

CONSOLIDATED FINANCIAL STATEMENTS  
AND OTHER FINANCIAL INFORMATION

CareFirst, Inc. and Affiliates  
Years Ended December 31, 2009 and 2008  
With Report of Independent Auditors

CareFirst, Inc. and Affiliates

Consolidated Financial Statements  
and Other Financial Information

Years Ended December 31, 2009 and 2008

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## Report of Independent Auditors

Board of Directors of CareFirst, Inc.  
Board of Directors of CareFirst of Maryland, Inc.  
Board of Trustees of Group Hospitalization and Medical Services, Inc.

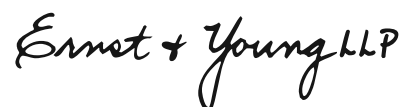
We have audited the accompanying consolidated balance sheets of CareFirst, Inc. and affiliates (collectively referred to as the Company) as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in reserves and cash flows for the years then ended. These financial 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 auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, on January 1, 2009, the Company changed its method of accounting for uncertainty in income taxes upon the adoption of FASB guidance.

As discussed in Note 2 to the consolidated financial statements, on April 1, 2009, the Company changed its method of accounting for other than temporary impairments.



March 1, 2010

# CareFirst, Inc. and Affiliates

## Consolidated Balance Sheets (In Thousands)

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 210,422	\$ 272,014
Short-term investments	48,004	39,423
Advances to providers	213,580	220,908
Accounts receivable, less allowance for doubtful accounts of \$22,086 and \$19,316 as of December 31, 2009 and 2008, respectively	541,658	528,520
Interest income receivable	14,334	10,880
Other current assets	733,389	648,279
Deferred tax assets, net	25,525	20,441
Total current assets	<u>1,786,912</u>	<u>1,740,465</u>
Long-term investments	1,536,303	1,425,058
Other invested assets	20,676	1,143
Property, equipment and capitalized software, net	274,823	215,298
Goodwill	29,956	29,956
Other assets	30,287	22,660
Deferred tax assets, net	14,486	35,375
Total assets	<u><u>\$ 3,693,443</u></u>	<u><u>\$ 3,469,955</u></u>
<b>Liabilities and reserves</b>		
Current liabilities:		
Short-term borrowings	\$ 171,361	\$ 168,050
Medical claims payable	545,960	589,963
Accounts payable and accrued expenses	341,430	279,915
Unearned revenues	137,934	158,289
Group experience funds and advances	875,953	795,536
Note payable, current portion	266	281
Total current liabilities	<u>2,072,904</u>	<u>1,992,034</u>
Note payable, noncurrent	296	561
Long-term employee benefit obligations	118,819	153,197
Other liabilities	25,243	27,644
Total liabilities	<u>2,217,262</u>	<u>2,173,436</u>
Reserves:		
Retained earnings	1,615,429	1,508,214
Accumulated other comprehensive loss	(139,248)	(211,695)
Total reserves	<u>1,476,181</u>	<u>1,296,519</u>
Total liabilities and reserves	<u><u>\$ 3,693,443</u></u>	<u><u>\$ 3,469,955</u></u>

See accompanying notes.

CareFirst, Inc. and Affiliates

Consolidated Statements of Operations  
(In Thousands)

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Premiums earned	\$ 6,574,533	\$ 6,320,242
Amounts attributable to self-funded arrangements	3,840,288	3,584,373
Less amounts attributable to claims under self-funded arrangements	(3,617,583)	(3,365,585)
Other	44,332	45,127
Net revenue	<u>6,841,570</u>	<u>6,584,157</u>
Operating expenses:		
Cost of care	5,684,833	5,572,973
General and administrative	1,152,870	1,023,454
Total operating expenses	<u>6,837,703</u>	<u>6,596,427</u>
Income (loss) from operations	3,867	(12,270)
Investment income, net	122,924	112,617
Other than temporary impairment losses on investments:		
Total other than temporary impairment losses on investments	(25,649)	(91,195)
Portion of other than temporary impairment losses recognized in other comprehensive income	6,881	—
Other than temporary impairment losses on investments recognized in net income	(18,768)	(91,195)
Other income (loss), net	3,664	(178)
Income before provision (benefit) for income taxes	<u>111,687</u>	<u>8,974</u>
Provision (benefit) for income taxes	14,867	(373)
Net income	<u>\$ 96,820</u>	<u>\$ 9,347</u>

See accompanying notes.

CareFirst, Inc. and Affiliates

Consolidated Statements of Changes in Reserves  
(In Thousands)

Years Ended December 31, 2009 and 2008

	<b>Accumulated Other Comprehensive Income (Loss)</b>			
	<b>Retained Earnings</b>	<b>Unrealized Gains (Losses) on Securities, Net</b>	<b>Defined Benefit Plans Adjustments</b>	<b>Total Reserves</b>
Balance, as of January 1, 2008	\$ 1,498,867	\$ 53,720	\$ (47,743)	\$ 1,504,844
Net income	9,347	-	-	9,347
Other comprehensive loss, net of tax:				
Change in net unrealized gains and losses on securities, net of reclassification adjustments	-	(95,777)	-	(95,777)
Defined benefit plans adjustments	-	-	(121,895)	(121,895)
Other comprehensive loss				(217,672)
Total comprehensive loss				(208,325)
Balance, as of December 31, 2008	1,508,214	(42,057)	(169,638)	1,296,519
Cumulative effect of adopting FASB guidance on OTTI, net of tax	<b>4,886</b>	<b>(3,940)</b>	-	<b>946</b>
Cumulative effect of adopting FASB guidance on uncertain tax positions	<b>5,509</b>	-	-	<b>5,509</b>
Net income	<b>96,820</b>	-	-	<b>96,820</b>
Other comprehensive income, net of tax:				
Change in net unrealized gains and losses on securities, net of reclassification adjustments	-	<b>60,283</b>	-	<b>60,283</b>
Defined benefit plans adjustments	-	-	<b>16,104</b>	<b>16,104</b>
Other comprehensive income				<b>76,387</b>
Total comprehensive income				<b>173,207</b>
Balance, as of December 31, 2009	<b>\$ 1,615,429</b>	<b>\$ 14,286</b>	<b>\$ (153,534)</b>	<b>\$ 1,476,181</b>

See accompanying notes.

# CareFirst, Inc. and Affiliates

## Consolidated Statements of Cash Flows (In Thousands)

	Year Ended December 31	
	2009	2008
<b>Operating activities</b>		
Net income	\$ 96,820	\$ 9,347
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	63,493	50,239
Realized gains on investments, net	(42,293)	(40,375)
Other than temporary impairment of investments	18,768	91,195
Realized (gains) losses on embedded derivatives	(14,618)	16,933
Provision for deferred income taxes	1,791	16,257
Loss (gain) on equity method investments	578	(468)
Gain on sale of invested assets	(970)	–
Changes in operating assets and liabilities:		
Decrease (increase) in advances to providers	7,328	(25,168)
Increase in accounts receivable, net	(13,138)	(29,448)
(Increase) decrease in interest income receivable	(3,454)	3,628
Increase in other current assets	(85,110)	(92,931)
Increase in other assets	(7,627)	(53,860)
(Decrease) increase in medical claims payable	(44,003)	50,598
Increase (decrease) in accounts payable and accrued expenses	60,450	(22,488)
(Decrease) increase in unearned revenues	(20,355)	2,071
Increase in group experience funds and advances	80,417	109,596
Decrease in other liabilities	(16,652)	(34,706)
Net cash provided by operating activities	81,425	50,420
<b>Investing activities</b>		
Purchases of investments	(2,286,195)	(3,516,033)
Proceeds from sales and maturities of investments	2,282,306	3,636,128
Purchases of other invested assets	(20,766)	(1,012)
Distributions of other invested assets	625	550
Proceeds from sales of other invested assets	1,000	–
Purchases of property, equipment and capitalized software, net	(123,018)	(94,961)
Net cash (used in) provided by investing activities	(146,048)	24,672
<b>Financing activities</b>		
Increase (decrease) in short-term borrowings	3,311	(148)
Repayment on long-term debt	(280)	(779)
Net cash provided by (used in) financing activities	3,031	(927)
Net (decrease) increase in cash and cash equivalents	(61,592)	74,165
Cash and cash equivalents at beginning of year	272,014	197,849
Cash and cash equivalents at end of year	\$ 210,422	\$ 272,014
<b>Supplemental disclosures</b>		
Cash paid for income taxes	\$ 10,313	\$ 15,954

See accompanying notes.

# CareFirst, Inc. and Affiliates

## Notes to Consolidated Financial Statements (In Thousands)

December 31, 2009

### **1. Organization**

CareFirst, Inc. (CFI) and affiliates (collectively referred to as the Company) provide a comprehensive array of health insurance and managed care products and services primarily through indemnity health insurance, health maintenance organization (HMO) coverage and health benefits administration. Other products and services include preferred provider and point of service networks, fee-for-service arrangements, third-party administrator services and other managed care services. These products and services are provided to individuals, businesses and governmental agencies primarily in the State of Maryland and in the Washington, D.C. metropolitan area.

CFI was incorporated on January 16, 1998, to become the not-for-profit parent of CareFirst of Maryland, Inc. (CFMI) and Group Hospitalization and Medical Services, Inc. (GHMSI). These affiliates do business as CareFirst BlueCross BlueShield. CFMI and GHMSI also hold joint interests in a health maintenance organization subsidiary, CareFirst BlueChoice, Inc. (CFBC).

Certain business has been written by CFMI and GHMSI which represents contracts outside the historic CFMI and GHMSI service areas (cross-jurisdictional sales). In 2006, the Boards of CFI, CFMI and GHMSI approved redistribution of earnings between CFMI and GHMSI related to cross-jurisdictional sales. The income or loss from operations from this cross-jurisdictional business would be transferred via a quota-share reinsurance contract from the company that earned them to the company in whose service area they were earned. The Company received regulatory approval for these earnings redistributions, effective January 1, 2008. This agreement has no impact on the consolidated financial statements of CFI.

Also in 2006, the Boards of CFI, CFMI, and GHMSI approved earnings redistributions to evenly share changes in the statutory surplus of CFBC. In 2008, the Boards approved in principle the creation of a new holding company, CareFirst Holdings, LLC. (CHC), which would be owned 50%/50% by CFMI and GHMSI. Following regulatory approval, the establishment of CHC would satisfy the earnings redistributions of CFBC.

### **2. Summary of Significant Accounting Policies**

#### **Basis of Presentation**

The Company's consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States (GAAP).

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

## **2. Summary of Significant Accounting Policies**

### **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of CFI and its affiliates: CFMI, GHMSI, and CFBC. All intercompany transactions have been eliminated in consolidation.

### **Use of Estimates**

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

### **Reclassifications**

Certain amounts from the prior year consolidated financial statements have been reclassified in order to conform to the current year presentation.

### **Fair Value of Financial Instruments**

The carrying amounts of financial instruments, including cash and cash equivalents, advances to providers, accounts receivable, interest income receivable, short-term borrowings, accounts payable and accrued expenses, unearned revenues, and note payable, current portion approximate fair value given the short-term nature of these financial instruments.

