CAREFIRST OF MARYLAND, INC.

EXAMINATION: DECEMBER 31, 2009

NAIC NUMBER 47058

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Baltimore, Maryland
March 10, 2011

Honorable Joseph Torti III, Chair
Chairman, NAIC Financial Condition (E) Committee
Superintendent of Insurance
Rhode Island Department of Business Regulation
Insurance Division
1511 Pontiac Avenue, Bldg 69-2
Cranston, RI 02920

Honorable Elizabeth Sammis
Acting Insurance Commissioner
Maryland Insurance Administration
200 St. Paul Place, Suite 2700
Baltimore, Maryland 21202-2272

Dear Sir and Madam:

In compliance with your instructions and in accordance with Section 14-125 of the Insurance Article of the Annotated Code of Maryland, we have examined the financial condition and activities of:

CAREFIRST OF MARYLAND, INC.

(hereinafter called the Company), at its administrative office located at 10455 Mill Run Circle, Owings Mills, Maryland 21117, and the following Report on Examination is submitted.

SCOPE OF EXAMINATION

This examination, covering the period from January 1, 2006 to December 31, 2009, including any material transactions and/or events noted occurring subsequent to December 31, 2009, was conducted by examiners of the Maryland Insurance Administration.

We have also examined the financial condition and activities of the Company's nonprofit health service plan parent, CareFirst, Inc. and two indirect subsidiaries, FirstCare, Inc. and The Dental Network, Inc. covering the same period. The Reports on Examination of these companies will be issued under separate covers.

Our examination was conducted in accordance with examination policies and standards established by the Maryland Insurance Administration and in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition

Examiners Handbook. The Handbook requires that we plan and perform the examination to evaluate the financial condition as well as to identify and evaluate prospective risks of the company. The evaluation is performed by obtaining information about the company, including corporate governance, identifying and assessing inherent risks within the company, and evaluating procedures and controls used to mitigate those risks. An examination also includes assessing significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and Annual Statement Instructions.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The Company was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2006 through 2009. We placed substantial reliance on the audited financial statements for calendar years 2006 through 2008, and consequently performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2009. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2009, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

Our examination included a review to determine the current status of the nine exception conditions commented upon in the preceding Report on Examination dated April 27, 2008, which covered the period from January 1, 2001 to December 31, 2005. We determined that the Company had satisfactorily addressed eight of those exception conditions. The remaining condition, regarding the margins included in its actuarial calculations is repeated in the "Comments and Recommendations" section of this Report under the caption "Claims Unpaid and Unpaid Claims Adjustment Expenses".

SUMMARY OF SIGNIFICANT FINDINGS

Our examination did not disclose any material adverse findings or material adjustments to the Company's 2009 annual statement. However, our examination disclosed an area in which board oversight could be improved which is included in the "Comments and Recommendations" section of this Report, under the caption "Conflicts of Interest". Additionally, as disclosed above in the "Status of Prior Examination Findings" caption of this Report, one of the prior examination findings was still currently unresolved. See additional comments in the "Comments and Recommendations" section of this Report under the caption "Claims Unpaid and Unpaid Claims Adjustment Expenses".

SUBSEQUENT EVENTS

On February 23, 2009, CareFirst, Inc. (CFI) filed a Form D, Prior Notice of a Transaction, with the Maryland Insurance Administration (MIA) and the District of Columbia Department of Insurance, Securities and Banking (DISB), dated February 23, 2009. The purpose of this filing was to provide notice to the MIA and DISB of a proposed reorganization of CareFirst's holding company system. This reorganization would streamline and restructure the ownership of virtually all of the for-profit subsidiaries, including the Company, owned either individually or collectively by the Company and GHMSI.

Under the proposed reorganization, the ownership of the subsidiaries would be transferred by the Company and GHMSI to a newly created intermediary holding company, CareFirst Holdings, LLC (CFH). CFH would be organized as a Maryland limited liability company, with 50.001 percent of its equity owned by the Company and 49.999 percent of its equity owned by GHMSI. In addition to the contributed subsidiaries, CareFirst proposed that GHMSI make an additional cash contribution totaling $39.2 to CFH in order to equalize the fair market values of the assets contributed to CFH by the Company and GHMSI. The intended result would be to consolidate the ownership of the subsidiaries under a single intermediary holding company, and for the Company and GHMSI to have essentially equal ownership interest in that intermediate holding company.

CareFirst made amended Form D filings with the MIA on September 2, 2010 and the DISB on September 29, 2010. The amended filings revised the valuation of one of GHMSI's subsidiaries and increased the cash contribution by GHMSI to CFH from $39.2 million to $45.3 million.

The Maryland Insurance Commissioner approved the proposed reorganization, effective retroactive to January 1, 2010, in her Order in Case No. MIA-2010-09-031, dated September 21, 2010. The District of Columbia Insurance Commissioner approved the reorganization on December 3, 2010.

HISTORY

General:

In 1937, legislation was passed by the Maryland Legislature allowing for the formation of nonprofit health care service plans. On June 18 of that year, twelve Baltimore hospitals formed the Associated Hospital Service of Baltimore, Inc., organized as a nonprofit hospital service plan to cover expenses for hospital care for subscribers. In 1947, the Blue Cross Commission was formed to coordinate uniform benefits and enrollment among all Blue Cross plans nationally. In that same year, the Associated Hospital Service of Baltimore, Inc. became associated with the Blue Cross Commission and changed its name to Maryland Hospital Service, Inc.

In 1948, legislation was passed by the Maryland Legislature allowing for the formation of an entity to provide coverage for payments to physicians not employed by hospitals. In 1950, as a response to this legislation, Maryland Medical Service, Inc. was organized as a nonprofit health service plan to cover charges related to services provided by physicians for people who became subscribers. This entity changed its name in 1969 to Maryland Blue Shield, Inc. and again in 1973 to Blue Shield of Maryland, Inc.

In 1984, the Company was created with the merger of Blue Cross of Maryland, Inc. and Blue Shield of Maryland, Inc. It was organized under the authority of Subtitle 20 of Article 48A of the Annotated Code of Maryland (currently codified as Title 14 of the Insurance Article of the Annotated Code of Maryland) to operate and maintain a nonprofit health service plan. The Company was chartered to provide hospital, medical, dental and other health care at a minimum cost to people who become subscribers. The Company was granted a certificate of authority by the Maryland Insurance Administration on December 21, 1984. The Company had no stockholders, and under Maryland Law and the Company's by-laws, the Company's membership consists of its Board of Directors. The Company's current name, CareFirst of Maryland, Inc. (CFMI) was adopted on January 16, 1998 pursuant to the forming of a business affiliation with Group Hospitalization and Medical Services, Inc. (GHMSI).

