COLORADO DIVISION OF INSURANCE

REPORT OF FINANCIAL EXAMINATION

OF

ROCKY MOUNTAIN HOSPITAL AND MEDICAL SERVICE
700 BROADWAY
DENVER, COLORADO 80273

AS OF

DECEMBER 31, 1998

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Denver, Colorado
August 31, 1999

Honorable William J. Kirven III
Commissioner of Insurance
Division of Insurance
State of Colorado
1560 Broadway, Suite 850
Denver, Colorado 80202

Commissioner:

Pursuant to your instructions and in compliance with the requirements of Section 10-1-201, et. seq., C.R.S., an examination has been made of the financial condition and affairs of:

ROCKY MOUNTAIN HOSPITAL AND MEDICAL SERVICE
700 Broadway
Denver, Colorado 80273

and the report thereon is respectfully submitted.

Rocky Mountain Hospital and Medical Service, hereinafter referred to as the "Company," was last examined as of December 31, 1992. That examination was conducted by the Colorado Division of Insurance with participation from the State of New Mexico. The current examination, as of December 31, 1998, was conducted by the Division of Insurance, State of Colorado.

All comments and recommendations made in the prior report of examination have been adequately addressed with the exception of the following:

Recommendation	Action by Company
It is recommended that the Company comply with its conflict of interest procedures and obtain signed disclosure forms from all directors, officers and key employees annually.	Problem still exists. See “Conflict of Interest” section of this report.
It is recommended that Colorado Blue Cross amend the custodial agreements to comply with Colorado Insurance Regulation 3-1-6.	Problem still exists. See “Accounts and Records” section of this report.

SCOPE OF EXAMINATION

This examination encompasses the period from January 1, 1993 through December 31, 1998. This examination is a continuation of a financial condition examination conducted by the Colorado Division of Insurance (Division) as of December 31, 1997. Pursuant to Section 10-1-205(3)(b), C.R.S. the Commissioner of Insurance ordered that the examination as of December 31, 1997 be reopened for purposes of obtaining additional data, documentation and information on matters including but not limited to operating losses, declines in financial condition and events and transactions subsequent to December 31, 1997.

During the course of examination, all assets were verified and valued and all known liabilities were established at December 31, 1998. Accounting and other pertinent records were reviewed to the extent deemed appropriate. The examination was conducted in accordance with statutory accounting practices and procedures. The work performed was in accordance with the procedures recommended in the Colorado Examiner's Handbook as well as the Examiner's Handbook published by the National Association of Insurance Commissioners (NAIC). External audit reports and related work papers were used on a limited basis. The examination did not address market conduct issues including policy language, policy issuance, policyholder treatment and claims settlement practices. These issues were addressed in a separate market conduct examination completed by the Division.

All phases of the examination were conducted to determine compliance with the insurance laws and regulations of the State of Colorado. Specific details pertaining to the various phases of the examination are set forth under the appropriate caption in subsequent sections of this report.

The Division also conducted concurrent financial condition examinations of the Company's subsidiaries, Rocky Mountain Life Insurance Company and HMO Colorado, Inc., which are also domiciled in Colorado.

HISTORY AND CAPITAL

History

The Company was formed on January 1, 1978 through the consolidation of Colorado Hospital Service, Inc. and Colorado Medical Service, Inc. into a single non-profit hospital, medical-surgical and health service corporation operated under the name of Blue Cross and Blue Shield of Colorado. The name of the Company was changed to Rocky Mountain Hospital and Medical Service effective September 14, 1979. The Company operates under the trade name of Blue Cross and Blue Shield of Colorado. (See “Affiliated Companies” section of this report for additional information concerning corporate activity)

The Company’s Articles of Incorporation stipulate that the business and objectives of the Company are to establish, maintain and operate non-profit hospital and medical service plans whereby hospital care, medical and surgical care and other related health care services shall be provided to persons who become subscribers. The Company is licensed to do business in the State of Colorado as a non-profit hospital and health service corporation pursuant to Section 10-16-301, et. seq., C.R.S.

During the examination period, the Company started the process to convert to a for profit entity in accordance with Section 10-16-324, C.R.S. This conversion process was halted in 1998 when the market for such healthcare stocks became volatile and when the Company’s financial problems, which began in 1997, continued. (See "Subsequent Events" section of this report for additional information concerning the for-profit conversion.)

Capital

The Company is organized as a non-profit hospital, medical-surgical corporation without capital stock.

Dividends to Stockholders

The Company has no stockholders thus no dividends were declared or paid during the examination period.

Surplus Debentures

The Company issued no surplus debentures during the examination period. However, on March 29, 1999, the Company obtained additional funding through the issuance of a $35,000,000 surplus note to Anthem Insurance Companies, Inc. (Anthem). Anthem has committed to provide up to $50,000,000 through the surplus note and the Company expects the final $15,000,000 to be issued in 1999 (see "Subsequent Events"). The surplus note was approved by the Division on March 26, 1999 in accordance with Section 10-3-239, C.R.S.

AFFILIATED COMPANIES

Parent, Subsidiaries and Affiliates

The Company is a member of the Blue Cross and Blue Shield Association (Association), a national organization, incorporated in the State of Illinois. The Association serves the member plans directly by assisting in such activities which will extend the application and principles of prepaid hospital care and medical/surgical care and improve the operation of member plans. To maintain the Blue Cross and Blue Shield trademark the Company must meet certain Association membership requirements which include capital benchmarks. Each plan affiliated with the Association is an independent entity, incorporated in its state of domicile.

The Company and New Mexico Blue Cross and Blue Shield (NMBCBS) jointly own (at 50% each) Rocky Mountain Health Care Corporation (RMHCC), which was incorporated in the State of Delaware in January of 1987. RMHCC was organized to provide management services to both of these companies and their subsidiaries. Effective December 15, 1987, RMHCC also assumed responsibility for the management, control and financial condition of Blue Cross and Blue Shield of Nevada (NVBCBS). RMHCC also provided management services to the Company, NMBCBS, NVBCBS, and all related subsidiaries through December 31, 1996. RMHCC owns two affiliates, Occupational Healthcare Management Services, Inc. (OHMS) and Health Management Systems, Inc. (HMS). OHMS, a Colorado corporation, was organized for the purpose of providing comprehensive claims management services to both public and private entities. HMS, a Colorado corporation, was organized for the purpose of providing comprehensive dental claims management services.

Based upon the 1998 audited financial statement for RMHCC the Company reported an annual statement value of ($792,837) for its 50% ownership in RMHCC. The negative valuation is due to the negative net worth of RMHCC as of December 31, 1998 and the Company’s potential obligation to provide additional funding to RMHCC to cover this deficit.

The Company owns 100% of Rocky Mountain Administrative Services Company, Inc. (RMASC). RMASC, a Delaware corporation, was formed for the purpose of providing administrative services to the Company and its subsidiaries. The Company formed RMASC in December 1996 and capitalized it with $5,000,000. RMASC entered into a Management Agreement with the Company effective January 1, 1997. RMASC entered into similar agreements with the Company’s subsidiaries, HMO Colorado, Inc. (HMOC) and Rocky Mountain Life Insurance Company (RML). RMASC also provides certain administrative services to NMBCBS and its subsidiaries. As of December 31, 1998, RMACS’s unaudited financial statements reported $18,642,000 in assets, $31,842,000 in liabilities and ($13,200,000) in net worth on a GAAP basis. The negative net worth of RMASC was reported in the Company’s financial statement as “Miscellaneous Liabilities”. See “Service and Management Agreements” of this report for additional information regarding the management agreements.

The Company formed Rocky Mountain Holding Company (RMHC) in 1984 to operate as an insurance holding company owning, managing and operating life insurance companies. RMHC directly owned Rocky Mountain Life Insurance Company (RML) until September 10,1998. RML, a Colorado domestic life insurer, reported $31,370,896 in admitted assets, $14,562,282 in liabilities and $16,808,614 capital and surplus in its December 31, 1998 Annual Statement filed with the Division. In turn, RML owns Consolidated Insurance Inc., an inactive New Mexico corporation organized as an insurance agency to market life, accident and health insurance products. The Company liquidated RMHC in 1998 to achieve operational efficiencies and now owns RML directly. RML has been examined concurrently with the Company.

The Company formed General Health Corporation, Inc. (GHC) in 1985 to operate as a holding company owning, managing, and operating companies which are authorized to do business under Title 10 (Insurance) of the Colorado Revised Statutes. GHC directly owned HMO Colorado, Inc. (HMOC) until September 10, 1998. HMOC, a Colorado domestic for-profit health maintenance organization, reported $109,925,575 in admitted assets, $90,598,076 in liabilities and $19,327,499 in net worth in its December 31, 1998 Annual Statement filed with the Division. HMOC also operates in the state of Nevada under the name HMO of Nevada. The Company liquidated GHC in 1998 to achieve operational efficiencies and now owns HMOC directly. HMOC has been examined concurrently with the Company.

The Company also owns other non-insurance companies which have minimal activity. Benefit Administration Services, Inc. (BAS), a Colorado corporation, is a third-party administrator of employee benefit plans. The Company sold the operating assets of BAS in January of 1999. Nevada Group Services (NGS), a Nevada corporation, is an inactive insurance agency. Health Systems Management, Inc. (HSM), a Colorado corporation, a management services company owned by the Company, was liquidated in 1998.