### **Cash and Cash Equivalents and Short-term Borrowings**

Cash and cash equivalents include amounts invested in accounts which are readily convertible to cash. Investments with contractual maturities of three months or less from the date of original purchase are classified as cash and cash equivalents. In accordance with the Company's cash management policy of maximizing the amount of funds invested in income-earning assets, the Company routinely anticipates the timing and amount of future cash flows. This policy frequently results in the existence of negative book cash balances, which are reflected as short-term borrowings in the accompanying consolidated financial statements.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Short-term Investments**

Short-term investments include investments with remaining maturities of one year or less, but greater than three months, at the time of acquisition and are carried at fair value.

##### **Accounts Receivable**

Accounts receivable primarily represent uncollected amounts earned from insured and self-funded groups. Provision is made for accounts considered uncollectible and/or potential adjustments, which arise as a result of review by management or a third party.

##### **Advances to Providers**

The Company has advances on deposit with certain regulated hospitals in the State of Maryland. These advances permit the Company to earn discounts of 2.25% and 2.00% of allowed inpatient and outpatient charges, respectively, by these hospitals.

##### **Investments**

###### *Investment Securities*

Investments consist primarily of U.S. Treasury and agency securities, state and municipal securities, foreign governments securities (U.S. dollar-denominated), corporate fixed maturity securities, mortgage-backed securities, asset-backed securities, convertible bonds and equity securities.

The Company has determined that its fixed maturity and equity securities are available-for-sale. Fixed maturity and equity securities are carried at estimated fair value based on quoted market prices for the same or similar instruments (refer to Note 8 *Fair Value Measurements* for discussion of valuation methods). The Company's policy is to classify all investments with contractual maturities within one year as current. Investment income is recognized when earned and reported net of investment expenses. Unrealized holding gains and losses are excluded from earnings and are reported as a separate component of accumulated other comprehensive loss until realized, unless the losses are deemed to be other than temporary. Realized gains or losses,

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

including any provision for other than temporary declines in value, are included in the consolidated statements of operations. For purposes of computing realized gains and losses, the specific-identification method of determining cost was used.

##### *Evaluating Investments for Other than Temporary Impairments (OTTI)*

The Company periodically performs evaluations, on a lot-by-lot and security-by-security basis, of its investment holdings in accordance with its impairment policy to evaluate whether any declines in the fair value of investments are other than temporary. This evaluation consists of a review of several factors, including but not limited to: length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; and the near term prospects for recovery of the market value of a security. Any unrealized loss identified as other than temporary was recorded directly in the consolidated statements of operations prior to April 1, 2009. As of April 1, 2009, the Financial Accounting Standards Board (FASB) issued, and the Company adopted, guidance for recognition and presentation of other than temporary impairment, or FASB OTTI guidance. Accordingly, any credit-related impairment of fixed maturity securities that the Company does not intend to sell, and is not likely to be required to sell, is recognized in the consolidated statements of operations, with the noncredit-related impairment recognized in other comprehensive income.

For equity securities, there was no change in the impairment methodology. The Company considers the various factors described above, including its intent and ability to hold the equity security for a period of time sufficient for recovery to cost. Where the Company lacks the intent or ability, the security's decline in fair value is deemed to be other than temporary and the entire difference between fair value and cost is recognized in the consolidated statements of operations.

For fixed maturity securities where fair value is less than amortized cost, and that are not deemed to be credit-impaired, the Company has asserted that it has no intent to sell and that it believes it is more likely than not that it will not be required to sell the investment before recovery of its amortized cost basis. If such an assertion had not been made, the security's decline in fair value is deemed to be other than temporary and the entire difference between fair value and amortized cost is recognized in the consolidated statement of operations.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

For fixed maturity securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. The difference between the present value of projected future cash flows expected to be collected and the amortized cost basis is recognized as credit-related OTTI in the consolidated statements of operations. If fair value is less than the present value of projected future cash flows expected to be collected, the portion of OTTI related to other than credit factors is recorded in other comprehensive income.

In order to determine the amount of credit loss for a fixed maturity security, the Company calculates the recovery value by performing a discounted cash flow analysis based on the present value of future cash flows expected to be received. The discount rate is generally the effective interest rate of the fixed maturity security prior to impairment.

When determining the collectability and the period over which the fixed maturity security is expected to recover, the Company considers the same factors utilized in its overall impairment evaluation process described above. Additional considerations are made when assessing the unique features that apply to certain structured securities such as residential mortgage-backed, commercial mortgage-backed and asset-backed securities. These additional features include, but are not limited to: the quality of underlying collateral; expected prepayment speeds; current and forecasted loss severity; consideration of payment terms of underlying assets backing a particular security; and the payment priority within the tranche structure of the security.

Based on its evaluation, the Company has recorded OTTI as follows:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Equity securities	\$ 6,342	\$ 65,351
Fixed maturity securities	12,426	25,844
Total	<u>\$ 18,768</u>	<u>\$ 91,195</u>

The Company believes that it has adequately reviewed its investment securities for OTTI and that its investment securities are carried at fair value. However, over time, the economic and market environment may provide additional insight regarding the fair value of certain securities, which could change management's judgment regarding OTTI. This could result in realized

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

losses relating to other than temporary declines being charged against future income. Given the judgments involved, there is a continuing risk that further declines in fair value may occur and additional material OTTI may be recorded in future periods.

##### *Derivative Financial Instruments*

A derivative is typically defined as an instrument whose value is “derived” from an underlying instrument, index or rate, has a notional amount, requires little or no initial investment and can be net settled. In accordance with FASB guidance, all investments in derivatives are recorded at fair value. Included within the Company’s long-term investments are certain financial instruments which contain embedded derivatives (options embedded in convertible fixed maturity securities). Derivatives embedded within non-derivative instruments are bifurcated from the host instrument when the embedded derivative is not clearly and closely related to the host instrument. These instruments have no hedge designation and as such, changes in the fair value are recorded as realized gains and losses. The Company recognized realized gains (losses) of \$14,618 and \$(16,933) related to the embedded derivatives, in investment income, net for the years ended December 31, 2009 and 2008, respectively.

##### *Securities Lending*

Prior to 2009, the Company participated in securities lending transactions whereby the Company lent investments in exchange for collateral. The Company had no securities on loan as of December 31, 2009 and 2008; however, it intends to re-establish its securities lending program at some point in the future.

#### **Other Invested Assets**

Other invested assets consist of direct investments in limited partnerships and a limited liability company, which are accounted for under the equity method. The unrealized gains and losses from the underlying investments are reported in investment income, net in the accompanying consolidated statements of operations. The Company’s investments in a limited partnership, BlueCross BlueShield Venture Partners LP, and a limited liability company, National Account Service Company LLC, had a book value of \$2,498 and \$18,178 respectively as of December 31, 2009.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

During December 2009, the Company sold its investment in a limited partnership and recognized a gain of \$970.

#### **Property, Equipment and Capitalized Software**

Property, equipment and capitalized software are recorded at cost and are depreciated using the straight-line method over useful lives ranging from three to five years for purchased computer and telecommunications equipment, three to eight years for capitalized software, and five to twelve years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or over the estimated useful lives of the improvements, if shorter than the lease term. The Company periodically assesses the carrying value of these fixed assets for purposes of determining any asset impairment.

Certain costs related to the development or purchase of internal-use software are capitalized and amortized over the estimated useful life of the software. Computer software costs that are incurred in the preliminary project stage are expensed as incurred. Direct consulting costs, payroll and payroll-related costs for employees incurred during the development stage that are directly associated with each project are capitalized and amortized over the estimated useful life of the software once placed into operation.

#### **Goodwill**

Goodwill represents the excess of the cost of businesses acquired over the fair value of the net identifiable assets at the date of acquisition. The Company follows FASB guidance and does not amortize goodwill. The Company has determined that it has five reporting units: third-party administrative, HMO, indemnity risk, indemnity non-risk, and the FEP. All of the Company's goodwill has been allocated to the HMO reporting unit (CFBC) at December 31, 2009 and 2008. The Company tests goodwill for impairment on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The Company uses discounted cash flow techniques to determine the price that could be received in a current transaction to sell the asset assuming the asset or asset group (in-use premise) would be at highest and best use. The Company completed its annual goodwill impairment evaluations at October 1, 2009 and 2008. These evaluations indicated that the estimated fair value of the HMO reporting unit exceeded its carrying value and thus no impairment loss was recognized for the years ended December 31, 2009 and 2008. There were no changes in the carrying amount of goodwill of \$29,956 during the years ended December 31, 2009 and 2008.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### Other Assets

Other assets primarily consist of prepaid expenses, the cash surrender value of life insurance policies, federal and state income tax recoverable and amounts due from the Office of Personnel Management (OPM) under the FEP contracts (refer to *Summary of Significant Accounting Policies – Federal Employee Program and Federal Employee Program – HMO*).

##### Retirement Benefit Plans

The Company sponsors various plans that provide defined benefit pension and other postretirement benefits covering eligible employees. Pension and other postretirement benefits are recorded in accordance with FASB guidance. The Company recognizes the funded status of the benefit obligations for each of its plans as a current and noncurrent asset or liability on the consolidated balance sheets. The actuarial gains or losses, prior year costs and credits, and remaining net transition asset or liability that have not been included in net periodic costs are recognized, net of tax, as a component of accumulated other comprehensive loss. Other postretirement benefits represent outstanding obligations for retiree health benefits. Liabilities for pension and other postretirement benefits are recorded based on the amount by which the actuarial present value of benefits exceeds the fair value of plan assets. The current portion of the liabilities is the value of payments over the next twelve months that is greater than the plan assets. The current portion is classified as accounts payable and accrued expenses and the noncurrent portion is classified as long-term employee benefit obligations, respectively, in the accompanying consolidated balance sheets. The Company uses the year end balance sheet date as the measurement date for all defined benefit pension and other postretirement benefit plans.

##### Note Payable

Effective January 1, 2005, a new subsidiary of GHMSI was created to operate the Federal Employee Program (FEP) Operations Center, which had previously been operated by GHMSI under a contract with the BCBSA. Service Benefit Plan Administrative Services Corporation (SBP), is 90% owned by GHMSI and 10% owned by BCBSA (refer to *Summary of Significant Accounting Policies – FEP Operations Center* for additional information).

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

In connection with the creation of SBP, fixed assets previously owned by GHMSI and used by the FEP Operations Center were sold to SBP at their net book value as of January 1, 2005. The costs of these fixed assets were funded under a revolving credit agreement with BCBSA. The amount available under the line of credit is \$15,000. The line of credit bears interest at variable rates. The balance outstanding under this line of credit was \$562 and \$842 as of December 31, 2009 and 2008, respectively.

#### **Revenue Recognition**

Premiums are recognized as earned on a monthly basis for the period the health care coverage is in effect. Unearned revenues represent prepayments of premiums for future health care coverage.

The Company provides coverage for certain groups whose contracts provide for payments based on group experience factors (experience-rated contracts). Under these contracts, revenue is generally recorded on the basis of incurred claims, plus retention. In certain cases, maximum rates are established by contract, and losses can result if claims and retention exceed these maximum rates. Any such losses are recorded in the year incurred and may, in many cases, be recouped against subsequent years' gains.

The Company participates with other BlueCross and BlueShield plans in administering certain health care benefits of various accounts of the other plans. Administrative fees are generally recognized as earned and are recorded as a reduction of general and administrative expenses.