CareFirst, Inc. (CFI) was incorporated in Maryland on January 16, 1998, to become a nonprofit health service plan and the holding company parent of the Company and GHMSI as well as becoming the Blue Cross and Blue Shield licensee for the District of Columbia, Maryland and northern Virginia. In 1998 and prior years, GHMSI did business as Blue Cross and Blue Shield of the National Capital Area. In 1999, both the Company and GHMSI began doing business as CareFirst Blue Cross Blue Shield. Although established as the parent entity, CFI holds no investments in these other entities in its statutory annual statement.

On March 22, 2000, CFI entered into a business affiliation with BCBSD, Inc., (BCBSD) which does business as BlueCross BlueShield of Delaware. In June, 2006, the Maryland Insurance Commissioner issued an Approval Order effective May 22, 2006 in response to a request by CFI to terminate the structural relationship with BCBSD and to approve a new contractual relationship with BCBSD, as well as to approve structural changes to the corporate governance structures of the Company, CFI and GHMSI. During 2006, the District of Columbia Department of Insurance, Securities and Banking also approved the above referenced request. However, on August 23, 2006, the Delaware Insurance Commissioner issued an Order rejecting this plan.

In September, 2006, as a result of various legal and regulatory actions, CFI ceased as the sole member of BCBSD, thus effecting the formal structural disaffiliation of BCBSD from CFI, the Company, GHMSI and their subsidiaries. A formal contractual relationship was established subsequent to the disaffiliation whereby administrative services continued to be provided to BCBSD on a fee for service basis.

As previously described in the "Subsequent Events" section of this Report, CareFirst underwent a significant reorganization effective January 1, 2010 in which virtually all of the for-profit subsidiaries owned either individually or collectively by the Company and GHMSI were transferred to a newly created intermediary holding company, CareFirst Holdings, LLC (CFH).

Management:

The following persons were serving as members of the Board of Directors of the Company as of December 31, 2009:

Michael J. Kelly Baltimore, MD	Chairman CareFirst of Maryland, Inc.
Andrea M. Amprey Finksburg, MD	Executive Vice-President and Co-Owner Amprey and Associates
Barbara B. Armstrong Baltimore, MD	President Armstrong Enterprises
Gregory V. Billups Waldorf, MD	President Systems Maintenance & Technology
James A. D'Orta, M.D. Washington, D.C.	Chairman Consumer Health Services, Inc.
Joseph G. Hall Washington, D.C.	Vice-President Goldman Sachs and Co.
Richard N. Kramer Baltimore, MD	Retired
Elizabeth St. J. Loker Royal Oak, MD	Director/Trustee Quality Health Services
Kevin G. Quinn Annapolis, MD	President Wye River Group, Inc.
Margaret S. Schiff University Park, MD	Retired
Loretta L. Schmitzer Arlington, VA	Vice-President, Government Affairs The Boeing Company
James J. Xinis Prince Frederick, MD	President and Chief Executive Officer Calvert Memorial Hospital

The following persons were serving as the Company Officers as of December 31, 2009:

Name	Title(s)
Chester E. Burrell	President and Chief Executive Officer
Jeanne A. Kennedy	Corporate Treasurer and Vice-President
John A. Picciotto	Corporate Secretary, Executive Vice-President and General Counsel
David D. Wolf	Executive Vice-President Medical Systems and Corporate Development
Gregory A. Devou	Executive Vice-President and Chief Marketing Officer
Gregory M. Chaney	Executive Vice-President and Chief Financial Officer
Sharon J. Vecchioni	Executive Vice-President and Chief of Staff

As of December 31, 2009, the Company's Board of Directors had established the following committees:

Audit Committee	Mission Oversight Committee
Joseph G. Hall, Chairman	Andrea M. Amprey, Chairman
Gregory V. Billups	Barbara B. Armstrong
Margaret S. Schiff	James A. D'Orta
	Michael J. Kelly
	Loretta L. Schmitzer

Finance and Investment Committee	Governance and Nominating Committee
Margaret S. Schiff, Chairman	Michael J. Kelly, Chairman
Elizabeth St. J. Loker	Richard N. Kramer
Kevin G. Quinn	Kevin G. Quinn
James J. Xinis	Margaret S. Schiff

Service and Quality Oversight Committee	Executive Committee
Barbara B. Armstrong, Chairman	Michael J. Kelly
Gregory V. Billups	
James A. D'Orta	
Richard N. Kramer	
Loretta L. Schmitzer	

Conflicts of Interest:

Code of Maryland Regulation 31.04.06 requires insurers to have a Board of Directors' resolution or by-law setting forth the Company's policy regarding the disclosure of possible conflicts of interest on the part of its officers, directors or responsible employees. Our examination disclosed that in accordance with this Regulation, the Company has adopted a conflict-of-interest policy.

The Regulation further requires that the Company have its officers, directors and responsible employees annually complete conflict-of-interest questionnaires disclosing any potential conflicts. However, our examination disclosed that the Company did not maintain sufficient records to determine compliance with the Regulation. See additional comments regarding conflicts of interest in the "Comments and Recommendations" section of this Report, under the caption "Conflicts of Interest". During our examination, we did not note any potential conflicts of interest.

Corporate Records**:**

We reviewed the minutes of the meetings of the Board of Directors and the committees for the period under examination. Based on our review, it appeared that the minutes documented the Company's significant transactions and events, and that the directors approved those transactions and events.

