

Blue Cross Blue Shield of Michigan and Subsidiaries

Consolidated Financial Statements
as of and for the Years Ended
December 31, 2008 and 2007,
and Independent Auditors' Report



Michigan
Blue Cross
Blue Shield



Discussion of Financial Results

Like most Michigan companies and residents, Blue Cross Blue Shield of Michigan's (the "Company") and its subsidiaries' (collectively, the "Corporation") financial health was adversely impacted by the deep recession that is currently gripping the nation. The dramatic economic changes underway in Michigan are leading more consumers out of health insurance plans offered by employers and into the state's individual health market. Under the individual marketplace's current regulatory framework, the Company serves as the only health insurer that guarantees coverage to every applicant, regardless of their health status. This unique role, coupled with the unlimited ability of commercial insurance companies to risk-select and deny coverage to the sick, has led to a significant risk imbalance in the Company's individual insurance pool. This imbalance – made worse with the rapid growth of that pool due to the economy – has led to adverse financial outcomes for the Corporation as premium rates have not kept up with the cost of the pool.

The current year net loss of \$144.9 million has, at its core, this broken State regulatory system for individual health insurance. In 2008, the Company lost more than \$133 million in its individual product lines as accelerating membership increases, due to higher unemployment and a decrease in employer-provided group coverage, had more individuals providing for their own coverage. Risk selection by the Company's competitors in the individual market exacerbated the financial impact, as the Company is forced exclusively to cover the most expensive cases in the market. On top of the incurred losses, the Company was required to add further premium deficiency reserve provisions to the balance sheet of \$187.3 million for future losses as inadequate premium rates, medical inflation and membership increases in the individual products is expected to continue for the foreseeable future. At year-end 2008, the Company has recorded a total of \$544 million in premium deficiency reserves.

The ill effects of the economy are also impacting the Corporation's subscriber reserves, which decreased by \$636.7 million in 2008, ending a 19-consecutive-year run of positive additions to subscriber reserves. The reduction in reserves was made up of a current-year net loss of \$144.9 million and \$491.8 million of additional reductions attributable to investment holding losses in the Corporation's investment portfolio and employee pension plans.

Investment income, which in past years produced positive returns, which in turn helped keep underwriting margins low, was a negative \$80.8 million for the year, \$490.4 million lower than the \$409.6 million of investment income realized by the Corporation during the prior year. The negative investment earnings primarily resulted from net realized capital losses and investment write-downs and unrealized holding losses in the Corporation's trading portfolio of common stock and high yield bonds of \$368.7 million.

continued on next page

Discussion of Financial Results *continued*

On a positive note, in spite of the investment market turmoil, earnings from interest and dividends was \$303.7 million for the year compared to prior year earnings of \$291.5 million. Even though the overall investment return for the Corporation was a negative 4.99 percent in 2008, this was a much better result than the S&P 500 Index which declined 37 percent for the year.

There were positives in 2008 that helped mitigate the poor results caused by the economy. Most notable of which was the net gain generated by Blue Care Network, the Company's not-for-profit HMO, of \$70.2 million driven by favorable medical trends and disciplined administrative spending. At the Parent Company, similar restraint in administrative spending and favorable claims experience in the underwritten group products helped produce positive underwriting results before premium deficiency reserves of \$69 million. Another bright spot was the improved underwriting results and continued strong membership growth in the Company's individual Medicare Advantage product which enrolled over 30 thousand new members in 2008. The membership growth in Medicare Advantage and self-funded products helped push total revenue for the Corporation to \$21.2 billion in 2008 compared to \$19.5 billion in the prior year.

The Accident Fund Insurance Company of America, the Company's for-profit workers compensation subsidiary, consistently provides the Company with strong operating results by maintaining strict adherence to sound underwriting principles and growth strategies, but financial markets and economic factors contributed to an overall net loss of \$30.7 million in the current year compared to a net gain of \$98.1 million in 2007.

The broken regulatory environment in the State of Michigan, a continued weak economy and uncertainty in the investment markets will continue to challenge the Company over the coming year. Management is undertaking a determined course of action to ensure that the Corporation remains financially stable despite these challenges – necessitating business decisions on individual product rates and benefit designs, reductions in workforce, and administrative cost reductions necessary to ensure a financially stable Corporation. In spite of the decline in subscriber reserves that occurred in 2008, the Corporation's accumulated subscriber reserves and cash and investment balances of \$2.3 billion and \$6.0 billion respectively provide assurance that the Corporation has sufficient cash and reserves to meet our obligations to customers, subscribers and the people of Michigan.

Management Statement of Responsibility



The management of Blue Cross Blue Shield of Michigan and its subsidiaries prepared the accompanying consolidated financial statements, and has the responsibility for the integrity, objectivity and freedom from material misstatement (whether caused by error or fraud). They were prepared in accordance with accounting principles generally accepted in the United States of America, and they include amounts that are based on management's best estimates and judgments. Management also prepared the other information in the annual report and is responsible for its accuracy and consistency with the consolidated financial statements.

Management is further responsible for maintaining a system of internal control designed to provide reasonable assurance that transactions are executed in accordance with management authorization, and that they are appropriately recorded, in order to permit preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America and to adequately safeguard, verify and maintain accountability of assets. An important element of the system is an ongoing internal audit program.

Deloitte & Touche LLP, independent certified public accountants, is engaged to audit the consolidated financial statements of Blue Cross Blue Shield of Michigan and its subsidiaries and express an opinion thereon. Their audit is conducted in accordance with auditing standards generally accepted in the United States of America, which comprehend the consideration of internal control and tests of transactions to the extent necessary to form an independent opinion on the consolidated financial statements prepared by management. The Independent Auditors' Report appears on the next page.

The Board of Directors, acting through its Audit Committee, is responsible for assuring that management fulfills its responsibilities in the preparation of the consolidated financial statements and the financial control of operations. The board appoints the independent public accountants on the recommendation of the Audit Committee. It meets regularly with management, internal auditors and independent accounts. The independent accountants have full and free access to the Audit Committee and meet with it to discuss their audit work, the company's internal controls and financial reporting matters.

Daniel J. Loepp
President and
Chief Executive Officer

Mark R. Bartlett
Executive Vice President,
Chief Financial Officer and
President of Emerging Markets

Independent Auditors' Report

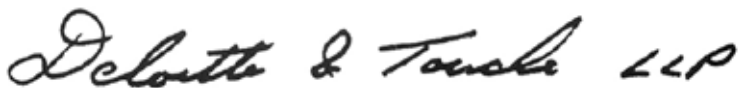
To the Board of Directors of Blue Cross Blue Shield of Michigan
Detroit, Michigan

We have audited the accompanying consolidated balance sheets of Blue Cross Blue Shield of Michigan and Subsidiaries (the "Corporation") as of December 31, 2008 and 2007, and the related consolidated statements of operations and subscribers' reserves, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the Corporation, effective December 31, 2007, began to recognize the funded status of its defined benefit plans in its consolidated balance sheet and effective December 31, 2008 changed the measurement date to conform to Financial Accounting Standards Board Statement No. 158 and as discussed in Note 3, changed its classification of certain investments from available-for-sale to trading.



March 20, 2009



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Consolidated Balance Sheets

AS OF DECEMBER 31, 2008 AND 2007

(Amounts in millions)

ASSETS

	2008	2007
CASH AND CASH EQUIVALENTS	\$ 405.7	\$ 526.7
INVESTMENTS :		
Trading securities	857.2	1,167.3
Available-for-sale securities	4,748.5	4,785.2
Total investments	5,605.7	5,952.5
SECURITIES LENDING COLLATERAL	961.2	1,304.4
RECEIVABLES – Net	2,391.6	2,509.9
PROPERTY AND EQUIPMENT – Net	545.9	478.1
NET DEFERRED TAX ASSETS	415.7	214.9
GOODWILL	218.1	245.4
OTHER ASSETS	271.7	299.4
TOTAL	\$ 10,815.6	\$ 11,531.3

LIABILITIES AND SUBSCRIBERS' RESERVES

LIABILITIES FOR UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES		
Health	\$ 2,019.8	\$ 2,240.8
Nonhealth	1,687.5	1,723.3
Total liabilities for unpaid claims and claim adjustment expenses	3,707.3	3,964.1
PREMIUM DEFICIENCY RESERVES	544.0	356.7
ACCRUED LIABILITY TO GROUPS	388.1	343.9
UNEARNED REVENUE	628.0	641.9
OTHER LIABILITIES:		
Securities lending collateral	961.2	1,304.4
Accrued employee expenses	1,027.1	706.1
Debt	533.1	307.9
Other liabilities	700.4	943.2
Total liabilities	8,489.2	8,568.2
CONTINGENCIES		
SUBSCRIBERS' RESERVES:		
Accumulated reserves	2,757.4	2,918.2
Accumulated other comprehensive (loss) income	(431.0)	44.9
Total subscribers' reserves	2,326.4	2,963.1
TOTAL	\$ 10,815.6	\$ 11,531.3

See notes to consolidated financial statements.

Consolidated Statements of Operations

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

(Amounts in millions)

	2008	2007
PREMIUM AND PREMIUM EQUIVALENT REVENUE:		
Underwritten premiums earned	\$ 9,880.2	\$ 9,094.2
Amounts attributed to self-funded arrangements	<u>11,347.9</u>	<u>10,365.9</u>
Total revenue	21,228.1	19,460.1
Less amounts attributable to claims under self-funded arrangements	<u>(10,548.3)</u>	<u>(9,611.1)</u>
Net premium and self-funded fee revenue	<u>10,679.8</u>	<u>9,849.0</u>
COST OF SERVICES:		
Benefits provided	8,640.6	8,139.7
Change in premium deficiency reserves	187.3	111.3
Operating expenses – net	<u>1,970.2</u>	<u>1,893.6</u>
Total cost of services	<u>10,798.1</u>	<u>10,144.6</u>
OPERATING LOSS	(118.3)	(295.6)
INVESTMENT AND OTHER (LOSS) INCOME	<u>(80.8)</u>	<u>409.6</u>
(REDUCTION) ADDITION TO SUBSCRIBERS' RESERVES BEFORE FEDERAL INCOME TAXES	(199.1)	114.0
BENEFIT FOR FEDERAL INCOME TAXES	<u>(54.2)</u>	<u>(38.2)</u>
(REDUCTION) ADDITION TO SUBSCRIBERS' RESERVES	<u>\$ (144.9)</u>	<u>\$ 152.2</u>

See notes to consolidated financial statements.

