PREMERA

Consolidated Financial Statements
as of and for the Years Ended
December 31, 2012 and 2011, and
Independent Auditors' Report

PREMERA

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
PREMERA:

We have audited the accompanying consolidated financial statements of PREMERA and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, net worth, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of PREMERA and its subsidiaries as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

March 18, 2013

PREMERA

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
ASSETS		
Cash and cash equivalents	$ 214,182	$ 184,983
Investments:		
Available-for-sale investments, at fair value:		
Short-term investments	780	5,135
Fixed-income securities (amortized cost — $937,959 and $907,542, respectively)	999,521	950,158
Marketable equity securities (cost — $301,079 and $297,696, respectively)	435,324	369,751
Other investments:		
Private equity funds (includes $21,415 and $0, respectively, measured at fair value)	91,646	63,535
Other long-term investments	19,873	17,845
Total investments	1,547,144	1,406,424
Receivables:		
Trade receivables, net of allowance for doubtful accounts of $3,504 and $4,437, respectively	201,159	184,873
ASC and ASO receivables, net of allowance for doubtful accounts of $60 and $47, respectively	316,230	276,988
Reinsurance receivables, net of allowance for doubtful accounts of $0 and $258, respectively	72,203	63,553
Investment income receivable	6,859	7,294
Federal income tax receivable	18,563	21,656
Total receivables	615,014	554,364
Property and equipment, net	70,657	72,283
Other:		
Prepaid expenses and deferred charges	42,819	24,182
Physicians' deferred compensation plan assets	5,918	6,237
Deferred federal income taxes, net	-	5,486
Total other	48,737	35,905
Total assets	$2,495,734	$2,253,959

(Continued)

PREMERA

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2012 AND 2011
(In thousands)

LIABILITIES AND NET WORTH	2012	2011
Liabilities:		
Benefit liability	$ 372,758	$ 351,618
ASC and ASO benefit liability	306,941	255,156
Outstanding checks in excess of bank balances	103,321	102,331
Unearned revenue	73,471	104,374
Accounts payable and accrued liabilities	63,171	61,902
Pension and postretirement benefits	78,597	66,222
Physicians' deferred compensation plan payable	5,918	6,237
Deferred federal income taxes, net	17,468	-
Policy reserves	87,485	79,249
Other liabilities	79,121	78,537
Total liabilities	1,188,251	1,105,626
Commitments and contingencies (Note 11)		
Net worth:		
General reserves	1,227,888	1,129,674
Accumulated other comprehensive income	79,595	18,659
Total net worth	1,307,483	1,148,333
Total liabilities and net worth	$2,495,734	$2,253,959

See accompanying notes to consolidated financial statements. (Concluded)

PREMERA

CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
Revenue:		
Premiums	$3,147,159	$3,050,272
Medical loss ratio rebates	(2,258)	(1,266)
Administrative fees	180,926	165,142
Other revenue	18,962	13,726
Total revenues	3,344,789	3,227,874
Expenses:		
Benefit expense	2,708,133	2,582,369
General and administrative	456,587	439,429
Commissions and brokerage	68,928	68,082
Premium taxes	47,407	47,466
Total expenses	3,281,055	3,137,346
Investment income (loss):		
Net investment income	33,590	36,227
Other-than-temporary impairment losses on investments (a)	(6,653)	(5,853)
Net realized gains on investments	26,953	17,970
Total investment income	53,890	48,344
Other income (expense)	8,835	(2,725)
Income from continuing operations before income taxes	126,459	136,147
Income taxes expense	(28,245)	(25,570)
Income from continuing operations	98,214	110,577
Discontinued operations, net of income taxes	-	(130)
Net income	$ 98,214	$ 110,447

(a) Total other-than-temporary impairment losses amounted to $6,757 and $8,474 for the years ended December 31, 2012 and 2011, respectively. Of these amounts, $6,653 and $5,853 were recognized in earnings and the remaining $104 and $2,621 were recognized in other comprehensive income in 2012 and 2011, respectively.

See accompanying notes to consolidated financial statements.