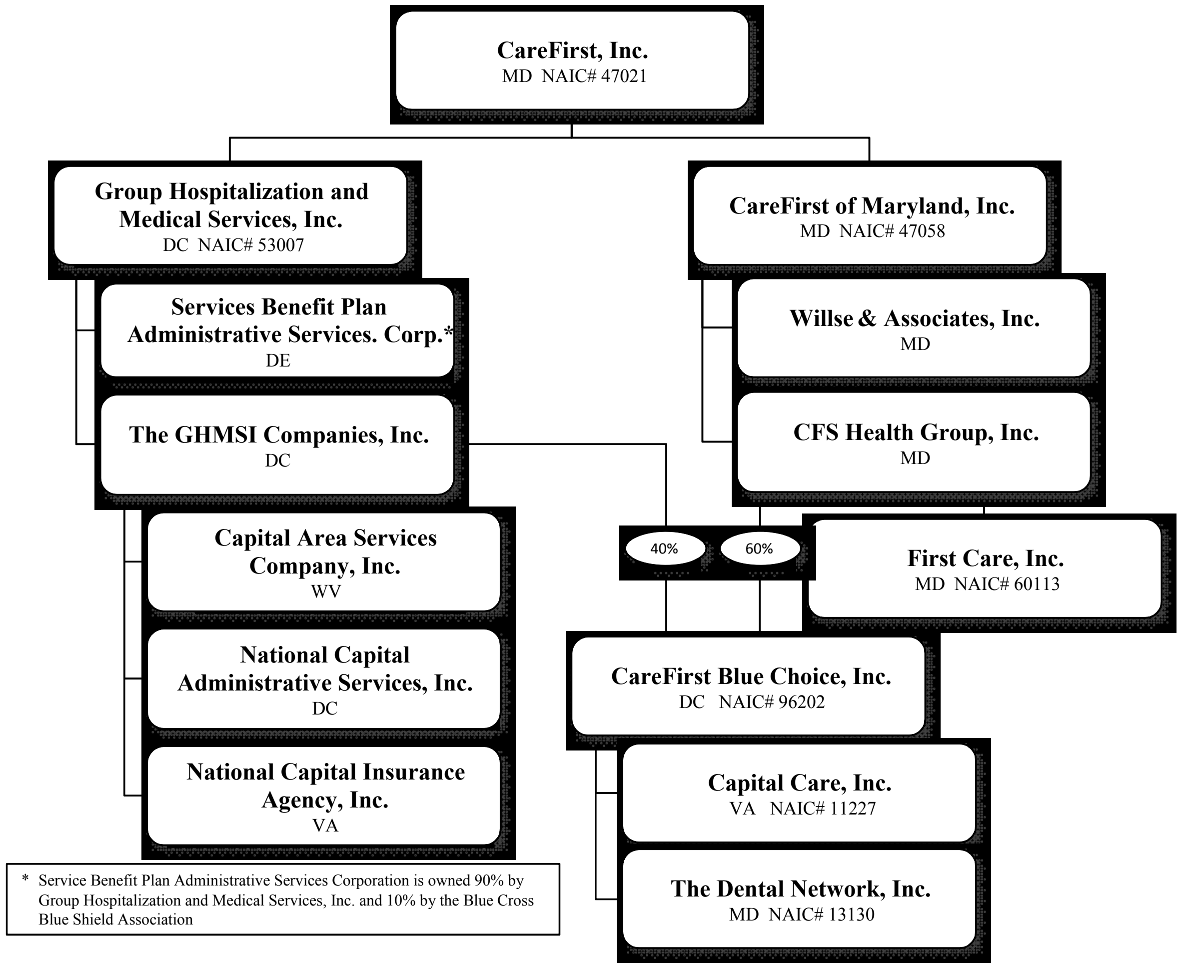
Taxes:

Section 833 of the Internal Revenue Code (the Code) specifically states that BlueCross and BlueShield organizations are subject to federal income taxes as if they were stock insurance companies. Accordingly, the Company was subject to federal income tax under Section 501(m) of the Code.

The Company was exempt from Maryland State income taxes under Section 10-104 of the Tax-General Article of the Annotated Code of Maryland. In addition, the Company was exempt from paying premium taxes under the provisions of Section 6-104 of the Insurance Article of the Annotated Code of Maryland. As prescribed by Section 14-106 of the Insurance Article of the Annotated Code of Maryland, such exception from taxation for nonprofit health service plans is granted so that funds which should otherwise be collected by the State and spent for a public purpose shall be used in a like manner and amount by the nonprofit health service plan.

AFFILIATED COMPANIES

The Company is a nonprofit health service plan that provides a comprehensive array of health insurance and managed care services primarily through indemnity health insurance and health benefit administration, and also has indirect partial ownership/investment in a health maintenance organization (HMO) and other managed care subsidiaries. The Company was controlled by CareFirst, Inc. (CFI), a nonprofit health service plan domiciled in Maryland. The holding company structure as of December 31, 2009 is depicted in the following chart:



INTERCOMPANY AGREEMENTS

In addition to intercompany reinsurance agreements described below under the "Reinsurance" caption of this Report, the Company was a party to the following agreements with affiliates:

Administrative Services Agreement:

The Company and GHMSI provided most services to its parent, CFI, and numerous subsidiaries under the terms of an administrative services agreement that was effective January 1, 2009 and automatically renews on each successive year unless either party terminates with a 180-day advance written notice or another date agreed upon. The agreement provided for the Company and GHMSI to provide certain services, including management information systems, staff and employment services, office space and support services, accounting and finance services, insurance and other services including, but not limited to, claims processing, claims adjudication, sales, legal, human resources and miscellaneous administrative services. In exchange for these services the Company and GHMSI were paid a monthly administration fee in an amount that approximated the actual cost of those services. The fees were based upon direct and indirect costs allocated to CFI and subsidiaries using a cost allocation methodology derived from operating statistics relevant to the types of services performed. The Company and GHMSI were reimbursed an amount based upon direct and indirect costs. Payment for services is due within 30 days of invoicing and in any event no later than the 30th day of the month following the month during which a cost is incurred. Net charges to GHMSI and its subsidiaries for services performed by the Company were $109,170,000 during the year ended December 31, 2009. Total allocations to the subsidiaries and affiliates, excluding GHMSI and its subsidiaries and FirstCare, for all services provided by the Company were $108,769,000 during the year ended December 31, 2009. During 2009, FCI was allocated $3,906,000 in expenses under the terms of this agreement.

Federal Income Tax Allocation Agreement:

Effective January 16, 1998, the Company entered into a federal income tax allocation agreement with CareFirst, Inc. (CFI) and Group Hospitalization and Medical Services, Inc. (GHMSI). This agreement was modified by the “Tax Sharing Agreement” effective March 23, 2000 which added BCBSD, Inc. and its subsidiaries to the agreement. This agreement was again amended effective September 22, 2006 and September 21, 2007 to exclude BCBSD, Inc. from the agreement as a result of the termination of the 2000 Business Affiliation Agreement between CFI and BCBSD, Inc., and to include The Dental Network, Inc., respectively.