Consolidated Statements of Subscribers' Reserves

AS OF DECEMBER 31, 2008 AND 2007

(Amounts in millions – net of tax)

	Accumulated Reserves	Accumulated Other Comprehensive Income (loss)	Total
BALANCES – January 1, 2007	\$ 2,766.0	\$ 74.2	\$ 2,840.2
Addition to subscribers' reserves	152.2		152.2
Other comprehensive income		25.1	25.1
Adoption of FAS 158 – Recognition provisions		(54.4)	(54.4)
BALANCES – December 31, 2007	2,918.2	44.9	2,963.1
Adoption of FAS 158 – Measurement date change	(15.9)	41.4	25.5
BALANCES – January 1, 2008, as adjusted	2,902.3	86.3	2,988.6
Reduction to subscribers' reserves	(144.9)		(144.9)
Other comprehensive loss		(517.3)	(517.3)
BALANCES – December 31, 2008	<u>\$ 2,757.4</u>	<u>\$ (431.0)</u>	<u>\$ 2,326.4</u>

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

(Amounts in millions)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Reduction) addition to subscribers' reserves	\$ (144.9)	\$ 152.2
Adjustments to reconcile (reduction) addition to subscribers' reserves to cash (used in) provided by operating activities:		
Depreciation and amortization	96.2	82.4
Realized loss (gain) on investments	47.8	(53.7)
Investment impairments	42.1	3.3
Asset impairment charges	2.9	3.7
Provision for deferred income taxes	(96.8)	(26.1)
Pension and other postretirement benefits	14.5	75.3
Change in premium deficiency reserve	187.3	111.3
Changes in assets and liabilities that (used) provided cash:		
Receivables	(0.8)	(176.7)
Other assets	(16.8)	(0.6)
Accrued liability to groups	44.2	4.8
Liabilities for unpaid claims and claim adjustment expense	(256.8)	68.3
Unearned revenue	(13.9)	24.4
Other liabilities	(31.6)	246.8
Cash (used in) provided by operating activities	<u>(126.6)</u>	<u>515.4</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(9,708.2)	(14,793.7)
Sales and maturities of investments	9,630.1	14,456.8
Acquisitions of property and equipment	(57.6)	(45.4)
Investment in capitalized software	(83.9)	(80.7)
Payment for purchase of subsidiaries – net of cash acquired of \$11.6		(127.8)
Cash used in investing activities	<u>(219.6)</u>	<u>(590.8)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable	167.0	150.0
Proceeds from sale-leaseback	74.9	
Repayment of debt	(16.7)	(16.0)
Cash provided by financing activities	<u>225.2</u>	<u>134.0</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	<u>(121.0)</u>	<u>58.6</u>
CASH AND CASH EQUIVALENTS – Beginning of year	<u>526.7</u>	<u>468.1</u>
CASH AND CASH EQUIVALENTS – End of year	<u>\$ 405.7</u>	<u>\$ 526.7</u>
SUPPLEMENTAL DISCLOSURES:		
Cash paid for federal income taxes	<u>\$ 39.2</u>	<u>\$ 56.0</u>
Cash paid for interest	<u>\$ 14.2</u>	<u>\$ 12.0</u>

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

(Amounts in millions)

1. SIGNIFICANT ACCOUNTING POLICIES

Blue Cross Blue Shield of Michigan (the “Company”) is incorporated as a nonprofit corporation under the provisions of Public Act 350 (P.A. 350) of the State of Michigan. Hospital, medical, and other health benefits are provided under contracts with subscribers. The Company also operates health maintenance organization (HMO) subsidiaries, Blue Care Network of Michigan (BCNM), and BlueCaid of Michigan that provide health care services to subscribers and contracts with various physician groups, hospitals, and other health care providers to provide such services. In addition, the Company provides workers’ compensation insurance through the Accident Fund Insurance Company of America and its subsidiaries (“Accident Fund”), as well as provider network services to numerous entities through DenteMax and Michigan Health Insurance Company (MHIC), and long-term care insurance through LifeSecure Insurance Company (“LifeSecure”). Collectively, the Company and its subsidiaries are referred to herein as the “Corporation.”

Basis of Presentation — The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which vary in certain respects from statutory basis accounting practices prescribed or permitted by the Michigan Office of Financial and Insurance Regulation (see Note 23).

Principles of Consolidation — All majority owned subsidiaries are consolidated. All significant non-majority owned investments, including investments in partnerships and joint ventures, are accounted for using the equity method when the Corporation is able to influence the financial operating policies of the investee, or the investment percentage is more than minor. Significant influence is deemed to exist when the Corporation owns at least 20% of the voting stock of the investee. For limited liability companies, the equity method is generally used. For all other investments, the Corporation applies the cost method. All significant intercompany transactions and balances are eliminated in consolidation.

Cash Equivalents — Cash equivalents which are carried at fair value are comprised of short-term investments with maturities of 90 days or less.

Investments — The Corporation classifies its investments in debt and equity securities as either trading or available-for-sale, and accordingly, such securities are carried at fair value. Securities are classified as trading if they are part of an investment portfolio that is actively managed by an external investment manager and the manager has broad authority to buy and sell securities without prior approval. All other securities are classified as available-for-sale.

The unrealized gains and losses related to trading securities are included in investment income. The unrealized gains and losses related to available-for-sale securities are excluded from investment income and reported as a component of other comprehensive income, net of related income taxes. Realized gains and losses on sales of securities are determined based on the specific identification method and are included in investment and other income. For available-for-sale securities, investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. The Corporation employs a systematic methodology that considers available evidence in evaluating potential impairment of its investments. In the event that the cost of an investment exceeds its fair value, the Corporation evaluates, among other factors, the magnitude and duration of the decline in fair value, the financial health and business outlook of the issuer and the Corporation’s ability and intent to hold the investment. When a decline in fair value is determined to be other-than-temporary on a security held as available-for-sale, an impairment charge is recorded as a realized capital loss and a new cost basis in the investment is established.

Fair Value Measurements — Included in various investment-related line items in the consolidated financial statements are certain financial instruments carried at fair value. The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Corporation estimates fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management estimation and judgment which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used. The Corporation's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy defined by Financial Accounting Standards Board (FASB) Statement No. 157, *Fair Value Measurements*. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3).

Securities Lending — The Corporation enters into secured lending transactions and recognizes the cash collateral received and the corresponding liability to return the cash collateral.

Property and Equipment — Property and equipment is stated at cost and is depreciated using the straight-line method over estimated useful lives ranging from 30 to 40 years for buildings and 5 to 10 years for equipment.

Software Costs — Certain costs related to acquired and developed computer software for internal use are capitalized as incurred. Capitalized costs are amortized, generally over a three- to ten-year useful life, using the straight-line method.

Long-Lived Assets — Long-lived assets held and used by the Corporation are reviewed for impairment based on market factors and operational considerations whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Other Assets — Other assets consist primarily of investments in non-majority owned entities, investments in partnerships and joint ventures and deferred policy acquisition costs of Accident Fund and LifeSecure. Deferred policy acquisition costs consist primarily of commissions, premium-based taxes and assessments, salaries and certain other underwriting expenses that vary with and are primarily related to, the production of new and renewal insurance policies. Policy acquisition costs are deferred and amortized over the period in which the related premiums are earned. Amortization expense of policy acquisition costs was \$0.5 and \$2.9 for 2008 and 2007, respectively.

Intangible Assets — The acquisition of subsidiaries has resulted in recognition of intangible assets consisting of customer contracts, provider networks, and trademarks. These intangible assets are being amortized over their expected useful life. The Corporation recorded amortization expense of \$14.9 and \$10.3 in 2008 and 2007, respectively, for these intangible assets. Additionally, intangible asset amortization of \$10.2 is scheduled to be recognized for 2009, \$9.7 for 2010, and \$9.4 for 2011, respectively.

Goodwill — In connection with acquiring the assets and liabilities of subsidiaries, the excess of the purchase price over fair value of identifiable net assets acquired is recorded as goodwill. Goodwill and other intangible assets with indefinite lives are not amortized for the Company and its for-profit subsidiaries. Goodwill on the books of BCNM, a not-for-profit HMO, is amortized over a period of 10 years. The carrying value of these assets is reviewed for impairment at least annually or more frequently should circumstances indicate. The Corporation completed its annual impairment tests as of December 31, 2008 and 2007, and no impairment was indicated.

Liabilities for Unpaid Claims and Claim Adjustment Expenses — Liabilities for unpaid claims and claim adjustment expenses are actuarial estimates of outstanding claims, including claims incurred but not reported (IBNR). These estimates are based upon historical claims experience modified for current trends and changes in benefit coverage, which could vary as the claims are ultimately settled. Health benefits payable to hospitals and other facilities are stated net of interim advances. Processing expense related to claims is accrued based on an estimate of expenses to process such claims. Revisions in actuarial estimates are reported in the period in which they arise.

Experience Rated Groups — A liability is recognized in accrued liability to groups for experience rated group contracts as a result of favorable experience based on an actuarial estimate of underwriting gains, which will be returned to groups either as cash refunds or future rate reductions. Under terms of most of the experience rated group contracts, recovery, if any, of underwriting losses through future rate increases is not recognized until received.

Premium Deficiency Reserve — A liability for premium deficiency losses is recognized when it is probable that expected claim losses and allocable administrative expenses will exceed future premiums on existing health and other contracts without consideration of investment income. For purposes of premium deficiency losses, contracts are grouped in a manner consistent with the Corporation's method of acquiring, servicing, and measuring the profitability of such contracts. Premium deficiency losses are generally released over the period that the contract is in a loss position.

Premium and Premium Equivalent Revenue — Underwritten premiums, which generally are billed in advance, are recognized as revenue during the respective periods of coverage. Premiums applicable to the unexpired portion of coverage are reflected in the accompanying consolidated balance sheets as unearned revenue.

Revenue from self-funded administrative service contracts (ASC) primarily consists of claim reimbursements and administrative fees for services provided, such as management of medical services, claims processing, and access to provider networks. Collectively the claim reimbursement and fee revenue from ASC arrangements is referred to as premium equivalents in the consolidated statement of operations. Amounts due from ASC groups are equal to the amounts required to pay claims and administrative fees. Under ASC arrangements, self-funded groups retain the primary underwriting risk of paying claims and the Company retains an element of credit risk to providers in the event reimbursement is not received from the group, therefore claims paid by the Corporation and the corresponding reimbursement of claims plus administrative fees are netted in the statements of operations. Administrative fees are earned as services are performed and are calculated based on the number of members in a group or the group's claim experience. Administrative expenses related to ASC arrangements are included in operating expenses.

ASC Receivables and Payables Reclassification — In 2008, the Corporation changed its accounting practice of recognizing in the consolidated balance sheet the IBNR for health care services provided to subscribers covered under ASC arrangements and the corresponding IBNR receivable amount for the reimbursement from the group. In prior years, the Corporation followed the promulgated guidance of the National Association of Insurance Commissioners (NAIC) and excluded the IBNR and related receivable from the consolidated balance sheet. The change in practice resulted in an increase to receivables and liabilities for unpaid claims and claims adjustment expenses – health of \$1,073.6 and \$1,001.6 for 2008 and 2007 respectively. There was no impact on the statements of operations, subscribers' reserves or cash flows.

Employee Benefit Plans — The Corporation has defined benefit retirement income plans covering substantially all employees 21 years or older having one year or more of continuous service. The Corporation sponsors a separate plan for its union and nonunion employees. Approximately 37% of the Corporation's workforce is unionized. The Corporation's policy is to fund accrued retirement costs, as determined by consulting actuaries, to the extent permitted by Internal Revenue Service (IRS) regulations.

The Corporation has defined benefit health care and other benefit plans covering substantially all employees and their dependents who retire from active employment and meet minimum age and service requirements. These plans are funded on a pay-as-you-go basis.

The Corporation has defined contribution plans, which are qualified under Section 401(k) of the Internal Revenue Code (IRC), covering all employees who elect to participate. The Corporation matches a certain percentage of employees' contributions.

The Corporation has a deferred compensation benefit plan for a group of key employees and members of the Corporation's Board of Directors. Under the plan, eligible participants may elect to defer to a future period a portion of salary or director fees that are earned and normally payable as services are rendered. Elections to defer compensation must be made prior to the beginning of the year in which the deferral is effective. Deferred amounts are unfunded and paid out of the general assets of the Corporation.

Reinsurance — Accident Fund reinsures certain of its risks, generally on an excess-of-loss basis, with other companies in order to limit losses. Reinsurance does not relieve Accident Fund of its primary obligations to its policyholders. Losses recoverable from reinsurers are reported as a reduction of benefits provided and a portion of the premiums paid to reinsurers are reported as other assets. Amounts receivable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsurance policies.

