enacted a tax bill, H.R.1, 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 many business deductions. Under the TCJA, the Corporate AMT is repealed effective for taxable years beginning after December 31, 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

At December 31, 2017 the Company measured deferred tax assets and liabilities based on the rates at which they are expected to be utilized in the future, which is generally 21%. The Company also estimated the effects of the TCJA on existing deferred tax balances. The provisional amount recorded related to the re-measurement of the deferred tax assets and liabilities was a net increase of \$61,229 and is included in unassigned surplus.

This includes a decrease in non-admitted assets of \$138,686, and decrease in net unrealized capital gains (losses) of \$14,696. However, the Company will continue to analyze certain aspects of the Tax Cuts and Jobs Act and refine the calculations, which could potentially affect the measurement of those balances or give rise to new deferred tax amounts.

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:

	2017			2016			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Gross deferred tax assets	\$ 410,551	\$ 3,311	\$ 413,862	\$ 439,916	\$ 11,242	\$ 451,158	\$ (29,365)	\$ (7,931)	\$ (37,296)
b. Statutory valuation allowance adjustments	106,726	3,311	110,037	353,705	—	353,705	(246,979)	3,311	(243,668)
c. Adjusted gross deferred tax assets (1a-1b)	303,825	—	303,825	86,211	11,242	97,453	217,614	(11,242)	206,372
d. Deferred tax assets non-admitted	160,603	—	160,603	29,842	—	29,842	130,761	—	130,761
e. Subtotal net admitted deferred tax asset (1c-1d)	143,222	—	143,222	56,369	11,242	67,611	86,853	(11,242)	75,611
f. Gross deferred tax liabilities	103	27,799	27,902	195	40,359	40,554	(92)	(12,560)	(12,652)
g. Net admitted DTA/DTL (1e-1f)	\$ 143,119	\$ (27,799)	\$ 115,320	\$ 56,174	\$ (29,117)	\$ 27,057	\$ 86,945	\$ 1,318	\$ 88,263

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 the DTA/DTL and admission calculation are as follows:

	2017			2016			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
a. Federal income taxes paid in prior years recoverable through loss carrybacks	\$ -	\$ -	\$ -	\$ 4,807	\$ -	\$ 4,807	\$ (4,807)	\$ -	\$ (4,807)
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)	115,320	-	115,320	22,250	-	22,250	93,070	-	93,070
b1. Adjusted gross deferred tax assets expected to be realized following the balance sheet date	265,847	-	265,847	22,250	-	22,250	243,597	-	243,597
b2. Adjusted gross deferred tax assets allowed per limitation threshold	N/A	N/A	115,320	N/A	N/A	107,096	N/A	-	8,224
c. Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from 2a and 2b above) offset by gross deferred tax liabilities	27,902	-	27,902	29,312	11,242	40,554	(1,410)	(11,242)	(12,652)
d. Deferred tax assets admitted as the result of application of SSAP No. 101 total (2a + 2b + 2c)	\$ 143,222	\$ -	\$ 143,222	\$ 56,369	\$ 11,242	\$ 67,611	\$ 86,853	\$ (11,242)	\$ 75,611

	2017	2016
Applicable ratio for realization limitation threshold table	584%	531%
Adjusted capital and surplus used to determine recovery period	\$ 779,702	\$ 701,119

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

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

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

	<u>2017</u>	<u>2016</u>
Current federal income tax (benefit) expense	\$ (2,443)	\$ 2,340
Tax expense on realized capital gains	563	840
Other, including prior year under accrual (over accrual)	2,966	(4,395)
Federal income taxes incurred	<u>\$ 1,086</u>	<u>\$ (1,215)</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:

	<u>2017</u>	<u>2016</u>	<u>Change</u>
DTAs resulting from book/tax differences in Ordinary:			
Discounting of unpaid losses and LAE	\$ 558	\$ 987	\$ (429)
Investments	28,980	–	28,980
Fixed assets	2,137	5,544	(3,407)
Compensation and benefit accruals	10,085	14,499	(4,414)
Pension accruals	26,178	50,262	(24,084)
Non-admitted assets	469	22,782	(22,313)
Intangible asset	15,352	25,810	(10,459)
Net operating loss carry-forward	4,041	6,734	(2,693)
Tax credit carry-forward	303,825	302,739	1,086
Other	18,927	10,559	8,368
Subtotal – gross ordinary DTAs	<u>410,552</u>	439,916	(29,365)
Statutory valuation adjustment – ordinary	106,726	353,705	(246,979)
Non-admitted ordinary DTAs	<u>160,603</u>	29,842	130,761
Admitted ordinary DTAs	<u>143,222</u>	56,369	86,853