The agreement now includes all subsidiaries of both the Company and GHMSI. Each member company has its tax liability computed on a “tax basis” as if it had filed a separate return. The agreement provides that the consolidated tax shall be apportioned among the member companies, based upon the ratio of each member company's separate tax to the total of the member companies' separate taxes. According to the agreement, CFI shall act as the agent for payment of federal and state income tax, the receipt of all federal and state income tax refunds, and dealings with the IRS or other agency of the federal or state government relating to federal or state income tax liability of the affiliated group, for any consolidated tax year.

Financial Support Agreement:

Effective September 21, 2006, the Company, CFI and GHMSI entered into an intercompany agreement which requires that in the event that the capital reserves of the Company, CFI, or GHMSI, or their respective subsidiaries, who are required by law to maintain a statutory or regulatory requirement, fall below their respective statutory, regulatory, or BCBSA requirements, the party with the shortfall shall notify all other parties of the shortfall. The other parties, subject to certain terms, conditions and limitations, shall transfer to the requesting party such financial resources as needed to satisfy the shortfall. In addition to reserve shortfalls, the agreement provides for financial support for other situations including the inability to pay claims and/or other legally enforceable obligations including, but not limited to, creditor demands, judgments and surplus notes. The determination as to whether any of the aforementioned conditions exists shall be made by the Board of Directors of CFI.

Contribution Agreement:

As described above in the "Subsequent Events" section of this Report, CareFirst underwent a significant reorganization effective January 1, 2010 in which virtually all of the for-profit subsidiaries owned either individually or collectively by the Company and GHMSI were transferred to a newly created intermediary holding company, CareFirst Holdings, LLC (CFH). In order to accomplish this reorganization, the Company, GHMSI and the newly created intermediary holding company, CareFirst Holdings, LLC (CFH) entered into a Contribution Agreement in 2009. Under the terms of this agreement, the Company contributed to CFH all of the Company's rights, title and interest in and to the assets of CFS Health Group, LLC, Willse and Associates, LLC, and FirstCare, Inc. as well as 60% of the outstanding stock of CareFirst BlueChoice, Inc. with a combined total net fair market value of $245,400,000.

All of the above agreements and amendments to the agreements were submitted to and approved by the Maryland Insurance Administration.

FIDELITY BOND AND OTHER INSURANCE

The Company was a named insured on a fidelity bond issued to its parent, CareFirst, Inc., which provides coverage in the amount of $5,000,000, with a single loss deductible of $100,000. The coverage exceeded the minimum amount of fidelity bond coverage recommended by the National Association of Insurance Commissioners for CFI and its subsidiaries on a consolidated basis.

In addition, the Company had other insurance policies (e.g., director's and officer's liability, business property, etc.). Based on our review, the Company's insurance coverage for these other risks appears adequate.

PENSION AND INSURANCE PLANS

Pension Benefits:

Prior to December 31, 2002, the Company maintained a noncontributory defined benefit retirement plan, which covered substantially all full-time employees. Effective December 31, 2002, the CFMI plan merged with a qualified noncontributory defined benefit retirement plan sponsored by GHMSI (the GHMSI Plan) to become the CareFirst, Inc. Retirement Plan (the CFI Plan). Although CFI merged the CFMI and GHMSI plans, it has committed to maintain separate record keeping of CFI Plan assets and benefit obligations so that it will comply with certain regulatory restrictions that apply to the Company and GHMSI. Consistent with the standards for multiple employer plan accounting, the Company and GHMSI have accounted for their net pension obligations as if the plans remained separate.

In November, 2007, the Company approved a freeze to the CFI Plan, made effective January 1, 2009; whereby any employee hired on or after January 1, 2009 is no longer eligible to participate in the CFI plan; however, they are offered an enhanced 401K program. The Company contributes to the 401K plan based on a percentage of employee contributions and recognized expenses for this plan totaling $3,959,000 in 2009.

In addition to the CFI Plan, the Company maintains a nonqualified supplemental retirement benefit plan, which covers certain officers. The plan provides for eligible officers to receive additional benefits based principally on years of service and compensation.

Post-Retirement Benefits:

The Company's post-retirement benefit program provided 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 funded post-retirement benefits as benefits were paid. During 2009, the Company made contributions and paid benefits related to the program totaling $2,328,000. The Company reported a $25 million liability as of December 31, 2009 for its unfunded post-retirement benefits.

STATUTORY DEPOSITS

As a not-for-profit health service plan licensed under Title 14 of the Insurance Article, Annotated Code of Maryland, the Company is not subject to trust deposit requirements.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to transact business in the State of Maryland and the District of Columbia.

The Company provided health insurance to individuals and groups through various contracts, including traditional indemnity, preferred provider networks, and point of service arrangements. During 2009, the Company wrote direct premiums totaling approximately $1.48 billion.

Uninsured Plans:

In addition, the Company participated in administrative claims service contracts ("ASC" contracts) with certain groups. Under these arrangements, the groups self-insure the health claims of their employees and the Company provides claims processing services in exchange for an administrative fee. The revenues associated with this business are reported as an offset to general and administrative expenses.

As of December 31, 2009, membership in the Company's non-risk business sector accounted for approximately 73% of the total membership of the Company. The Company recognized consistent growth in its non-risk membership during the examination period, as a percentage of the total membership. It should be noted that the Company has historically recognized significant operating losses in this line of business.

Federal Employees Health Benefit Program:

Service Benefit Plan Administrative Services Corporation, a subsidiary of GHMSI, performs certain administrative functions as the national operations center for the Federal Employee Health and Benefit Program (FEHBP) under its ten-year cost-reimbursement contract, which was effective January 1, 2005, with BlueCross BlueShield Association. The reimbursement of allocable costs under this contract is allocated to GHMSI and the Company. FEHBP reimbursed the Company for costs incurred in connection with this agreement totaling $16,582,000 for the year ended December 31, 2009.

National Account Business:

The Company also participated in the provision of health care benefits to National Accounts generally on a "non-risk" basis. National Accounts were customers that had national operations and contracted with the BlueCross and BlueShield Plan in the state in which they were headquartered (that plan was referred to as the "Control Plan") to have benefits paid across the nation while taking advantage of locally negotiated discounts with provider networks. Plans that contract with Control Plans to provide administrative services to National Accounts are referred to as Servicing Plans. Servicing Plans provide benefit payments outside the Control Plans service area.

Contractual Providers:

The Company arranged under various contractual arrangements for health benefit services to be provided to subscribers or certificate holders.