Certain claim payments, premium rates, administrative expense reimbursements and provider discounts are subject to review and potential retroactive adjustment by third parties. Reserves to reduce revenue are established for potential obligations arising from such reviews. Management believes that the resolution of these claims will not be materially different from amounts recorded in the accompanying consolidated financial statements.

#### **Cost of Care and Medical Claims Payable**

The Company negotiates contractual agreements with physicians and medical management groups to provide defined health care services to its members. All other physician and institutional services are provided by medical providers to whom the Company pays fees based upon fee schedules. Cost of care is recognized in the period in which members receive medical

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

services. In addition to actual benefits paid, cost of care includes the impact of accruals for estimates of reported and unreported claims, which are unpaid as of the balance sheet dates. The liability for medical claims payable, as discussed in more detail below, is computed in accordance with generally accepted actuarial practices and is based upon past claims payment experience, together with other current factors which, in management's judgment, require recognition in the calculation.

Each reporting period, the Company estimates its liability for medical care services that have been rendered on behalf of insured members but for which claims have either not been received or processed. The Company develops its estimates for medical care services incurred but not reported using an actuarial process that is consistently applied.

The actuarial models consider factors such as time from the dates of service to claims receipt, claims backlogs, seasonal variances in medical care consumption, provider rate changes, medical care utilization and other medical cost trends, membership volume and demographics and other factors. Depending on the health care provider and type of service, the typical billing lag for services can vary significantly. Substantially all claims related to medical care services are known and settled within twelve months from the date of service.

The Company regularly re-examines its previously established medical claims payable estimates based on actual claim submissions and other changes in facts and circumstances. As the liability estimates recorded in prior periods become more exact, the Company increases or decreases the amounts of the estimates and includes the changes in estimates in cost of care in the period in which the changes are identified. If the revised estimate of prior period cost of care is less than the previous estimate, the Company decreases reported cost of care in the current period. Conversely, if the revised estimate of prior period cost of care is greater than the previous estimate, the Company increases reported cost of care in the current period. Due to the uncertainties inherent in the claims estimation process, it is at least reasonably possible that the actual claims paid could differ materially from the amounts accrued in the accompanying consolidated balance sheets.

#### **Income Taxes**

The Company's provision (benefit) for income taxes reflects the estimated current and future tax consequences of all events that have been recognized in the consolidated financial statements as measured by the provisions of currently enacted tax laws and rates applicable to future periods.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Comprehensive Income (Loss)**

Comprehensive income (loss) encompasses all changes in reserves and includes net income, net unrealized gains or losses on available-for-sale securities, the noncredit component of OTTI on fixed maturity securities, and defined benefit plans adjustments. Comprehensive income (loss) is net of reclassification adjustments to adjust for items currently included in net income, such as realized gains or losses on investment securities.

##### **Federal Employee Program**

CFMI and GHMSI participate in the Federal Employee Health Benefits Program (FEHBP) with other BlueCross BlueShield plans. This program includes an experience-rated contract between OPM and the BCBSA, which acts as an agent for the participating BlueCross BlueShield plans. In addition, each participating plan, including CFMI and GHMSI, 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 approved by OPM annually. These rates determine the funds that will be available to the participating BlueCross BlueShield plans to provide insurance to Federal employees that enroll with the BlueCross BlueShield FEHBP.

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 considered the special reserve under the contract between OPM and BCBSA. Each year, OPM also allocates additional funds to a contingency reserve which may be utilized by the participating plans in the event that funds set aside from annual premiums are insufficient or fall below certain prescribed levels by OPM. Funds available to each participating BlueCross BlueShield plan, including the special reserve and the contingency reserve, are held at the U.S. Treasury, including amounts unused from prior periods. Any funds which remain unused 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 BCBSA contract renews automatically each year unless written notice of termination is given by either party.

In accordance with the BCBSA contract, OPM holds the unused funds on behalf of CFMI and GHMSI to provide funding for claims, administrative expenses, and other charges to the contract. CFMI and GHMSI, along with other BlueCross BlueShield plans who participate in the FEHBP contract, have an unrestricted right to draw funds being held in the special reserve for

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

any valid claim or expense. The unaudited amounts being held in the special reserve are \$3,522,412 and \$2,356,278, as of December 31, 2009 and 2008, respectively. The unaudited amounts being held in the contingency reserve are \$4,535,454 as of September 30, 2009 and \$4,158,212 as of December 31, 2008. If the balance of the special reserve is exhausted or falls below certain prescribed levels, OPM will transfer funds from the contingency reserve to the special reserve.

Amounts incurred in excess of the total reserves held at the U.S. Treasury for the FEHBP would not be reimbursed to CFMI or GHMSI.

Based upon formulas developed by BCBSA, CFMI and GHMSI have recorded their allocable share of the special reserve being held by OPM as an asset, with an equivalent amount recorded as a rate stabilization reserve included in other current assets and group experience funds and advances, respectively, in the accompanying consolidated balance sheets. These amounts are \$650,604 and \$553,397 as of December 31, 2009 and 2008, respectively.

FEP represented approximately 58% and 59% of consolidated accounts receivable as of December 31, 2009 and 2008, respectively. FEP represented approximately 35% and 36% of consolidated net revenue for the years ended December 31, 2009 and 2008, respectively.

#### **Federal Employee Program – HMO**

CFBC has an experience-rated HMO contract with the OPM to provide managed health care services under the FEHBP.

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 considered the special reserve under the contract between OPM and CFBC. Each year, OPM also allocates additional funds to a contingency reserve, which may be utilized by CFBC in the event that funds set aside from annual premiums are insufficient or fall below certain prescribed levels. OPM funds available to CFBC are held at the U.S. Treasury, including amounts unused from prior periods. Any funds which remain unused upon termination of the contract, after the claims run-out and reimbursement of allowable administrative expenses, would be returned to OPM for the benefit of the FEHBP. The OPM contract renews automatically each year unless written notice of termination is given by either party.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

In accordance with the OPM contract, OPM holds the unused funds on behalf of CFBC to provide funding for claims, administrative expenses, and other charges to the contract. CFBC has an unrestricted right to draw funds being held in the special reserve for any valid claim or expense. The amounts being held in the special reserve are \$9,986 and \$12,624 as of December 31, 2009 and 2008, respectively. The amounts being held in the contingency reserve are \$26,492 and \$26,837 as of December 31, 2009 and 2008, respectively. If the balance of the special reserve is exhausted or falls below certain prescribed levels, OPM will transfer funds from the contingency reserve to the special reserve. Amounts incurred in excess of the total reserves held at the U.S. Treasury for the FEBHP would not be reimbursed to CFBC.

CFBC has recorded the amount of the special reserve being held by OPM as an asset, with an equivalent amount recorded as a rate stabilization reserve. These amounts are included in other current assets and group experience funds and advances, respectively, in the accompanying consolidated balance sheets.

FEHBP represented less than 1% of consolidated accounts receivable as of December 31, 2009 and 2008. FEHBP represented approximately 2% and 1% of consolidated net revenue for the years ended December 31, 2009 and 2008, respectively.

#### **FEP Operations Center**

SBP performs certain administrative functions as the national operations center for FEP under its ten-year cost-reimbursement contract, which was effective January 1, 2005, with BCBSA. The reimbursement of allocable costs under this contract is recorded as a reduction to general and administrative expenses. FEP reimbursed the Company for costs incurred in connection with this agreement totaling \$94,558 and \$87,636 for the years ended December 31, 2009 and 2008, respectively.

#### **Medicare Part D Benefits**

Effective January 1, 2006, FirstCare, Inc. (FirstCare), a wholly-owned subsidiary of CFS Health Group, Inc. (CFS), which in turn is a wholly-owned subsidiary of CFMI, began serving as a plan sponsor offering Medicare Part D prescription drug insurance coverage under a contract with the Centers for Medicare and Medicaid Services (CMS). From January 1, 2006 to December 31,

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

2008, CFMI, GHMSI and BCBSD, Inc. (BCBSD) were operating under a quota-share reinsurance contract with FirstCare. The agreement, which renews annually unless terminated prior to renewal, relates to all Medicare Part D insurance policies written by FirstCare for individuals living in CFMI's, GHMSI's and BCBSD's service areas. Under the terms of the agreement, CFMI, GHMSI and BCBSD assume all underwriting risk on the business written in their respective service areas. Effective January 1, 2009, BCBSD opted out of the reinsurance contract with FirstCare, and the business FirstCare writes in BCBSD's service area is being ceded to CFMI. All revenue, claims costs and expenses related to the members covered by the quota-share reinsurance contract with respect to CFMI and GHMSI are included in the accompanying consolidated statements of operations for the years ended December 31, 2009 and 2008.

Under the Medicare Part D program, there are six separate elements of payment received by FirstCare during the plan year. These payment elements are as follows:

- CMS Premium – CMS pays a fixed monthly premium per member to FirstCare for the entire plan year.
- Member Premium – Additionally, each member pays a fixed monthly premium to FirstCare for the entire plan year.
- Low-Income Premium Subsidy – For qualifying low-income members, CMS pays some portion or all of the member's monthly premiums to FirstCare on the member's behalf.
- Catastrophic Reinsurance Subsidy – CMS pays FirstCare a cost reimbursement estimate monthly to fund the CMS obligation to pay approximately 80% of the costs incurred by individual members in excess of the individual annual out-of-pocket maximum. A settlement is made based on actual cost experience subsequent to the end of the plan year.
- Low-Income Member Cost Sharing Subsidy – For qualifying low-income members, CMS pays on the member's behalf some portion or all of a member's cost sharing amounts, such as deductibles and coinsurance. The cost sharing subsidy is funded by CMS through monthly payments to FirstCare. FirstCare administers and pays the subsidized portion of the claims on behalf of CMS, and a settlement payment is made between CMS and FirstCare based on actual claims experience subsequent to the end of the plan year.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

- CMS Risk-Share – If the ultimate per member per month benefit costs of any Medicare Part D regional plan varies more than 5.0 percentage points above or below the level estimated in the original bid submitted by the plan and approved by CMS, there is a risk-share settlement with CMS that is settled subsequent to the end of the plan year. The risk-share adjustment, if any, is recorded as an adjustment to premiums earned and accounts receivable, net or other liabilities.

The CMS Premium, the Member Premium, and the Low-Income Premium Subsidy represent payments for FirstCare's insurance risk coverage under the Medicare Part D program and therefore are recorded as premiums earned in the accompanying consolidated financial statements. Premiums earned are recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. FirstCare records premium payments received in advance of the applicable service period as unearned revenues.

The Catastrophic Reinsurance Subsidy and the Low-Income Member Cost Sharing Subsidy represent cost reimbursements under the Medicare Part D program. FirstCare is fully reimbursed by CMS for costs incurred for these contract elements and, accordingly, there is no insurance risk to FirstCare.

As of December 31, 2009 and 2008, the Company estimated a receivable of \$1,493 and \$5,014, respectively, is due under the risk-sharing provisions with CMS.