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

	2017	2016	Change
Capital:			
Investments	\$ 3,311	\$ 11,242	\$ (7,931)
Net capital loss carry/forward	-	-	-
Gross capital DTAs	<u>3,311</u>	11,242	(7,931)
Statutory valuation adjustment – capital	<u>3,311</u>	-	3,311
Non-admitted capital DTAs	-	-	-
Admitted capital DTAs	-	11,242	(11,242)
Admitted DTAs	<u>\$ 143,222</u>	\$ 67,611	\$ 75,611
DTLs resulting from book/tax differences in			
Ordinary DTLs:			
Other	\$ 103	\$ 195	\$ (92)
Capital DTLs:	-	-	-
Investments	<u>27,799</u>	40,359	(12,560)
Total DTLs	<u>27,902</u>	40,554	(12,652)
Net DTA	<u>\$ 115,320</u>	\$ 27,057	\$ 88,263

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

	2017	2016	Change
Total DTAs	\$ 413,862	\$ 451,158	\$ (37,296)
Total DTLs	<u>27,902</u>	40,554	(12,652)
Net DTAs/DTLs	<u>385,960</u>	410,604	(24,644)
Statutory Valuation Allowance adjustment	<u>110,037</u>	353,705	(243,668)
Net DTAs/DTLs after SVAs	<u>275,923</u>	56,899	219,024
Tax effect of unrealized gains			(6,637)
Tax effect of pension liability adjustment			29,738
Change in net deferred income tax benefit			<u>\$ 242,125</u>

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:

	<u>Statutory Rate Tax Effect</u>
Income before taxes (including all realized capital gains)	\$ (44,544)
162(m)(6) adjustment	4,925
Non-deductible expenses	772
Dividends received deduction	(333)
Rabbi Trust CSV build-up over cost	(2,922)
Investment and reinsurance termination	48,300
Change in non-admitted assets	1,157
Statutory valuation allowance adjustment	(243,668)
Other	(4,726)
Total	<u>\$ (241,039)</u>
Federal income taxes incurred	1,086
Change in net deferred income tax	(242,125)
Total statutory income taxes	<u>\$ (241,039)</u>

At December 31, 2017, the Company had net operating loss carry-forwards of \$19,241, expiring in 2018 and AMT credits of \$303,825 which do not expire.

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 2014 through 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

7. Income Taxes (continued)

The amount of federal income taxes incurred and available for recoupment in the event of future net losses is \$0 and \$5,532 from 2017 and 2016, respectively.

Blue Cross and Blue Shield of Massachusetts, Inc. files a consolidated tax return with Zaffre Affiliated Services, LLC (“Zaffre Affiliated”), and Zaffre Investment Services, LLC (“Zaffre Investments”). For 2017, Zaffre Affiliated had a tax expense of \$4,158 and Zaffre Investments had a tax benefit of \$258. As of December 31, 2017, tax-related balances due from these companies was \$1,286. No tax-related balances were due from these companies as of December 31, 2016. Taxes are allocated among members of the consolidated tax return under the terms of a written tax sharing agreement.

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 2017 were utilized against Massachusetts tax liabilities and are, therefore, admitted.

As of December 31, 2017 and 2016, the carrying value of the Massachusetts tax credits applied to related tax liabilities was \$20,562 and \$10,674, respectively. Gains and losses on tax credits are recorded as other income in the statements of operations. As of December 31, 2017 and 2016, the Company did not have any unused Massachusetts tax credits.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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, 2017 and 2016, 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, 2017 and 2016, the Company's total adjusted capital is in excess of the regulatory RBC requirements.