Institutional Providers:

The Company contracts with numerous types of institutional providers: such as hospitals, ambulatory surgery centers skilled nursing facilities, dialysis, hospice and home healthcare providers. Most hospital providers are reimbursed for services provided to the Company's subscribers based on regulatory rates established by the State of Maryland Health Services Cost Review Commission. Non-hospital institutional providers are reimbursed based on a negotiated fee schedule agreed to by the Company and the provider.

Non-Institutional Providers:

The Company entered into contracts with health care professionals for the procurement of medical services for its subscribers. The health care professionals were physicians and non-physicians included in the network of providers available to the Company's members. The physicians could contract to be participating professional providers, which meant that if they performed medical services to a subscriber, they would be reimbursed the CareFirst allowed benefit. The professionals could also contract to become a participant in the preferred provider network, which meant that they were listed in the directory of preferred providers and the professional provider would be reimbursed the CareFirst Preferred allowed benefit. The third type of contract that the professional could enter into with the Company was the "point of service" contract to become a primary care provider for Maryland Point of Service members. The professional would act as a "gatekeeper" and be reimbursed the CareFirst allowed benefits. The Company used uniform provider agreements. The Company also contracted with dentists to provide dental services to its subscribers.

INSURANCE PRODUCTS AND RELATED PRACTICES

The Maryland Insurance Administration's Life and Health Section's Market Conduct Unit conducted a market conduct examination of the Company covering the period from January 1, 2004 to December 31, 2004. The market conduct Examination Report dated September 25, 2007 addressed denied claims, business practices and had no market conduct related concerns that were relevant to the financial condition of the Company.

During this examination, we did not review the following market conduct-related areas:

Policy Forms
Fair Underwriting Practices
Advertising and Sales Material
Treatment of Policyholders:
- Claims Processing (timeliness)
- Complaints

GROWTH OF COMPANY

The following table illustrates the direct premium written by the Company in relation to its surplus for the four year period ended December 31, 2009:

	2009	2008	2007	2006
Direct Premiums Written	$1,483,291,609	$1,476,030,536	$1,348,718,809	$1,372,460,771
Policyholder surplus	407,902,716	394,250,693	513,479,900	466,648,317
Premium to Surplus	363.6%	374.4%	262.7%	294.1%

Ratio

The decrease in surplus in 2008 was due to a combination of unrealized capital losses and net loss from operations.

LOSS EXPERIENCE

The following table reflects the Company's loss ratio for medical and hospital expenses to premium revenue for the four year period ended December 31, 2009:

	2009	2008	2007	2006
Premium Income	$1,830,328,487	$1,835,266,886	$1,443,202,654	$1,399,482,622
Medical and Hospital Expenses	1,589,293,290	1,629,624,164	1,253,604,345	1,208,053,127
Loss Ratio	86.8%	88.8%	86.8%	86.3%

REINSURANCE

The Company was party to the following reinsurance agreements:

Reinsurance Agreement between FirstCare, Inc., CareFirst of Maryland, Inc., BCBSD, Inc. and Group Hospitalization and Medical Services, Inc.

From January 1, 2006 to December 31, 2008, FirstCare maintained a reinsurance agreement with CareFirst of Maryland, Inc. (CFMI), Group Hospitalization and Medical Services, Inc. (GHMSI) and BCBSD, Inc. (BCBSD) which renewed annually unless terminated prior to renewal. Under the agreement FirstCare's underwriting results were distributed among the three entities based upon the experience of the Company's Medicare enrollees in each reinsuring affiliate's service areas. Effective January 1, 2009, BCBSD opted out of the reinsurance contract with FCI; therefore the business that FCI writes in BCBSD's service area was ceded to CFMI.

Stop Loss Reinsurance Agreement between CareFirst BlueChoice, Inc., CareFirst of Maryland, Inc. and Group Hospitalization and Medical Services, Inc.

The agreement executed January 1, 2009 with CFBC is a guarantee of losses above a specified level without any compensation to CFMI or GHMSI. It serves as a corporate guarantee but was designed to meet stop loss requirements for affiliated HMOs in other states. CFBC self administers the stop loss program. Collected premiums are placed in the Annual Experience Fund by CFBC. This Fund is the source of payment for all claims falling under the stop loss threshold. Those claims in excess of the threshold are calculated as medical claims that exceed 105% of CFBC's Medical Loss Ratio. At this attachment point the reinsurers (CFMI and GHMSI) are liable for all losses. The reinsurers will share the liability based upon their respective ownership percentage in CFBC at the beginning of the calendar year. At the end of the calendar year reinsurance profits are returned to CFBC. Reinsurance profits are defined as amounts remaining in the Annual Experience Fund less $25,000. This $25,000 is paid to the reinsurers in accordance with their respective ownership percentages in CFBC. There is a typical indemnity and hold harmless clause between the parties for any actions alleging injuries out of or related to the acts or omissions with performance under this agreement.

Stop Loss Reinsurance Agreement between CapitalCare, Inc., CareFirst of Maryland, Inc. and Group Hospitalization and Medical Services, Inc.

Under this agreement CFMI and GHMSI are to provide CapitalCare, Inc. (CCI) with Stop Loss Reinsurance Coverage on all claims made by or on behalf of any HMO member in excess of $100,000 during any one-year term. The reinsurers share liability for this coverage based upon their respective ownership percentages in CFBC (CCI's parent) at the beginning of the calendar year. The $100,000 per member liability is net of amounts recovered from other sources, as permitted under applicable law. The agreement commenced on July 1, 2008 and is for one year renewable terms. There is a typical indemnity and hold harmless clause between the parties for any actions alleging injuries out of or related to the acts or omissions with performance under this agreement.

Quota-Share Reinsurance Contract between CareFirst of Maryland, Inc. and Group Hospitalization & Medical Services, Inc.

The purpose of the Cross-Jurisdictional Parity Agreement is to return to GHMSI and CFMI profits derived from business written on contracts outside the Companies' respective service areas (cross-jurisdictional sales). In 2006, the Boards of CFI, CFMI and GHMSI approved redistribution of earnings between them related to these cross-jurisdictional sales. The income or loss from operations from the cross-jurisdictional business is transferred via a quota-share reinsurance contract from the company that earned them to the company in whose service area they were earned. There is a typical indemnity and hold harmless clause between the parties for any actions alleging injuries out of or related to the acts or omissions with performance under this agreement. CFMI and GHMSI received approval from the Maryland Insurance Administration for these earnings redistributions, effective January 1, 2008.