Acquisitions, Mergers or Sales

Effective December 31, 1996, the Company merged with Nevada Blue Cross and Blue Shield (NVBCBS). The merger was approved by both the Colorado Division of Insurance and the Nevada Department of Insurance. The net effect of the merger was an increase to the Company's total reserves and unassigned funds of $12,215,596. The merger effectively canceled the $9,700,000 in surplus notes owed to the Company by NVBCBS. These surplus notes had been previously reported on the Company's financial statements as non-admitted assets. At the date of the merger, NVBCBS owned all of the outstanding stock of Nevada Group Services (NGS). In connection with the merger a contribution of $1.5 million was made to a Nevada non-profit fund.

Effective July 1, 1997, the Company merged with HSI Health Plans, Inc. (HSI). HSI was a Colorado domestic non-profit hospital, medical-surgical and health service corporation. The merger was approved by the Division on July 10, 1997. The merger resulted in a decrease to the Company's unassigned funds of $1,222,315 due to the deficiency in assets to fund HSI's projected losses. At the date of the merger, HSI owned all of the outstanding stock of Benefit Administration Services, Inc. (BAS) and 16.7% of the outstanding stock of Health Systems Management, Inc. (HSM). On July 11, 1997, the Company purchased the remaining 83.3% equity interest in HSM for $1,018,605. HSM was liquidated in 1998.

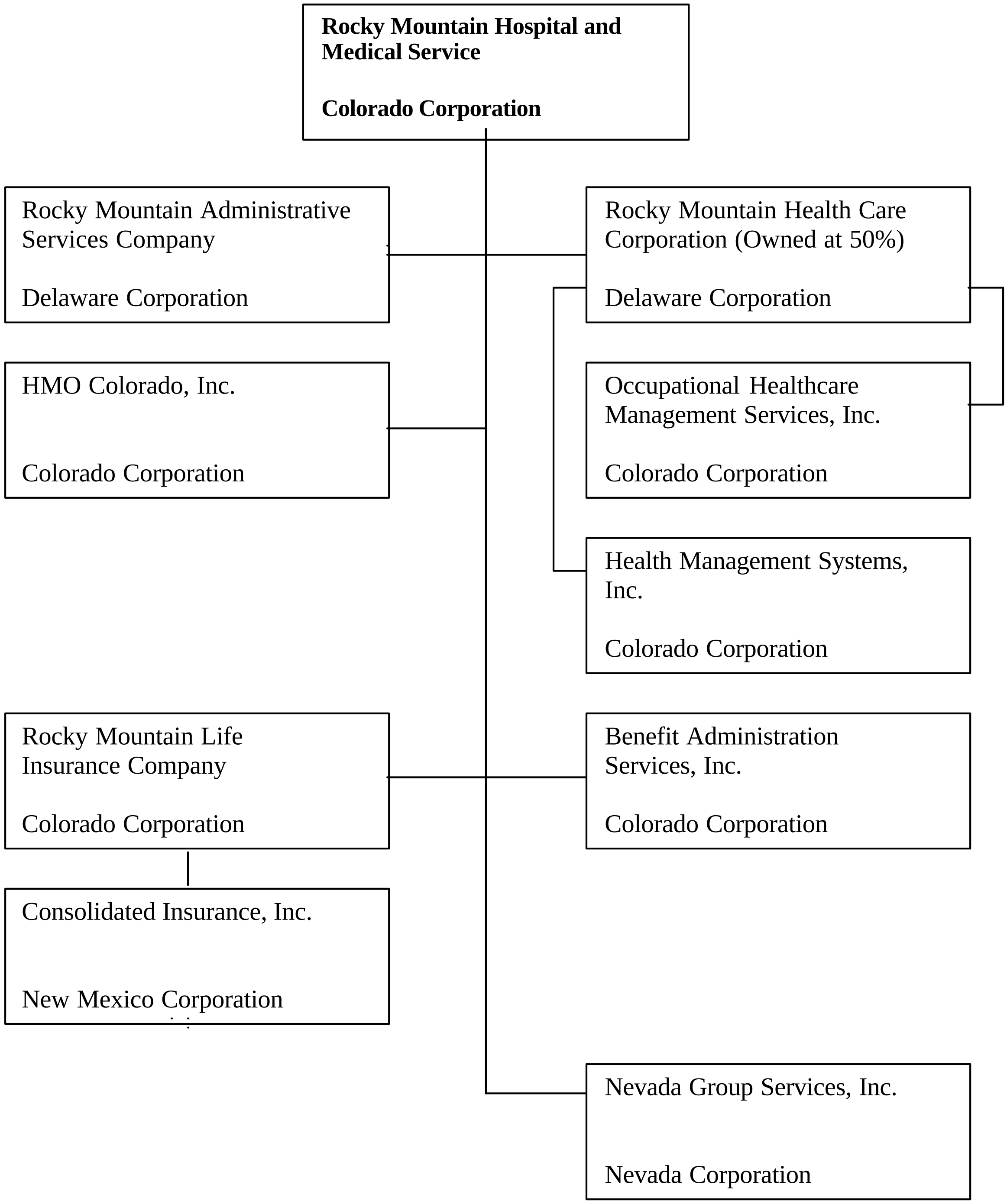
Holding Company Filings

The Company is a member of an insurance holding system and is therefore subject to the registration requirements of Section 10-3-804, C.R.S. and Colorado Insurance Regulation 3-4-1.

The Company filed numerous Form D's during the examination period. A Form D was filed for the proposed management services agreement with the Company's wholly owned subsidiary, Rocky Mountain Administrative Services Company (RMASC) (see "Service and Management Agreements"). The original Form D filing requesting approval of the management services agreement was filed on December 2, 1996. This filing was initially disapproved by the Division in accordance with Section 10-3-805(4), C.R.S. However, the Company began to operate under the terms of the RMASC agreement effective January 1, 1997. The Division became aware of the unauthorized use of the agreement and fined the Company $50,000 for this violation of the holding company act. The management services agreement as amended, was ultimately approved by the Colorado Division of Insurance on July 3, 1997.

The Company became subject to the holding company registration requirements of Section 10-3-804, C.R.S. on July 1, 1992. The Company did not file holding company registration statements for 1992 or 1993. The first holding company registration filing for 1994 dated December 19, 1995 was filed after the due date of April 30, 1995. The annual holding company registration statements and amendments thereto for 1995, 1996, 1997 and 1998 have been filed on a timely basis with the Division. The filings contain the required information pertaining to transactions, relationships and agreements with affiliates.

Organization Chart



Note: Unless otherwise specified, ownership is 100%.

MANAGEMENT AND CONTROL

The By-laws provide that the Board of Directors be vested with all corporate powers and shall control, manage and direct the affairs, funds and property of the Company. The business and affairs of the Company are controlled by a Board of Directors presently consisting of 10 members.

Board of Directors

Pursuant to the By-laws, the Board of Directors shall consist of not less than 10 nor more than 24 Directors. The Board of Directors are elected by the Board of the Company. No person, other than the Chief Executive Officer of the Company, is eligible to serve as a director of the Company while that person is serving at the same time as a director of any insurance entity associated or affiliated with the Company, other than a wholly owned subsidiary of the Company. The terms of the directors are for a period of one, two, or three years and are staggered such that one-third, or as near as possible, of the terms of office shall expire each year. No Director, other than the Chief Executive Officer of the Company or any other officer of the Company shall serve more than four consecutive terms as a director. A majority of the Board of Directors shall be residents of the State of Colorado. In accordance with Section 10-16-305, C.R.S. a majority of the Board of Directors shall consist of persons who are not any of the following:

- Members of the medical or nursing profession;
- Employed by a hospital, clinic, or employed by a corporation subject to the Colorado Health Care Coverage Act and the Non-Profit Hospital, Medical Surgical, and Health Service Corporations Act; or
- Otherwise directly or indirectly connected with hospitals or licensed health care institutions or purveyors of health services in Colorado.

All meetings of the Board of Directors shall be held at the principal office of the Company or at such other place as may be designated in the notice of such meeting. The annual meeting of the Board of Directors shall be held during the first four months of each year at such time as the Board of Directors may determine. The Board shall meet at least four times each calendar year for the transaction of such business as may properly come before the Board. Special meetings of the Board of Directors may be called at any time, for any purpose or purposes, by the Chair of the Board, the Vice Chair or by the Chief Executive Officer. At all meetings of the Board of Directors, a majority of the Directors then in office shall constitute a quorum for the transaction of business by the Board.

During the examination period the Company held six annual meetings, 38 regular meetings, seven special meetings and two Consent to and Record of Action Without a Meeting resolutions in accordance with the By-laws.

Directors serving at December 31, 1998, together with their state of residence and principal business affiliations are presented as follows:

Name	Business Affiliations
B. LaRae Orullian Colorado	Vice Chair of the Board – Guarantee Bank and Trust; Chair of the Board - Frontier Airlines; Chair of the Board – Rocky Mountain Hospital and Medical Service
Charles R. Frederickson Colorado	CEO and Chair of the Board - VICORP Restaurants, Inc.
Dorothy S. Gallagher Nevada	University of Nevada Board of Regents
Margaret S. Hansson Colorado	President and Chief Executive Officer - Adrop, Inc.