In December 2016, the Company issued a surplus note for \$100,000 to HMO Blue in exchange for cash. The term of the note was for 5 years at an interest rate of 2.5% and paid principal and interest semiannually commencing on July 1, 2017 and thereafter on January 1st and July 1st of each year for the duration of the loan. On December 15, 2017 the Company received approval from the Commissioner of the Massachusetts Division of Insurance and paid the \$100,000 of remaining outstanding principal and \$2,447 in accrued interest.

In December 2017, the Company issued a surplus note for \$285,000 to HMO Blue in exchange for cash. The term of this note is 10 years at an interest rate of 2.95% to be paid annually, commencing on September 30, 2018. As of December 31, 2017 there were no unapproved interest or principal payments. During 2017, no interest or principal was paid.

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, 2017 and 2016.

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 \$108,841 and \$98,147 as of December 31, 2017 and 2016, respectively, and are included in premium receivables and aggregate policy reserves in the accompanying balance sheets.

12. Related-Party Transactions

BCBSMA has three subsidiaries and two affiliated companies. HMO Blue is a wholly-controlled subsidiary. Zaffre Affiliated Services, LLC (Zaffre Affiliated) and Zaffre Investments, LLC (Zaffre Investments) are wholly-owned subsidiaries. BlueCross BlueShield Venture Partners (“BCBS Venture”), L.P. and BlueCross BlueShield Venture Partners II L.P. (BCBS Venture II) are controlled affiliated entities.

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 character of the business of Zaffre Affiliated and Zaffre Investments is to act as holding companies for certain strategic investments of BCBSMA as its sole member, and to engage in providing services to 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 \$858 and \$945 in 2017 and 2016, respectively.

In 2008, BCBSMA and HMO Blue each committed to invest \$10,000 in BlueCross BlueShield Ventures, Inc. (the “General Partner”) and BlueCross BlueShield Venture Partners, L.P. (the “Partnership”), in the form of 20 Class A shares of the General Partner and 17.1% limited interest in the Partnership. BCBS Venture is a strategic corporate venture fund formed by eleven Blue Cross and Blue Shield plans to invest in emerging companies that will bring greater innovation, efficiency, consumer-focus and transparency to healthcare. As of December 31, 2017, BCBSMA has contributed \$9,439 to the Partnership and \$100 to the General Partner. As of December 31, 2017 and 2016, the admitted book values of the company’s investment in BCBS Venture were \$7,129 and \$6,237, 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.

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, 2017, BCBSMA has contributed \$7,438 to the Partnership II and \$100 to the General Partner II. As of December 31, 2017 and 2016, the admitted book values of the company's investment in BCBS Venture II were \$7,293 and \$6,302, respectively.

During 2017, BCBSMA made additional contributions to its Subsidiaries, Controlled, and Affiliated Entities ("SCA") as follows:

<u>SCA Entity</u>	<u>Contribution Amount</u>
Zaffre Investments, LLC	\$ 16,500
Zaffre Affiliated Services, LLC	619
BlueCross BlueShield Venture Partners, L.P.	72
BlueCross BlueShield Venture Partners II, L.P.	1,015

As of December 31, 2017, Zaffre Affiliated has ownership interest in three subsidiaries, Indigo Insurance Services, LLC ("Indigo"), Massachusetts Benefit Administrators, LLC ("MBA") and Core Administrative Systems I, LLC ("CASI"). Zaffre Investments has ownership interest in two subsidiaries, HealthBox Boston II, LLC and QCentive LLC ("QCentive").

BCBSMA utilizes the look-through approach in valuing its investments in Zaffre Affiliated Services. The book value for Zaffre Affiliated Services was \$71,382 as of December 31, 2017. Zaffre Affiliated Services financial statements are not audited and the Company has limited the value of its investment in these companies to the value contained in the GAAP audited financial statements, including adjustments required by SSAP No. 97 – Investments in Subsidiary, Controlled, and Affiliated Entities ("SSAP No. 97"), of SCA entities and SSAP No. 48 – Joint Ventures, Partnerships, and Limited Liability Companies ("SSAP No. 48"), of non-SCA entities owned by both companies and valued in accordance with paragraphs 17 through 20 of SSAP No. 97. All liabilities, commitments, contingencies, guaranties or obligations of Zaffre Affiliated Services, which are required to be recorded under applicable statutory accounting guidance, are reflected in BCBSMA's determination of the carrying value of the investment in Zaffre Affiliated Services, if not already recorded in the financial statements of the Company.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

12. Related-Party Transactions (continued)

The book value of Zaffre Investments is \$40,099 and is non-admitted as it does not meet the criteria of SSAP No. 97 to utilize the look-through approach. In addition, the unaudited immaterial assets of Zaffre Affiliated Services are non-admitted for the amount of \$5,553.