LifeSecure ceded 100% of its acquired business from Columbia Universal Life Insurance Company (Columbia Life) with Allstate Life Insurance Company (Allstate). Under the coinsurance agreement, Allstate receives 100% of the premiums and pays 100% of the claims, surrender benefits and other expenses that are directly allocable to the reinsured business. Allstate administers the reinsurance business and shoulders all administrative expenses. Allstate reimburses LifeSecure for any reinsurance expenses it pays.

LifeSecure assumes the risk on certain long term care business from Blue Cross Blue Shield of Kansas (BCBSKS) and Florida Combined Life Insurance Company, Inc. (FCL) under various coinsurance agreements. In accordance with these agreements, LifeSecure assumes varying percentages of the premiums, claims, and expenses on this business, ranging from 40% to 100%.

Medicare Part D Prescription Drug Benefits — The Corporation serves as a plan sponsor offering Medicare Part D prescription drug insurance coverage under a contract with the Center for Medicare & Medicaid Services (CMS). In general, pharmacy benefits under Part D plans may vary in terms of coverage levels and out-of-pocket costs for beneficiary premiums, deductibles, and coinsurance. However, all Part D plans must offer either “standard coverage” or its actuarial equivalent (with out-of-pocket threshold and deductible amounts that do not exceed those of standard coverage). These “defined standard” benefits represent the minimum level of benefits required under law. In addition to defined standard plans, the Corporation offers other prescription drug plans containing benefits in excess of the standard coverage limits, in many cases for an additional beneficiary premium.

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

- *CMS Premium* — CMS pays a fixed monthly premium per member to the Corporation for the entire plan year.
- *Member Premium* — Each member pays a fixed monthly premium to the Corporation for the entire plan year.
- *Low-Income Premium Subsidy* — For qualifying low-income members, CMS pays some portion or all of the member’s monthly premiums to the Corporation on the member’s behalf.
- *Catastrophic Reinsurance Subsidy* — CMS pays the Corporation a cost reimbursement estimate monthly to fund the CMS obligation to pay approximately 80% of the costs incurred by individual members in excess of the individual annual out-of-pocket maximum of \$4,050 (in dollar). A settlement is made based on actual cost experience subsequent to the end of the plan year.
- *Low-Income Member Cost Sharing Subsidy* — For qualifying low-income members, CMS pays on the member’s behalf, some portion or all of a member’s cost sharing amounts, such as deductibles and coinsurance. The cost sharing subsidy is funded by CMS through monthly payments to the Corporation. The Corporation administers and pays the subsidized portion of the claims on behalf of CMS, and a settlement payment is made between CMS and the Corporation based on actual claims experience, subsequent to the end of the plan year.
- *CMS Risk Share* — If the annual per member per month benefit costs varies by more than a pre-determined percentage above or below the level anticipated in the CMS approved annual bid, there is a risk share settlement with CMS that is settled subsequent to the end of the plan year. The risk share adjustment, if any, is recorded as an adjustment to premium revenues and other receivables or liabilities.

The CMS premium, the member premium, and the low-income premium subsidy represent payments for the Corporation's insurance risk coverage under the Medicare Part D program and therefore are recorded as premium revenues in the statements of operations. Premium revenues are recognized ratably over the period in which eligible individuals are entitled to receive prescription drug benefits. We record premium payments received in advance of the applicable service period as unearned premiums.

The catastrophic reinsurance subsidy and the low-income member cost sharing subsidies represent cost reimbursements under the Medicare Part D program. The Corporation is fully reimbursed by CMS for costs incurred for these contract elements and, accordingly, there is no insurance risk to the Corporation. Amounts received for these subsidies are not considered premium revenue, but are accounted as ASC revenue when the corresponding claims are paid. The Corporation has a reimbursement from CMS of \$14.7 of incurred costs as of December 31, 2008 and had payments received in advance of incurred costs of \$11.7 as of December 2007. The reimbursement is recorded as receivables-net and the outstanding advance is recorded as other liabilities in the consolidated balance sheets.

Pharmacy benefit costs and administrative costs under the contract are expensed as incurred and are recognized in medical costs and operating costs, respectively, in the statement of operations. Pharmacy benefit costs are recognized net of rebates. The Corporation has subcontracted certain membership enrollment and pharmacy claims administration functions to third-party vendors.

Adoption of New Accounting Standards — In December 2008, the FASB issued Staff Position 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets (FAS 132(R)-1). FAS 132(R)-1 requires entities to provide enhanced disclosures about how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period, and significant concentrations of risk within plan assets. FAS 132(R)-1 is effective for the Corporation beginning with its year ending December 31, 2009. The Corporation is currently assessing the potential impacts, if any, on its consolidated financial statements.

In December 2007, the FASB issued SFAS 141(R), *Business Combinations*, (SFAS 141(R)). The objective of SFAS 141(R) is to improve the financial reporting of business combinations. This statement retains a substantial portion of the requirements contained in the original SFAS 141, but requires assets and liabilities acquired be valued at fair market value instead of using a purchase price allocation process. SFAS 141(R) also requires that acquisition related costs be expensed as incurred and restructuring costs contemplated at the time of acquisition be accounted for separately from the business combination. SFAS 141(R) is effective for corporate acquisitions occurring after January 1, 2009. The Corporation is currently assessing the potential impacts, if any, on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, expands disclosures about fair value measurements, and specifies a hierarchy of valuation techniques. Following are the levels of the hierarchy, and a brief description of the type of inputs used in valuation techniques used to measure fair value for each level:

- a. Level 1 – Unadjusted quoted prices for identical assets or liabilities in active markets
- b. Level 2 – Inputs other than Level 1 that are based on observable market data, including quoted prices for similar assets in active markets, quoted prices for identical assets in inactive markets, and inputs derived principally from or corroborated by observable market data by correlation or other means.
- c. Level 3 – Unobservable inputs reflecting the Corporation's own assumptions based on the best information available in the circumstances.

The Corporation adopted SFAS 157 effective January 1, 2008. The only financial instruments recorded at fair value are the Corporation's investments in debt and equity securities and security lending collateral. Therefore, the adoption of SFAS 157 resulted in additional disclosures in the cash and investments footnote; however, it did not have an impact on the Corporation's financial position or results of operations.

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). SFAS 158 requires employers to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position, recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position, and recognize changes in that funded status in the year in which the changes occur through changes in other comprehensive income. Prior standards relegated this information to the notes to financial statements. Retrospective revision of financial statements from prior periods is not permitted. The provisions to recognize the funded status of a defined benefit postretirement plan was adopted in 2007. The adoption of the balance sheet recognition provisions of SFAS 158 decreased subscribers' reserves as of December 31, 2007, by approximately \$54.4. The provision to measure plan assets and benefit obligations as of the December 31 was adopted in 2008. The change in the measurement date of the defined benefit plan assets and benefit obligations decreased accumulated reserves by \$15.9 and accumulated other comprehensive income by \$41.4 as of January 1, 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* (SFAS 159). The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported net income caused by measuring related assets and liabilities differently. This statement, which is elective, permits entities to choose, at specified election dates, to measure eligible items at fair value (i.e., the fair value option). Items eligible for the fair value option include certain recognized financial assets and liabilities, rights and obligations under certain insurance contracts that are not financial instruments, host financial instruments resulting from the separation of an embedded nonfinancial derivative instrument from a nonfinancial hybrid instrument, and certain commitments. Business entities shall report unrealized gains and losses on items for which the fair value option has been elected in net income. The fair value option (a) may be applied instrument by instrument, with certain exceptions; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective and available for the Corporation in 2008. The Corporation did not apply the fair value option to any of its financial assets and liabilities under the provisions of SFAS 159.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51* (SFAS 160). The objective of SFAS 160 is to improve the relevancy and transparency of the financial information that an entity provides in its consolidated financial statements of noncontrolling interests. SFAS 160 requires that the ownership interest of minority interests be clearly labeled and reported as a component of subscribers' reserves, but separate from the parent's reserves. The amount of consolidated net income attributable to the parent and the noncontrolling party must also be clearly identified on the face of the income statement. FASB 160 is effective for the Corporation on January 1, 2009. The Corporation is currently assessing the potential impacts, if any, on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts an Interpretation of FASB Statement No. 60*. This statement requires the recognition of premium revenue for financial guarantee insurance contracts to be recognized over the term of the contract in proportion to the amount of the guarantee insured. The guidance also requires the recognition of a claim liability before an event of default occurs if there is evidence that a credit deterioration of the guaranteed obligation has occurred. This statement is effective for the Corporation in 2009. The Corporation is currently assessing the potential impacts, if any, on its consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* (FIN 48). Among other things, FIN No. 48 creates a model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing a minimum recognition threshold, which all income tax positions must achieve to meet before being recognized in the financial statements. In addition, FIN No. 48 requires expanded annual disclosures, including a roll-forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within 12 months. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN No. 48 and the amounts reported after adoption are generally accounted for as a cumulative-effect adjustment recorded to the beginning balance of subscribers' reserves. The Corporation has completed a preliminary evaluation of the impact of the adoption of FIN No. 48 and has determined that such adoption is not expected to have a material impact on the Corporation's consolidated financial statements.

FASB Staff Position No. FIN 48-3 deferred the effective date of FIN No. 48 for nonpublic companies and pass through entities to fiscal years beginning in 2009 in order to provide additional authoritative guidance for these entities. The Corporation has elected to defer the application of FIN No. 48 until 2009 and accordingly continues to evaluate uncertain tax provisions utilizing the guidance set forth in SFAS No. 5, *Accounting for Contingencies*.

Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. PURCHASE, SALE and formation OF SUBSIDIARIES

CWI Acquisition — On November 20, 2007, Accident Fund acquired 100% of the outstanding common shares of CWI Holdings, Inc. (CWI). Results of operations from CWI for the 41 days ended December 31, 2007, have been included in the consolidated financial statements for the year ended December 31, 2007.

CWI is a Delaware domiciled insurance holding company that owns 100% of the shares of CompWest Insurance Company (“CompWest”). CompWest is a California domiciled property/casualty insurance company that writes workers compensation insurance primarily in California. The purchase allows for Accident Fund to have an established presence in California and other western states.

The aggregate purchase price was \$127.8. The following table, at December 31, 2008, summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition.

Cash and invested assets	\$ 172.4
Premiums receivable	3.8
Reinsurance receivable	10.4
Property and equipment – net	3.5
Goodwill	35.8
Intangible assets	32.0
Other assets	10.1
Total assets acquired	<u>268.0</u>
Reserves for losses	87.6
Unearned premiums	9.0
Debt	20.6
Other	23.0
Total liabilities assumed	<u>140.2</u>
Purchase price	<u>\$ 127.8</u>

The excess of cost over the fair value of net assets acquired totaled \$35.8 was assigned to goodwill. In 2008, the purchase allocation was finalized by an independent valuation firm resulting in the reallocation and decrease of goodwill by approximately \$18.2 and increase of intangible assets approximately by \$26. There was no impairment of goodwill deemed necessary at December 31, 2008 and 2007.

Third Coast Acquisition — On August 31, 2007, Accident Fund acquired 100% of the outstanding common shares of Third Coast Insurance Company (“Third Coast”). Results of operations from Third Coast for the four months ended December 31, 2007, have been included in the consolidated financial statements for the year ended December 31, 2007. Third Coast is an inactive Illinois domiciled property/casualty insurance company.