All of the above inter-company reinsurance agreements and amendments to the agreements were submitted to and approved by the Maryland Insurance Administration.

ACCOUNTS AND RECORDS

The Company's general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records.

FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2009, as determined by this examination:

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The accompanying Notes to Financial Statements are an integral part of these Financial Statements.

BALANCE SHEET

ASSETS

	Assets	Nonadmitted Assets	Admitted Assets	Examination Adjustments Increase (Decrease)	Net Admitted Assets Per Examination
Bonds	$ 264,427,030	$	$ 264,427,030	$	$ 264,427,030
Preferred stocks	2,523,035		2,523,035		2,523,035
Common stocks	318,054,949		318,054,949		318,054,949
Cash ($(75,937,271)) and short-term investments ($39,584,046)	(36,353,225)		(36,353,225)		(36,353,225)
Other invested assets	10,671,098	333,333	10,337,765		10,337,765
Subtotals, cash and invested assets	$ 559,322,887	$ 333,333	$ 558,989,554	$ 0	$ 558,989,554
Investment income due and accrued	2,466,500		2,466,500		2,466,500
Uncollected premiums and agents' balances in the course of collection	121,633,564	4,505,502	117,128,062		117,128,062
Other amounts receivable under reinsurance contracts	56,627,573		56,627,573		56,627,573
Amounts receivable relating to uninsured plans	48,966,803	832,999	48,133,804		48,133,804
Current federal and foreign income tax recoverable and interest thereon	12,710,245		12,710,245		12,710,245
Net deferred tax asset	85,475,166	81,075,166	4,400,000		4,400,000
Electronic data processing equipment and software	108,473,475	97,828,625	10,644,850		10,644,850
Furniture and equipment	52,191,001	52,191,001	0		0
Receivables from parent, subsidiaries, and affiliates	36,697,609		36,697,609		36,697,609
Health care ($163,137,435) and other amounts receivable	317,792,131	10,236,924	307,555,207		307,555,207
Aggregate write-ins for other than invested assets	126,875,301	126,875,301	0		0
Totals	$ 1,529,232,255	$ 373,878,851	$ 1,155,353,404	$ 0	$ 1,155,353,404

LIABILITIES, CAPITAL AND SURPLUS

Claims unpaid (less $7,871,294 reinsurance ceded) **(NOTE 1)**	$ 157,166,277
Unpaid claims adjustment expenses **(NOTE 1)**	5,480,789
Aggregate health policy reserves	148,164,688
Premiums received in advance	31,048,021
General expenses due and accrued	179,523,957
Amounts withheld or retained for the account of others	61,726,811
Remittances and items not allocated	8,212,501
Amounts due to parent, subsidiaries and affiliates	36,608
Liability for amounts held under uninsured plans	112,384,295
Aggregate write-ins for other liabilities	43,706,741
Total liabilities	$ 747,450,688
Common capital stock	0
Unassigned funds (surplus)	407,902,716
Surplus as regards policyholders	$ 407,902,716
Total liabilities and surplus	$ 1,155,353,404

STATEMENT OF REVENUE AND EXPENSE

Net premium income (including $0 non-health premium income)	$	1,871,224,679
Change in unearned premium reserves and reserve for rate credits		(47,826,194)
Aggregate write-ins for other health care related revenues		6,930,000
Total revenues	$	1,830,328,485
Hospital and Medical:		
Hospital/medical benefit	$	943,480,154
Other professional services		10,214,952
Outside referrals		15,097,234
Emergency room and out-of-area		32,310,787
Prescription Drugs		270,227,241
Subtotal	$	1,271,330,368
Less:		
Net reinsurance recoveries		(317,962,922)
Total hospital and medical		1,589,293,290
Claims adjustment expenses		63,238,450
General administrative expenses		199,221,755
Total underwriting deductions		1,851,753,495
Net underwriting gain (loss)		(21,425,011)
Net investment income earned		11,719,534
Net investment realized gains(losses)		689,434
Net investment gains (losses)		12,408,968
Aggregate write-ins for other income or expenses		153,137
Net income (loss) after capital gains tax and before all other federal income taxes	$	(8,862,905)
Federal and foreign income taxes incurred		(7,071,859)
Net income (loss)	$	(1,791,046)

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders per examination, December 31, 2005	$	400,658,724
Net income, 2006	$	12,865,572
Change in net unrealized capital gains and (losses)		51,212,970
Change in net deferred income taxes		8,160,608
Change in non-admitted assets		(6,608,944)
Aggregate write-ins for gains or (losses) in surplus		359,387
Change in surplus as regards policyholders, 2006	$	65,989,593
Surplus as regards policyholders, December 31, 2006	$	466,648,317
Net income, 2007	$	32,638,116
Change in net unrealized capital gains and (losses)		42,172,336
Change in net unrealized foreign exchange capital gain or (loss)		243,986
Change in net deferred income taxes		200,551
Change in non-admitted assets		(27,712,080)
Aggregate write-ins for gains or (losses) in surplus		(711,325)
Change in surplus as regards policyholders, 2007	$	46,831,584
Surplus as regards policyholders, December 31, 2007	$	513,479,901
Net loss, 2008	$	(10,046,557)
Change in net unrealized capital gains and (losses)		(3,006,318)
Change in net unrealized foreign exchange capital gain or (loss)		(243,861)
Change in net deferred income taxes		165,950,092
Change in non-admitted assets		(261,898,730)
Aggregate write-ins for gains or (losses) in surplus		(9,983,834)
Change in surplus as regards policyholders, 2008	$	(119,229,208)
Surplus as regards policyholders, December 31, 2008	$	394,250,693
Net loss, 2009	$	(1,791,046)
Change in net unrealized capital gains and (losses)		41,383,399
Change in net deferred income taxes		(119,680,741)
Change in non-admitted assets		83,499,054
Cumulative effect of changes in accounting principles		951,500
Aggregate write-ins for gains or (losses) in surplus		9,289,857
Change in surplus as regards policyholders, 2009	$	13,652,023
Surplus as regards policyholders, December 31, 2009	$	407,902,716

ANALYSIS OF EXAMINATION CHANGES TO SURPLUS

There were no changes to surplus as a result of our examination.