The Companies have an inter-company 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.

In December, 2016, HMO Blue borrowed \$100,000 from BCBSMA at a fixed rate of 2.50% after receiving confirmation from the Massachusetts Division of Insurance of no matters which would preclude the Companies from entering into this transaction. Transaction details for this loan are as follows:

	<u>2017</u>	<u>2016</u>
Interest accrued	\$ 1,127	\$ 156
Interest paid	1,283	—
Principal paid	70,000	30,000

As of December 31, 2017, BCBSMA's inter-company balances were as follows:

	<u>Receivables</u>	
	<u>2017</u>	<u>2016</u>
HMO Blue	\$ 18,908	\$ 27,748
BCBSF	551	668
Indigo	479	448
MBA	81	56
Zaffre Affiliated	45	43
Zaffre Investments	261	686
Totals	<u>\$ 20,325</u>	<u>\$ 29,649</u>

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

The Company participates in a bilateral inter-company 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.

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.

Both BCBSMA and HMO Blue have an undivided interest in what had been BCBSMA’s property and equipment. The initial basis of the property and equipment were systematically allocated to each company. Ongoing depreciation expenses are charged to each company based on utilization.

Existing employees of the Companies (the “Associates”) are either concurrently employed by both BCBSMA and HMO Blue or solely employed by BCBSMA. 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 BCBSMA and HMO Blue 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.

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 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.

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

12. Related-Party Transactions (continued)

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.

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.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

13. Third Party Administrators (continued)

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 \$426 and \$697 in 2017 and 2016, 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	33-1113587	No	Medicare Part D	Admin Services	\$ 183,046
Health Reinsurance Management Partnership 300 Rosewood Drive, Suite 250, Danvers, MA 01923	51-0397873	No	Stop loss	Admin Services	\$ 46,580

14. Reinsurance

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

The difference between the amount arrived at by subtracting the aggregate value of claims incurred plus the ceded commission from the reinsurance premiums is invoiced monthly and settled between the parties within 45 days. The settlement amount due to US Able Life was \$2,440 and \$1,260 at December 31, 2017 and 2016, respectively.

Premiums earned have been reduced for the amounts ceded of \$150,653 and \$145,366 in 2017 and 2016, respectively. Healthcare benefits incurred have been reduced for the recoverable amounts of \$113,484 and \$113,238 in 2017 and 2016, respectively, related to individuals with high claim costs.

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 agreements with Axis Specialty Insurance Company (“Axis”) and as of July 1, 2017, 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, 2017, 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 \$6,103 and \$7,705 in 2017 and 2016, respectively. Healthcare benefits incurred have been increased for the amount assumed of \$6,037 and \$7,977 in 2017 and 2016, respectively.

The net amount of increase in surplus if all reinsurance agreements were cancelled would be \$31,219 and \$28,671 as of December 31, 2017 and 2016, 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 \$183,046 and \$156,960 for the years ended December 31, 2017 and 2016, respectively, which represents approximately 6% of the Company's written premiums for both 2017 and 2016. 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, 2017 and 2016 are as follows:

	<u>Individual</u>	<u>Small Group</u>	<u>Large Group</u>	<u>Medicare Part D</u>	<u>Total</u>
<u>2016 Reporting Year</u>					
MLR rebates unpaid, January 1	\$ -	\$ -	\$ -	\$ -	\$ -
MLR rebates incurred	-	-	-	8,393	8,393
MLR rebates paid	-	-	-	-	-
MLR rebates unpaid, December 31	-	-	-	8,393	8,393
<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	\$ -	\$ -	\$ -	\$ 1,998	\$ 1,998

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, 2017		2017		Ref ⁽¹⁾
	Receivable	(Payable)	Income	(Expense)	
a. 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)		
b. 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	-	
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	\$ 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)