#### **Sale of Joint Venture Partnership/Leaseback of Building**

Effective December 22, 2006, CFMI entered into a transaction in which CFMI sold its 50% share of a joint venture that owns the Company's Corporate Headquarters in Owings Mills, Maryland. In connection with the sale, the Company entered into a 12-year operating lease effective January 1, 2007. These transactions are accounted for as a sale-leaseback with no continuing involvement. The gain on the sale of the joint venture along with other deferred rent received of \$12,693 is being recognized ratably over the remaining lease term. The balance of the deferred income as of December 31, 2009 and 2008 is \$9,519 and \$10,577, respectively. As of December 31, 2009 and 2008, the current portion of \$1,058 is classified as accounts payable and accrued expenses and the non-current portion of \$8,461 and \$9,519, respectively, is classified as other liabilities in the accompanying consolidated financial statements.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

## 2. Summary of Significant Accounting Policies (continued)

### Recent Accounting Pronouncements

In June 2009, the FASB established the FASB Accounting Standards Codification, or Codification, as the single source of GAAP recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements. Beginning in September 2009, Codification supersedes all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification became non-authoritative. Following Codification, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standard Updates, which will serve to update Codification, provide background information about the guidance and provide the basis for conclusions on the changes to Codification. Codification does not change or alter existing GAAP, and, therefore, did not have a material impact on the Company's consolidated financial statements.

In June 2006, the FASB issued guidance on accounting for uncertainty in income taxes. The guidance clarifies the accounting for income taxes by prescribing a minimum recognition threshold, which all income tax positions must achieve before being recognized in the financial statements. The guidance requires companies to determine whether it is "more likely than not" that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the tax benefit can be recorded in the financial statements. It also provided guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest and penalties. Previously recorded income tax benefits that no longer meet this standard are required to be charged to earnings in the period that such determination is made. In addition, the guidance requires expanded annual disclosures, including a rollforward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of the unrecognized tax benefit will significantly increase or decrease within twelve months. The Company adopted this guidance effective January 1, 2009, which resulted in an increase to 2009 beginning retained earnings of \$5,509 (refer to *Note 10 Income Taxes* for additional information).

On February 12, 2008, the FASB delayed, for one year, the effective date of its fair value measurement guidance for all nonfinancial assets and liabilities, except those that are recognized or disclosed in the financial statements on at least an annual basis. The Company adopted FASB fair value measurement guidance as of January 1, 2008, except for those provisions that were

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

deferred (refer to Note 8 *Fair Value Measurements* for additional information). The Company adopted the deferred fair value measurement provisions as of January 1, 2009. The Company's adoption of the deferred provisions of the FASB fair value measurement guidance did not have a material impact on its consolidated financial statements.

In December 2008, the FASB issued guidance that requires additional disclosures about assets held in an employer's defined benefit pension and other postretirement plans, including fair value measurement disclosures. The Company adopted this guidance for the financial statements issued for the year ended after December 31, 2009 (refer to Note 9 *Retirement Plans and Other Postretirement Benefit Plans* for additional information). The Company's adoption of this guidance did not have a material effect on its consolidated financial statements.

In April 2009, the FASB issued guidance that amends the accounting for OTTI by establishing new criteria for the recognition of OTTI on fixed maturity securities and also requiring additional financial statement disclosure. The new criteria requires OTTI to be recognized if either a credit-related loss is deemed to have occurred or the company has the intention to sell a security that is in an unrealized loss position or will more likely than not be required to sell a security that is in an unrealized loss position (refer to *Summary of Significant Accounting Policies – Investments* for the Company's OTTI evaluations of fixed maturity securities in accordance with the new guidance). Upon the adoption of the FASB OTTI guidance, the Company evaluated securities held at April 1, 2009 for which a previous OTTI was recognized, and identified those fixed maturity securities that the Company does not currently intend to sell or will be required to sell and for which previous OTTI recognized included a noncredit component. Additionally, the Company separately assesses the realizability of deferred tax assets related to losses on fixed maturity securities recorded in accumulated other comprehensive loss (AOCL). As such, to the extent that the Company expects to recover the unrealized losses on available-for-sale fixed maturity securities by holding the securities until recovery or maturity, the related deferred tax assets will reverse as the unrealized losses reverse and no valuation allowance is required. Therefore, the cumulative effect of adopting the FASB OTTI guidance includes the reversal of the valuation allowance related to the noncredit losses reclassified to AOCL. The Company's adoption of the FASB OTTI guidance resulted in an increase to retained earnings of \$4,886 with a corresponding adjustment of \$3,940, net of tax, to AOCL as of April 1, 2009. The difference between these adjustments of \$946 represents the release of the valuation allowance on deferred tax assets described above. (refer to Note 4 *Investments* and Note 11 *Other Comprehensive Income (Loss)* for additional information).

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

In May 2009, the FASB issued subsequent events guidance which establishes general standards of accounting for and disclosure of events that occur through the balance sheet date but before financial statements are issued or are available to be issued. Financial statements are considered to be available to be issued when they are complete in a form and format that complies with GAAP and all necessary approvals for issuance, such as from management, the board of directors, and/or significant shareholders, have been obtained. The date through which an entity has evaluated subsequent events and the basis for that date should also be disclosed. The Company adopted this guidance for the annual financial statements issued for the year ended December 31, 2009. The Company has evaluated subsequent events that have occurred for recognition or disclosure through March 1, 2010, the date the financial statements were available to be issued. The Company's adoption of this guidance did not have a material impact on its consolidated financial statements.

There were no other new accounting pronouncements issued during the year ended December 31, 2009 that had a material impact on the Company's financial position, operating results or disclosures.

#### **3. Regulatory Matters**

The Company is subject to regulation and supervision by regulatory authorities of the various jurisdictions in which CFI and its affiliates are licensed to conduct business. The authorities mandate, among other things, the maintenance of minimum statutory reserves and unassigned funds and prohibit certain transactions between the affiliates within the Company without prior regulatory approval. In addition, the Company must also comply with various conditions, restricting certain operations and financial transactions, that were contained in regulatory orders approving the affiliation of CFMI and GHMSI.

Financial statements filed by CFI and its affiliates with their respective state insurance regulators are prepared in accordance with statutory accounting practices prescribed or permitted by said regulators, which differ from GAAP. The most significant differences result from the exclusion of certain assets from statutory capital and surplus, differences in the carrying value of investments, valuation of investments in subsidiaries, treatment of subsidiary net income (loss) as an unrealized capital gain (loss), and the modification or exclusion of certain Codification guidance.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**3. Regulatory Matters (continued)**

At December 31, 2009, the Company's regulated subsidiaries' statutory reserves and unassigned funds exceed the minimum statutory requirements as determined by each of the jurisdictions in which those subsidiaries conduct business.

**4. Investments**

The Company's short-term and long-term investments consist of the following:

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Noncredit Component of OTTI Recognized in AOCL	Fair Value
<b>December 31, 2009</b>					
U.S. Treasury and other U.S. government agencies securities	\$ 371,569	\$ 857	\$ 16,320	\$ —	\$ 356,106
State and municipal securities	31,523	458	672	—	31,309
Foreign governments securities	1,655	34	9	—	1,680
Corporate fixed maturity securities	486,802	26,566	6,878	—	506,490
Options embedded in convertible securities	28,013	—	—	—	28,013
Government sponsored enterprise mortgage-backed securities	377,585	10,103	1,350	—	386,338
Residential mortgage-backed securities	130,614	267	13,697	6,881	110,303
Commercial mortgage-backed securities	16,253	356	193	—	16,416
Other asset-backed securities	14,727	513	60	—	15,180
Publicly-traded index funds	90,078	23,820	—	—	113,898
Privately-held equity securities	3,651	4,531	—	—	8,182
Publicly-traded equity securities	10,062	619	289	—	10,392
Total investments	<u>\$ 1,562,532</u>	<u>\$ 68,124</u>	<u>\$ 39,468</u>	<u>\$ 6,881</u>	<u>\$ 1,584,307</u>

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

4. Investments (continued)

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2008</b>				
U.S. Treasury and other U.S. government agencies securities	\$ 106,550	\$ 3,016	\$ 149	\$ 109,417
State and municipal securities	8,630	60	62	8,628
Corporate fixed maturity securities	499,901	7,956	32,993	474,864
Options embedded in convertible securities	10,254	–	–	10,254
Government sponsored enterprise mortgage-backed securities	411,463	9,346	963	419,846
Residential mortgage-backed securities	224,687	481	33,827	191,341
Commercial mortgage-backed securities	20,124	–	2,686	17,438
Other asset-backed securities	13,868	296	850	13,314
Publicly-traded index funds	201,078	173	2,205	199,046
Privately-held equity securities	3,651	4,531	–	8,182
Publicly-traded equity securities	16,114	90	4,053	12,151
Total investments	<u>\$ 1,516,320</u>	<u>\$ 25,949</u>	<u>\$ 77,788</u>	<u>\$ 1,464,481</u>

The amounts shown above as amortized cost basis include the effects of OTTI of investments previously recognized through net income.

The amortized cost and estimated fair value of fixed maturity securities at December 31, 2009, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**4. Investments (continued)**

	<b>Amortized Cost Basis</b>	<b>Fair Value</b>
Within 1 year	\$ 48,066	\$ 48,004
After 1 year through 5 years	233,095	238,173
After 5 years through 10 years	274,206	278,244
After 10 years	364,195	359,177
Mortgage-backed securities	539,179	528,237
Total	<u>\$ 1,458,741</u>	<u>\$ 1,451,835</u>

*Continuous Gross Unrealized Loss for Investments by Category*

The following tables present the gross unrealized losses and fair value, of the Company's investment securities in an unrealized loss position, aggregated by investment category and by length of time that the securities have been in a continuous unrealized loss position. The unrealized loss amounts presented below at December 31, 2009 include the noncredit component of OTTI loss. Fixed maturity securities on which a noncredit OTTI loss has been recognized in accumulated other comprehensive loss are categorized by length of time as being less than one year or greater than one year in a continuous unrealized loss position based on the point in time that the estimated fair value initially declined to below the amortized cost basis and not the period of time since the unrealized loss was deemed a noncredit OTTI loss.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

(In Thousands)

4. Investments (continued)

	Fair Value < 1 year	Unrealized Losses < 1 year	Fair Value > 1 year	Unrealized Losses > 1 year	Total Unrealized Losses
<b>December 31, 2009</b>					
U.S. Treasury and other U.S. government agencies securities	\$ 296,607	\$ 16,008	\$ 5,376	\$ 312	\$ 16,320
State and municipal securities	21,127	658	806	14	672
Foreign governments securities	—	—	762	9	9
Corporate fixed maturity securities	95,110	2,355	64,567	4,523	6,878
Government sponsored enterprise mortgage-backed securities	135,411	1,291	1,613	59	1,350
Residential mortgage-backed securities	4,701	66	87,407	20,512	20,578
Commercial mortgage-backed securities	—	—	5,365	193	193
Other asset-backed securities	374	2	4,552	58	60
Publicly-traded equity securities	6,328	88	942	201	289
Total investments	\$ 559,658	\$ 20,468	\$ 171,390	\$ 25,881	\$ 46,349

	Fair Value < 1 year	Unrealized Losses < 1 year	Fair Value > 1 year	Unrealized Losses > 1 year	Total Unrealized Losses
<b>December 31, 2008</b>					
U.S. Treasury and other U.S. government agencies securities	\$ 26,258	\$ 124	\$ 2,007	\$ 25	\$ 149
State and municipal securities	514	24	5,901	38	62
Corporate fixed maturity securities	218,237	17,359	92,938	15,634	32,993
Government sponsored enterprise mortgage-backed securities	41,531	573	7,669	390	963
Residential mortgage-backed securities	94,581	25,022	31,491	8,805	33,827
Commercial mortgage-backed securities	12,789	2,170	4,650	516	2,686
Other asset-backed	5,869	274	4,095	576	850
Publicly-traded index funds	116,100	2,205	—	—	2,205
Publicly-traded equity securities	7,825	3,763	851	290	4,053
Total investments	\$ 523,704	\$ 51,514	\$ 149,602	\$ 26,274	\$ 77,788

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### 4. Investments (continued)

##### *Realized Gains and Losses on the Sale of Investments*

A primary objective in the management of the fixed maturity and equity portfolios is to maximize total return relative to underlying liabilities and respective liquidity needs. In achieving this goal, assets may be sold to take advantage of market conditions or other investment opportunities, as well as tax considerations. Sales will generally produce realized gains and losses. In the ordinary course of business, the Company may sell securities for a number of reasons, including, but not limited to: (i) changes to the investment environment; (ii) expectation that the fair value could deteriorate further; (iii) desire to reduce exposure to an issuer or an industry; (iv) changes in credit quality; and (v) changes in expected cash flow.