Name	Business Affiliations
E. Pete Honnen Colorado	Chief Executive Officer - Honnen Equipment Company
C. David Kikumoto Colorado	President, Chief Executive Officer and Vice Chair of the Board – Rocky Mountain Hospital and Medical Service
Robert L. Manning, Jr. Colorado	Principal – Thoma Cressey Equity Partners
James B. Mulcock, Jr. New Mexico	Consultant – ALCE Enterprises
Reynaldo U. Ortiz Colorado	Self-employed telecommunications consultant
Richard D. Lamm Colorado	Professor, University of Denver – Center for Public Policy and Contemporary Issues

All of the above directors are currently serving on the Board. The Board composition complies with the provisions of Section 10-16-305, C.R.S.

Officers

Pursuant to the By-laws, the officers of the Company shall include the Chair and one or more Vice Chairs of the Board of Directors, a Chief Executive Officer, a President, one or more Vice Presidents who may be Senior or Executive Vice Presidents, a Secretary and a Treasurer. The Board of Directors, by resolution, may create other such offices as may be deemed necessary. Any two or more offices may be held by the same person except that the office of Secretary may not be held by the Chair, Chief Executive Officer or President. The Chair of the Board shall be a member of the Board of Directors and shall be elected annually by the Board of Directors. Vice Chairs of the Board shall be members of and be elected by the Board of Directors annually. The President shall be elected by the Board of Directors annually. The remaining officers shall serve at the pleasure of the Chief Executive Officer.

Officers serving at December 31, 1998, are as follows:

Name	Title
B. LaRae Orullian	Chair of the Board
C. David Kikumoto	President, Chief Executive Officer and Vice-Chair of the Board
Ronald H. Bargatze	Chief Operating Officer and Executive Vice President
Michael E. Huotari	Secretary and Executive Vice President
Mary F. Barber	Assistant Secretary
Kenneth A. Harris	Treasurer

All of the above officers are currently serving.

Committees

Pursuant to the By-laws, there shall be an Audit Committee of the Board of Directors which shall consist of not less than two directors, none of whom may be employed by or be an officer of the Company. No director elected by the Board to serve as Chair or as a member of the Audit Committee shall serve more than three consecutive one-year terms. The Audit Committee shall recommend to the Board of Directors annually who shall be employed as the independent auditor of the Company. During the examination period, the Audit Committee held 31 meetings.

Audit Committee members serving at December 31, 1998 are as follows:

Name	Title
James B. Mulcock, Jr.	Board Member
E. Pete Honnen	Board Member
Richard D. Lamm	Board Member
B. LaRae Orullian	Chair of the Board

Pursuant to the By-laws, the Board of Directors may designate such additional committees as it deems necessary or desirable. The Chair of the Board of Directors shall appoint the members of such additional committees in the manner, for the terms and with such duties as functions as may be prescribed by the Board of Directors. During the examination period the Company had numerous ad hoc committees and standing committees that were not in effect at December 31, 1998. The Company had three additional committees (Compensation, Finance and Board Affairs) that were standing at December 31, 1998.

The Compensation Committee was formed in 1994 for the purpose of providing guidance and monitoring all executive compensation and benefit programs. This committee held 27 meetings during the examination period.

Compensation Committee members serving at December 31, 1998 are as follows:

Name	Title
Dorothy S. Gallagher	Board Member
Reynaldo U. Ortiz	Board Member
B. LaRae Orullian	Chair of the Board

The Finance Committee was formed in 1996 for the purpose of providing assistance to the Board in fulfilling its responsibility related to financial reporting and corporate investment practices. This committee held 11 meetings during the examination period.

Finance Committee members serving at December 31, 1998 are as follows:

Name	Title
Robert L. Manning, Jr.	Board Member
Charles R. Frederickson	Board Member
Margaret S. Hansson	Board Member
C David Kikumoto	President, Chief Executive Officer and Vice-Chair of the Board
B. LaRae Orullian	Chair of the Board

The Board Affairs Committee was formed in 1997 for the purpose of evaluating and recommending Board and committee structures, Board and committee compensation and benefits, and director selection and tenure. This committee held 2 meetings during the examination period. This committee replaced the previously existing Nominating Committee.

Board Affairs Committee members serving at December 31, 1998 are as follows:

Name	Title
Charles R. Frederickson	Board Member
Dorothy S. Gallagher	Board Member
C David Kikumoto	President, Chief Executive Officer and Vice-Chair of the Board
B. LaRae Orullian	Chair of the Board
James B. Mulcock, Jr.	Board Member

Conflict of Interest

The Company has adopted a procedure for the annual disclosure of any material interest or affiliation which might conflict with the respective duties of officers, directors and key employees. However, upon request, the Company was unable to produce all of the conflict of interest statements required for each year covered during the examination period with the exception of 1997 and 1998.

RECOMMENDATION:

No. 1:

It is again recommended that the Company utilize its existing conflict of interest procedure and obtain annual disclosure statements from all key employees, officers and directors.

Service and Management Agreements

Rocky Mountain Health Care Corporation (RMHCC)

From January 1, 1993 through December 31, 1996, the Company was managed by its affiliate, Rocky Mountain Health Care Corporation (RMHCC) under the terms of an administrative services agreement dated January 1, 1987. Under this agreement, RMHCC had the authority and responsibility to conduct, supervise and direct the day-to-day business activities of the Company. These duties included fiscal matters, planning, personnel and operations. A specialized cost accounting system referred to as the Standard National Accounting Program (SNAP) was utilized to calculate reimbursements to RMHCC for the costs incurred in providing services to the Company. The Company paid the allocated costs under this agreement to RMHCC.

Rocky Mountain Administrative Services Company (RMASC)

Effective January 1, 1997, the Company terminated the RMHCC agreement and entered into an agreement with its wholly owned subsidiary, Rocky Mountain Administrative Services Company, Inc. (RMASC). Under this agreement, RMASC has the authority and responsibility to conduct, supervise and direct the day-to-day business activities of the Company. The services to be provided essentially encompass all services required to operate a regulated health insurance provider. In accordance with this agreement, the Company is obligated to pay certain direct costs which are detailed in the agreement.

Additionally, RMASC is reimbursed on a fee basis for the costs of providing services to the Company. The per member per month fee is based upon the category of insurance or service provided to the Company's members. These fees are specified in the agreement and the agreement contains provisions covering future rates to be charged for these services. The rates charged in 1997 follow:

Type of Insurance/Service	January through June of 1997 Rate Per Member Per Month	July through December of 1997 Rate Per Member Per Month
PPO/POS	$12.65	$12.62
FEP	$8.79	$9.98
Service Benefits/Indemnity	$10.98	$10.94
All Other	$11.52	Category not Utilized

In addition to the per member per month fees noted above, the Company was obligated to pay RMASC for administration of the Colorado Medicaid contract. A monthly fee of $725,218 was paid to RMASC for the 1997 calendar year and for a portion of 1998 for this service. The Company is also obligated to pay RMASC a monthly fee of $62,619 for property management services. Fees paid to RMASC in 1997 totaled $47,658,263. Review of the agreement noted that services provided and fees paid were in accordance with the agreement with the exception of certain items. Fees totaling $4,246,505 were charged to the Company by RMASC for administration of the Company's Medicaid business in Nevada. There were no provisions in the agreement to provide for these charges. Also, the product classifications used and the rates charged for the July through December 1997 period were not in accordance with the agreement. The "All Other" category was deleted and the rates were changed for all other product categories without a contract amendment. Thus, the fees paid during that period were not in complete accordance with the agreement. This issue was also noted in 1998.

The Company was managed under the terms of the same management agreement in 1998. The rates charged by RMASC in 1998 were as follows:

Type of Insurance/Service	1998 Rate Per Member Per Month
PPO/POS	$18.45
FEP	Company to pay RMASC $445,035.91 per month for Colorado FEP business and $181,775.33 for Nevada FEP business.
Service Benefits/Indemnity	$16.90
All Other	Category Deleted
Nevada Medicaid	Company to pay RMASC $435,250 per month.

The Company was also obligated to pay RMASC for administration of the Colorado Medicaid contract. A monthly fee of $725,218 was paid to RMASC for a portion of 1998 for this service. Additionally, the Company is obligated to pay RMASC a monthly fee of $62,619 for property management services. Fees paid to RMASC in 1998 relating to this agreement totaled $65,793,686.

Review of the agreement noted that services provided and fees paid were typically in accordance with the agreement. However, four specific exceptions were noted:

- Fees totaling $2,039,947 were charged to the Company by RMASC for administration of the Colorado Children's Health Plan. These fees were based on a rate of $12.62 per member per month. There were no provisions in the agreement to provide for these charges. The expenses relating to this program had been transferred to the Company by its subsidiary, HMO Colorado, Inc., during 1998. No agreement or amendment documented the transfer of this responsibility.

- Review of other fees paid to RMASC noted that the Company paid $915,552 to RMASC for system access fees. The payment of these fees was not provided for in the RMASC agreement.

- Review of other fees paid to RMASC noted that the Company paid RMASC $6,901,785 for additional services provided to the Company. These payments were purportedly made in accordance with the additional service provisions included in the RMASC agreement. Given the material dollar amount and varying nature of these charges it is apparent that the agreement should include specific provisions to address these items.