The aggregate purchase price was \$11.9 and there was no final purchase adjustment related to this acquisition. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition, August 31, 2007.

Cash and invested assets	\$ 12.5
Reinsurance receivables	<u>3.9</u>
Total assets acquired	<u>16.4</u>
Other payable	0.3
Reserves for losses	1.0
Reserves for IBNR	2.3
Federal income tax payable	<u>0.1</u>
Total liabilities assumed	<u>3.7</u>
Net assets acquired	<u><u>\$ 12.7</u></u>

The net assets acquired exceeded the purchase price by \$0.8, resulting in the recognition of a gain in accordance with SFAS 141.

3. CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents consist primarily of corporate notes and commercial paper, money market funds, and certificates of deposit.

Investments in debt and equity securities are classified as either trading or available for sale.

The amortized cost, fair value, and unrealized gains and losses of available-for-sale securities, at December 31, 2008, by asset category are as follows:

	Cost or Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
U.S. government and agency securities	\$ 908.6	\$ 124.3	\$ –	\$ 1,032.9
Asset-backed securities and collateralized mortgage obligations	1,711.5	41.5	66.6	1,686.4
Corporate notes	1,830.3	6.7	106.9	1,730.1
Equity mutual funds	323.8		91.7	232.1
Collateralized debt obligations	<u>67.7</u>	<u></u>	<u>0.7</u>	<u>67.0</u>
Total available-for-sale investments	<u>\$ 4,841.9</u>	<u>\$ 172.5</u>	<u>\$ 265.9</u>	<u>\$ 4,748.5</u>

The amortized cost, fair value, and unrealized gains and losses of available-for-sale securities, at December 31, 2007, by asset category are as follows:

	Cost or Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
U.S. government and agency securities	\$ 1,274.2	\$ 48.8	\$ –	\$ 1,323.0
Asset-backed securities and collateralized mortgage obligations	1,748.5	28.1	1.0	1,775.6
Corporate notes	1,202.6	9.5	8.0	1,204.1
Equity mutual funds	302.5	45.2	0.8	346.9
Municipal bonds	50.3	0.3		50.6
Collateralized debt obligations	<u>85.0</u>	<u></u>	<u></u>	<u>85.0</u>
Total available-for-sale investments	<u>\$ 4,663.1</u>	<u>\$ 131.9</u>	<u>\$ 9.8</u>	<u>\$ 4,785.2</u>

The amortized cost and estimated fair values of available-for-sale securities at December 31, 2008, by contractual maturity, are shown below:

	Cost or Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 515.9	\$ 513.6
Due after one year through five years	897.8	890.2
Due after five years through ten years	1,234.9	1,271.4
Due after ten years	<u>90.3</u>	<u>87.8</u>
Total	2,738.9	2,763.0
Asset-backed securities and collateralized mortgage obligations	1,711.5	1,686.4
Equity securities	323.8	232.1
Collateralized debt obligations	<u>67.7</u>	<u>67.0</u>
Total available-for-sale securities	<u>\$ 4,841.9</u>	<u>\$ 4,748.5</u>

The following table shows the gross unrealized losses and fair value of the Corporation's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that the securities in each investment category have been in a continuous unrealized position at December 31, 2008 and 2007, respectively.

	Less Than 12 months		12 months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2008						
Asset-backed securities and collateralized mortgage obligations	\$ 288.6	\$ 66.6	\$ –	\$ –	\$ 288.6	\$ 66.6
Corporate notes and commercial paper	1,556.3	99.4	27.0	7.5	1,583.3	106.9
Equity mutual funds	212.7	88.2	11.6	3.5	224.3	91.7
Other	49.3	0.7			49.3	0.7
Total available-sale-securities	\$ 2,106.9	\$ 254.9	\$ 38.6	\$ 11.0	\$ 2,145.5	\$ 265.9

The Corporation's unrealized loss in corporate notes and commercial paper of \$99.4 and \$7.5 for less than 12 months and 12 months or greater, respectively, is primarily caused by recent unilateral sector downgrades. The Corporation's unrealized loss in common and preferred stock of \$88.2 and \$3.5 for less than 12 months and 12 months or greater, respectively, is primarily caused by weak economic conditions, a tight credit market and diminishing consumer confidence.

Because the Corporation has determined that the underlying securities remain fundamentally sound and has the ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Corporation does not consider these investments to be other-than-temporarily impaired at December 31, 2008.

	Less Than 12 months		12 months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2007						
U.S. government and agency securities	\$ –	\$ –	\$ 19.3	\$ 0.2	\$ 19.3	\$ 0.2
Asset-backed securities and collateralized mortgage obligations	1.1		86.6	0.9	87.7	0.9
Corporate notes and commercial paper	181.4	0.2	282.1	7.7	463.5	7.9
Equity mutual funds			21.1	0.8	21.1	0.8
Other						
Total available-sale-securities	\$ 182.5	\$ 0.2	\$ 409.1	\$ 9.6	\$ 591.6	\$ 9.8

In accordance with the Corporation's impairment policy, securities that have a fair market value that is below amortized cost are analyzed and reviewed by management for other-than-temporary impairment. Factors taken into account for each individual security include the length of time and extent to which the fair value has been less than the carrying value, the underlying financial condition and the specific circumstances that are impacting the issuer in the marketplace and whether the Corporation has the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in value. The 2008 unrealized loss of \$265.9 represents securities whose decline in value is deemed to be temporary and management believes the value of the security will fully recover over a reasonable period of time.

Effective December 31, 2007, the Corporation reclassified \$1,167.3 of securities from available-for-sale to trading status resulting in \$95.2 of gross gains and \$62.7 of gross losses, with a net pretax gain of \$32.5 recognized in earnings. Prior to this reclassification, all securities were classified as available-for-sale. The Corporation's trading portfolios are investments that are externally managed. The Corporation believes the trading classification more properly reflects the operation of the portfolio.

At December 31, 2008 the Corporation has \$857.2 in its trading portfolio. The Corporation recognized \$284.2 in losses relating to investments held at year end for the year ended December 31, 2008.

The proceeds received from sales of investment securities and the related gross realized gains and losses at December 31, 2008 and 2007, are summarized as follows:

	2008	2007
Proceeds from sales of investment securities	\$ 6,134.0	\$ 8,635.7
Gross gains on sales of investment securities	120.9	117.8
Gross losses on sales of investment securities	(169.7)	(67.5)
Impairment losses of investment securities	(42.1)	

The Corporation enters into investment transactions that are not settled as of December 31. As of December 31, 2008 and 2007, there was approximately \$45.7 and \$274.9 in other liabilities, respectively, for investments purchased on account and \$8.6 and \$127.7 in accounts receivable, respectively, for investments sold on account. As these amounts are noncash, they have been excluded from the statements of cash flows.

The Corporation, in the normal course of business, enters into securities lending agreements with various other counterparties. Under these agreements, the Corporation lends U.S. Treasury securities in exchange for collateral, consisting primarily of cash and U.S. government notes, approximating 102% of the value of the securities loaned. These agreements are primarily overnight in nature and settle the next business day. As of December 31, 2008 and 2007, the Corporation had securities loaned of \$941.9 and \$1,969.8, respectively, corresponding cash collateral of \$961.2 and \$1,304.4, respectively, and corresponding noncash collateral of \$5.3 and \$717.5, respectively. As these amounts are noncash, they have been excluded from the statements of cash flows.

The Corporation voluntarily holds a portion of its securities in two grantor trusts in order to fund medical malpractice and stop loss claims of BCNM. Oversight of the trusts is provided by a Policy Committee, which is comprised of officers and board members of the Corporation. In accordance with the trust agreements, BCNM is beneficiary of the trust assets. As of December 31, 2008 and 2007, the value of the securities held in trust was \$87.5 and \$90.2, respectively, and are included in the investment tables above.

As part of its Blue Cross Blue Shield Association (BCBSA) license requirements, the Corporation is required to maintain a custodial bank account to assure the payment of claims in the event of the Corporation's insolvency. The account balance is calculated as a percentage of the Corporation's unpaid claim liability and consists primarily of marketable securities. The funds in the account are included in the Corporation's investment portfolio. The Corporation has the ability to trade and transfer securities within the account as long as the balance in the account is at or above the required minimum. The required balance for the period April 1, 2008 through March 31, 2009, is \$140.4. As of December 31, 2008 and 2007, the balance in this custodial account was \$ 161.7 and \$162.9, respectively, and is included in the investment tables above.

The Corporation's investment in Rabbi Trust funds at December 31, 2008 and 2007, had a fair market value of \$38.4 and \$39.5, respectively, for its nonqualified benefit plans and are included in the investment tables above.

During 2008, the Corporation adopted FAS 157, which expanded disclosure requirements for financial instruments measured at fair value.

The following table summarizes the Corporation's assets recorded at fair value that are measured on a recurring basis at December 31, 2008 (There were no assets measured at fair value on a non-recurring basis as of December 31, 2008):

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Cash Equivalents	\$ 405.7	\$ —	\$ —	\$ 405.7
Available-for-sale securities	\$ 4,653.0	\$ 95.5	\$ —	\$ 4,748.5
Trading securities	829.9	27.3		857.2
Total Investments	\$ 5,482.9	\$ 122.8	\$ —	\$ 5,605.7
Securities lending collateral	\$ 961.2	\$ —	\$ —	\$ 961.2
Total Assets	\$ 6,849.8	\$ 122.8	\$ —	\$ 6,972.6

The Corporation and its investment managers determine fair values by applying the following guidelines. If available, the Corporation uses market prices in active markets for identical assets and classifies these assets as Level 1. When market prices for similar financial instruments in an active market are not available, the Corporation estimates fair value based on pricing models using matrix pricing and classifies these assets as Level 2. In situations where there is little or no market activity for same or similar financial instruments, the Corporation estimates fair value using its own assumptions about future cash flows and appropriate risk-adjusted discount rates and classifies these assets as Level 3.

4. INVESTMENT AND OTHER INCOME

Net investment and other (loss) income for the years ended December 31, 2008 and 2007, consist of the following:

	2008	2007
Dividends and interest:		
Short-term investments	\$ 37.4	\$ 51.4
Debt securities	250.7	223.4
Equity securities	15.6	16.7
Total dividends and interest	303.7	291.5
(Loss) gain on sales of securities	(48.8)	50.3
Gain on long-term invested assets	6.4	
Loss on trading securities held at year end	(284.2)	
Transfer from available-for-sale to trading		32.5
Total (loss) gain on securities	(326.6)	82.8
Interest income on federal tax refund		45.2
Other expense	(15.8)	(6.6)
Realized impairment loss on investments	(42.1)	(3.3)
Total investment and other (loss) income	\$ (80.8)	\$ 409.6

5. RECEIVABLES — NET

Receivables outstanding as of December 31, 2008 and 2007, consist of the following:

	2008	2007
Underwritten contracts	\$ 392.4	\$ 361.1
Administrative service contracts – Claim and fees	187.3	203.3
Administrative service contracts – IBNR	1,073.6	1,001.6
Reinsurance recoverable on worker’s compensation business	233.4	283.4
Reinsurance recoverable on long-term care business	337.9	369.1
Securities receivable	8.6	127.7
Accrued interest	59.8	54.1
Drug rebates	72.8	44.1
Other	<u>25.8</u>	<u>65.5</u>
Total	<u>\$ 2,391.6</u>	<u>\$ 2,509.9</u>

Receivables are net of allowances for potentially uncollectible amounts of \$20.1 and \$11.1 as of December 31, 2008 and 2007, respectively.

6. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2008 and 2007, consist of the following:

	2008	2007
Land and buildings	\$ 416.7	\$ 394.7
Equipment	236.7	221.0
Software	<u>486.2</u>	<u>406.8</u>
Total	1,139.6	1,022.5
Less accumulated depreciation	<u>(593.7)</u>	<u>(544.4)</u>
Net property and equipment	<u>\$ 545.9</u>	<u>\$ 478.1</u>

Depreciation expense was \$73.7 and \$73.4 for the years ended December 31, 2008 and 2007, respectively.

7. GOODWILL

Subsidiary acquisitions are accounted for under the purchase method of accounting and, accordingly, the purchase price is allocated to assets acquired and liabilities assumed based on their estimated fair values. The excess of acquisition cost over the fair value of net assets acquired is recorded as goodwill. Goodwill was amortized on a straight-line basis over a 15-year period from 1995 through 2001. Goodwill continues to be amortized over 10 years on acquisitions made by the Company's not-for-profit subsidiaries.

Goodwill from the purchase of subsidiaries, at December 31, 2008 and 2007, consists of the following:

	2008	2007
Goodwill:		
Accident Fund	\$ 124.9	\$ 124.9
UWIC	24.8	24.8
CompWest	35.8	54.0
DenteMax	1.4	1.4
MHIC	17.0	17.0
M-CARE	90.7	90.7
Total	<u>294.6</u>	<u>312.8</u>
Less accumulated amortization	<u>(76.5)</u>	<u>(67.4)</u>
Net goodwill	<u>\$ 218.1</u>	<u>\$ 245.4</u>

The Corporation completed its annual impairment tests as of December 31, 2008 and 2007, and no impairment was deemed necessary.

8. OTHER ASSETS

Other assets at December 31, 2008 and 2007, consist of the following:

	2008	2007
Prepaid pension costs	\$ —	\$ 62.6
Net intangible assets	74.6	63.5
Other invested assets	83.9	64.3
Deferred policy acquisition costs	53.8	54.0
Prepaid assets	21.8	18.2
Investment in NASCO	16.7	18.0
Other	<u>20.9</u>	<u>18.8</u>
Total	<u>\$ 271.7</u>	<u>\$ 299.4</u>

At December 31, 2008, the Corporation holds a 33% interest in National Account Service Company LLC (NASCO). NASCO maintains and operates a national claim processing system for several Blue Cross plans. The Corporation's investment is accounted for using the equity method. The summarized financial position and results of operations for NASCO as of and for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Total assets	\$ 94.4	\$ 95.8
Total liabilities	47.7	46.8
Equity	46.6	49.1
Revenue	179.3	190.1
Net income	1.1	3.7

Other invested assets consist of investments in partnerships and joint ventures in which the Corporation does not exert significant influence but, in some cases, does hold a more than minor ownership interest. Investments with a more than minor ownership interest are accounted for using the equity method and are not considered available-for-sale. All other invested assets are accounted for using the cost basis of accounting. The aggregate carrying amount of all cost method investments as of December 31, 2008 and 2007, was \$56.6 and \$ 40.8, respectively. The Corporation regularly reviews these investments for impairment. No significant impairments were recognized in the current year. The Corporation has concluded that it is not practicable to estimate fair value of cost method investments because they do not have a ready market. Management does not believe there were any changes in circumstances or adverse events that would be expected to change the carrying value of such investments.

Intangible assets from the purchase of subsidiaries are comprised primarily of customer related assets, provider and broker networks, trademarks, and covenants not to compete. Intangible assets are amortized over periods ranging from 1 year to 12 years, as applicable. Trade names and similar assets with indefinite useful lives totaled \$9.8 are not amortized, but are evaluated for impairment on an annual basis. Intangible assets at December 31, 2008 and 2007, at each of the subsidiaries, amount to the following:

	2008	2007
Intangible assets		
DenteMax	\$ 12.9	\$ 12.9
M-CARE	49.8	49.8
MHIC	8.1	8.1
Columbia Life	2.3	2.3
CompWest	<u>32.0</u>	<u>6.0</u>
Total	105.1	79.1
Less accumulated amortization	<u>(30.5)</u>	<u>(15.6)</u>
Net intangible assets	<u>\$ 74.6</u>	<u>\$ 63.5</u>

9. LIABILITIES FOR UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

Activity in the liabilities for unpaid claims and claim adjustment expenses, at December 31, 2008 and 2007, is summarized as follows:

	2008	2007
Balance of unpaid claims – January 1	\$ 2,827.9	\$ 2,655.6
Less reinsurance recoverable	<u>616.2</u>	<u>712.6</u>
Net balance – January 1	<u>2,211.7</u>	<u>1,943.0</u>
Incurred related to:		
Current year	8,784.9	8,250.0
Prior year	<u>(145.1)</u>	<u>(110.2)</u>
Total incurred	<u>8,639.8</u>	<u>8,139.8</u>
Paid related to:		
Current year	7,870.6	7,015.6
Prior year	<u>1,016.3</u>	<u>935.7</u>
Total paid	<u>8,886.9</u>	<u>7,951.3</u>
Balance of unpaid claims – December 31	1,964.6	2,131.5
Unpaid loss assumed by purchase of subsidiaries		80.2
Liabilities subject to reinsurance recoverables	542.3	616.2
Liability for claim adjustment expenses	126.8	134.6
Liability for ASC claims	<u>1,073.6</u>	<u>1,001.6</u>
Total unpaid claims and claim adjustment expenses	<u>\$ 3,707.3</u>	<u>\$ 3,964.1</u>

Changes in actuarial estimates of unpaid claims reported as “incurred related to prior year” reflect revisions in estimates of loss development trends and changes in claims processing patterns. The growth in incurred related to prior year amounts is due to conservative assumptions in 2007 when setting the Medicare Advantage outstanding claims liability. In 2007, Medicare Advantage was a relatively new product and payment patterns from our vendors were still emerging.

10. REINSURANCE

Accident Fund reinsures certain risks with other companies in order to limit losses. Because reinsurance does not relieve Accident Fund of its primary obligations to its policyholders, failure of reinsurers to honor their obligations could result in losses to Accident Fund. To minimize its exposure to significant losses from reinsurer insolvencies, Accident Fund evaluates the financial condition of its reinsurers. When needed, allowances are established for doubtful amounts recoverable from reinsurers. Liabilities for losses ceded to reinsurers are reported as reinsurance recoverables on unpaid losses and a portion of the premiums paid to reinsurers are reported as prepaid reinsurance, which is a component of other assets.

Accident Fund participates in, and assumes business from, residual market workers' compensation pools, as required by certain public acts of states in which Accident Fund conducts business. Pool underwriting results are distributed to companies writing workers' compensation insurance in each state based upon each company's market share, by policy year, of the total voluntary workers' compensation market.

As a servicing carrier, Accident Fund administers policies assigned to it by the Michigan Workers' Compensation Placement Facility ("Michigan Facility"). Associated premiums and losses are recorded as direct business, which is then ceded 100% to the Michigan Facility.

The effects of Accident Fund's reinsurance activities on premiums and losses for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Premiums written:		
Direct	\$ 873.5	\$ 739.9
Reinsurance assumed	31.7	29.4
Reinsurance ceded	<u>(28.0)</u>	<u>(44.7)</u>
Net premiums written	<u>\$ 877.2</u>	<u>\$ 724.6</u>
Premiums earned:		
Direct	\$ 855.9	\$ 723.8
Reinsurance assumed	32.6	33.0
Reinsurance ceded	<u>(28.8)</u>	<u>(57.9)</u>
Net premiums earned	<u>\$ 859.7</u>	<u>\$ 698.9</u>
	2008	2007
Losses and loss adjustment expenses incurred:		
Direct	\$ 585.8	\$ 489.5
Reinsurance assumed	18.2	21.1
Reinsurance ceded	<u>(3.7)</u>	<u>(49.7)</u>
Net losses and loss adjustment expenses incurred	<u>\$ 600.3</u>	<u>\$ 460.9</u>

The reinsurance recoverables at December 31, 2008 and 2007, consist of the following:

	2008	2007
Reinsurance recoverables:		
Unpaid losses recoverable on workers' compensation policies	\$ 181.6	\$ 218.6
Unpaid losses recoverable on disability policies	22.8	28.6
Accrued reinsurance premiums recoverable	7.0	14.8
Paid losses recoverable	<u>22.0</u>	<u>21.4</u>
Total	233.4	283.4
Total prepaid reinsurance	<u>8.5</u>	<u>8.8</u>
Total	<u>\$ 241.9</u>	<u>\$ 292.2</u>

LifeSecure reinsures 100% of the block of business it acquired from Columbia Universal Life Insurance Company with Allstate. Under the coinsurance agreement, Allstate receives 100% of the premiums and pays 100% of the claims, surrender benefits, and other expenses that are directly allocable to the reinsured business. Allstate administers the reinsurance business and bears all administrative expenses. Allstate reimburses LifeSecure for any reinsurance expenses it pays.

LifeSecure has a stoploss reinsurance agreement with BCS Life Insurance Company, whereby it reinsures excess liability arising from its long-term care business. LifeSecure pays an annual premium for this coverage, which is subject to experience adjustment premiums.

On April 15, 2008, LifeSecure entered into a reinsurance agreement with Blue Cross Blue Shield of Kansas (BCBSKS) where BCBSKS markets LifeSecure's long-term care policy under its brand name. LifeSecure assumes 100% of the premiums, claims, and expenses associated with these policies under a coinsurance agreement. In accordance with a separate administrative service agreement, LifeSecure performs most of the administrative functions for this business. BCBSKS receives a marketing allowance from LifeSecure to cover its sales and marketing costs.

On October 1, 2008, LifeSecure entered into a purchase agreement with Florida Combined Life Insurance Company (FCL), whereby LifeSecure was assigned the rights and obligations associated with various reinsurance and administrative service contracts with Blue Cross and Blue Shield of Florida (BCBSFL) and Arkansas Blue Cross Blue Shield (ABCBS). BCBSFL and ABCBS own FCL. Under the assignment agreement, LifeSecure replaces FCL as the reinsurer of the existing long-term care business under various coinsurance agreements with BCBSFL and ABCBS. Subsequent to October 1, 2008, LifeSecure assumes the monthly premiums, claims and other expenses on this block of business, in accordance with the percentages in the underlying reinsurance agreements. LifeSecure pays BCBSFL and ABCBS monthly commission and expense allowances on this block of business.