PREMERA

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
General reserves:		
Net income	$ 98,214	$ 110,447
Other comprehensive income (loss), net of tax:		
Change in noncredit component of other-than-temporary impairment losses on investments (net of tax: 2012 — $729; 2011 — $(540))	2,917	(2,159)
Unrealized net appreciation on available-for-sale investments (net of tax: 2012 — $17,782; 2011 — $3,258)	70,433	13,324
Reclassification adjustment for net realized gains included in net income (net of tax: 2012 — $(2,365); 2011 — $(2,934))	(9,462)	(11,738)
Change in unrecognized retirement benefit costs (net of tax: 2012 — $(738); 2011 — $(6,790))	(2,952)	(27,159)
Total other comprehensive income (loss)	60,936	(27,732)
Comprehensive income	$ 159,150	$ 82,715

See accompanying notes to consolidated financial statements.

PREMERA

CONSOLIDATED STATEMENTS OF NET WORTH
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
General reserves:		
Balance at beginning of year	$1,129,674	$1,019,227
Net income	98,214	110,447
Balance at end of year	1,227,888	1,129,674
Accumulated other comprehensive income:		
Available-for-sale adjustments, net of tax:		
Balance at beginning of year	92,539	93,112
Noncredit gains (losses) of other-than-temporary impairment losses on investments	2,917	(2,159)
Unrealized net appreciation on available-for-sale investments	70,433	13,324
Reclassification adjustment for net realized gains included in net income	(9,462)	(11,738)
Balance at end of year	156,427	92,539
Unrecognized retirement benefit costs:		
Balance at beginning of year	(73,880)	(46,721)
Change in unrecognized retirement benefit costs, net of tax	(2,952)	(27,159)
Balance at end of year	(76,832)	(73,880)
Accumulated other comprehensive income at end of year	79,595	18,659
Total net worth	$1,307,483	$1,148,333

See accompanying notes to consolidated financial statements.

PREMERA

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)

	2012	2011
Operating activities:		
Net income	$ 98,214	$ 110,447
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized gains on available-for-sale investments	(14,131)	(14,332)
Net realized (gains) losses on other investments	(3,070)	2,313
Net realized losses on disposals of property and equipment	244	-
Depreciation of property and equipment	11,644	23,209
Net accretion of discounts and amortization of premiums on investment securities	7,235	4,516
Deferred income taxes	7,546	4,447
Changes in certain assets and liabilities:		
Trade receivables, net	(20,692)	(22,079)
ASC and ASO receivables, net	(39,242)	(22,243)
Reinsurance receivables, net	(8,650)	(6,479)
Investment income receivable	435	(356)
Federal income tax recoverable (receivable)	3,093	(4,546)
Prepaid expenses and deferred charges	(17,532)	(19,380)
Benefit liability	21,140	35,628
ASC and ASO benefit liability	51,785	2,361
Outstanding checks in excess of bank balances	990	30,714
Unearned revenue	(30,903)	32,562
Accounts payable	3,617	(5,691)
Pension and postretirement benefits	6,988	5,604
Policy reserves	8,236	(2,709)
Other liabilities	584	5,419
Net cash provided by operating activities	87,531	159,405
Investing activities:		
Proceeds from sales of investments	870,472	736,199
Proceeds from maturities of investments	115,051	109,724
Proceeds from redemption of note receivable	4,000	-
Purchases of investments	(1,009,287)	(952,031)
Purchases of other long-term investments	(28,306)	(4,210)
Purchases of property and equipment	(10,262)	(9,831)
Net cash used in investing activities	(58,332)	(120,149)
Net increase in cash and cash equivalents	29,199	39,256
Cash and cash equivalents at beginning of year	184,983	145,727
Cash and cash equivalents at end of year	$ 214,182	$ 184,983

See accompanying notes to consolidated financial statements.