	December 31, 2016		2016		Ref ⁽²⁾
	Receivable	(Payable)	Income	(Expense)	
e. Permanent ACA Risk Adjustment Program					
Premium adjustments	\$ 1,488	\$ –	\$ (1,749)	\$ –	a)
Risk adjustment user fees	–	–	–	–	f)
Subtotal ACA Permanent Risk Adjustment Program	1,488	–	(1,749)		
f. Transitional ACA Reinsurance Program					
Claims paid	66	–	93	–	b)
Claims unpaid	8	–	(3)	–	g)
Related to uninsured plans	–	–	–	–	g)
Contributions – not reported as ceded premium	–	–	–	(7,067)	c) d)
Ceded reinsurance premiums	–	–	–	(6)	e)
Subtotal ACA Transitional reinsurance Program	74	–	90	(7,073)	
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	\$ 1,562	\$ –	\$ (1,659)	\$ (7,073)	

Ref ⁽²⁾:

- a) This receivable has been admitted.
- b) This recoverable has been admitted.
- c) Reinsurance contributions (not reported as ceded premium) were paid in December 2016, for \$7,067.
- d) This expense was recorded within administrative expenses.
- e) Ceded reinsurance premiums were paid in 2016 for \$6.
- 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	\$ 1,488	\$ -	\$ 1,321	\$ -	\$ 167	\$ -	\$ (167)	\$ -	a	\$ -	\$ -
Premium adjustments (payable)	-	-	-	-	-	-	-	-	b	-	-
Subtotal ACA permanent risk adjustment program	1,488	-	1,321	-	167	-	(167)	-		-	-
b. Transitional ACA reinsurance											
Claims paid	66	-	80	-	(14)	-	22	-	c	8	-
Claims unpaid	8	-	-	-	8	-	(8)	-	d	-	-
Related to uninsured plans	-	-	-	-	-	-	-	-		-	-
Contributions – not reported as ceded premium	-	-	-	-	-	-	-	-		-	-
Ceded reinsurance premiums	-	-	-	-	-	-	-	-		-	-
Subtotal ACA transitional reinsurance program	74	-	80	-	(5)	-	14	-		8	-
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	\$ 1,562	\$ -	\$ 1,401	\$ -	\$ 162	\$ -	\$ (153)	\$ -		\$ 8	\$ -

Ref⁽³⁾:

- Adjustments to the prior benefit year ACA Risk Adjustment program as of December 31, 2017 were \$167 (gross of non-admitted) and were based on the reconsideration settlement notice received in November 2017 from the Commonwealth of Massachusetts Health Insurance Connector Authority.
- There were no adjustments to the prior benefit year ACA Risk Adjustment program as of December 31, 2017.
- The adjustment for amounts recoverable for claims paid under the Transitional ACA Reinsurance Program reflects the differences between previously estimated amounts and the final settlement notice received in September 2017 for the year ended December 31, 2017.
- The adjustment for amounts recoverable for claims unpaid under the Transitional ACA Reinsurance Program reflects the differences between previously estimated amounts and the final settlement notice received in September 2017 for the year ended December 31, 2017.

As of December 31, 2017 and 2016, 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
12/31/2017	\$ 18,404	\$ 40,254	\$ 5,403	\$ –	\$ –
9/30/2017	18,146	25,388	5,027	–	–
6/30/2017	23,578	32,386	5,074	15,207	–
3/31/2017	22,254	26,477	–	16,489	5,730
12/31/2016	21,383	49,511	5,790	7,812	7,411
9/30/2016	22,786	41,660	–	14,497	7,866
6/30/2016	20,808	32,862	–	6,881	14,145
3/31/2016	20,520	21,443	–	6,693	14,865
12/31/2015	12,666	12,660	–	5,883	6,331
9/30/2015	13,164	12,887	–	5,404	6,857
6/30/2015	12,260	12,234	–	6,234	5,544
3/31/2015	11,085	11,030	–	6,068	4,601

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, 2017 and 2016:

	ASC Uninsured Plans	
	2017	2016
Gross reimbursement for medical cost incurred	\$ 8,031,999	\$ 7,998,777
Gross administrative fees accrued	371,663	391,429
Gross expenses incurred (claims and administrative)	(8,469,568)	(8,422,081)
Net loss from operations	\$ (65,906)	\$ (31,875)

At December 31, 2017 and 2016, the Company had admitted assets of \$169,860 and \$153,683, 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, 2017 and 2016, the Company recorded gross ASC administrative fees accrued and not billed of \$23,486 and \$23,432, respectively.