- Review of the payment transactions associated with the agreement noted that the Company has not been reimbursing RMASC in the manner as prescribed in the agreement. Per the agreement, the Company is to pay RMASC via wire transfer for the administrative fees within the first five days of each month. Actual 1998 transactions noted that the Company has been advancing funds to RMASC in excess of the monthly fees due and recording the amounts in a receivable account. Funds advanced to RMASC are recorded as a receivable and the monthly RMASC fee estimates are recorded into a payable account. Settlement entries between the receivable account and the payable account typically take place each month to clear the prior month's payable balance. However, as the advances have consistently exceeded the fees due, the balance of the receivable from RMASC grew from $1,325,971 at December 31, 1997 to $16,515,799 as of December 31, 1998. The payable account at December 31, 1998 totaled $10,355,326. As of June 30, 1999, this receivable balance has increased to $22,517,124. The corresponding payable account at June 30, 1999 totaled $7,167,891. The total advances made to RMASC were approximately $61 million dollars in 1998. The total advances made to RMASC in 1999 through June 30, 1999 were approximately $51 million dollars. The Company did not report these 1998 transactions in the 1998 Form B filing as required pursuant to Section 10-3-804, C.R.S. In addition, these cash advances were not reported by the Company on Schedule Y of the 1998 Annual Statement.

HMO Colorado, Inc. (HMOC)

The Company jointly markets its "Choice" products with its wholly owned subsidiary, HMO Colorado, Inc. (HMOC). This arrangement is documented in a service agreement dated October 19, 1994. Under this agreement, the Company receives premiums from employer groups on underwritten contracts and remits amounts attributable to HMO coverage to HMOC. The agreement covered both alternately funded groups and underwritten groups. However, at December31, 1998, all active contracts were underwritten. Review of the agreement noted transactions made were in accordance with the agreement.

The Company had an agreement with HMOC effective November 4, 1994 to offer a dual option product to groups desiring health care coverage in the state of Nevada. The agreement was originally between the Nevada Blue Cross and Blue Shield (NVBCBS) and HMOC with the Company becoming a party to the agreement through its merger with NVBCBS effective December 31, 1996. Under this agreement, the Company and HMOC shared profits and losses for the product based upon their respective membership in the dual choice program. The agreement was canceled effective January 1, 1998.

In October 1995, the Company entered into a series of transactions whereby the Company's subsidiary, HMO Colorado, Inc. (HMOC) administers the out-of-network benefit underwritten by the Company that is a rider to HMOC's BlueAdvantage point of service product. The Company assumes the underwriting risk for this rider and pays a service fee of 21.1% of the associated rider premium to HMOC for the administration services performed by HMOC. For 1998, the Company reported fees paid to HMOC of $666,611 and a net gain from the arrangement of $2,080,987. Review of the associated transactions noted that since inception through the end of the examination period, the Company had no executed inter-company agreement with HMOC documenting this arrangement. In addition, these inter-company transactions were not reported by the Company on Schedule Y of the 1995 and 1996 Annual Statements.

Health Management Systems, Inc. (HMS)

The Company entered into an agreement with its affiliate, Health Management Systems, Inc. (HMS) effective January 1, 1996. Under this agreement HMS is to provide administrative services relating to the Company's dental business on a per member fee basis. Review of the related transactions found them to be in compliance with the agreement. Fees paid to HMS for 1998 totaled $1,686,113. However, it was noted the 1998 Schedule Y reported these fees paid as being $1,808,463 which was in error. These inter-company transactions were not reported by the Company on Schedule Y of the 1996 Annual Statement. In addition, it was noted that the Company failed to report these inter-company transactions on the 1997 Form B filing pursuant to Section 10-3-804, C.R.S. The fees paid by the Company that year exceed the threshold of the Form B filing requirements.

Tax Allocation Agreement

Effective January 1, 1987, the Company entered into an income tax allocation agreement with its subsidiaries HMO Colorado Inc. and Rocky Mountain Life Insurance Company. For those taxable years in which each member of the consolidated group generates taxable income, the consolidated tax liability will be allocated among the members of the consolidated group in the ratio that each member's separate return tax liability for the year bears to the sum of the separate return tax liabilities of the members of the group. For this purpose, the separate return tax liability of a member is its tax liability computed as if it had filed a separate income tax return, subject to certain adjustments for inter-company sales of assets and inter-company dividends paid. Review of the Company's inter-company tax settlements found them to be in compliance with the agreement.

RECOMMENDATIONS:

No. 2:

It is recommended that the Company comply with the provisions of its inter-company service agreement with RMASC.

No. 3:

It is recommended that the Company comply with the Form B inter-company reporting requirements of Section 10-3-804, C.R.S.

No. 4:

It is recommended that the Company report inter-company transactions on Schedule Y in compliance with the NAIC Annual Statement Instructions for Hospital, Medical and Dental Service or Indemnity Corporations.

No. 5:

It is recommended that the Company ensure that it has executed agreements covering all inter-company arrangements.

CORPORATE RECORDS

The Articles of Incorporation, By-Laws and amendments thereto, as well as the minutes of the meetings of the board of directors and committees were reviewed for the period under examination.

The Articles of Incorporation were amended once during the examination period. This amendment, dated February 24, 1994, further defined the membership criteria of the Board of Directors.

The By-laws were amended and restated on February 23, 1994. Substantial re-writes and updates of the By-laws were made at that time. The By-laws were also amended on February 26, 1997. These amendments made minor changes to the section of the By-laws covering the election, appointment and term of office for officers and made a change to the section concerning the audit committee. The By-laws were also amended on December 18, 1997 eliminating the required appointment of a Nominating Committee. The Company replaced the Nominating Committee with a Board Affairs Committee which was to commence service on January 1, 1998.

Review of the investment authorization process utilized by the Company during the examination period found that it was in compliance with Section 10-3-234, C.R.S.

FIDELITY BOND AND OTHER INSURANCE

The Company maintains fidelity coverage by means of a Financial Institution Bond, Standard Form Number 25. The bond provides fidelity protection in an amount of $1,000,000 for a single loss with a $25,000 deductible against loss resulting from theft, forgery or alteration. The aggregate liability of the policy is $2,000,000. The limits of coverage in the current bond meet the minimum amount of fidelity bond insurance required by Colorado Insurance Regulation 3-1-1. This bond includes the required notice of cancellation to the Colorado Insurance Commissioner in the event of cancellation and the “Colorado Rider” regarding definition of employees.

The Company maintains Directors and Officers coverage under surplus lines policies from two authorized surplus lines companies. The Company also maintains Errors and Omissions coverage under surplus lines policies from two authorized surplus lines companies. The policies are issued in the Company's name but are arranged for and paid by the Company's affiliate, Rocky Mountain Administrative Services Company (RMASC). The Company's other affiliates are also named insureds on these policies. RMASC allocates the related insurance expenses to the covered entities.

The Company has additional insurance protection relating to its business operations including property, general liability, business automobile and umbrella liability. The policies are issued in the Company's name but are arranged for and paid by the Company's affiliate, RMASC. The Company's other affiliates are also named insureds on these policies. RMASC allocates the premium expense of the property coverage back to the Company but retains the expense for other coverages.

Through December 31, 1996, the Company was self insured for workers' compensation insurance. Effective with the January 1, 1997 conversion of the Company's employees to employees of RMASC (See Employees' and Agents' Welfare and Pension Plans), the Company ceased its risk for new claims.

All contracts evidencing coverage pertaining to hazards summarized above were found to be in force and written by companies authorized to conduct business in Colorado.

EMPLOYEES' AND AGENT'S' WELFARE AND PENSION PLANS

From January 1, 1993 to December 31, 1996 the Company had its own employees and provided them with compensation and benefits. Compensation included salary and incentive plans. Benefits included health, dental and life insurance along with a 401(k) plan and a pension plan. Effective January 1, 1997, all of the Company's employees were converted to employees of Rocky Mountain Administrative Services Company (RMASC), a subsidiary of the Company. Various employee benefit liabilities totaling $5.7 million were also transferred to RMASC at this time. Effective January 1, 1997 the Company was provided management services by RMASC which was compensated in accordance with a fee schedule contained in the management services agreement (see "Service and Management Agreements"). RMASC presently provides all compensation and benefits to its employees who provide services to the Company.

TERRITORY AND PLAN OF OPERATIONS

Territory

The Company is licensed to transact the business of a nonprofit hospital, medical, surgical and health service plan in the states of Colorado and Nevada. The Company also participates in the Inter-Plan Service Benefit Bank through the Blue Cross and Blue Shield Association, which provides service benefits to enrollees hospitalized in a member hospital of another plan.

Six district sales offices are located throughout the states of Colorado and Nevada. These offices also provide customer service functions for group contract administrators.

Plan of Operations

The Company markets its health products to both individuals and employer groups on a statewide basis. The Company uses a combination of internal sales representatives and an external broker distribution channel to market its products. The Company pays brokers a commission on their in-force business. Internal sales representatives have responsibility for their direct business clients as well as external brokers in their geographic region.

The Company contracts with various providers for health care services offered under its benefit plans. These providers are reimbursed on a fee for service basis.

The Company also participates in a line of business denoted as “National Accounts”. This business consists of a Control Plan, a Participating Plan and an Equalization Agreement. This program was established by the national Blue Cross and Blue Shield Association to provide business and governmental agencies that operate in more than one state the ability to deal with one plan when negotiating contracts, rates and settlements of claims. A control plan is the plan located where the policy is written. The control plan maintains the accounting records, accounts to the various participating plans and develops the rates charged to the groups. A participating plan is the plan located where other employees of the group live. It provides the services and settlements of claims of policyholders in that location. The contracts between the control and participating plans generally call for an equalization fund. All receipts received from the National Accounts are deposited into the equalization fund. Should the claims incurred be greater or less than the fund, the individual control and participating plans will be assessed or rebated accordingly. As of the date of this report, the Company is the control plan for 3 groups and is a participating plan for approximately two thousand groups. The National Accounts business accounted for approximately 2% of the Company’s net written premiums in 1998.