COMPARATIVE FINANCIAL POSITION OF THE COMPANY

The comparative financial position of the Company for the five year period ended December 31, 2009, was as follows:

	2009	2008	2007	2006	2005
Assets	$1,155,353,404	$1,149,945,385	$1,135,066,931	$1,158,194,162	$1,002,143,040
Liabilities	747,450,688	755,694,692	621,587,031	691,545,845	601,484,316
Capital and surplus	407,902,716	394,250,693	513,479,900	466,648,317	400,658,724
Revenue	1,830,328,485	1,835,266,886	1,443,202,654	1,399,482,622	1,382,804,236
Medical and Hospital expenses	1,589,293,290	1,629,624,164	1,253,604,345	1,208,053,127	1,178,153,326
Administrative Expenses	262,460,205	240,179,339	178,898,758	189,421,781	193,136,031
Net income (loss)	(1,791,046)	(10,046,557)	32,638,116	12,865,572	26,200,723

Note: Amounts in the preceding financial statements for the years ended December 31, 2006, 2007 and 2008 were taken from the Company's Annual Statements as filed with the Administration. Amounts for the years ended December 31, 2005 and December 31, 2009 are amounts per examination.

NOTES TO FINANCIAL STATEMENTS

1. The Company reported "Claims unpaid" of $157,166,277 and "Unpaid claims adjustment expenses" of $5,480,789. These amounts represented the actuarially determined value of all claims that had been incurred but still unpaid or incurred but not reported as of December 31, 2009. The methodologies utilized by the Company to compute these amounts and their adequacies as of December 31, 2009 were reviewed by our contracted actuary and were determined to be redundant by a combined total of $12,331,516. This was primarily due to our consulting actuary having an additional 15 months of development to consider at the time of his analysis and due to the Company adding a 9% explicit margin to its estimate of IBNR reserve. For the purposes of our examination, we did not post an adjustment to reflect this redundancy in the financial statements of this Report. However, if an adjustment had been made, the Company's net income/(loss) before taxes would have been increased from ($1,791,047) to $10,540,469 as a result of such adjusting entry.

COMMENTS AND RECOMMENDATIONS

Conflicts of Interest:

Code of Maryland Regulation 31.04.06 (the "Regulation") requires the Company to have a board of directors' resolution or by-law setting forth the Company's policy as to disclosure of possible conflicts of interest on the part of its officers, directors, and responsible employees. The Regulation further requires Company officers, directors and responsible employees to annually complete a questionnaire disclosing possible conflicts of interest, and that the completed and signed questionnaires be readily available for convenient inspection by examiners. However, we were advised by Company management that the Company utilized an electronic conflict-of-interest questionnaire and the electronic responses to these questionnaires were neither saved nor printed. Since the Company failed to maintain the completed questionnaires, we were unable to verify that conflict-of-interest questionnaires were actually completed.

Without completed questionnaires, the board of directors and officers could have conflicts of interest the board is not aware of that may have a negative impact on the Company. **We recommend that the Commissioner order the Company to comply with the aforementioned Regulation. Additionally, we recommend that the Company ensure that completed and signed questionnaires for all directors, officers and responsible employees are maintained on file and are readily available for convenient inspection by examiners.**

Claims Unpaid and Unpaid Claims Adjustment Expenses:

As of December 31, 2009, the Company reported "Claims unpaid" of $157,166,277 and "Unpaid claims adjustment expenses" of $5,480,789. These amounts represented the actuarially determined value of all claims that had been incurred but still unpaid or incurred but not reported as of December 31, 2009. The methodologies utilized by the Company to compute these amounts and their adequacies as of December 31, 2009 were reviewed by our contracted actuary and were determined to be redundant by a combined total of $12,331,516. For the purposes of our examination, we did not post an adjustment to reflect this redundancy in the financial statements of this Report. $4,440,330 or 36% of the redundancy was related to a 9% explicit margin established as a cushion for adverse deviations from expectations. The remaining redundancy related to implicit margin established with in the Company's reserve calculations. A similar condition was commented upon in our preceding Report on Examination where it was noted that the Company had included a 10% explicit margin in its IBNR estimate as of December 31, 2005, and we recommended that the Company consider reducing its explicit margin and monitor its ongoing margin policy by examining its implicit margin in its actuarial calculations. In its response, the Company indicated that it had reduced its explicit margin. **We again recommend that the Company consider further reducing its explicit margin based on hindsight analysis. We also recommend that the Company monitor its ongoing margin policy by examining its implicit margin in its actuarial calculations.**

Additional Comments and Recommendations:

In addition to the above Comments and Recommendations, during our examination, we made a number of other suggestions and recommendations to the Company with regard to record keeping and other procedures relating to its operations.

CONCLUSIONS

The results of our examination disclosed that as of December 31, 2009, the Company had:

Admitted Assets	$ 1,155,353,404
Liabilities	747,450,688
Unassigned surplus	$ 407,902,716
Surplus Notes	0
Total Capital and Surplus	$ 407,902,716
Total Liabilities, Capital and Surplus	$ 1,155,353,404

Based on our examination, the accompanying balance sheet properly presents the statutory financial position of the Company at December 31, 2009, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the Annotated Code of Maryland, the Code of Maryland Regulations and the National Association of Insurance Commissioners.

Section 14-117 of the Insurance Article of the Annotated Code of Maryland specifies the level of capital and surplus required for the Company. We concluded that the Company met the capital and surplus requirements during the period under examination.

SIGNATURES

In addition to the undersigned, the following examiners representing the Maryland Insurance Administration participated in certain phases of this examination:

Billy Bostick, Bostick/Crawford Consulting Group
Richard Buchwald, Maryland Insurance Administration
Leeanne Creevy, RSM McGladry
Cara Fisher, Bostick/Crawford Consulting Group
Phillip McMurray, RSM McGladry
Michael Mayberry, Lewis & Ellis
Vasili Rousseas, Maryland Insurance Administration
Purushotam Shrestha, Maryland Insurance Administration
Abraham Weinschneider, Maryland Insurance Administration

Respectfully submitted,

Original Signature on File

____
Robert F. Crawford, CFE
Examiner-In-Charge
Bostick/Crawford Consulting Group
Representing the Maryland Insurance Administration

Under the Supervision of,

Original Signature on File

____
George P. Hutschenreuter, CFE
Assistant Chief Examiner
Maryland Insurance Administration

MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lt. Governor

MARYLAND
INSURANCE
ADMINISTRATION

ELIZABETH SAMMIS
Acting Commissioner

KAREN STAKEM HORNIG
Deputy Commissioner

NEIL A. MILLER
Associate Commissioner
Examination and Auditing

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www.mdinsurance.state.md.us

May 31, 2011

Mark Chaney
Chief Financial Officer
CareFirst of Maryland, Inc.
10455 Mill Run Circle
Owings Mills, Maryland 21117

Dear Mr. Chaney:

Enclosed is a draft copy of the Report on Examination of the affairs and financial condition of CareFirst of Maryland, Inc., as of December 31, 2009, dated February 25, 2011. Please call our attention to any errors or omissions.