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations — PREMERA is a Washington nonprofit and miscellaneous corporation that is the sole voting member of Premera Blue Cross (PBC). PBC is a Washington nonprofit corporation that is registered as a health care service contractor in the state of Washington and a hospital and medical service corporation in the state of Alaska. PBC is primarily engaged in the business of providing basic medical, hospital, major medical, comprehensive, and other prepaid health care benefits for its subscribers in the states of Washington and Alaska.

PBC owns 100% of the voting stock of PremeraFirst, Inc., Academe, Inc. ("Academe"), and Ucentris Insured Solutions, Inc. ("Ucentris"), 9% of International Plan Solutions, LLC (IPS), a Delaware limited liability company, and 35% of EveryMove, Inc. ("EveryMove"), a Delaware corporation. PremeraFirst, Inc., is a Washington corporation that primarily serves, on behalf of certain affiliates, as an agent for contracting with physicians and providers. Academe is a dormant Washington for-profit corporation licensed as a life-and-disability carrier. IPS is a shareholder of HTH Worldwide, a company providing health coverage to expatriates and students. EveryMove is a wellness company that rewards people for engaging in physical activities.

Ucentris is a Washington for-profit corporation and insurance agency, which, in turn, owns 100% of the voting interests of LifeWise Assurance Company (LWAC), LifeWise Health Plan of Oregon, Inc. (LWO), LifeWise Health Plan of Washington (LWW), NorthStar Administrators, Inc. ("NorthStar"), Calypso Healthcare Solutions ("Calypso"), LifeWise Administrators, Inc. (LWA), and Vivacity, Inc. ("Vivacity").

LWAC, LWO, NorthStar, LWA, and Vivacity are for-profit corporations. LWAC is domiciled in the state of Washington and primarily offers group life, accident, disability, student health, and stop-loss insurance in a number of states where it is licensed to do so. LWO is domiciled in the state of Oregon and primarily offers individual and group health insurance policies to Oregon residents. NorthStar is a Washington corporation that in turn owns 20% of WPMI, LLC (WPMI), which is a Delaware limited liability company that provides third-party administrative services in the People's Republic of China. LWA provides services under the Consolidated Omnibus Budget Reconciliation Act to employer groups. LWA owns 19% of WorldDoc, Inc. ("WorldDoc"), a Nevada for-profit corporation providing a web-based portal with health and wellness applications. Vivacity is a Washington corporation that provides innovative wellness services and products to employers. LWW is a Washington nonprofit miscellaneous corporation and health care service contractor registered in the state of Washington that primarily provides individual and group health benefits coverage to Washington State residents. Calypso is a Washington nonprofit and miscellaneous corporation that provides investigation and recovery services to health plans and self-funded employer health plans.

Principles of Consolidation — The consolidated financial statements have been prepared using U.S. generally accepted accounting principles (GAAP) and include the accounts of PREMERA and subsidiaries (collectively, hereinafter referred to as the "Company"). All intercompany balances and transactions have been eliminated in the consolidated financial statements.

Use of Estimates — Preparation of these consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and the accompanying notes. We consider some of our most important accounting policies that require estimates and management judgment to be those policies with respect to benefit liabilities, income taxes, investments, and retirement benefits. Actual results could differ from those estimates.

Cash and Cash Equivalents — Cash and cash equivalents consist primarily of cash balances on hand and deposited in financial institutions and are all highly liquid investments with a maturity of three months or less when purchased.

Short-Term Investments — Short-term investments are carried at fair value based on quoted market prices for identical or similar securities. The Company considers securities with maturities greater than three months and less than one year at the date of purchase to be short-term investments.

Investments — The Company classifies all securities, except other investments, as available-for-sale. All available-for-sale securities are recorded at fair value with unrealized gains and losses, net of tax, recognized as a component of other comprehensive income, with the exception of embedded derivatives for which the change in fair value is recorded within net realized gains on investments in the consolidated statements of income. The fair value of all securities, except other investments, is based on quoted market prices for identical or similar securities.

The fixed-income portfolio is invested primarily in U.S. Treasury and government agency securities, corporate bonds, asset-backed bonds, and mortgage-related securities. The Company also maintains a diverse portfolio of domestic and foreign equity securities. There were no non-U.S. dollar-denominated investments held as of December 31, 2012 and 2011.