The Company also functions as an administrator for various private, state and federal self insurance plans. The Company is reimbursed for certain administrative costs and for payments made on behalf of the beneficiaries of these programs. The recording of these types of plans varies. The claims paid and reimbursements received for the Federal Employees Program are recorded as if they were direct insured business per the NAIC Annual Statement Instructions. The Federal Employees Program business was approximately 57% of the net written premiums in 1998. The NAIC Annual Statement Instructions direct that the net claims and reimbursements of the other self insured plans be reported in the Underwriting and Investment Expense Exhibit as a contra expense. The Company provides stop-loss coverage to some of these groups. The stop-loss coverage is reported as underwritten business.

A summary of the Company’s earned premiums by line of business follows:

Line of Business	Premiums Earned
Comprehensive (Hospital and Medical)	$33,032,350
Medical only	34,197,193
Medical Supplemental	24,786,137
Dental	8,709,966
Federal Employee Health Benefit Plans	133,867,736
	$234,593,382

GROWTH OF COMPANY

The growth and progress of the Company for selected years is presented in the following schedule:

Year	Admitted Assets	Liabilities	Statutory Reserves	Special and Unassigned Funds
1992	$152,328,062	$63,539,796	$3,905,579	$84,882,687
1993	190,201,731	77,879,621	2,361,209	109,960,901
1994	198,042,538	80,450,222	2,173,712	115,418,604
1995	204,811,755	70,144,564	2,140,527	132,526,664
1996	225,460,668	77,299,540	2,337,222	145,823,906
1997	210,000,724	113,311,935	2,503,900	94,184,889
1998	145,476,334	121,841,515	2,542,275	21,092,544

The above amounts were extracted from filed annual statements. The 1992 and 1998 figures were determined as a result of examination.

Note: The decrease in special and unassigned funds in 1997 and 1998 was attributed to significant losses incurred by the Company and its subsidiary HMOC as well as the Company's investment in information systems which are non-admitted for statutory reporting purposes. Please refer to the "Summary" section of this report for additional information.

Enrollment and annual premium for selected years is shown in the following schedule:

Year	Type Contract	Number of Contracts	Number of Participants	Annual Premium
1993	Medical	79,940	146,816	$115,460,838
1993	Hospital	60,645	127,521	90,407,440
1993	Dental	53,262	116,624	11,266,565
Total				$217,134,843
1994	Medical	76,954	140,503	$107,123,571
1994	Hospital	58,503	122,052	84,800,925
1994	Dental	42,308	93,702	7,806,974
Total				$199,731,470
1995	Medical	69,521	124,247	$106,097,050
1995	Hospital	52,119	106,845	83,746,017
1995	Dental	40,069	90,731	7,187,398
Total				$197,030,465
1996	Medical	76,794	138,286	$112,049,642
1996	Hospital	58,823	120,315	86,648,697
1996	Dental	51,906	112,897	7,971,951
Total				$206,670,290

Year	Type Contract	Number of Contracts	Number of Participants	Annual Premium
1997	Medical	97,023	154,226	$121,222,154
1997	Hospital	80,537	137,740	102,288,753
1997	Dental	56,606	107,577	10,459,273
Total				$233,970,180
1998	Medical	116,482	165,120	$124,116,219
1998	Hospital	100,006	143,301	100,280,811
1998	Dental	61,842	109,444	10,196,352
Total				$234,593,382

Amounts reported in the above exhibits were extracted from the filed annual statements. These amounts include FEP and National Accounts business.

PREMIUMS BY STATE

Premium collected for 1998 by state is presented in the following schedule:

State	Direct Premiums Written
Colorado	$197,419,638
Nevada	66,628,611
Total Direct Business	$264,048,249
Plus: Reinsurance Assumed	0
Total All Business	$264,048,249
Less: Reinsurance Ceded	29,454,867
Total All Business Less Reinsurance Ceded	$234,593,382

Premium is allocated based on the state of residence of the insured.

LOSS AND UNDERWRITING EXPERIENCE

The ratio of losses and expenses incurred to premiums earned for selected years is as follows:

Year	Premiums Earned	Benefits Incurred	Loss Ratio	Expenses Incurred	Expense Ratio	Loss and Expense Ratio
1993	$217,134,843	$164,661,314	75.84%	$44,861,916	20.66%	96.50%
1994	199,731,470	161,788,792	81.01%	40,352,653	20.21%	101.21%
1995	197,030,465	152,186,210	77.24%	40,039,063	20.33%	97.57%
1996	206,670,290	170,186,446	82.35%	40,870,236	19.78%	102.13%
1997	233,970,180	201,939,338	86.31%	39,011,906	16.68%	102.99%
1998	234,593,382	203,857,085	86.90%	59,072,978	25.19%	112.09%

Amounts reported in the above exhibits were extracted from the filed annual statements.

The increase in 1998 expenses was primarily due to increased fees charged by Rocky Mountain Administrative Services Company (RMASC) for management services.

REINSURANCE

Ceded

The Company entered into a 90% quota share reinsurance agreement with BCS Insurance Company (BCS) effective September 1, 1984 to cover the Company's liability for organ transplant procedures for policies sold in Colorado. The business reinsured is experience/merit rated at time of purchase by groups which could add this rider to their contracts with the Company. A review of the above agreement finds that it did not contain the "Colorado Law Clause" and the "Entire Law Clause" required by Colorado Insurance Regulation 3-3-2(VII)(A)(6) and (A)(7), for the allowance of reinsurance reserve credits under the agreement. The Company had claimed credit for paid loss recoverables relating to this agreement. However, due to the immaterial amount of the reserve credits claimed, no financial adjustment was warranted for this report.

The Company has a similar agreement with BCS Insurance Company to cover the Company's liability for organ transplant procedures for policies sold in Nevada. This agreement had been entered into by Blue Cross and Blue Shield of Nevada (prior to its merger with the Company) effective January 1, 1994. A review of the above agreement finds that it did not contain the "Colorado Law Clause" and the "Entire Law Clause" which is required by Colorado Insurance Regulation 3-3-2(VII)(A)(6) and (A)(7) for the allowance of reinsurance reserve credits under the agreement. The Company did not claim any reinsurance reserve credits relating to this agreement. The agreement designates the Company's affiliate, Rocky Mountain Hospital and Medical Service (RMHCC) as the reinsurance intermediary. RMHCC is not a licensed reinsurance intermediary in Colorado as required by Section 10-2-903(1), C.R.S. Likewise, review of the intermediary agreement notes that it did not meet the requirements of Section 10-2-904, C.R.S.

In 1998 the Company ceded $831,976 of premiums under the two BCS reinsurance agreements described above.

The Company also entered into an excess of loss reinsurance agreement effective January 1, 1995 with ReliaStar Life Insurance Company (ReliaStar). The Company's affiliate, HMO Colorado, Inc. (HMOC), is also a party to this agreement. The Company, and HMOC, cede 100% of the net excess liability which may accrue during an agreement year as a result of loss or injury by any one insured/member arising out of covered claims for sickness or injury covered by the various plans. The Company's annual retention per individual is $500,000 with ReliaStar providing an annual recovery limit of $500,000. The agreement contains a provision for annual experience refunds and the Company reported a related recoverable of $254,246 under the agreement. However, since this experience rating refund is contingent on future experience, it should have been non-admitted in the statutory financial statements. However, due to the immaterial amount involved, no examination change was warranted. The agreement was amended effective July 11, 1997, to cover HMO business originally written by HSI Health Plan, Inc. (HSI), prior to that entity's merger with the Company. The Company's annual retention for that business is $250,000 per individual with ReliaStar providing an annual recovery limit of $1,750,000.

The Company entered into a second excess of loss reinsurance agreement with ReliaStar effective January 1, 1995. The Company cedes 100% of the net excess liability which may accrue during an agreement year as a result of loss or injury by any one insured/member arising out of covered claims for sickness or injury. The Company's annual retention per individual is $1,000,000 with ReliaStar providing an annual recovery limit of $1,000,000.

At different times during the examination period, the ReliaStar agreement was administered by different reinsurance intermediaries. These reinsurance intermediaries were licensed in Colorado. However, the Company did not maintain reinsurance intermediary agreements with these entities as required by Section 10-2-904, C.R.S.

In 1998 the Company ceded a total of $1,265,180 of premiums under the two ReliaStar reinsurance agreements described above.

Effective July 1, 1998 through December 31, 1998, the Company entered into an automatic excess of loss agreement with The Cologne Life Reinsurance Company (Cologne). The Company's subsidiary, HMOC is also a party to this agreement. The Company cedes 100% of the net excess liability which may accrue during the agreement period as a result of loss or injury by any one insured/member arising out of covered claims for sickness or injury covered by the various plans. The Company's annual retention per individual is $6,500 with Cologne providing an annual recovery limit of $493,500 per individual. The agreement also provides catastrophe reinsurance coverage with an annual treaty loss limit of 20% of reinsurance premiums paid per treaty year period. The agreement contains a provision for ceding commissions and annual experience refunds which limit the reinsurers profits. Due to its declining financial position, the Company needed to take measures to reduce the benchmark requirements imposed by the Blue Cross and Blue Shield Association. The purpose of this agreement was to reduce premium reported for 1998 in order to reduce the capital benchmarks applied to premium. A total fee of $296,197 was actually submitted to the reinsurer as settlement of the 1998 treaty year. The Company's reported premium was reduced by $27,357,711 for the premium ceded under this agreement.