19. Leases

The Companies jointly have a long-term operating lease agreement for 308,210 square feet for its corporate headquarters on Huntington Avenue in Boston, Massachusetts. Occupancy and rental expense commenced in 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)

During 2016 the Companies entered into an agreement to sublease 34,417 square feet of space at its Huntington Avenue location. Payments to the Companies began in June 2017 at an annual amount of \$1,566 and will continue through May of 2020.

For 2017 and 2016, the Company recorded rental expenses of \$10,903 and \$10,068 respectively, of which, \$10,744 and \$9,891 were office space rental expenses, respectively.

At December 31, 2017, allocated minimum rental commitments on significant non-cancelable operating leases for the Company are as follows:

2018	\$	10,825
2019		10,624
2020		10,653
2021		10,737
2022		10,765
Thereafter		74,402

In addition, the Companies have agreements with two outside vendors to provide certain information technology services for a significant portion of the Companies' business operations. The Companies minimum commitments under this agreement vary by year, with amounts ranging from \$7,079 to \$13,916 per year from 2018 through 2021.

20. Debt

At December 31, 2017, 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 2017 and was renewed until June 2018. The second facility for \$50,000 matured in June 2017 and was renewed until June 2018 and the third facility for \$50,000 matured in October 2017 was renewed until October 2018. At December 31, 2017 the Company had no outstanding principal and accrued fees of \$50 and at December 31, 2016, the Company had \$155,000 of outstanding principal and \$13 of accrued interest and fees due under these facilities.

Blue Cross and Blue Shield of Massachusetts, Inc.

Notes to Statutory-Basis Financial Statements (continued)

(Dollars in Thousands)

20. Debt (continued)

During 2017 and 2016, the Company paid interest of \$1,358 and \$1,436 and fees of \$121 and \$112, 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, 2017, 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 2017, BCBSMA paid principal of \$15,000 and interest of \$847. At December 31, 2017, BCBSMA has a carrying value of \$27,500 outstanding and accrued interest of \$4. As of December 31, 2017, 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 2017, BCBSMA paid principal of \$7,500 and interest of \$991. At December 31, 2017, BCBSMA has a carrying value of \$42,500 outstanding and accrued interest of \$7. As of December 31, 2017, 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)

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 \$1,694 and \$1,497 of FHLB Class B Membership Stock at December 31, 2017 and 2016, respectively. The Class B Membership Stock is not eligible for redemption. In addition, the Company is required to purchase FHLB Activity Stock up to 4.5% of the value of principal borrowed. At December 31, 2017 and 2016, the Company recorded \$4,500 of FHLB Activity Stock.

At December 31, 2017, 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 2017 and 2016, the Company paid interest expense of \$2,099 and \$1,926, respectively. At December 31, 2017 and 2016, 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, 2017 and 2016, the total collateral pledged against these borrowings had a fair value of \$111,302 and \$110,029, respectively, and a carrying value of \$112,283 and \$110,772, respectively.

At December 31, 2017 and 2016, the maximum amount pledged during the reporting period had a fair value of \$112,845 and \$112,747, respectively, and a carrying value of \$113,405 and \$112,308, respectively. The Company has no prepayment obligations with the FHLB.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

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.

At December 31, 2017, the Company's remaining commitments, pursuant to the terms of the investment agreements, are as follows:

Blue Cross Blue Shield Venture Partners, L.P.	\$ 461
Blue Cross Blue Shield Venture Partners II, L.P.	2,462
Blue Cross Blue Shield Venture Partners III, LLC.	2,037
Hancock Capital Partners V, L.P.	2,748
Comvest Capital III, L.P.	5,914
Park Square Capital Credit Opp II Feeder, L.P.	5,297
Comvest Capital IV, L.P.	13,624
Long River Ventures III, L.P.	1,100
Excel Venture Fund II, L.P.	1,110
Park Square Capital Credit Opp III Feeder, L.P.	22,500
Total Commitments	<u>\$ 57,253</u>

Also, there is the commitment for \$1,110 to Long River Ventures III, L.P., a non-affiliated investment fund, which is through Zaffre Investments, LLC a wholly-owned subsidiary of BCBSMA.