Available-for-sale securities sold were as follows:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Proceeds from sales	<b>\$ 2,131,973</b>	\$ 2,804,949
Gross realized gains	<b>60,953</b>	71,082
Gross realized losses	<b>18,660</b>	30,707

For purposes of computing realized gains and losses, the specific-identification method of determining cost was used.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
*(In Thousands)*

**4. Investments (continued)**

*Credit Loss Rollforward*

The table below presents a rollforward of the cumulative credit loss component of OTTI loss recognized in earnings on fixed maturity securities still held by the Company at December 31, 2009, for which a noncredit portion of the OTTI loss was recognized in other comprehensive income:

Balance, December 31, 2008	\$	–
Credit loss component of OTTI loss not reclassified to other comprehensive loss in the cumulative effect transition adjustment		<b>1,563</b>
Additions:		
Initial impairments — credit loss OTTI recognized on securities not previously impaired		<b>7,631</b>
Additional impairments — credit loss OTTI recognized on securities previously impaired		<b>4,795</b>
Reductions:		
Due to sales (or maturities, pay downs or prepayments) during the year of securities previously credit loss OTTI impaired		<b>(665)</b>
Balance, December 31, 2009	<u>\$</u>	<u><b>13,324</b></u>

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
*(In Thousands)*

**5. Property, Equipment and Capitalized Software**

Property, equipment and capitalized software are comprised of the following:

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
Leasehold improvements	\$ 62,374	\$ 53,246
Purchased computer equipment and software	121,565	103,349
Capitalized software	406,915	324,302
Furniture and equipment	72,270	63,755
	<b>663,124</b>	544,652
Less accumulated depreciation and amortization	<b>388,301</b>	329,354
Property, equipment and capitalized software, net	<b>\$ 274,823</b>	<b>\$ 215,298</b>

Depreciation and amortization expense on property, equipment and capitalized software was \$63,493, and \$50,239 for the years ended December 31, 2009 and 2008, respectively, and is included as a component of general and administrative expenses in the accompanying consolidated statements of operations. For the years ended December 31, 2009 and 2008, the Company recognized an impairment loss of \$1,863 and \$4,198, respectively, as a result of the annual evaluation of property, equipment and capitalized software, in accordance with FASB guidance.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**6. Medical Claims Payable**

Activity in the liability accounts for medical claims is summarized as follows:

	<u>2009</u>	<u>2008</u>
Balance at January 1	\$ 589,963	\$ 539,364
Incurred related to:		
Current year	5,745,475	5,594,571
Prior years	(60,642)	(21,598)
Total incurred	<u>5,684,833</u>	<u>5,572,973</u>
Paid related to:		
Current year	5,207,182	5,012,365
Prior years	521,654	510,009
Total paid	<u>5,728,836</u>	<u>5,522,374</u>
Balance at December 31	<u>\$ 545,960</u>	<u>\$ 589,963</u>

Changes in the estimates associated with medical claims payable are recorded prospectively as changes in claims payment patterns, membership and utilization trends are identified and quantified.

For the years ended December 31, 2009 and 2008, approximately \$(18,560) and \$(18,627), respectively, of the incurred amount related to prior years was a result of changes in estimates for FEP contracts. These changes were offset by similar changes in revenue and thus, no significant change in income from operations arose as a result of these changes.

The negative amounts noted as “prior year” medical costs are favorable adjustments for claim estimates being settled for amounts less than originally anticipated. As noted above, these favorable changes from original estimates occur due to changes in medical utilization, mix of provider rates and other components of medical cost trends.

The Company accrues estimated claims processing expenses related to the liability for unpaid claims. These accruals totaled \$21,190 and \$20,649 as of December 31, 2009 and 2008, respectively, and are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### 6. Medical Claims Payable (continued)

Anticipated subrogation included as a reduction to medical claims payable as of December 31, 2009 and 2008 was \$4,351 and \$4,824, respectively.

#### 7. Lease Commitments

The Company leases certain administrative facilities, including its corporate offices, and equipment under operating leases. Some of these lease agreements contain escalation clauses for increases in real estate taxes and operating costs over base year amounts. These leases expire on various dates with renewal options available on many of the leases.

Future noncancelable minimum payments for leases are as follows:

2010	\$ 32,857
2011	31,882
2012	31,576
2013	28,455
2014	23,491
Thereafter	81,742
Total minimum payments	<u>\$ 230,003</u>

Rent expense for the years ended December 31, 2009 and 2008 for all operating leases was \$44,080 and \$41,607, respectively, and has been included within general and administrative expenses in the accompanying consolidated statements of operations.

#### 8. Fair Value Measurements

The FASB guidance on fair value measurement establishes a framework for measuring fair value and expands disclosures about fair value measurements. The fair value hierarchy is as follows:

*Level 1* – Quoted (unadjusted) prices for identical assets or liabilities in active markets.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **8. Fair Value Measurements (continued)**

*Level 2* – Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar assets/liabilities in active markets;
- Quoted prices for identical or similar assets in non-active markets (few transactions, limited information, non-current prices, high variability over time);
- Inputs other than quoted prices that are observable for the asset/liability (e.g., interest rates, yield curves, volatilities, or default prices); and
- Inputs that are derived principally from or corroborated by other observable market data.

*Level 3* – Unobservable inputs that cannot be corroborated by observable market data.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset. Management is responsible for the determination of fair value, and performs monthly analysis on the prices received from third parties to determine whether the prices appear to be reasonable estimates of fair value.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**8. Fair Value Measurements (continued)**

The following table presents information about the fair value of the Company's financial assets on a recurring basis at December 31, 2009 and 2008:

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value as of December 31, 2009
<b>Assets</b>				
Fixed maturity securities – available-for-sale:				
U.S. Treasury and other U.S. government agencies securities	\$ 233,228	\$ 122,878	\$ –	\$ 356,106
State and municipal securities	–	31,309	–	31,309
Foreign governments securities	–	1,680	–	1,680
Corporate fixed maturity securities	–	534,503	–	534,503
Government sponsored enterprise mortgage-backed securities	–	386,338	–	386,338
Residential mortgage-backed securities	–	108,735	1,568	110,303
Commercial mortgage-backed securities	–	16,416	–	16,416
Other asset-backed securities	–	15,180	–	15,180
Total fixed maturity securities	233,228	1,217,039	1,568	1,451,835
Equity securities – available-for-sale:				
Publicly-traded index funds	–	113,898	–	113,898
Privately-held equity securities	–	–	8,182	8,182
Publicly-traded equity securities	497	9,895	–	10,392
Total equity securities	497	123,793	8,182	132,472
Total assets	\$ 233,725	\$ 1,340,832	\$ 9,750	\$ 1,584,307

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

8. Fair Value Measurements (continued)

	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value as of December 31, 2008
<b>Assets</b>				
Fixed maturity securities – available-for-sale:				
U.S. Treasury and other U.S. government agencies securities	\$ 71,527	\$ 37,890	\$ –	\$ 109,417
State and municipal securities	–	8,628	–	8,628
Corporate fixed maturity securities	–	485,118	–	485,118
Government sponsored enterprise mortgage-backed securities	–	419,846	–	419,846
Residential mortgage-backed securities	–	144,170	47,182	191,352
Commercial mortgage-backed securities	–	17,438	–	17,438
Other asset-backed securities	–	13,303	–	13,303
Total fixed maturity securities	71,527	1,126,393	47,182	1,245,102
Equity securities – available-for-sale:				
Publicly-traded index funds	–	199,046	–	199,046
Privately-held equity securities	–	–	8,182	8,182
Publicly-traded equity securities	–	12,151	–	12,151
Total equity securities	–	211,197	8,182	219,379
Total assets	\$ 71,527	\$ 1,337,590	\$ 55,364	\$ 1,464,481

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

**Fixed maturity securities.** Fixed maturity securities consist of U.S. Treasury and other U.S. government agencies securities, state and municipal securities, foreign governments securities, corporate fixed maturity securities, mortgage-backed securities and other asset-backed securities, which are all held as available-for-sale investments. The fair value of U.S. Treasury securities is determined by an active price for an identical security in an observable market and is therefore classified as Level 1. Other U.S. government agencies securities, state and municipal securities,

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**8. Fair Value Measurements (continued)**

foreign governments securities, corporate fixed maturity securities, mortgage-backed securities and other asset-backed securities that are priced by independent pricing services using observable inputs are classified as Level 2. Certain mortgage-backed securities where the fair value is obtained from the Company's internal discounted cash-flow model (2009 only) and non-binding broker quotes (2008 only) are classified as Level 3.

**Equity securities.** Equity securities consist of publicly-traded index funds, publicly-traded equity securities (common stocks and preferred stocks), and privately-held equity securities which are held as available-for-sale investments. Common stocks valued at the closing price reported on the exchanges are classified as Level 1. Fair value of publicly-traded index funds and preferred stocks where market quotes are available but are not considered actively traded are classified as Level 2. Fair values of privately-held equity securities, where there has been limited trading activity or where less price transparency exists around the inputs to the valuation, are classified as Level 3.