Premiums and discounts on fixed-income securities are recognized as adjustments to investment income, using the scientific method.

Interest on fixed-income securities is recognized in income on an accrual basis. The retrospective-adjustment method is used to amortize all asset-backed securities. Gain or loss on the sale of fixed-income securities and marketable equity securities is determined using the maximum loss convention cost of all shares of that type of security held at the time of sale.

Private equity funds are organized as limited liability-type entities or corporations that hold diversified portfolios of high-yield bank loans and real estate. Readily determinable fair values are not available for the underlying investments and these financial instruments involve varying degrees of risk. Private equity funds are less liquid than the Company's available-for-sale investments. The Company holds a minor influence and each fund maintains specific ownership accounts on the Company's behalf. The Company accounts for private equity limited liability-type funds using the equity method and recognizes its share of each fund's earnings or losses in the periods they are reported. The Company accounts for private equity funds organized as corporations using the fair value option, measuring each fund at fair value and recognizing changes in fair value in earnings in the periods they are reported.

Other long-term investments include investments held for the deferred benefit of PBC's defined contribution supplemental retirement program, as well as investments in our noncontrolling interests in EveryMove, WPMI, IPS, CommunityConnect HealthPlan of Pennsylvania (CCHP), and WorldDoc. The deferred benefit program investments are stated at fair value, which is determined based upon quoted market prices for identical or similar securities. The Company's investment in EveryMove is accounted for under the cost method. Noncontrolling interests in the remaining other long-term investments are accounted for under the equity method.

Other-than-Temporary Impairment — The Company evaluates its marketable equity securities for other-than-temporary impairment based on current economic conditions, duration and severity of declines in fair value, declining credit quality, and financial condition of the issuers. Private equity funds and other long-term investments are evaluated based on qualitative and quantitative factors, including history of operating losses and the Company's knowledge of the investee, its activities, and financial condition. Fixed-income securities are evaluated by estimating the future discounted cash flows of the security compared to the Company's amortized cost basis. Cash flows are estimated using the remaining contractual cash flows of the underlying collateral, adjusted for future expected credit losses (which consider current delinquencies, expected future default rates, vintage, and collateral value by geographic region) and prepayments, as applicable. The estimated cash flows are discounted using the effective yield at the time of acquisition.

Any fixed-income securities with declines in fair value considered to be other than temporary, and that we do not intend to sell and will not be required to sell prior to recovery of amortized cost, are separated into the amount that is credit-related and the amount related to all other factors. The credit loss component is recognized as a realized loss in the consolidated statements of income and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The noncredit component, calculated as the difference between the security's fair value and the present value of future expected cash flows, is recognized as a component of other comprehensive income. Any fixed-income security that the Company intends to sell or will be required to sell prior to recovery of amortized cost is written down to its fair market value with the realized loss recognized in the consolidated statements of income.

Marketable equity securities with declines in fair value considered to be other than temporary are written down to estimated fair value and the impairment charge is recorded within other-than-temporary impairment losses on investments in the consolidated statements of income.

The Company continues to review its investment portfolios under its impairment review policy. Given past market conditions and the significant judgments involved, there is a continuing risk that further declines in fair value may occur and additional material other-than-temporary impairment losses on investments may be recorded in future periods.

Derivatives — The Company's investment guidelines provide that a portion of the Company's investment portfolio may comprise convertible bonds. Convertible bonds diversify the portfolio and these investments have the potential to provide the opportunity of gains similar to equity securities while preserving capital investment similar to a bond. The conversion feature of the bond into an equity security is considered an embedded derivative under the accounting guidance for derivative instruments, Accounting Standards Codification (ASC) Topic 815, *Derivatives and Hedging*. The Company bifurcates this embedded derivative from the related bond and reports it at fair value in marketable equity securities. Changes in the fair value of the embedded derivative are recorded in the consolidated statements of income as realized gains on investments.