The effects of reinsurance activities of LifeSecure on premiums and losses for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Direct premiums earned	\$ 12.2	\$ 13.0
Reinsurance assumed	2.6	
Reinsurance ceded	<u>(12.0)</u>	<u>(13.0)</u>
Net premiums earned	<u>\$ 2.8</u>	<u>\$ -</u>
Direct claims incurred	\$ \$25.5	\$ \$24.8
Reinsurance assumed	1.7	
Reinsurance ceded	<u>(25.3)</u>	<u>(24.8)</u>
Net premiums earned	<u>\$ 1.9</u>	<u>\$ -</u>

The reinsurance recoverables at December 31, 2008 and 2007, consist of the following:

	2008	2007
Recoverable on life insurance and other policies	\$ 337.9	\$ 369.1

11. PREMIUM DEFICIENCY RESERVES

Premium deficiency reserves for the year ended December 31, 2008 and 2007 consist of the following:

	Balance December 31, 2007	Additional Provision	Amortization	Balance December 31, 2008
MiChild	\$ 10.8	\$ 15.1	\$ 14.7	\$ 11.2
Individual	136.6	256.3	42.5	350.4
Medicare Complementary	<u>209.3</u>	<u>40.7</u>	<u>67.6</u>	<u>182.4</u>
Total	<u>\$ 356.7</u>	<u>\$ 312.1</u>	<u>\$ 124.8</u>	<u>\$ 544.0</u>

	Balance December 31, 2006	Additional Provision	Amortization	Balance December 31, 2007
MiChild	\$ 10.6	\$ 14.2	\$ 14.0	\$ 10.8
Individual	36.6	125.0	25.0	136.6
Medicare Complementary	<u>198.2</u>	<u>99.2</u>	<u>88.1</u>	<u>209.3</u>
Total	<u>\$ 245.4</u>	<u>\$ 238.4</u>	<u>\$ 127.1</u>	<u>\$ 356.7</u>

Projected Loss by Year	MiChild	Individual	Medicare Comp	Total
2009	\$ 11.2	\$ 106.7	\$ 66.7	\$ 184.6
2010		101.5	58.7	160.2
2011		89.1	41.8	130.9
2012		<u>53.1</u>	<u>15.2</u>	<u>68.3</u>
	<u>\$ 11.2</u>	<u>\$ 350.4</u>	<u>\$ 182.4</u>	<u>\$ 544.0</u>

The MiChild premium deficiency reserve (PDR) was established for the anticipated losses on the state sponsored insurance program, which provides health and dental benefits for uninsured children of Michigan's working families. The \$11.2 balance at December 31, 2008, was the estimated loss for the contract period in effect ended September 30, 2009. At October 1, 2008, the Corporation established a new premium deficiency reserve of \$15.1 based on a current valuation of anticipated losses for the new contract period ending September 30, 2009. For the 2006 through 2008 contract years, an agreement with the State of Michigan limits the Corporation's annual underwriting loss from the MiChild program to \$15.5 million per year. The outstanding receivable balances for excess losses were \$16.8 and \$7.5 at December 31, 2008 and 2007, respectively.

The premium deficiency reserve for the Corporation's Individual business and the Medicare complementary business were established for anticipated losses primarily due to expected future premium rate increases approved by the Michigan Office of Financial and Insurance Regulation (OFIR) being insufficient to cover anticipated benefit trends.

12. RETIREMENT INCOME PLANS

Defined Contribution Plan — Substantially all employees of the Corporation who have attained the age of 21 years and have completed three months of continuous service may elect to participate in one of two employee savings plans, which are qualified under Section 401(k) of the Internal Revenue Code. Effective January 1, 2009, current and newly-hired represented employees will be automatically enrolled in the 401(k) plan after meeting eligibility requirements. For both nonrepresented and represented employees, the Corporation matches 50% of employee contributions up to 10% of biweekly adjusted W-2 wages for employees with one year of continuous service. The Corporation's expense for matching contributions during 2008 and 2007 totaled approximately \$17.8 and \$16.8, respectively.

Nonqualified Plans — Retirement benefits are provided for a group of key employees under nonqualified defined benefit pension plans. The general purpose of the plans is to provide additional retirement benefits to participants who are subject to the contribution and benefit limitations contained in the Internal Revenue Code. Benefits under the plans are unfunded and paid out of the general assets of the Corporation. The accumulated benefit obligation for these plans at December 31, 2008 and 2007, was \$31.3 and \$29.4, respectively.

Defined Benefit Plans — Substantially all employees who meet certain requirements of age and length of service are covered by the Corporation's defined benefit retirement income plans. Benefits paid to retirees are based on age at retirement, years of credited service, and highest monthly average earnings over 60 consecutive months. Revisions to the represented employees' retirement benefits will take effect on January 1, 2009. The Corporation will provide defined benefit cash balance pension program for newly-hired represented employees.

The Corporation maintains a separate plan for unionized employees and employees not represented by the union. Under the Corporation's retirement account plan for non-represented employees, each participant has an account balance to which interest and earnings credits are added. Interest is credited quarterly based on the prior August one-year treasury bill rate. For employees hired prior to January 1, 2007, annual earnings credits of 6% to 10% are credited to participants' account balances on a monthly basis and monthly 2% annual transition credits are made through 2008. For employees hired on or after January 1, 2007, annual earnings credits of 3% to 5% are credited to participants' account balances on a monthly basis. Employees can elect to receive the lump-sum value of their vested account balance or monthly payments at retirement or termination.

The Corporation's retirement income plan weighted-average target asset allocation and actual asset allocation at December 31, 2008 and 2007, by asset category are as follows:

Asset Category	Target	2008	2007
Equity securities	70.0 %	62.0 %	72.0 %
Debt securities	25.0	31.0	26.0
Other	5.0	7.0	2.0

The Corporation has developed an asset allocation policy based on its objectives, characteristics of pension liabilities, capital market expectations, and asset-liability projections. This policy is long-term oriented and consistent with the Corporation's risk posture. The Corporation uses a mix of core and satellite managers to implement its asset allocation policy. The Corporation reviews on a periodic basis its asset mix and reallocates its portfolio at any time there is a material deviation in the asset class as described in the allocation policy. The policy includes a target allocation as included in the table above and a range of plus or minus 3% of the target established. Asset allocations are currently outside of the target range charged due to the fact that market value reductions on equity securities exceed those on debt securities in 2008. The Corporation will rebalance pension asset allocations as provided in the guidelines as market conditions allow.

At December 31, 2008 and 2007, the following table sets forth the projected benefit obligation and funded status at the plan measurement date and the accrued (prepaid) pension expense:

	2008	2007
Accumulated benefit obligation	\$ 958.0	\$ 923.4
Effects of estimated future pay increases	<u>100.5</u>	<u>100.6</u>
Projected benefit obligation	1,058.5	1,024.0
Plan assets at fair market value, principally government bonds, notes, and corporate equity securities	(625.7)	(1,036.8)
Directly paid benefits after measurement date	<u> </u>	<u>(0.6)</u>
Funded status – underfunded (overfunded)	<u>\$ 432.8</u>	<u>\$ (13.4)</u>
Pension assets included in other assets	<u>\$ –</u>	<u>\$ (62.6)</u>
Pension liability included in accrued employee expenses	<u>\$ 432.8</u>	<u>\$ 49.2</u>
Information for pension plans with an accumulated benefit obligation in excess of plan assets:		
Projected benefit obligation	\$ 1,058.5	\$ 33.6
Accumulated benefit obligation	958.0	29.4
Fair value of plan assets	625.7	

The discount rate used in determining the actuarial present value of the projected benefit obligation was 6.9% and 6.3% at December 31, 2008 and 2007, respectively for the non-represented defined benefit plan and the non-qualified plans, and 6.35% and 6.4% for the defined benefit plan for union employees. The discount rate used in determining the net periodic pension cost was 6.8% and 5.9% at December 31, 2008 and 2007, respectively, and 6.9% and 6.1% for the unionized plan. Assumed rates of increase in future compensation range from 3.0% to 6.5% for 2008 and 2007, depending on the ages of the participants. The expected long-term rate of return on assets for all plans was 9% for 2008 and 2007. The Corporation calculates return on assets based on the return expected to be realized over the long term using the current investment policy of the plan.

The benefit costs, employer contributions, and benefits paid for the plans for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Service cost for benefits earned during the year	\$ 37.7	\$ 40.7
Interest cost	64.5	59.8
Expected return on assets	(82.3)	(78.4)
Amortization of net prior service cost	1.0	1.1
Amortization of net loss	<u>0.5</u>	<u>8.7</u>
Net periodic pension cost	<u>\$ 21.4</u>	<u>\$ 31.9</u>
Employer contributions	<u>\$ 30.0</u>	<u>\$ –</u>
Benefits paid	<u>\$ 76.1</u>	<u>\$ 61.3</u>

At December 31, 2008, the following benefit payments which reflect expected future service are expected to be paid as follows:

**Years Ending
December 31**

2009	\$ 127.1
2010	53.3
2011	57.0
2012	62.1
2013	66.0
2014 through 2018	<u>409.6</u>
Total	<u>\$ 775.1</u>

In 2008, the Corporation contributed \$30.0 to its defined benefit pension plans. As of December 31, 2008, the Corporation does not expect to contribute to its defined benefit pension plans in 2009.

The incremental impact of adopting the recognition provisions of SFAS 158 at December 31, 2007 was an increase in accumulated other comprehensive loss of \$24.1, net of \$7.4 tax impact.

The incremental impact of adopting the measurement date change per SFAS 158 at January 1, 2008, was a decrease in accumulated reserves of \$5.1, net of \$1.0 tax impact and an increase in accumulated other comprehensive loss of \$0.2, net of \$0.7 tax impact.

The amounts recognized in the balance sheet at December 31, 2008 and 2007, and the amounts in accumulated other comprehensive income that have not yet been recognized as components of net periodic benefit cost are as follows:

Balance Sheet

	2008	2007
Pension assets in other assets	\$ —	\$ 62.6
Pension liabilities in other liabilities	<u>(432.8)</u>	<u>(49.2)</u>
Total balance sheet (liability) asset	<u>\$ (432.8)</u>	<u>\$ 13.4</u>

Accumulated Other Comprehensive Loss

Net actuarial loss	\$ 480.0	\$ 28.0
Net prior service cost	7.2	8.4
Deferred income taxes	<u>(89.2)</u>	<u>(7.9)</u>
Total accumulated other comprehensive loss	<u>\$ 398.0</u>	<u>\$ 28.5</u>

Changes in the net actuarial loss and the accumulated other comprehensive loss at December 31, 2008 and 2007 are as follows:

	2008	2007
Change in Net Actuarial Loss		
Net actuarial loss at the beginning of the year	\$ 28.0	\$ 124.8
Amortization cost for the year	(1.2)	(8.7)
Liability gain	(1.4)	(25.0)
Asset loss	<u>454.6</u>	<u>(63.1)</u>
Net actuarial loss at the end of the year	<u>\$ 480.0</u>	<u>\$ 28.0</u>
Change in Accumulated Other Comprehensive Loss		
Accumulated other comprehensive loss in prior year	\$ 28.5	\$ 3.0
Recognized during the year:		
Net prior service cost	(1.3)	(1.1)
Net actuarial loss	(1.2)	(8.7)
Occuring during the year:		
Net prior service cost (credit)	0.2	(88.1)
Net actuarial loss	453.2	131.3
Deferred tax	<u>(81.4)</u>	<u>(7.9)</u>
Total accumulated other comprehensive loss at the end of the year	<u>\$ 398.0</u>	<u>\$ 28.5</u>

The Corporation expects to recognize the following as components of the net periodic benefit cost in 2009:

Net loss	\$ 6.1
Prior service cost	<u>1.1</u>
Total	<u>\$ 7.2</u>

13. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Corporation provides certain health care and selected other benefits to all employees and their dependents. Represented and nonrepresented employees hired before January 1, 2004, who have at least 10 years of service after age 45 and retire from active employment or who become disabled and meet certain benefit and service requirements are eligible. Nonrepresented employees hired on or after January 1, 2004, are required to have 15 years of service after age 45 to be eligible for retiree health care benefits and selected other benefits. Nonrepresented employees hired on or after January 1, 2007, will be provided access to retiree health care coverage but will be responsible for 100% of the cost of such benefit. Certain revisions to the represented employees' postretirement benefits other than pensions will take effect January 1, 2009. Effective for all non-represented employees not retired by January 1, 2010, a 4% annual cap will be placed on the annual increase in health care costs that will be paid by the Corporation. Any annual increase in cost above 4% will be paid by the plan participant. Effective January 1, 2008, and January 1, 2009, all participants in the non-represented plan and the represented plan will be required to enroll in the Medicare Advantage program upon reaching age 65. Represented employees eligible to retire after December 31, 2016, are required to have 15 years of service after age 45 to be eligible for retiree health care benefits and selected other benefits, and will be subject to premium sharing based on selected coverage options and retirement date.