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 Services, LLC (Zaffre) 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.

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, 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 income statement.

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, 2017, 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 2017, BCBSMA and HMO were obligated to pay three major state 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. BCBSMA’s assessment to cover CHIA FY2018 operations was \$4,713, payable in the two payments. During 2017, the BCBSMA paid CHIA \$2,122. The remaining \$2,591 is payable in the first quarter of 2018.

The second is the Commonwealth of Massachusetts Health Policy Commission’s assessment pursuant to Section 958 Chapter 9.04, “*Assessment on Certain Health Care Provider and Surcharge Payors*”. This amount is based on the assessment percentage of the Company and the annual legislatively approved budget of the Health Policy Commission for FY2018. During 2017, BCBSMA paid this assessment for \$1,240.

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' DOI "*Health Care Assess Bureau*" ("HCAB") assessment to pay for HCAB expenses. This assessment is based on the Company's portion of health premiums as reported to the HCAB. During 2017, BCBSMA paid \$100 to the HCAB.

24. ACA Insurer Fee

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

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

As of December 31, 2017, the Company has written health insurance that is subject to the ACA and expects to conduct health insurance business in 2018. The Company's estimated portion of the annual fee is \$43,483 and is payable on September 30, 2018. This amount is reflected in special surplus and would have had a 33% impact on the Company's risk based capital ("RBC"). As of December 31, 2017 this impact would not have triggered an RBC action level.

	<u>2017</u>	<u>2016</u>
ACA fee assessment payable for the upcoming year	\$ 43,483	\$ –
ACA fee assessment paid	–	36,358
Premium written subject to ACA 9010 assessment	2,259,254	2,045,675
Total adjusted capital before surplus adjustment	895,022	728,177
Total adjusted capital after surplus adjustment	851,539	728,177
Authorized control level after surplus adjustment	133,485	132,056

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 27, 2018, 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.

Our audits were conducted for the purpose of forming an opinion on the statutory-basis 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 statutory-basis 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 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 27, 2018

Blue Cross and Blue Shield of Massachusetts, Inc.

Investment Risk Interrogatories – Statutory Basis
(Dollars in Thousands)

December 31, 2017

- Blue Cross and Blue Shield of Massachusetts, Inc.'s total admitted assets as reported on Page 2 of its Annual Statement are \$2,547,980.
- 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 High Yield Bond Fund	Other invested asset	\$ 72,690	2.85%
Zaffre Affiliated Services, LLC	Other invested asset	71,382	2.80
Lazard Asset Management Fund	Other invested asset	48,009	1.88
Putnam Total Return Fund LLC	Other invested asset	42,477	1.67
Bluerock Market Neutral Fund	Other invested asset	41,522	1.63
Zaffre Investments, LLC	Other invested asset	40,099	1.57
Newton Global Equity Income Fund	Common Stock	39,359	1.54
RREEF America II Core REIT Fund	Common Stock	38,364	1.51
Parametric Defensive Equity Fund	Other invested asset	35,381	1.39
Westwood Trust LC Value Equity Fund	Other invested asset	34,531	1.36

- 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	\$ 786,265	30.86%	P/RP-1	\$ –	0.00%
NAIC-2	54,055	2.12	P/RP-2	–	–
NAIC-3	2,285	0.09	P/RP-3	–	–
NAIC-4	–	–	P/RP-4	–	–
NAIC-5	–	–	P/RP-5	–	–
NAIC-6	–	–	P/RP-6	–	–
	<u>\$ 842,605</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	\$ 112,915	4.43%

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

NAIC Sovereign Rating	Amount	Percentage of Total Admitted Assets
Countries rated NAIC-1	\$ 108,577	4.26%
Countries rated NAIC-2	4,338	0.17
Countries rated NAIC-3 or below	–	–