Subprime Risk — The investment guidelines of the Company allow its core fixed-income manager to invest in mortgage-backed securities (MBS) that are rated investment grade or higher. This would include an MBS that is collateralized with subprime mortgage loans if the security has an adequate credit rating at the time of purchase. The general categories of information considered related to the purchase and subsequent evaluation of subprime securities for other-than-temporary impairment include:

- The credit rating of the security.
- Whether the underlying loans have fixed or variable interest rates.

- The payment priority of the tranche (senior vs. subordinate).
- The expected life of the tranche.
- Whether there is overcollateralization of the underlying loans to the current face value of the security.
- Whether the principal and interest of the security is insured by a third-party bond insurer. The Company has exposure to unrealized loss due to changes in the fair value.

Fair Values of Financial Instruments — The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments in the accompanying consolidated financial statements and notes thereto:

*Cash and Cash Equivalents, Short-Term Investments, and Outstanding Checks in Excess of Bank Balance*s — The carrying amounts reported in the accompanying consolidated balance sheets for these financial instruments approximate their fair values due to the short nature of their duration.

Available-for-Sale Securities — The fair values of fixed-income and marketable equity securities are based on quoted market prices. These fair values are obtained primarily from third-party pricing services, which generally use Level I or Level II inputs for the determination of fair value in accordance with ASC Topic 820, *Fair Value Measurements and Disclosures*. Third-party pricing services normally derive the security prices through recently reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information. For securities not actively traded, the third-party pricing services may use quoted market prices of comparable instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. Fair values of investment securities are disclosed in Note 3.

Private Equity Funds — The fair values of private equity funds accounted for under the fair value option are based on the Company's proportionate ownership interest in the underlying fund's net asset value (NAV). Funds accounted for under the fair value option are commercial real estate funds. The NAV is based on the underlying fair value of the commercial property held by the fund. The income capitalization, sales comparison, and cost approach are used to value the underlying property in the fund, depending on the type of asset or business being valued. Inputs include, but are not limited to, comparable sales in each asset's market, replacement cost, revenue and expense growth rates, terminal capitalization rates, and discount rates.

Receivables:

Trade Receivables — Trade receivables include the uncollected premium amounts from insured groups, receivables from the Federal Employee Health Benefit Program (FEHBP), and other miscellaneous receivables. FEHBP is a health benefit program providing coverage to federal employees and dependents administered by the U.S. government. Trade receivables are shown net of an allowance based on historical collection trends and management's judgment on the collectability of these accounts. The Company writes off trade receivable balances when there is no reasonable expectation of collecting the balances due. This balance is routinely monitored by management and any adjustments required are reflected in current operations.

Administrative Service Contract (ASC) and Administrative Services Only (ASO) Receivables — ASC and ASO receivables are uncollected amounts due from self-funded groups for administrative services provided and for claims paid or estimated claims incurred but not paid on behalf of the group.

Reinsurance Receivables — Reinsurance receivables are uncollected amounts due from other companies, related to reinsured portions of the accident, life, and health risks on certain policies the Company underwrites and services. Reinsurance receivables are shown net of an allowance based on historical collection trends and management's judgment on the collectability of these accounts. This balance is routinely monitored by management and any adjustments required are reflected in current operations.

Prepaid Expenses and Deferred Charges — Costs incurred that provide economic benefit to the Company are deferred and amortized on the straight-line method over the estimated useful life of the asset.

Reinsurance — Reinsurance premiums, claims, and claims processing expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. The Company remains obligated for amounts ceded in the event the reinsurers do not meet their obligations.

Property and Equipment — Property and equipment are stated at cost, less accumulated depreciation and amortization. Included in property and equipment are capitalized software costs, which consist of certain costs incurred in the development of internal-use software, including external direct costs of materials and services and payroll costs of employees devoted to specific software development. Depreciation and amortization are computed on the straight-line basis over the estimated useful lives of the assets, which are 10 years for land improvements; 10 to 30 years for buildings, improvements, and furniture; and three to seven years for office equipment, computer hardware, and software.