This benefit is subject to revision at the discretion of Corporation's Chief Executive Officer for nonrepresented employees and for represented employees, subject to collective bargaining agreements.

The Corporation's postretirement health care plan is unfunded. The accumulated obligation for employee postretirement benefits attributable to active and retired employees at the measurement date and other relevant information at December 31, 2008 and 2007, is as follows:

	2008	2007
Service cost for benefits earned during the year	\$ 21.2	\$ 25.8
Interest cost	35.7	34.4
Amortization of net prior service credit	(6.8)	(5.5)
Amortization of net gain	<u>0.1</u>	<u>4.4</u>
Net periodic postretirement cost	<u>\$ 50.2</u>	<u>\$ 59.1</u>
Accumulated postretirement obligation	<u>\$ 530.1</u>	<u>\$ 574.7</u>
Accrued postretirement expense included in accrued employee expenses	<u>\$ 530.1</u>	<u>\$ 574.7</u>
Benefits paid	<u>\$ 20.9</u>	<u>\$ 22.4</u>

For 2008 measurement purposes, the health care trend rate on covered benefits is assumed to be 7.36% for 2009, ratably downgrading to 5.00% by 2015 and all years thereafter.

For 2007 measurement purposes, the health care trend rate on covered benefits is assumed to be 7.75% for 2008, ratably downgrading to 5.00% by 2015 and all years thereafter.

The discount rate used in determining the actuarial present value of the accumulated postretirement obligation was 6.60% and 6.40% for the non-bargaining plan, and 6.65% and 6.40% for the bargaining plan, at December 31, 2008 and 2007, respectively. Increasing the assumed health care cost trend by 1% for all future years result in increases of approximately \$9.2 in annual service and interest costs and increases of approximately \$73.7 in the accumulated postretirement benefit obligations.

At December 31, 2008, the gross benefit payments expected to be paid and Medicare Part D subsidies anticipated to be received are as follows:

Years Ending December 31	Future Benefit Payments	Anticipated Future Subsidies
2009	\$ 29.9	\$ 1.7
2010	30.2	2.0
2011	32.9	2.3
2012	35.6	2.6
2013	38.2	3.0
2014 through 2018	<u>230.7</u>	<u>22.1</u>
Total	<u>\$ 397.5</u>	<u>\$ 33.7</u>

The incremental impact of adopting the recognition provision of SFAS 158 at December 31, 2007 was an increase in accumulated other comprehensive loss of \$30.3, net of \$4.6 tax impact.

The incremental impact of adopting the measurement date change per SFAS 158 at January 1, 2008, was a decrease in accumulated reserves of \$10.8, net of \$2.2 tax impact and an increase in accumulated other comprehensive loss of \$41.6, net of \$8.8 tax impact.

The amounts recognized in the consolidated balance sheet at December 31, 2008 and 2007, and the amounts in accumulated other comprehensive income that have not yet been recognized as components of net periodic benefit cost are as follows:

Balance Sheet	2008	2007
Postretirement liabilities in other liabilities	\$ <u>(530.1)</u>	\$ <u>(574.7)</u>
Total	<u>\$ (530.1)</u>	<u>\$ (574.7)</u>
Accumulated Other Comprehensive Income		
Net actuarial loss	\$ 57.2	\$ 80.9
Net prior service credit	(111.0)	(46.0)
Deferred income taxes	<u>10.7</u>	<u>(4.6)</u>
Total	<u>\$ (43.1)</u>	<u>\$ 30.3</u>

Changes in the net actuarial loss (gain) and the accumulated other comprehensive loss at December 31, 2008 are as follows:

	2008	2007
Change in Net Actuarial Loss		
Net actuarial loss at the beginning of the year	\$ 80.2	\$ 172.8
Amortization cost for the year	(0.4)	(4.4)
Liability gain	<u>(22.6)</u>	<u>(88.3)</u>
Net actuarial loss at the end of the year	<u>\$ 57.2</u>	<u>\$ 80.1</u>
Change in Accumulated Other Comprehensive Loss		
Accumulated other comprehensive loss in prior year	\$ 28.8	\$ -
Amortized during the year:		
Net prior service credit	8.5	5.5
Net actuarial loss	(0.4)	(4.4)
Occurring during the year:		
Net prior service credit	(72.6)	(30.6)
Net actuarial gain	(22.6)	(88.3)
Balance of actuarial items arising in prior years recognized per SFAS No. 158		151.9
Other adjustments	(0.1)	
Deferred tax	<u>15.3</u>	<u>(4.6)</u>
Total accumulated other comprehensive (loss) income at the end of the year	<u>\$ (43.1)</u>	<u>\$ 29.5</u>

The Corporation expects to recognize the following as components of the net periodic benefit cost in 2009:

Net loss	\$ 2.4
Prior service credit	<u>(16.4)</u>
Total	<u>\$ (14.0)</u>

14. DEBT

The Corporation's outstanding debt as of December 31, 2008 and 2007 is as follows:

	2008	2007
RBS Asset Finance Inc. – sale-leaseback	\$ 74.4	\$ 90.9
Banc of America Leasing & Capital, LLC – sale-leaseback	74.9	
FHLBI – Parking Garage	46.0	46.0
FHLBI – Liquidity and arbitrage	267.4	150.4
FHLBI – AFICA Corporate Headquarters	49.8	
CompWest junior subordinated debt	<u>20.6</u>	<u>20.6</u>
Total	<u>\$ 533.1</u>	<u>\$ 307.9</u>

In 2003, the Company entered into a long-term debt financing transaction on certain computer hardware and systems with RBS Asset Finance Inc. The loan, which was for an initial five-year term, was renewed in 2008 for an additional five-year term. The renewal borrowings in September and November were \$50.5 and \$26.6, respectively.

The effective interest rate on the RBS financing was fixed at 4.9% for the initial five-year term and is fixed at 4.73% for September renewal and 3.46% for November renewal. Total interest paid for the leases in 2008 and 2007 was \$4.0 and \$4.8, respectively. Capitalized financing costs are fully amortized at December 31, 2008, and were \$0.3 at December 31 2007. At December 31, 2008 and 2007, the fair value of the RBS debt approximates fair value.

In December 2008, the Company entered into a second long-term debt financing transaction on its capitalized software with Banc of America Leasing & Capital, LLC. The borrowing under this financing arrangement is \$74.9. The loan has a five-year term with a fixed interest rate at 5%. The capitalized financing cost at December 31, 2008 was \$0.8. At December 31, 2008, the fair value of the Banc of America debt approximates fair value.

As part of both sale-leaseback agreements, the Company is required to maintain letters of credit to collateralize the debt. The letter of credit for the RBS financing is with Comerica Bank and the required amount is at least 100% and 50% in 2008 and 2007 of the financed amount. The term of the letter of credit is for one year and renews annually. At December 31, 2008 and 2007, the notional amount of the letter of credit was approximately \$77.1. The letter of credit for the Banc of America financing is with Federal Home Loan Bank of Indianapolis and the amount of the letter of credit is 105% of the financed amount. The term of the letter of credit is for five years. At December 31, 2008, the notional amount of the letter of credit was \$78.6. No amounts have been drawn on either line of credit.

In addition to the line of credit described previously, the Company, as a member of the Federal Home Loan Bank of Indianapolis (FHLBI), has long-term and line of credit borrowing privileges. Outstanding borrowings with the FHLBI total \$ 363.2 and \$196.4 at December 31, 2008 and 2007, respectively. The \$46.4 acquired in 2006 was borrowed under the FHLBI's Community Investment Program to finance the Corporation's Detroit Campus Improvement Project. The borrowings have a ten-year term and are subject to floating interest rate provisions that are reset every three months based on the FHLBI's cost of funds. The \$200.0 total acquired in 2007 and 2008 were five year term loans borrowed due to favorable interest rate level. The remaining \$67.0 was borrowed for liquidity purpose. All loans are collateralized by government securities at 105% of the outstanding loan balance. The weighted-average borrowing rate is 2.6% and 4.26% at December 31, 2008 and 2007, respectively. Total interest paid and accrued was \$10.2 and \$7.5 as of December 31, 2008 and 2007, respectively. In October 2008, AFICA borrowed \$50.0 from FHLBI to finance the construction of their new headquarters. As of December 31, 2008, the total outstanding debt was \$49.8 and it is collateralized by \$72.3 of available-for-sale bonds held in a segregated trust account at Comerica Bank. The loans have twenty-year term and the average borrowing rate is 5.17% and the total interest paid and accrued was \$0.6 as of December 31, 2008. At December 31, 2008, the fair value of FHLBI loans approximates fair value.

With the purchase of CompWest, AFICA assumed \$20.6 million in junior subordinate debt. The maturity date of the junior debt is June 15, 2036. Interest on the debt is payable quarterly at a rate of 9.045% through June 2011 and the three-month LIBOR plus 3.6% for each subsequent period thereafter. As of December 31, 2008, the fair value of the junior subordinate debt approximates fair value.

At December 31, 2008, future minimum payments required for outstanding debt are as follows:

**Years Ending
December 31**

2009	\$ 117.7
2010	51.2
2011	51.8
2012	201.4
2013	91.5
2014 and thereafter	<u>157.2</u>
Total minimum payments	670.8
Less amount representing interest	<u>(137.7)</u>
Total debt	<u>\$ 533.1</u>

15. FEDERAL INCOME TAXES

Significant components of net deferred tax assets at December 31, 2008 and 2007, are summarized as follows:

	2008	2007
Deferred tax assets:		
Alternative Minimum Tax (AMT) credit carryforward	\$ 461.5	\$ 461.5
Accrued expenses associated with postretirement and pension benefits	299.7	173.7
Amounts accrued to groups	0.9	0.5
Amount accrued for premium deficiency	190.4	124.8
Accrued expenses and bad debts	40.3	26.5
Net operating loss carryover	12.8	6.5
Unrealized losses on investments	119.0	0.0
Discount of claim liabilities as required for tax purposes	<u>111.4</u>	<u>112.2</u>
Total deferred tax assets	1,236.0	905.7
Valuation allowance	<u>(774.7)</u>	<u>(620.7)</u>
Net deferred tax assets	<u>461.3</u>	<u>285.0</u>
Deferred tax liabilities:		
Depreciation – amortization and other	45.6	26.7
Unrealized gains on investments	<u> </u>	<u>43.4</u>
Total deferred tax liabilities	<u>45.6</u>	<u>70.1</u>
Total	<u>\$ 415.7</u>	<u>\$ 214.9</u>

The Company and its taxable subsidiaries file a consolidated federal income tax return. Further, the Company has tax-sharing agreements with its taxable subsidiaries to provide that each taxable subsidiary is responsible for its own federal tax liability.

Under current tax law, the Company is subject to a 20% AMT rate. Given the preference items afforded Blue Cross and Blue Shield organizations, management believes it is likely to remain an AMT taxpayer. The deferred tax assets are recorded at the regular corporate tax rate of 35% and a valuation allowance has been established for the difference between the value of the asset at the regular tax rate and its likely value at the AMT rate. In addition, the AMT credit carryforward has been fully reserved in the valuation allowance. The valuation allowance increased by \$154.0 and \$54.8 in 2008 and 2007, respectively, primarily due to increases in accrued expenses associated with postretirement and pension benefits, amounts accrued for premium deficiency and the unrealized capital losses. The valuation allowance reduces deferred tax assets to an amount that represents management's best estimate of the amount of such deferred tax assets that more-likely-than-not will be realized.