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:		
United Kingdom	\$ 42,442	1.67%
Cayman Islands	14,390	0.56
Countries rated NAIC-2:		
United Kingdom	979	0.04
France	1,505	0.06
Countries rated NAIC-3 or below:		

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
Newton Global Equity Income Fund	Common stock	\$ 39,359	1.54%
Park Square Capital Opportunity II Fund	OIA	19,917	0.78
GE Capital International FDG	1FE	3,450	0.14
Carlyle Global 144A	1FE	2,950	0.12
Sparebank 1 Boligkreditt 144A	1FE	1,948	0.08
Stadshypotek 1 Boligkreditt 144A	1FE	1,946	0.08
Sumimotot Mitsu Finl Group Inc.	1FE	1,883	0.07
Mitsubishi UF Finl Group Inc.	1FE	1,775	0.07
UBS AG Stamford Brh	1FE	1,747	0.07
Bank of Tokyo- Mitsubishi LTD 144A	1FE	1,745	0.07

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 High Yield Bond Fund	\$ 72,690	2.85%
Zaffre Affiliated Services, LLC	71,382	2.80
Lazard Asset Management Fund	48,009	1.88
Putnam Total Return Fund LLC	42,477	1.67
Bluerock Market Neutral Fund	41,522	1.63
Zaffre Investments, LLC	40,099	1.57
Newton Global Equity Income Fund	39,359	1.54
RREEF America II Core REIT Fund	38,364	1.51
Parametric Defensive Equity Fund	35,381	1.39
Westwood Trust LC Value Equity Fund	34,531	1.36

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.

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 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

21. The Company had no warrants not attached to other financial instruments, options, caps, and floors during 2017.
22. The Company had no potential exposure for collars, swaps, and forwards during 2017.
23. The Company had no potential exposure for future contracts during 2017.

Blue Cross and Blue Shield of Massachusetts, Inc.

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

December 31, 2017

Investment Categories	Gross Investment Holdings*		Admitted Assets as Reported in Annual Statement	
	Amount	Percentage	Amount	Percentage
Bonds				
U.S. Treasury securities	\$ 242,926	12.88%	\$ 242,926	13.20%
U.S. governmental agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	31,423	1.67	31,423	1.71
Issued by U.S. government sponsored agencies	8,522	0.45	8,522	0.46
Non U.S. government (including Canada, excluding mortgage-backed securities)	4,197	0.22	4,197	0.23
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
States, territories and possessions general obligations	794	0.04	794	0.04
Political subdivisions of states, territories and possessions general obligations	928	0.05	928	0.05
Revenue and assessment obligations	3,317	0.18	3,317	0.18
Industrial development and similar obligations				
Mortgage-backed securities (includes RMBS and MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	27,729	1.47	27,729	1.51
Issued or guaranteed by FHMA and FHLMC	169,457	8.98	169,457	9.21
All other	–	–	–	–
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	55,704	2.95	55,704	3.03
Issued by non-U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies	141	0.01	141	0.01
All other	19,956	1.06	19,956	1.08
Other debt and other fixed income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	206,617	10.95	206,617	11.22
Unaffiliated Non-U.S. securities (including Canada)	56,510	2.99	56,510	3.07
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	\$ 139,905	7.42%	\$ 139,905	7.60%
Preferred stock:				
Affiliated	–	–	–	–
Unaffiliated	–	–	–	–
Publicly traded equity securities (excluding preferred stock):				
Affiliated	–	–	–	–
Unaffiliated	–	–	–	–
Other equity securities:				
Affiliated	251	0.01	251	0.01
Unaffiliated	13,160	0.70	13,160	0.71
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	102,393	5.43	102,393	5.56
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	6,102	0.32	6,102	0.33
Securities for lending	–	–	–	–
Cash, cash equivalents and short term investments	212,222	11.25	212,222	11.53
Other invested assets	584,267	30.97	538,615	29.26
Total invested assets	<u>\$ 1,886,521</u>	<u>100.00%</u>	<u>\$ 1,840,869</u>	<u>100.00%</u>

*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, 2017

Note—Basis of Presentation

The accompanying supplemental schedules present selected investment disclosures as of December 31, 2017, 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 2017 Statutory Annual Statement as filed with the Commonwealth of Massachusetts Division of Insurance.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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