RECOMMENDATIONS:

No. 6:

It is recommended that the Company ensure that all reinsurance agreements comply with the required provisions of Colorado Insurance Regulation 3-3-2 if related reserve credits are to be claimed in its financial statements.

No. 7:

It is recommended that the Company comply with the requirements of Section 10-2-903(1), C.R.S. and Section 10-2-904, C.R.S. concerning the use of reinsurance intermediaries.

RECOMMENDATION:

No. 8:

It is recommended that the Company comply with the reporting requirements of the NAIC Accounting and Practices and Procedures Manual and non-admit those reinsurance experience rating refunds which are subject to change due to future experience.

Assumed

During the examination period, the Company assumed no reinsurance.

STATUTORY AND SPECIAL DEPOSITS

In compliance with statutory and other special requirements the Company maintained the following deposits as of December 31, 1998:

Special Deposits:

Location	Type of Security	Par Value	Statement Value	Market Value
Colorado –Blue Cross and Blue Shield Association Parental Guarantee Requirement	Various Corporate and Governmental Bonds	$29,728,602	$30,257,408	$30,511,800
Totals		$29,728,602	$30,257,408	$30,511,800

The above deposit was required to meet certain standards of the Blue Cross and Blue Shield Association (Association). The deposit was placed to satisfy the Subscriber Protection Requirements of the Association's Financial Responsibility Membership Standard in order for the Company to maintain the Association's trade name and mark. These funds are available to pay subscriber claims.

All Other Deposits:
(Held for the protection of all policyholders)

Location	Type of Security	Par Value	Statement Value	Market Value
Colorado	U.S. Treasury Note	$1,700,000	$1,751,535	$1,870,000
Totals		$1,700,000	$1,751,535	$1,870,000

The deposit held by the State of Colorado complies with the provisions of Sections 10-3- 206, 210 and 211 and Section 10-16-310, C.R.S.

ACCOUNTS AND RECORDS

The accounts and records of the Company are generated and maintained through an electronic data processing system. The system generates a general ledger, cash receipts and disbursements information, as well as subsidiary records common to the health insurance industry.

A trial balance was extracted from the general ledger for the year ending December 31, 1998, and traced to the appropriate assets, liabilities, income and expense exhibits of the annual statement. The Company's trial balances for 1993 through 1997 were also reviewed and the asset and liability amounts traced to the respective annual statements. A review of income and disbursements and other postings to the general ledger was made for selected periods under examination. Test checks of postings from original documents to the general ledger revealed no material differences.

The Company is audited annually by a firm of independent certified public accountants in accordance with Colorado Insurance Regulation 3-1-3. The work papers of this firm were made available to the examiners for use in the examination. These work papers were utilized for this examination on a limited basis. The Company filed actuarial opinions for the period under review as required by Colorado Insurance Regulation 3-1-8.

The Company’s safekeeping agreements were reviewed for compliance with Colorado Insurance Regulation 3-1-6(IV). The trust accounts under which the Company securities are held do not have complying safekeeping agreements. The safekeeping agreement for the Company's statutory deposit does not comply with Colorado Insurance Regulation 3-1-6(IV)(B)(10) regarding disclosure (in the custodial agreement) of insurance coverage maintained by the custodian in compliance with bank regulatory requirements. The safekeeping agreement for securities held by another custodian does not comply with 9 of the 14 contractual provisions required by Colorado Insurance Regulation 3-1-(IV)(B). The more critical provisions missing from the agreement include the requirement that securities be held separate from the other securities of the custodian, that securities be identified as separately owned by the Company and that disclosure of insurance coverage maintained by the custodian comply with bank regulatory requirements. The deposit agreement for the trust account required by the Blue Cross and Blue Shield Association does not comply with 12 of the 14 contractual provisions required by Colorado Insurance Regulation 3-1-(IV)(B). The more critical provisions missing from the agreement include the requirement that securities be held separate from the other securities of the custodian, that securities be identified as separately owned by the Company and that disclosure of insurance coverage maintained by the custodian be in compliance with bank regulatory requirements.

During the examination period, the Company had an internal audit department which reported directly to the Audit Committee of the Board. The department performed internal control reviews and audits using a risk-based approach and as requested by management. In addition, the department assisted the Company’s external auditors during the annual audit. Effective January 1, 1997, this function was performed by the Company’s affiliate, Rocky Mountain Administrative Services Company (RMASC), pursuant to the management services agreement (See Management and Services Agreements). Effective January 1, 1998, the Company outsourced this function to its external auditors.

RECOMMENDATION:

No. 9:

It is again recommended that the Company comply with the safekeeping requirements of Colorado Insurance Regulation 3-1-6.

FINANCIAL STATEMENTS

The following pages present a Statement of Assets, Liabilities, Surplus and Other Funds as determined by this examination. This statement is followed by supporting statements and reconciliations presented in the following order:

STATEMENT OF ASSETS, LIABILITIES, RESERVES AND OTHER FUNDS

December 31, 1998

ASSETS

	Ledger Assets	Non-Ledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$33,213,542			$33,213,542
Preferred Stocks	350,813			350,813
Common Stocks (Note 1)	48,023,986		$15,089,249	32,934,737
Mortgage Loans On Real Estate:				
First Liens				
Properties Occupied by the Company	19,444,125			19,444,125
Cash and Short Term Investments	(3,528,492)			(3,528,492)
Aggregate Write-ins for Invested Assets	16,080,504		12,070,000	4,010,504
Uncollected Premiums (Note 2)	2,049,713		2,046,716	2,997
Amounts Receivable Relating to Uninsured Accident and Health Plans (Note 3)	5,583,566		1,604,377	3,979,189
Experience Rating and Other Refunds	254,246			254,246
Amounts Recoverable from Reinsurers	573,503		84,236	489,267
Federal Income Tax Recoverable	1,868,260			1,868,260
EDP Equipment	4,509,847			4,509,847
Investment Income Due and Accrued	483,626			483,626
Receivable from Parent, Subsidiaries and Affiliates	6,934,116		822,220	6,111,896
Other Assets Non-admitted (Note 4)	53,215,652		53,215,652	
Aggregate Write-ins for Other Than Invested Assets (Note 5)	40,836,185	$28,870,018	28,354,426	41,351,777
Totals	$229,893,192	$28,870,018	$113,286,876	$145,476,334

STATEMENT OF ASSETS, LIABILITIES, RESERVES AND OTHER FUNDS (continued)

December 31, 1998

LIABILITIES, RESERVES AND OTHER FUNDS

Claims Unpaid		$51,643,605
Unpaid Claims Adjustment Expenses		1,336,562
Unearned Premiums (Note 6)		6,214,759
Taxes, Licenses and Fees Due or Accrued		829,118
Other Expenses Due or Accrued		951,635
Amounts Withheld or Retained for Account of Others		2,542,887
Miscellaneous Other Liabilities (Note 7)		50,622,504
Post Retirement Benefit Obligations		6,468,213
Payable to Parent, Subsidiaries and Affiliates		1,232,232
Total Liabilities		$121,841,515
Statutory Reserve	$2,542,275	
Aggregate Write-ins for Reserves and Other Funds	6,486	
Unassigned Funds	21,086,058	
Total Reserves and Unassigned Funds		$23,634,819
Total Liabilities, Surplus and Other Funds		$145,476,334

UNDERWRITING AND INVESTMENT EXHIBIT

YEAR 1998

Underwriting Income		
Premiums Earned		$234,593,382
Claims Incurred	$203,857,085	
Expenses Incurred:		
Claims Adjustment	36,006,543	
Administrative	12,949,891	
Soliciting	12,980,957	
Reinsurance Allowances - Expense and Experience Refund	(2,864,413)	
Total Underwriting Deductions		$262,930,063
Net Underwriting Gain of (Loss)		($28,336,681)
Investment Income		
Net Investment Income Earned	$7,460,606	
Net Realized Capital Gains or (Losses)	13,812,945	
Net Investment Gain or Loss		$21,273,551
Other Income or Expense		
Aggregate Write-ins for Other Income or Expense (Note 8)	($33,406,406)	
Total Other Income or Expense		($33,406,406)
Net Gain or (Loss) Before Federal Income Tax		(40,469,536)
Federal Income Tax Incurred		(2,921,268)
Net Gain or (Loss)		($37,548,268)

RESERVES AND UNASSIGNED FUNDS

YEAR 1998

Reserves and Unassigned Funds December 31, Prior year		$96,688,789
Net Gain or (Loss)	($37,548,268)	
Net Unrealized Capital Gains or Losses	(8,958,167)	
Change in Non-admitted Assets	(47,674,536)	
Aggregate Write-ins for Changes to Reserves and Unassigned Funds	21,127,001	
Change in Reserves and Unassigned Funds for the Year		($73,053,970)
Reserves and Unassigned Funds December 31, 1998		$23,634,819