The effective tax rate differs from the expected AMT rate of 20% primarily because BCNM is a tax-exempt organization under the provisions of IRS Code Section 501(c)(4) and the recording of tax adjustments that are attributable to prior years.

Components of the provision for federal income taxes for the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Current expense	\$ 42.6	\$ (12.1)
Deferred benefit	<u>(96.8)</u>	<u>(26.1)</u>
Total	<u>\$ (54.2)</u>	<u>\$ (38.2)</u>

During 2007, the Corporation closed out several open tax years that were under various stages of the examination process with the IRS. The field examination for the tax years 2004 and 2005 was completed and closed in 2007 with no material tax adjustments required. The 1996 through 1999 audit, which was favorably resolved by the IRS Appeals Division in 2005, but held open for administrative matters, was also closed in 2007. The 2000 through 2003 audit cycle was favorably settled in 2007 by the IRS Appeals Division and closed in 2008. During 2008, the 2006 tax year was selected for examination and closed in 2008 with no tax adjustments required.

In 2007, the Corporation recorded a tax benefit of \$40.7 for intangible asset deductions pertaining to tax years 1989 through 2004 that were in existence when the Company first became taxable in 1987. Refunds were received amounting to \$38.1 attributable to tax years 1989 through 1999. The remaining \$2.6 attributable to tax years 2000 through 2004 was refunded in 2008 as part of the IRS audit agreements mentioned above.

FASB Staff Position No. FIN 48-3 deferred the effective date of FIN No. 48 for nonpublic companies and pass-through entities to fiscal years beginning in 2009 in order to provide additional authoritative guidance for these entities. The Corporation has elected to defer the application of FIN No. 48 until 2009 and accordingly continues to evaluate uncertain tax provisions utilizing the guidance set forth in SFAS No. 5.

16. INDUSTRY CONCENTRATION

The Corporation primarily conducts business within the State of Michigan. A significant portion of the Corporation's customer base is concentrated in companies that are part of the automobile manufacturing industry. Receivables from the significant customers in this industry are \$88.8 and \$131.6 at December 31, 2008 and 2007, respectively. These receivables primarily represent reimbursable claims and administrative fees for services provided to them as part of their ASC arrangements with the Corporation. The Corporation held cash advances from these customers of \$22.1 and \$21.5 at December 31, 2008 and 2007, respectively, to partially offset these receivables. Under an ASC arrangement, the group sponsor retains the primary financial responsibility for the underwriting risk of their employees. The Corporation retains an element of credit risk to providers in the event reimbursement is not received from the plan sponsor, accordingly, the Corporation has recorded a liability for IBNR and a related receivable in the amount of \$283.9 and \$283.2 at December 31, 2008 and 2007, respectively. In addition, the Corporation holds investments in these customers' equity securities, corporate bonds, commercial paper, and medium-term notes with a total fair value of \$15.9 and \$16.1 at December 31, 2008 and 2007, respectively.

17. OPERATING LEASES

The Corporation leases certain computer equipment and office space under various noncancelable operating leases. Rental expense was \$16.8 and \$16.5 for 2008 and 2007, respectively. At December 31, 2008, future minimum lease payments are as follows:

Years Ending December 31

2009	\$ 12.3
2010	12.1
2011	12.1
2012	12.3
2013	11.3
2014 and thereafter	<u>10.9</u>
Total	<u>\$ 71.0</u>

18. UNCONDITIONAL PURCHASE OBLIGATIONS

The Corporation has entered into certain noncancelable, long-term computer maintenance and license contracts. Payments recognized under such contracts totaled \$20.0 and \$16.4 for the years ended December 31, 2008 and 2007, respectively.

At December 31, 2008, future payments are as follows:

Years Ending December 31

2009	\$ 17.9
2010	13.2
2011	<u>6.8</u>
Total	<u>\$ 37.9</u>

19. OTHER LIABILITIES

Other liabilities at December 31, 2008 and 2007, consist of the following:

	2008	2007
Securities payable	\$ 45.7	\$ 274.9
Accrued administrative expenses	193.8	204.9
Advance deposits from ASC groups	184.7	199.4
Administrative cash overdrafts	95.9	66.9
Accrued taxes, assessments, and fees	30.0	31.3
Policyholder dividends	44.7	45.8
Reinsurance liabilities	15.3	12.4
Board of Escheats	10.9	11.7
Advances from CMS	0.6	17.0
Other	<u>78.8</u>	<u>78.9</u>
Total	<u>\$ 700.4</u>	<u>\$ 943.2</u>

20. CONTINGENCIES

During 2007, the Corporation along with BCBSA and several Blue Cross Blue Shield Plans (the Plans) reached an agreement with a nationwide class of physicians resolving a class action lawsuit with respect to the pricing of medical claim payments. The final order approving the settlement was entered by the trial court in April 2008. The agreement resolved business disagreements between the Plans and physicians regarding payments, and calls for the Plans to strengthen business practices that promote open communication and cooperation with physicians in the future. The Corporation's share of the cash portion of the settlement amounting to \$15.9 is fully accrued in the consolidated balance sheets. There is one remaining appeal pending pertaining to the final settlement.

The Corporation is the defendant in numerous other lawsuits arising in the normal course of business primarily related to subscribers' benefits and provider reimbursement issues, such as incentive payments and participation arrangements.

While the ultimate outcome and estimate of range of potential loss of the aforementioned lawsuits and others not specifically mentioned cannot be determined at this time, it is the opinion of management and legal counsel that the outcome of such lawsuits will not have a material adverse effect on the Corporation's consolidated financial position or results of operations.

Under the terms of self-funded administrative service contracts with its customers, the Corporation is subject to audits of claims processed by the Corporation as well as those processed by its related participating plans in other states. Such audits encompass the accuracy of claims payments made on behalf of customers and the administrative expenses charged to the customer. The Corporation records an estimated amount for the resolution of customer disputes. Settlements of such disputes are not expected to have a material effect on the Corporation's consolidated financial position or results of operations.

Management believes any probable contingencies are appropriately recorded in other liabilities.

21. SUBSCRIBERS' RESERVES

Under the provisions of Public Act No. 59 of 2003 ("Act 59") of the State of Michigan, the Company must maintain adequate subscribers' reserves to comply with Section 403 of the Michigan Insurance Code, which requires authorized insurers to be safe, reliable and entitled to public confidence. As a result, the Company is required to file with the Office of Financial and Insurance Regulation (OFIR), on an annual basis, its risk-based capital (RBC) calculation based on the National Association of Insurance Commissioners (NAIC) model. Act 59 requires the Company to maintain a RBC ratio of at least 200%, but not to exceed 1,000% of subscribers' reserves. At December 31, 2008 and 2007, the Company was in compliance with the RBC requirement.

BCNM's Articles of Incorporation state that no dividends shall be directly paid on any shares nor shall the shareholder be entitled to any portion of the earnings derived through increment of value upon its property or otherwise incidentally made. BCNM's statutory capital and surplus as of December 31, 2008 and 2007, is \$336.7 and \$244.1, respectively. BCNM is required by OFIR to comply with certain RBC requirements. At December 31, 2008 and 2007, BCNM was in compliance with the RBC requirement.

Accident Fund is subject to state regulatory restrictions that limit the maximum amount of annual dividends or other distributions, including loans or cash advances, available to the parent without prior approval of the State of Michigan's Commissioner of Financial and Insurance Regulation. As of December 31, 2008, the maximum amount of dividends and other distributions that may be made by Accident Fund during 2009 without prior approval is \$57.7. Accident Fund's statutory capital and surplus as of December 31, 2008 and 2007, is \$577.3 and \$656.8, respectively. Accident Fund is required by OFIR to comply with certain RBC requirements. At December 31, 2008 and 2007, Accident Fund was in compliance with the RBC requirement.

At December 31, 2008, \$284.2 of cash and \$1,856.7 of investments are held at the Corporation's subsidiaries, which are subject to the aforementioned dividend limitations.

22. OTHER COMPREHENSIVE (LOSS) INCOME

Other comprehensive (loss) income at December 31, 2008 and 2007, consists of the following:

	2008	2007
Unrealized gains and losses on available-for-sale securities	\$ (215.7)	\$ 63.5
Transfer from available-for-sale to trading		<u>(32.5)</u>
Net unrealized (losses) gains on available-for-sale securities	(215.7)	31.0
Change in unrecognized pension and postretirement liabilities	(417.4)	
Income tax benefit (expense) related to items of other comprehensive income	<u>115.8</u>	<u>(5.9)</u>
Other comprehensive (loss) income – net of tax	<u>\$ (517.3)</u>	<u>\$ 25.1</u>

The accumulated other comprehensive (loss) income at December 31, 2008 and 2007, is as follows:

	2008	2007
Unrealized (losses) gains on available-for-sale securities	\$ (76.1)	\$ 98.0
Unrecognized pension and postretirement liabilities	<u>(354.9)</u>	<u>(53.1)</u>
Total	<u>\$ (431.0)</u>	<u>\$ 44.9</u>

23. STATUTORY BASIS ACCOUNTING INFORMATION

Statutory basis financial statements are filed with the OFIR. GAAP differs from the statutory basis accounting practices prescribed or permitted by OFIR. A reconciliation of GAAP net income to statutory basis net income at December 31, 2008 and 2007 is as follows:

	2008	2007
GAAP (reduction) additions to subscribers' reserves in the accompanying statements	\$ (144.9)	\$ 152.2
Add (deduct) adjustments in accordance with statutory basis accounting principles:		
Sale-leaseback adjustments – net	(9.3)	2.6
Statutory PDR changes – adjustment required to record 2-year PDR	196.5	
Deferred implementation premium		32.5
Impairment of trading securities	(93.8)	
Nonvested retiree pension expense	(14.6)	(1.0)
Affiliates' earnings recorded in equity	(33.7)	(126.6)
Changes in unrealized gain or losses for trading reclassified to equity	168.8	(14.2)
Deferred tax expense recorded in equity	<u>(64.9)</u>	<u>(29.3)</u>
Statutory basis net income as prescribed by OFIR	<u>\$ 4.1</u>	<u>\$ 16.2</u>

A reconciliation of the Corporation's GAAP subscribers' reserves to SAP subscribers' reserves is shown below for December 31, 2008 and 2007, respectively:

	2008	2007
GAAP Subscribers' Reserves	\$ 2,326.4	\$ 2,963.1
Add (deduct):		
Sale-leaseback adjustments – net	48.0	55.4
Bonds and preferred stocks	0.5	(47.8)
Investment in subsidiaries	(316.4)	(342.8)
Furniture, equipment, and automobiles	(22.4)	(18.3)
Computer and software equipment not included in the sale-leaseback	(111.4)	(142.5)
Retiree health obligation	124.3	138.3
Retiree pension asset	(97.1)	(91.4)
Premium and other receivables	(23.1)	(9.7)
Deferred tax assets	(121.1)	(85.7)
Prepaid expenses and other assets	(108.3)	(66.9)
Premium deficiency reserve adjustment	157.2	
SFAS 158 pension and postretirement adjustment	<u>370.8</u>	<u>54.4</u>
	<u>(99.0)</u>	<u>(557.0)</u>
SAP Subscribers' Reserves as prescribed by OFIR	<u>\$ 2,227.4</u>	<u>\$ 2,406.1</u>