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using Level 3 inputs as December 31, 2009 and 2008 is as follows:

	<b>Fixed Maturity Securities</b>	<b>Equity Securities</b>	<b>Total</b>
Beginning balance at January 1, 2009	\$ 47,182	\$ 8,182	\$ 55,364
Total gains and losses:			
Realized in net income	(781)	–	(781)
Unrealized in accumulated other comprehensive loss	2,694	–	2,694
Purchases, (sales), issuances, and (settlements), net	(31,568)	–	(31,568)
Transfers out of Level 3	(15,959)	–	(15,959)
Ending balance at December 31, 2009	<u>\$ 1,568</u>	<u>\$ 8,182</u>	<u>\$ 9,750</u>
Change in unrealized losses included in net income related to assets still held	<u>\$ 4,013</u>	<u>\$ –</u>	<u>\$ 4,013</u>

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**8. Fair Value Measurements (continued)**

	<b>Fixed Maturity Securities</b>	<b>Equity Securities</b>	<b>Total</b>
Beginning balance at January 1, 2008	\$ —	\$ 7,012	\$ 7,012
Total gains and losses:			
Realized in net income	(2,520)	—	(2,520)
Unrealized in accumulated other comprehensive loss	(5,624)	1,170	(4,454)
Purchases, (sales), issuances, and (settlements), net	43,333	—	43,333
Transfers into Level 3	11,993	—	11,993
Ending balance at December 31, 2008	<u>\$ 47,182</u>	<u>\$ 8,182</u>	<u>\$ 55,364</u>
 Change in unrealized losses included in net income related to assets still held	 <u>\$ 2,367</u>	 <u>\$ —</u>	 <u>\$ 2,367</u>

**9. Retirement Plans and Other Postretirement Benefit Plans**

Prior to December 31, 2002, CFMI and GHMSI maintained qualified noncontributory defined benefit retirement plans covering substantially all full-time employees. Effective December 31, 2002, these plans merged to become the CareFirst, Inc. Retirement Plan. Although the Company merged the CFMI and GHMSI plans, it has committed to maintain separate recordkeeping of plan assets and benefit obligations so that it will comply with certain regulatory restrictions that apply to CFMI and GHMSI. Consistent with the standards for multiple-employer plan accounting, CFMI and GHMSI have accounted for their net pension obligation as if the plans had remained separate. In November 2007, the Company approved a freeze to the Plan, effective January 1, 2009, whereby employees hired on or after January 1, 2009, are no longer eligible to participate in the Plan. These employees participate in an enhanced 401(k) program.

During 2005, in connection with the creation of SBP, a separate qualified noncontributory defined benefit retirement plan was established covering substantially all full-time SBP employees. A Voluntary Employee Beneficiary Association (VEBA), a tax-exempt trust, was also established to fund certain healthcare benefits for eligible SBP employees. Contributions to the VEBA during 2009 and 2008 were \$852 and \$675, respectively.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

The annual contributions exceeded the minimum funding standards set forth in the Employee Retirement Income Security Act of 1974, as amended (ERISA). The plans provide for eligible employees to receive benefits based principally on years of service with the Company and a percentage of certain compensation prior to normal retirement.

The Company also has nonqualified supplemental retirement benefit plans covering certain officers, which provide for eligible employees (and former employees) to receive additional benefits based principally on compensation and years of service. These plans provide for incremental benefit payments so that total benefit payments equal amounts that would have been payable from the Company's principal retirement plans if it were not for limitations imposed by income tax regulations.

In addition, the Company provides certain health care benefits for retired employees. Substantially all CFMI and GHMSI employees become eligible for those benefits if they have at least ten years of service, are at least age 55, and have the Company's medical benefit coverage at the time of termination or retirement. The Company's postretirement benefit program provides for a specific credit amount, which may be used to purchase health insurance upon retirement. The credit amount is based upon the retiree's age and years of service with the Company. The Company funds postretirement benefits as benefits are paid.

The following table sets forth the obligations, funded status, and amount recognized for the pension benefits, which include the qualified and nonqualified pension plans described above, and other postretirement benefits described above, in the accompanying consolidated financial statements as of December 31:

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
<b>Accumulated benefit obligations</b>	<b>\$ 593,557</b>	<b>\$ 525,173</b>	<b>\$ 77,655</b>	<b>\$ 71,287</b>
<b>Change in projected benefit obligations</b>				
Benefit obligations at beginning of year	\$ 531,838	\$ 503,871	\$ 71,287	\$ 74,051
Service cost	22,867	23,432	2,181	2,177
Interest cost	32,619	30,640	4,317	4,263
Benefits paid	(22,325)	(28,225)	(3,327)	(3,833)
Plan amendments	–	1,044	–	(3,422)
Actuarial loss (gain)	35,554	1,076	3,197	(1,949)
Benefit obligations at end of year	<b>\$ 600,553</b>	<b>\$ 531,838</b>	<b>\$ 77,655</b>	<b>\$ 71,287</b>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 425,007	\$ 479,993	\$ 2,534	\$ 2,851
Actual return on plan assets	100,133	(115,739)	656	(859)
Employer contributions	26,542	88,978	4,102	4,416
Benefits paid	(22,325)	(28,225)	(3,359)	(3,874)
Fair value of plan assets at end of year	<b>\$ 529,357</b>	<b>\$ 425,007</b>	<b>\$ 3,933</b>	<b>\$ 2,534</b>
Funded status	<b>\$ (71,196)</b>	<b>\$ (106,831)</b>	<b>\$ (73,722)</b>	<b>\$ (68,753)</b>
<b>Net amount included in the consolidated balance sheets</b>				
Current liabilities	\$ (21,887)	\$ (18,129)	\$ (4,212)	\$ (4,258)
Noncurrent liabilities	(49,309)	(88,702)	(69,510)	(64,495)
Net amount at December 31	<b>\$ (71,196)</b>	<b>\$ (106,831)</b>	<b>\$ (73,722)</b>	<b>\$ (68,753)</b>

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
<b>Amounts included in accumulated other comprehensive loss that have not been recognized in net periodic benefit cost</b>				
Net actuarial loss	\$ 185,215	\$ 210,008	\$ 11,357	\$ 8,933
Prior service asset	(4,252)	(6,554)	(1,421)	(1,698)
Transition liability	–	–	1,019	1,359
Net amount at December 31	<u>\$ 180,963</u>	<u>\$ 203,454</u>	<u>\$ 10,955</u>	<u>\$ 8,594</u>

The estimated net actuarial loss and prior service asset for the defined benefit pension plans that will be amortized from accumulated other comprehensive loss into net periodic benefit costs over the next fiscal year are \$8,759 and \$(2,302), respectively.

The estimated net actuarial loss, prior service asset and transition liability for other postretirement benefit plans that will be amortized from accumulated other comprehensive loss into net periodic benefit costs over the next fiscal year are \$496, \$(277) and \$340, respectively.

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
<b>Components of net periodic benefit cost</b>				
Service cost	\$ 22,867	\$ 23,432	\$ 2,181	\$ 2,177
Interest cost	32,619	30,640	4,317	4,263
Expected return on plan assets	(41,704)	(38,563)	(112)	(126)
Amortization of transition liability	–	–	340	340
Amortization of prior service asset	(2,302)	(2,354)	(277)	(277)
Net recognized actuarial loss	<u>1,916</u>	<u>1,633</u>	<u>228</u>	<u>477</u>
Net periodic benefit cost for the year ended December 31	<u>\$ 13,396</u>	<u>\$ 14,788</u>	<u>\$ 6,677</u>	<u>\$ 6,854</u>

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

The weighted-average assumptions used in calculating the benefit obligations for all plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
Discount rate – benefit obligation	5.50%	6.50%	5.75%	6.50%
Discount rate – net benefit cost	6.50%	6.25%	6.50%	6.25%
Expected return on plan assets	8.00% / N/A*	8.50% / N/A*	N/A	N/A
Rate of compensation increase	4.50%	4.50%	N/A	N/A
Annual rate of increase in the per capita cost of covered health care benefits	N/A	N/A	6.00%	6.00%

\* As of December 31, 2009 and 2008, the expected return on plan assets is 8.00% and 8.50%, respectively, for qualified pension benefits and N/A for nonqualified pension benefits. The Company contributes to the nonqualified pension plans as benefits are paid.

The discount rates used to determine the Company's pension and other postretirement plan obligations were based on a Aa yield curve represented by a series of annualized individual discount rates. Each bond issue underlying the yield curve is required to be non-callable and have a rating of Aa or better by Moody's Investor Service, Inc. or a rating of AA or better by Standard & Poor's. The yields are used to discount future pension and postretirement benefit plan cash flows at an interest rate specifically applicable to the timing of each respective cash flow. The sum of these discounted cash flows are totaled into a single present value and an equivalent weighted-average discount rate is calculated by imputing the singular interest rate that equates the total present value of the stream of future cash flows. This resulting interest rate, rounded, is used by the Company as its discount rate.

An important factor in determining the pension expense is the assumption for expected long-term rate of return on plan assets. The Company uses a total portfolio return analysis in the development of its assumption. Factors such as past market performance, the long-term relationship between fixed maturity and equity securities, interest rates, inflation and asset allocations are considered in the assumption. The assumption includes an estimate of the additional return expected from active management of the investment portfolio. Peer data and historical returns are also reviewed for appropriateness of the selected assumption.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

The expected long-term rate of return for the qualified pension plans' total assets is based on the expected return of each of the investment categories, weighted based on the median of the target allocation for each class. The key objective of the pension asset portfolio is to meet the assumed actuarial rate of return while maintaining a diversified asset allocation. Equity securities are expected to return 8% to 12% over the long-term, while cash and fixed maturity securities are expected to return between 4% and 6%. Based on historical experience, the CareFirst, Inc. Retirement Committee (Retirement Committee) expects that the qualified pension plans' active asset managers will provide a modest (0.5% to 1.0% per annum) premium to their respective market benchmark indices.

The Company's pension investment policy, as established by the Retirement Committee, is to provide for growth of capital with a moderate level of volatility by investing assets through adequate asset diversification per the target allocations stated below. Plan assets include a diversified mix of investment grade fixed maturity securities, equity securities and alternatives across a range of sectors and levels of capitalization to maximize the long-term return for a prudent level of risk. The assets are reallocated as needed to meet the target allocations and achieve the target return. The investment policy is reviewed on a quarterly basis, under the advisement of a certified investment advisor, to determine if the policy should be changed. The weighted-average asset allocations by asset category for the qualified pension plans are as follows:

	<b>Target Allocation</b>	<b>December 31, 2009      2008</b>	
Domestic equity securities	30% – 50%	<b>37%</b>	30%
International equity securities	15% – 25%	<b>19</b>	16
Emerging markets equity securities	0% – 10%	<b>7</b>	2
Real estate	0% – 10%	<b>3</b>	6
Fixed maturity securities	25% – 35%	<b>33</b>	24
Cash and cash equivalents	Residual	<b>1</b>	22
Total		<b>100%</b>	100%

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

As shown above, the Company's actual weighted-average asset allocations were not within the target allocations for certain asset categories at December 31, 2008. The Company funded the qualified pension plan in December 2008, but did not invest the cash and cash equivalents prior to December 31, 2008. The assets were reallocated to meet the target asset allocations in the first week of 2009.

The investment policy related to the VEBA provides that the assets in the trust be invested in a "balanced" type of fund that provides diversification reasonably similar to an asset allocation of 60% domestic equity securities and 40% fixed maturity securities.

The fair value of the Company's qualified pension plan assets at December 31, 2009, by asset category are as follows:

Asset Category	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Total Fair Value as of December 31, 2009
Cash and cash equivalents	\$ 9,647	\$ —	\$ —	\$ 9,647
Fixed maturity securities:				
U.S. Treasury and other U.S. government agencies securities	9,034	1,709	—	10,743
State and municipal securities	—	1,768	—	1,768
Corporate fixed maturity securities	—	32,030	—	32,030
Government-sponsored enterprise mortgage-backed securities	—	33,782	—	33,782
Residential mortgage-backed securities	—	1,159	—	1,159
Other asset-backed securities	—	1,077	—	1,077
Equity securities:				
Domestic companies	16,592	—	—	16,592
International companies	43,500	—	—	43,500
Mutual funds (a)	—	96,082	—	96,082
Private equity funds (b)	—	271,372	15,538	286,910
Total assets	\$ 78,773	\$ 438,979	\$ 15,538	\$ 533,290

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

(In Thousands)

#### 9. Retirement Plans and Other Postretirement Benefit Plans (continued)

- (a) This category represents investments in investment grade fixed maturity securities.
- (b) This category includes several common/collective trust funds that invest approximately 62% in domestic equity index funds, 19% in international equity securities, 13% in emerging markets equity securities, and 6% in real estate investment trusts.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

**Cash equivalents.** The carrying value of cash equivalents approximates fair value as maturities are less than three months.