Unless a written request for a Hearing with respect to the Report (in accordance with the provisions of Sections 2-209 and 2-210, Insurance Article of the Annotated Code of Maryland) is received on or before **June 30, 2011** the Report will become final, and will be filed as a public document within this Administration.

All of your comments concerning these matters must be in writing and shall be furnished to this Administration **within thirty (30) days** from the date of this letter **(June 30, 2011). In addition to the hard copy mailed to the Administration, also please send our response electronically in Microsoft Word format to *pgiles@mdinsurance.state.md.us.***

The Report on Examination should be called to the attention of your Board of Directors at its next meeting. Each Director should review the Report and acknowledge such review over his signature. Documentation of such review should be maintained for future verification.

If you have any questions or if you would like to discuss these recommendations, please do not hesitate to call me at 410-468-2129.

Sincerely,

Donald A. Crawley, CPA, CFE
Chief Examiner

William V. Stack
Vice President and
Corporate Controller

CareFirst BlueCross BlueShield
10455 Mill Run Circle
Owings Mills, MD 21117-4208
Tel. 410-998-7011
Fax 410-998-6850
Cellular 410-218-6634
E-mail: bill.stack@carefirst.com

CareFirst BlueCross BlueShield

June 21, 2011

Don Crawley
Chief Financial Examiner
Maryland Insurance Administration
200 St. Paul Place, Suite 2700
Baltimore, Maryland 21202

Dear Mr. Crawley:

We would like to thank you for the opportunity to respond to your financial examination report of CareFirst of Maryland, Inc. (CFMI) as of December 31, 2009. We have responded to certain notes and to all of the comments and recommendations in the report by including the text from the report followed by our comments.

Comments and Recommendations:

CFMI's Response:

Code of Maryland Regulation 31.04.06 (the "Regulation") requires the Company to have a board of directors' resolution or by-law setting forth the Company's policy as to disclosure of possible conflicts of interest on the part of its officers, directors, and responsible employees. The Regulation further requires Company officers, directors and responsible employees to annually complete a questionnaire disclosing possible conflicts of interest, and that the completed and signed questionnaires be readily available for convenient inspection by examiners. However, we were advised by Company management that the Company utilized an electronic conflict-of-interest questionnaire and the electronic responses to these questionnaires were neither saved nor printed. Since the Company failed to maintain the completed questionnaires, we were unable to verify that conflict-of-interest questionnaires were actually completed.

Without completed questionnaires, the board of directors and officers could have conflicts of interest the board is not aware of that may have a negative impact on the Company. *We recommend that the Commissioner order the Company to comply with the aforementioned Regulation. Additionally, we recommend that the Company ensure that completed and signed questionnaires for all directors, officers and responsible employees are maintained on file and are readily available for convenient inspection by examiners.*

CFMI's Response: The Company made significant enhancements to its conflict of interest (COI) process in 2010. The Company acknowledges that the old process did not allow us to retrieve COI Questionnaires when no conflict was disclosed. Under that earlier process, COI Questionnaires were only saved when they disclosed

information pertaining to a potential conflict. The current process allows us to readily store and retrieve all COI Questionnaires for all employees.

Claims Unpaid and Unpaid Claims Adjustment Expenses:

As of December 31, 2009, the Company reported "Claims unpaid" of $157,166,277 and "Unpaid claims adjustment expenses" of $5,480,789. These amounts represented the actuarially determined value of all claims that had been incurred but still unpaid or incurred but not reported as of December 31, 2009. The methodologies utilized by the Company to compute these amounts and their adequacies as of December 31, 2009 were reviewed by our contracted actuary and were determined to be redundant by a combined total of $12,331,516. For the purposes of our examination, we did not post an adjustment to reflect this redundancy in the financial statements of this Report. $4,440,330 or 36% of the redundancy was related to a 9% explicit margin established as a cushion for adverse deviations from expectations. The remaining redundancy related to implicit margin established with in the Company's reserve calculations. A similar condition was commented upon in our preceding Report on Examination where it was noted that the Company had included a 10% explicit margin in its IBNR estimate as of December 31, 2005, and we recommended that the Company consider reducing its explicit margin and monitor its ongoing margin policy by examining its implicit margin in its actuarial calculations. In its response, the Company indicated that it had reduced its explicit margin. *We again recommend that the Company consider further reducing its explicit margin based on hindsight analysis. We also recommend that the Company monitor its ongoing margin policy by examining its implicit margin in its actuarial calculations.*

CFMI's Response: The Company will continue to monitor its ongoing margin policy in light of Health Care Reform Legislation and the Minimum Loss Reserve requirements.

If you have any questions or need additional information, please feel free to contact me at (410) 998-7011.

Sincerely,

William V. Stack
Vice President, Corporate Controller

MARTIN O'MALLEY
Governor

ANTHONY G. BROWN
Lt. Governor

MARYLAND
INSURANCE
ADMINISTRATION

THERESE M. GOLDSMITH
Acting Commissioner

BETH SAMMIS
KAREN STAKEM HORNIG
Deputy Commissioners

NEIL A. MILLER
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June 30, 2011

Mark Chaney
Chief Financial Officer
CareFirst of Maryland, Inc.
10455 Mill Run Circle
Owings Mills, Maryland 21117

Dear Mr. Chaney:

We are in receipt of a letter, dated June 27, 2011, from William V. Stack, Vice President, Corporate Controller, which addresses the corrective action taken by CareFirst of Maryland, Inc., to comply with the recommendations made in the Report on Examination as of December 31, 2009, dated February 25, 2011. The response adequately addresses the recommendations made in the Report.

During our next examination of the Company, we will review the implementation of the corrective actions taken.

As the June 27, 2011 letter did not request a hearing, pursuant to § 2-209 of the Insurance Article, Annotated Code of Maryland, the Report is Final and is attached for your records. The Report will be forwarded electronically, along with a copy of this letter, to the National Association of Insurance Commissioner, and to each State in which the Company is licensed, according to your Annual Statement.

Sincerely,

Neil A. Miller

Neil A. Miller, CPA, CFE
Associate Commissioner