RECONCILIATION OF RESERVES AND UNASSIGNED FUNDS

DECEMBER 31, 1992 THROUGH DECEMBER 31, 1998

	1993	1994	1995	1996	1997	1998
Reserves and Unassigned Funds, December 31, Previous Year	$123,746,190	$112,322,110	$117,592,316	$142,525,060	$148,161,128	$96,688,789
Net Gain or (Loss)	$17,623,293	$4,165,960	$12,220,200	$10,603,581	($23,436,816)	($37,548,268)
Net Unrealized Capital Gains/ (Losses)	(3,966,715)	(446,495)	3,200,422	2,795,645	701,100	(8,958,167)
Change in Non-Admitted Assets	(25,080,658)	876,671	1,110,554	(7,763,158)	(21,717,736)	(47,674,536)
Aggregate Write-ins for Changes to Reserves and Unassigned Funds	0	674,070	543,699	0	(7,018,887)	21,127,001
Changes in Reserves and Unassigned Funds for the Year	($11,424,080)	$5,270,206	$17,074,875	$5,636,068	($51,472,339)	($73,053,970)
Reserves and Unassigned Funds, December 31, current year	$112,322,110	$117,592,316	$134,667,191	$148,161,128	$96,688,789	$23,634,819

The above figures were extracted from the Company's filed annual statements. The 1998 amounts were determined by examination. The 1996 column includes the restated figure of $142,525,060 as the Company's ending 1995 surplus. This restatement, for presentation purposes in this chart, combined the Company's surplus and that of Blue Cross and Blue Shield Plan of Nevada as of December 31, 1995. The Company and the Blue Cross and Blue Shield Plan of Nevada merged effective December 31, 1996 (see "Acquisitions, Mergers or Sales").

ANALYSIS OF EXAMINATION CHANGES

December 31, 1998

Admitted Assets	Per Company	Per Examination	Surplus Increase (Decrease)
Common Stocks	$36,493,086	$32,934,737	($3,558,349)
Uncollected Premiums	2,049,713	2,997	(2,046,716)
Amounts Receivable Relating to Uninsured Accident and Health Plans	5,583,566	3,979,189	(1,604,377)
Liabilities			
Unearned Premiums	5,675,748	6,214,759	(539,011)
Miscellaneous Other Liabilities	42,838,919	50,622,504	(7,783,585)
Net Change Per Examination			($15,532,038)

Reserves and Unassigned Funds Per Annual Statement	$39,166,857
Net Change Per Examination	(15,532,038)
Reserves and Unassigned Funds Per Examination	$23,634,819

COMPARATIVE FINANCIAL STATEMENTS

December 31, 1992 and December 31, 1998

ADMITTED ASSETS

	December 31, 1992	December 31, 1998
Bonds	$58,711,739	$33,213,542
Preferred Stocks	2,308,313	350,813
Common Stocks	45,204,010	32,934,737
Mortgage Loans on Real Estate	71,779	0
Real Estate: Properties Occupied by the Company	17,257,906	19,444,125
Aggregate Write-ins for Invested Assets	0	4,010,504
Cash On Hand and On Deposit	(9,156,290)	(3,528,492)
Short Term Investments	6,926,976	0
Uncollected Premiums	2,063,741	2,997
Amounts Recoverable Relating to Uninsured Accident and Health Plans	0	3,979,189
Experience Rating and Other Refunds	0	254,246
Amounts Recoverable from Reinsurers	4,974	489,267
Federal Income Tax Recoverable	0	1,868,260
Electronic Data Processing Equipment	6,463,083	4,509,847
Interest and Other Investment Income Due and Accrued	778,810	483,626
Misc. Accounts Receivable	13,626,971	0
Receivable from Parent, Subsidiaries and Affiliates	6,192,026	6,111,896
Other Assets	1,874,024	0
Aggregate Write-ins for Other Than Invested Assets	0	41,351,777
Total Assets	$152,328,062	$145,476,334

COMPARATIVE FINANCIAL STATEMENTS (continued)

December 31, 1992 and December 31, 1998

LIABILITIES, RESERVES AND OTHER FUNDS

	December 31, 1992	December 31, 1998
Claims Unpaid	$26,159,091	$51,643,605
Unpaid Claims Adjustment Expenses	2,368,960	1,336,562
Unearned Premiums	6,719,326	6,214,759
Taxes, Licenses and Fees Due or Accrued	653,057	829,118
Federal Income Taxes	3,415,759	0
Other Expenses Due or Accrued	5,264,476	951,635
Amounts Withheld or Retained for Account of Others	3,718,184	2,542,887
Provision for Experience Rating Refunds	198,158	0
Amounts Due to Subsidiaries and Affiliates	12,476,681	0
Unclaimed Property	66,104	0
Foundation Contribution	1,500,000	0
Reserve for Discount Liability	1,000,000	0
Miscellaneous Other Liabilities	0	50,622,504
Post Retirement Benefit Obligation	0	6,468,213
Payable to Parent, Subsidiaries and Affiliates	0	1,232,232
TOTAL LIABILITIES	$63,539,796	$121,841,515

RESERVES AND OTHER FUNDS

	December 31, 1992	December 31, 1998
Statutory Reserve	$3,905,579	$2,542,275
Aggregate Write-ins for Reserves and Other Funds	2,244,587	6,486
Unassigned Funds	82,638,100	21,086,058
Total Reserves and Unassigned Funds	88,788,266	$23,634,819
Total Liabilities, Reserves and Unassigned Funds	$152,328,062	$145,476,334

NOTES TO FINANCIAL STATEMENT

Note 1: Common Stocks

The admitted value of this asset was reduced by $3,558,349 from $36,493,086 to $32,934,737 due to reductions to the reported values of the Company's wholly owned subsidiaries, HMO Colorado, Inc. (HMOC) and Rocky Mountain Life Insurance Company (RML), resulting from the financial condition examination conducted on these entities.

HMOC and RML, which are Colorado domestic companies, were examined concurrently with the Company. Certain examination changes made as a result of these examinations reduced the surplus positions of both entities. As a result the value reported by the Company was reduced accordingly.

Note 2: Uncollected Premiums

The admitted value of this asset was reduced by $2,046,716 from $2,049,713 to $2,997 due to non-admission of certain receivables reported as admitted assets. The decrease resulted primarily from the Company's MCS billing system and the "I" report representing billing adjustments entered into the MCS system but not yet billed to the groups. The report accrues receivable adjustments after the normal billing cycle has been completed. During the conversion to the AMISYS system, this report began accumulating inaccurate data and became unreliable. The Company was not able to provide documentation to support the balances contained in the report. Because adequate support was not available for examination, the aging and eventual collection of receivables could not be tested. These unsupported balances were non-admitted for examination purposes.

Note 3: Amounts Receivable Relating to Uninsured Accident and Health Plans

The admitted value of this asset was reduced by $1,604,377 from $5,583,566 to $3,979,189 due to the non-admission of certain receivables. The decrease resulted primarily from changes in the billed and unbilled receivables due from alternatively funded groups (AFG). Subsequent to year-end 1998, the Company investigated balances at December 31, 1998 by reviewing subsequent cash receipts and billing transactions. The Company determined that the year-end billed and unbilled balances due from AFG groups were overstated. Accordingly, the excess balances have been non-admitted.

Note 4: Other Assets Non-admitted

These assets are comprised of furniture and equipment that are non-admitted per statutory accounting guidelines. These balances include the capitalized costs of the computer conversion project which are also non-admitted per statutory accounting guidelines.

Note 5: Aggregate Write-ins for Other Than Invested Assets

This asset is comprised of miscellaneous accounts receivables, miscellaneous assets, deferred tax assets and a receivable from a large alternately funded group. This amount also included assets which were non-admitted by the Company. These amounts are primarily composed of deferred tax assets which were calculated by the Company but were determined by the Company to be non-admissible.

Note 6: Unearned Premiums

This liability was increased by $539,011 from $5,675,748 to $6,214,759 due to the increase of an estimated rate stabilization liability which had been accrued for at year end. The Company has rate stabilization provisions in agreements with two group contract holders. The Company's underwriting department prepared an estimated year-end accounting for each group contract based upon information available at the time. Subsequent to the balance sheet date, final accountings were performed for these contracts and the estimated liability was determined to have been insufficient. Thus, the liability balance was increased for purposes of this examination.

Note 7: Miscellaneous Other Liabilities

This liability was increased by $7,783,585 from $42,838,919 to $50,622,504 due to the establishment of a liability which had not been accrued at year end and for the increase of another liability which had been included in the statutory financial statements. A description of these liabilities follows:

- The Company, New Mexico Blue Cross and Blue Shield, Inc. and their subsidiary, Rocky Mountain Health Care Corporation (RMHCC) were subject to examination and investigation by agencies of the federal government in connection with the administration of the Medicare A and B contracts during the examination period. The Company had not made provision for any fines or penalties related to the findings of these investigations. The Company settled this issue during the examination fieldwork. As such, a liability of $6,844,000 was established for this settlement.

- The Company's subsidiary, Rocky Mountain Health Care Corporation (RMHCC), was subject to an audit by the Office of Inspector General relating to the termination of the Medicare A and Medicare B contracts during 1995. The audit concluded that RMHCC owed $4,079,171 to the Department of Health and Human Services for overcharges of pension costs related to these contracts. RMHCC is insolvent and any repayments will by made by the Company or by the Company and New Mexico Blue Cross and Blue Shield, Inc., which each own 50% of RMHCC. The Company had included a provision of $1,100,000 in its December 31, 1998 Annual Statement for expected repayments. The examination has determined that the Company's likely repayment falls within a range and that the mid point of that range is $2,039,585. Thus, an additional liability of $939,585 was established for examination purposes.