**Fixed maturity securities.** Fixed maturity securities consist of U.S. Treasury and other U.S. government agencies securities, state and municipal securities, corporate fixed maturity securities, mortgage-backed securities and other asset-backed securities. The fair value of U.S. Treasury securities is determined by an active price for an identical security in an observable market and is therefore classified as Level 1. Other U.S. government agencies securities, state and municipal securities, corporate fixed maturity securities, mortgage-backed securities and other asset-backed securities that are priced by independent pricing services using observable inputs are classified as Level 2.

**Equity securities.** Equity securities consist of domestic and international common stocks, which are denominated in U.S. dollars. Common stocks valued at the closing price reported on the exchanges are classified as Level 1.

**Mutual funds.** Mutual funds' net asset value is calculated as of the close of business of the NYSE. The fair value of the mutual funds is the market quoted price but the funds are not considered actively traded; therefore, mutual funds are classified as Level 2.

**Private equity funds.** Private equity funds consist of common/collective trust funds in domestic, international and emerging markets equity securities as well as a real estate investment trust fund. The fair value of the funds where the redemption value of the units of participation (sum of the market value of its underlying investments) is determined by observable inputs on a daily basis is classified as Level 2. The fair value of the real estate investment trust fund is determined by valuation techniques using unobservable inputs, including discounted cash flow analysis, which are classified as Level 3.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The table below sets forth a summary of changes in the fair value of the Company's Level 3 pension plan investments for the year ended December 31, 2009.

	<u>Private Equity Funds*</u>
Beginning balance at January 1, 2009	\$ 24,194
Unrealized losses relating to instruments still held at the reporting date	(9,569)
Purchases, (sales), issuances, and (settlements), net	913
Ending balance at December 31, 2009	<u>\$ 15,538</u>

\* Represent investments in real estate investment trust fund.

*Cash Flows*

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the pension benefit plans and other postretirement benefit plans for the years ending December 31:

	<u>Pension Benefits</u>	<u>Other Postretirement</u>
2010	\$ 65,723	\$ 4,360
2011	41,698	4,643
2012	42,049	4,855
2013	45,440	5,039
2014	45,372	5,234
2015 through 2019	192,227	31,163
	<u>\$ 432,509</u>	<u>\$ 55,294</u>

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued) (In Thousands)

#### **9. Retirement Plans and Other Postretirement Benefit Plans (continued)**

The Company expects to make contributions of \$21,892 and \$4,956, respectively, to the pension benefit plans and other postretirement benefit plans during 2010.

In addition, the Company sponsors 401(k) plans for the benefit of all eligible employees. The Company contributes to certain of these plans and recognized expenses of \$6,736 and \$5,806 for the years ended December 31, 2009 and 2008, respectively.

#### **10. Income Taxes**

The Company files a consolidated federal income tax return. The federal statutory income tax rate for the Company is 35 percent. For federal income tax purposes, the Company benefits from a special deduction available to certain BlueCross and BlueShield organizations under Internal Revenue Code Section 833(b) (the 833(b) deduction). The 833(b) deduction results in the Company incurring federal income taxes at the Tentative Minimum Tax (TMT) rates of 20 percent. As a result, the Company's income tax provision is reduced from the statutory rate of 35 percent to account for the benefit of the 833(b) deduction. The Company could lose the benefit of the 833(b) deduction in the future if there is a change in the tax law, if CFMI and/or GHMSI cease to be not-for-profit, if CFMI's and/or GHMSI's reserves reach certain levels, or if certain other events occur. If the Company can no longer use the 833(b) deduction, the Company will incur federal income taxes at the statutory rate of 35 percent net of available Alternative Minimum Tax (AMT) credits.

CFMI is exempt from Maryland state income tax under Title 10, Subtitle 1, Section 10-104(2) of the Maryland Code and is governed by Title 14, Subtitle 1, Section 14-102 of the Maryland Insurance Code. GHMSI is exempt from all income taxes in the District of Columbia, Maryland and Virginia. Subsidiary operations are subject to the applicable state income taxes.

Provision (benefit) for income taxes includes deferred income taxes resulting primarily from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. In addition, generally, the Company's TMT liability results in AMT credits for future use. AMT credits do not expire under current law. The Company records its deferred tax assets and liabilities at the federal statutory rate of 35 percent. Because the Company anticipates continued benefits of the 833(b) deduction, its net deferred tax assets have been reduced by valuation allowances to the amounts realizable at the TMT rates. Generally, changes to the Company's valuation allowances are accounted for in the Company's

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **10. Income Taxes (continued)**

income tax (benefit) provision. If the Company were to incur federal income taxes at the statutory rate of 35 percent primarily due to the loss of the 833(b) deduction, at such time, the Company will also evaluate the continued need for any existing valuation allowances on its deferred tax assets.

The principal sources of temporary differences include nondeductible accruals, accounts receivable, property and equipment, capitalized software costs, pension and postretirement obligations, medical claims payable, unrealized gains and losses on investments, and AMT credits. The Company experienced significant declines in the value of its investment portfolio during 2008. As a result, the Company recognized losses in its consolidated statement of operations as well as through other comprehensive loss. These losses are not recognized for income tax purposes until the investments are disposed and result in deferred tax assets. For the year ending December 31, 2008, the Company performed additional analysis of its deferred tax assets related to unrealized losses from its investments. The realization of these deferred tax assets was limited by the Company's ability to generate capital gains through sales of securities in an unrealized gain position, holding fixed maturity securities to maturity, or the carry-back of prior year capital gains. Because of these limitations, for the year ending December 31 2008, the Company recorded a valuation allowance of \$12,097 against deferred tax assets arising from OTTI of investments. This valuation allowance was recorded through the Company's tax benefit. The Company also recorded a valuation allowance of \$1,132 related to other deferred tax assets for unrealized losses included in other comprehensive loss at December 31, 2008. The Company experienced significant increases in the value of its investment portfolio during 2009. As a result, there are sufficient unrealized investment gains of adequate amount and character available to support the realizability of its deferred tax assets related to unrealized losses from investments. Accordingly, the Company reversed the valuation allowances recorded through the income tax benefit in the prior year. At December 31, 2009, the Company does not maintain any valuation allowances to offset its gross deferred tax assets related to unrealized losses from its investments.

As of December 31, 2009 and 2008, the Company had deferred tax assets of \$420,902 and \$424,532, (net of valuation allowances of \$278,006 and \$277,456) respectively, and deferred tax liabilities of \$102,885 and \$91,260, respectively. At December 31, 2008 these amounts also include the deferred tax assets and related valuation allowances from investment losses discussed above. A substantial amount of the valuation allowance in 2008 and the entire valuation allowance in 2009 is related to the difference between the 35% statutory rate and the 20% TMT

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)

(In Thousands)

**10. Income Taxes (continued)**

rate. Management has determined, based on the Company's long-term history of operating earnings and its expectations for the future, that income of the Company will more likely than not be sufficient to realize fully any net recorded deferred tax assets.

The provision (benefit) for income taxes consists of the following components:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Current:		
Federal	\$ 12,009	\$ (16,001)
State	1,067	(629)
	<u>13,076</u>	<u>(16,630)</u>
Deferred:		
Federal	1,278	16,350
State	513	(93)
	<u>1,791</u>	<u>16,257</u>
Provision (benefit) for income taxes	<u>\$ 14,867</u>	<u>\$ (373)</u>

The provision (benefit) for income taxes for 2009 and 2008 differs from the statutory rate of 35 percent principally as a result of the 833(b) deduction, changes in tax contingency reserves and changes in the valuation allowance.

In June 2006, the FASB issued guidance on accounting for uncertainty in income taxes. The FASB guidance requires the evaluation of a tax position under a two-step process. The first step requires that the enterprise determine whether it is more likely than not that a tax position will be sustained. The second step is the amount of benefit to be recognized in the financial statements and is determined as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. The cumulative effect of applying the provisions of the guidance shall be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **10. Income Taxes (continued)**

In 2008, the FASB delayed the effective date for the implementation of accounting for uncertainty in income taxes for nonpublic entities. The deferral was granted to allow nonpublic entities more time to implement the guidance on accounting for uncertainty in income taxes and to allow the FASB time to develop implementation guidance for such entities. The Company deferred the implementation of uncertainty in income taxes in accordance with the aforementioned deferral provisions. On September 2, 2009, the FASB issued guidance that provides additional implementation guidance on the accounting for uncertainty in income taxes and eliminates certain disclosure requirements for nonpublic entities. The additional implementation guidance is effective upon the adoption of the FASB guidance on accounting for uncertainty in income taxes for annual financial statements for years beginning after December 15, 2008. Accordingly, the Company adopted the additional implementation guidance and implemented the FASB guidance on accounting for uncertainty in income tax positions effective January 1, 2009 with a favorable adjustment to retained earnings of \$5,509. The Company records interest and penalties on its uncertain tax positions as part of its income tax provision. The Company's total unrecognized tax benefit at December 31, 2009 of \$4,185 includes \$35 interest (net of federal benefit) that was recognized in its consolidated statement of operations. The Company is subject to examination by the Internal Revenue Service and state taxing authorities. In general, the Company's tax years 2008 and forward remain open under the statutes of limitation and subject to examination. The Company does not anticipate any significant changes to its uncertain tax positions within the next 12 months.

CareFirst, Inc. and Affiliates

Notes to Consolidated Financial Statements (continued)  
(In Thousands)

**11. Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss), including the reconciliation of net unrealized holding gains and losses to net unrealized holding gains and losses, net of reclassification adjustments and taxes, the noncredit component of OTTI on investments, and the impact of recording the defined benefit plans adjustments, are as follows:

	<u>Before-Tax Amount</u>	<u>Tax Benefit (Expense)</u>	<u>Net-of-Tax Amount</u>
<b>Year Ended December 31, 2009</b>			
Net unrealized gains and losses arising during the period	\$ 108,041	\$ (24,850)	\$ 83,191
Less reclassification adjustments for net gains and losses realized or recognized in net income	23,606	(6,137)	17,469
Net unrealized gains and losses	84,435	(18,713)	65,722
Noncredit component of OTTI on investments	(6,881)	1,442	(5,439)
Defined benefit plans adjustments	20,128	(4,024)	16,104
Total other comprehensive income	<u>\$ 97,682</u>	<u>\$ (21,295)</u>	<u>\$ 76,387</u>
<b>Year Ended December 31, 2008</b>			
Net unrealized gains and losses arising during the period	\$ (170,423)	\$ 34,525	\$ (135,898)
Less reclassification adjustments for net gains and losses realized or recognized in net income	(50,819)	10,698	(40,121)
Net unrealized gains and losses	(119,604)	23,827	(95,777)
Defined benefit plans adjustments	(152,220)	30,325	(121,895)
Total other comprehensive loss	<u>\$ (271,824)</u>	<u>\$ 54,152</u>	<u>\$ (217,672)</u>

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **12. Commitments and Contingencies**

CFI and its affiliates have employment contracts and other benefit arrangements with certain executives which contain provisions that could trigger the acceleration of certain benefits and/or payment of additional compensation. Such acceleration occurs upon termination of employment without cause or “good reason” as defined in the contract. Additional acceleration occurs if said termination occurs “in connection with a change of control.” Potential incremental payments related to sums owed for a termination in connection with a change of control have not been accrued as of December 31, 2009 or 2008, as the Company believes that the relevant triggering events have not occurred.

In December 2008, the District of Columbia’s City Council Committee on Public Services and Consumer Affairs (D.C. City Council) passed legislation giving the District of Columbia’s Insurance Commissioner (Commissioner) authority to cap GHMSI’s statutory reserves attributable to the District of Columbia and compel the offering of an expanded open enrollment product in the District of Columbia. Pursuant to this law, a hearing was held in September 2009 by the Commissioner to inquire into the appropriateness of GHMSI’s reserve level. A decision is expected by the Commissioner in the first half of 2010.

Various other lawsuits, including class action lawsuits and other claims, occur in the normal course of business and are pending against the Company. The Company records accruals for such matters when a loss is deemed to be probable and estimable. Management, after consultation with legal counsel, is of the opinion that the lawsuits and other claims, when resolved, will not have a material adverse effect on the accompanying consolidated financial statements; however, there can be no assurance in this regard.

In the jurisdictions in which the Company is licensed to conduct business, associations have been created for the purpose, among others, of protecting insured parties under health insurance policies. The Company is contingently liable for assessments in any calendar year, in order to provide any required funds to carry out the power and duties of the associations.

The Company, through CFI, operates under licensing agreements with BCBSA, whereby the Company uses the service marks of BCBSA in the course of its business. The Company files periodic reports with BCBSA.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **12. Commitments and Contingencies (continued)**

CFMI and GHMSI entered into an intercompany agreement that requires CFMI or GHMSI, or their respective subsidiaries, to provide the financial resources necessary to satisfy the respective statutory or regulatory reserve requirements, subject to specific limitations, if either CFMI or GHMSI or their respective subsidiaries fail to meet or maintain their respective statutory or regulatory reserve requirements as required by law, or if such transfer of financial resources is needed to satisfy any other legally enforceable obligation.

During 2008, the Company, through its affiliates (CFMI and GHMSI) made a commitment to fund \$15,000 into the BlueCross BlueShield Venture Fund Limited Partnership. The amount of the unfunded commitment was \$11,748 at December 31, 2009. The Company anticipates that the additional amount will be invested in the limited partnership over the next four years.

The Company's professional liability coverage is on a claims-made basis. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured. The claims-made policy has been renewed through November 1, 2010. The Company also purchased an extended reporting period (ERP) endorsement to ensure that claims made against physicians that were employed by the Company are insured. This ERP for the medical malpractice program covered the period November 2, 2004 through November 1, 2009. Reserves have been established to cover estimated exposure related to this program not covered by the ERP.

The Company has a commitment for a credit facility with a commercial bank under which certain of its affiliates may borrow up to a maximum amount of \$60,000. There have been no draws made on this line of credit during 2009 or 2008.

The Company insures individuals who are qualified Medicare beneficiaries. Medicare law identifies the primary payer and secondary payer of claims when individuals are insured by both the Company and Medicare. Principally as a result of information systems programming errors, the Company incorrectly paid certain claims in years prior to 2009 as the secondary payer rather than as the primary payer. The issues were communicated to the Centers for Medicare and Medicaid Services (CMS) in May 2009. The Company has implemented corrective measures to (1) correctly identify Medicare beneficiaries that should be paid primary and (2) modify information systems to correctly adjudicate claims on behalf of Medicare beneficiaries.

## CareFirst, Inc. and Affiliates

### Notes to Consolidated Financial Statements (continued)

*(In Thousands)*

#### **12. Commitments and Contingencies (continued)**

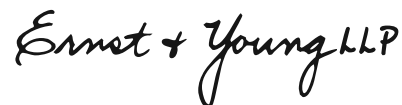
Based on its interpretation of Medicare law, the Company believes it is liable for improperly processed claims for the period from January 1, 2006 to December 31, 2008. CFI has provided CMS with the data of the incorrectly paid claims and offered to settle its obligations to CMS for approximately \$19 million. Accordingly, CFI has recorded a liability of \$19,044 at December 31, 2009 for this proposed settlement. The liability is included in the caption accounts payable and other accrued expenses in the accompanying 2009 consolidated balance sheet. The settlement remains subject to government approval. While there can be no assurances that the settlement will be accepted, or that CMS will accept the Company's legal interpretation that Medicare law limits its liability in this matter to the Company's proposed settlement amount, the Company's management, after consultation with legal counsel, does not believe the final resolution of this matter will result in additional material liabilities to the Company.

# Other Financial Information

## Report of Independent Auditors on Other Financial Information

Board of Directors of CareFirst, Inc.  
Board of Directors of CareFirst of Maryland, Inc.  
Board of Trustees of Group Hospitalization and Medical Services, Inc.

Our audit was conducted for the purpose of forming an opinion on the December 31, 2009 consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis and is not a required part of the December 31, 2009 consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit of the December 31, 2009 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the December 31, 2009 consolidated financial statements taken as a whole.

A handwritten signature in cursive script that reads 'Ernst & Young LLP'.

March 1, 2010

CareFirst, Inc. and Affiliates

Consolidating Balance Sheet  
(In Thousands)

December 31, 2009

	<b>Group Hospitalization</b>					
	<b>CareFirst, Inc.</b>	<b>CareFirst of Maryland, Inc. and Subsidiaries</b>	<b>and Medical Services, Inc. and Subsidiaries</b>	<b>CareFirst BlueChoice, Inc. and Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$ 332	\$ 43,958	\$ 84,154	\$ 81,978	\$ –	\$ 210,422
Short-term investments	–	9,600	18,923	19,481	–	48,004
Advances to providers	–	138,981	34,101	40,498	–	213,580
Accounts receivable, net	–	192,047	289,783	59,828	–	541,658
Due from affiliates, net	–	36,770	182	18,790	(55,742)	–
Interest income receivable	2	2,533	6,475	5,324	–	14,334
Other current assets	–	195,417	527,046	10,926	–	733,389
Deferred tax assets, net	–	8,471	7,333	9,721	–	25,525
Total current assets	334	627,777	967,997	246,546	(55,742)	1,786,912
Long-term investments	135	286,071	775,182	474,915	–	1,536,303
Other invested assets	–	10,338	10,338	–	–	20,676
Property, equipment and capitalized software, net	–	160,746	114,077	–	–	274,823
Investment in affiliates	–	291,387	194,258	–	(485,645)	–
Goodwill	–	12,710	–	17,246	–	29,956
Other assets	–	10,978	19,309	–	–	30,287
Deferred tax assets, net	–	16,046	–	427	(1,987)	14,486
Total assets	\$ 469	\$ 1,416,053	\$ 2,081,161	\$ 739,134	\$ (543,374)	\$ 3,693,443

CareFirst, Inc. and Affiliates

Consolidating Balance Sheet (continued)  
(In Thousands)

December 31, 2009

	<b>CareFirst, Inc.</b>	<b>CareFirst of Maryland, Inc. and Subsidiaries</b>	<b>Group Hospitalization and Medical Services, Inc. and Subsidiaries</b>	<b>CareFirst BlueChoice, Inc. and Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Liabilities and reserves</b>						
Current liabilities:						
Short-term borrowings	\$ —	\$ 76,046	\$ 87,610	\$ 7,705	\$ —	\$ 171,361
Medical claims payable	—	136,670	273,523	135,767	—	545,960
Due to affiliates, net	461	—	42,727	12,554	(55,742)	—
Accounts payable and accrued expenses	—	168,424	127,204	45,802	—	341,430
Unearned revenues	—	32,685	65,648	39,601	—	137,934
Group experience funds and advances	—	288,336	575,557	12,060	—	875,953
Note payable, current portion	—	—	266	—	—	266
Total current liabilities	461	702,161	1,172,535	253,489	(55,742)	2,072,904
Note payable, noncurrent	—	—	296	—	—	296
Deferred taxes, net	—	—	1,987	—	(1,987)	—
Long-term employee benefit obligations	—	73,714	45,105	—	—	118,819
Other liabilities	—	18,651	6,592	—	—	25,243
Total liabilities	461	794,526	1,226,515	253,489	(57,729)	2,217,262
Reserves:						
Retained earnings	—	693,773	921,656	482,396	(482,396)	1,615,429
Accumulated other comprehensive income (loss)	8	(72,246)	(67,010)	3,249	(3,249)	(139,248)
Total reserves	8	621,527	854,646	485,645	(485,645)	1,476,181
Total liabilities and reserves	\$ 469	\$ 1,416,053	\$ 2,081,161	\$ 739,134	\$ (543,374)	\$ 3,693,443

## CareFirst, Inc. and Affiliates

### Consolidating Statement of Operations (In Thousands)

December 31, 2009

	<b>CareFirst, Inc.</b>	<b>CareFirst of Maryland, Inc. and Subsidiaries</b>	<b>Group Hospitalization and Medical Services, Inc. and Subsidiaries</b>	<b>CareFirst BlueChoice, Inc. and Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Premiums earned	\$ —	\$ 1,821,778	\$ 2,875,973	\$ 1,876,782	\$ —	\$ 6,574,533
Amounts attributable to self-funded arrangements	—	2,684,625	1,155,663	—	—	3,840,288
Less amounts attributable to claims under self-funded arrangements	—	(2,532,259)	(1,085,324)	—	—	(3,617,583)
Other	445	22,351	21,421	115	—	44,332
Net revenue	445	1,996,495	2,967,733	1,876,897	—	6,841,570
Operating expenses:						
Cost of care		1,589,036	2,576,669	1,519,128	—	5,684,833
General and administrative	413	428,471	391,999	331,987	—	1,152,870
Total operating expenses	413	2,017,507	2,968,668	1,851,115	—	6,837,703
Income (loss) from operations	32	(21,012)	(935)	25,782	—	3,867
Investment income, net	(26)	22,100	60,730	40,120	—	122,924
Other than temporary impairment (OTTI) losses on investments:						
Total OTTI losses on investments	—	(9,062)	(12,047)	(4,540)	—	(25,649)
Portion of OTTI losses recognized in other comprehensive loss	—	1,977	4,468	436	—	6,881
OTTI losses on investments recognized in income	—	(7,085)	(7,579)	(4,104)	—	(18,768)
Equity in gain of affiliate	—	27,666	18,444	—	(46,110)	—
Other (loss) income, net	(6)	319	2,195	1,156	—	3,664
Income before (benefit) provision for income taxes	—	21,988	72,855	62,954	(46,110)	111,687
(Benefit) provision for income taxes	—	(6,480)	4,503	16,844	—	14,867
Net income	\$ —	\$ 28,468	\$ 68,352	\$ 46,110	\$ (46,110)	\$ 96,820