The remainder of this liability is composed of unallocated cash, miscellaneous payables, commissions payable, contingent liabilities (including the negative net worth of the Company's subsidiaries HMO Colorado, Inc. and Rocky Mountain Administrative Services Company) and reinsurance premiums payable.

Note 8: Aggregate Write-ins for Other Income or Expense

This expense item is primarily composed of the losses in the equity values of the Company's subsidiaries, HMO Colorado, Inc. and Rocky Mountain Administrative Services Company during 1998. A second material component is attributed to the write-off of previously capitalized costs incurred by the Company in its efforts to convert to a for-profit entity.

SUMMARY

Based upon the results of this examination, as of December 31, 1998, the Company had admitted assets of $145,476,334, liabilities of $121,841,515, statutory reserve of $2,542,275, aggregate write-ins for reserves and other funds of $6,486, and unassigned funds of $21,086,058. The balance of the Company's total reserves and unassigned funds per this examination is $23,634,819. The Company's reserves and unassigned funds was reduced by $15,532,038 as result of this examination. A schedule of changes to the Company's reserves and unassigned funds per this examination is included on page 31 of this report.

The Company's reserves and unassigned funds have decreased by over $100,000,000 from December 31, 1996 to December 31, 1998. The Company, and its subsidiaries, HMO Colorado, Inc. (HMOC) and Rocky Mountain Administrative Services Company (RMASC) experienced significant operating losses during 1997 and 1998. Additionally, investments in EDP hardware and software during the examination period resulted in declines to surplus as well. The Company's operating losses were attributed primarily to the following:

- In 1998, the Company experienced high administrative costs. The Company's expense percentage for 1998 was 25% of written premiums which was one of the highest expense percentages for any Blue Cross / Blue Shield Plan in the nation.

- Higher expenses in 1998 were partially attributed to the costs incurred by the Company in its efforts to convert to a for-profit entity. The Company incurred expenses in excess of $7 million from 1996 to 1998 in this regard. These previously capitalized costs were expensed in 1998.

- Another cause of the high expense percentage was attributed to the implementation costs associated with a computer conversion project. The conversion costs are materially over budget. Likewise, the expected administrative savings have not yet been realized. In fact, the conversion has required a great deal of non-budgeted contract services expense in an effort to get the system working properly. By the time the conversion is completed, the Company expects to have invested approximately $41,000,000 in the project. These amounts are capitalized, and then non-admitted, for statutory reporting purposes.

- The Company's managed health care subsidiary, HMOC has lost a total of $38,059,435 over 1997 and 1998. These losses are primarily attributed to operating losses and changes in non-admitted assets. This required the Company to contribute an additional $20,000,000 to HMOC in 1998. HMOC's losses were primarily due to high administrative expenses and inadequate rates. During 1998, the computer conversion described above caused HMOC many operational problems. Claims processing was halted for approximately two months while these problems were addressed. Severe customer service issues also arose during this period. As HMOC began implementing rate increases in late 1998 and 1999, renewals have declined significantly.

- The Company's administrative services subsidiary, RMASC, has experienced losses in each of its first two years of operations. The fees charged by RMASC to the Company and the other affiliates have not covered the costs of providing services to them. The Company had originally capitalized RMASC with $5,000,000 in 1997. RMASC had an un-audited negative net worth of $13,200,242 as of December 31, 1998. This negative position will require additional funding from the Company.

- Effective July 1, 1997, the Company merged with HSI Health Plans (HSI). HSI was a Colorado domestic non-profit hospital, medical-surgical and health service corporation. This merger resulted in a decrease to the Company's unassigned funds of $1,222,315 due to the deficiency in assets to fund HSI's projected losses.

Refer to the "Subsequent Events" section of this report regarding regulatory actions initiated by the Division and actions initiated by the Company.

RECOMMENDATIONS

Recommendations made as a result of this examination follow:

Issue	Rec. No.	Page No.	Recommendation
The Company was unable to produce, for examination purposes, all of the required conflict of interest statements for each year covered during the examination period with the exception of 1997 and 1998.	1	12	It is again recommended that the Company utilize its existing conflict of interest procedure and obtain annual disclosure statements from all key employees, officers and directors.
Review of the management services agreement with RMASC noted that services provided and fees paid were typically in accordance with the agreement. However, four specific exceptions were noted:	2	16	It is recommended that the Company comply with the provisions of the inter-company service agreement with RMASC.
The Company did not report certain transactions on the 1998 Form B filing as required pursuant to Section 10-3-804, C.R.S.	3	16	It is recommended that the Company comply with the Form B inter-company reporting requirements of Section 10-3-804, C.R.S.
Cash advances were not reported by the Company on Schedule Y of the 1998 Annual Statement.	4	16	It is recommended that the Company report all inter-company transactions on Schedule Y in compliance with the NAIC Annual Statement Instructions for Hospital, Medical and Dental Service or Indemnity Corporations.
The Company had no inter-company agreement with HMOC.	5	16	It is recommended that the Company ensure that it has executed agreements covering all inter-company service arrangements.
A review of the Company's reinsurance agreement finds that it did not contain the “Colorado Law Clause” and the “Entire Law Clause” required by Colorado Insurance Regulations 3-3-2(VII)(A)(6) and (A)(7), for the allowance of reinsurance reserve credits under the agreement.	6	22	It is recommended that the Company ensure that all reinsurance agreements comply with the provisions of Colorado Insurance Regulation 3-3-2 if related reserve credits are to be claimed.
The Company has designated its affiliate, Rocky Mountain Hospital and Medical Service (RMHCC) as its reinsurance intermediary. RMHCC is not a licensed reinsurance intermediary in Colorado as required by Section 10-2-903(1), C.R.S. Likewise, review of the intermediary agreement notes that it did not meet the requirements of Section 10-2-904, C.R.S.	7	22	It is recommended that the Company comply with the requirements of Section 10-2-903(1), C.R.S. and Section 10-2-904, C.R.S. concerning the use of reinsurance intermediaries.

Issue	Rec. No.	Page No.	Recommendation
The reinsurance agreement with ReliaStar contains a provision for annual experience refunds and the Company reported a related recoverable of $254,246 under the agreement. However, the experience rating refund reported is contingent on future experience and should have been non-admitted.	8	23	It is recommended that the Company comply with the reporting requirements of the NAIC Accounting and Practices and Procedures Manual and non-admit, on future Annual Statement filings, those reinsurance experience rating refunds which are subject to change due to future experience.
The terms contained in the Company's safekeeping agreements are not in compliance with Colorado Insurance Regulation 3-1-6.	9	24	It is again recommended that the Company comply with the safekeeping requirements of Colorado Insurance Regulation 3-1-6.

CONCLUSION

The courtesy, assistance and cooperation extended by the officers and employees of the Company during the course of this examination is greatly appreciated.

Arthur Andersen, LLP conducted the actuarial and related phases of the examination.

In addition to the undersigned, Mr. Roy Worden, Mr. Roland Fortman, Ms. Julie Hansen and Mr. Arthur Mowry, Insurance Examiners, Division of Insurance, State of Colorado, also participated in the examination.

Respectfully submitted,

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Greg Doane, C.F.E.
Examiner in Charge
Senior Insurance Examiner
Division of Insurance
State of Colorado

SUBSEQUENT EVENTS

Due to the significant financial losses and operational problems experienced by the Company in 1997 and 1998 and the fact that the Company's financial projections indicate that it will continue to experience losses through 1999, the Colorado Division of Insurance has appointed an independent examiner to monitor remediation plans and activities of the Company and HMOC. Monitoring is to be accomplished through a target examination approach to assess the Company's ability to implement rate increases, complete the computer conversion project, address the many customer service issues, including claims payment processes, and determine the viability of the Company's future business plans. This process was designed to provide continual reporting to the Colorado Division of Insurance for consideration of additional regulatory action.

During the examination period, the Company commenced the process to convert to a for profit entity in accordance with Section 10-16-324, C.R.S. The original intent had been to hold an initial public offering for the Company's newly created stock. Proceeds from the sale were to be placed in a charitable foundation. This conversion process was halted in 1998 when the market for such healthcare stocks became volatile and when the Company's financial problems continued.

In 1998 the Company's focus shifted towards finding a strategic partner who could provide financial and operational support. The Company completed a selection process, made a selection, and entered into an agreement with Anthem Insurance Companies, Inc. (Anthem) for the purchase of the Company. Anthem is a mutual insurance company domiciled in Indiana. Anthem committed to provide additional funding up to $50,000,000 through the purchase of a surplus note of the Company and to provide other technical and consulting services to the Company. Anthem purchased the surplus note in 1999.

On August 16, 1999 the Company filed a "Plan of Conversion to a Stock Insurance Company" (Conversion) and "Plan of Exchange of Insurance Securities" (Exchange) with the Colorado Division of Insurance in accordance with Sections 10-16-324 and 10-3-601 through 10-3-610, C.R.S. respectively. These plans provide for the conversion of the Company into a for-profit stock insurance company and the subsequent transfer of shares of the Company to Anthem West, Inc., a wholly owned subsidiary of Anthem.

The Conversion in conjunction with the Exchange is intended to benefit the Company and its policyholders by providing the Company access to capital markets, alleviating the Company's short term surplus strain, improving the Company's competitiveness and to achieve economies of scale. The Conversion and Exchange were approved by the Commissioner of Insurance on November 5, 1999.