Expenditures for maintenance and repairs are expensed as incurred. Major improvements that increase the estimated useful life of an asset are capitalized. Upon the sale or retirement of assets, the recorded cost and the related accumulated depreciation are eliminated and any gain or loss on disposal is reflected in operations.

Impairment of Long-Lived Assets — In accordance with ASC Topic 360-10-35-15, *Impairment or Disposal of Long-Lived Assets*, assets such as property and equipment and capitalized software are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable or the fair value is deemed to be lower. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Benefit Liability — The benefit liability represents the Company's best-estimated cost of settling claims relating to insured events that have occurred on or before the consolidated balance sheet date and are unpaid at year-end. The estimated liability includes the amount that will be required for future payments of claims that have been reported, claims related to insured events that have occurred but that have not been reported, and unpaid claims processing expense. Unpaid claims processing expense is an estimate of the costs to record, process, and adjudicate unpaid claims.

Liabilities for both incurred but not reported and reported but not yet paid claims are determined employing actuarial methods that are commonly used by health insurance actuaries, meet Actuarial Standards of Practice (ASOP), and are appropriate under GAAP. These ASOPs require that the benefit liabilities be adequate under moderately adverse circumstances. The amount of the liability for incurred but not reported claims is determined by following a detailed actuarial process that entails using both historical claim payment patterns, as well as emerging medical cost trends to project the best estimate of claim liabilities. These estimates are subject to the effects of trends in claims severity and frequency. Although considerable variability is inherent in such estimates, management believes that the benefit liability is adequate. The estimates are continually reviewed and adjusted as necessary, as experience develops or new information becomes known; such adjustments are included in current operations.

ASC and ASO benefit liability is the estimate of unreported claims from certain group contracts in which the Company is not at risk for any of the claims experience. The Company is reimbursed by the groups for amounts of actual claims paid.

Policy Reserves — Policy reserves consist mainly of groups with experience-rated refunding provisions. These groups are monitored monthly and their provisions are adjusted based on their current experience levels. Policy reserves also include premium deficiency reserves, active life reserves, and medical loss ratio (MLR) rebate reserves. Premium deficiency reserves are established when future premiums and current reserves are deemed to be insufficient to cover future claim payments for the remainder of a contract period. This calculation is performed annually or as needed and the reserve is adjusted accordingly. Active life reserves are established to pay future policy benefits on insurance policies for which some of the premiums received in earlier years are intended to pay anticipated benefits to be incurred in future years. MLR rebate reserves represent the Company's best estimate of premium rebates that will be owed to subscribers and/or groups for lines of business that experience an actual MLR below the minimum prescribed by law. MLR reserves are monitored monthly and the provision is recorded as a reduction of revenue in the consolidated statements of income.

Pension and Postretirement Benefits — The funded status, accumulated other comprehensive income (cost), and annual expense of the Company's pension and postretirement benefit plans are determined using methodologies that involve several actuarial assumptions, the most significant of which are the discount rate and long-term rate of asset return. Accumulated other comprehensive income (cost) consists primarily of accumulated net after-tax actuarial losses. Net actuarial gains or losses are redetermined annually and principally arise from gains or losses on plan assets due to variations in the market-related value of the underlying assets and changes in the benefit obligation due to changes in actuarial assumptions. Net actuarial gains or losses are amortized to expense in future periods when they exceed 10% of the greater of the plan assets or projected benefit obligations by benefit plan. The excess of gains or losses over the 10% threshold is subject to amortization over the average future service period of employees of approximately 10 years. The Company uses a total portfolio return analysis to determine the expected long-term rate of return on plan assets. Factors such as past market performance, the long-term relationship between asset classes, interest rates, and inflation are considered in the assumption. Peer data and an average of historical returns are also reviewed for appropriateness of the selected assumption.

Other Liabilities — Other liabilities include amounts for accrued compensation, vacation, taxes, and unclaimed property.

Revenue Recognition — Premiums are earned at contractual rates and are recorded as earned during the month subscriber coverage is provided. Premiums applicable to the unexpired contractual coverage periods are reflected in the accompanying consolidated balance sheets as unearned revenue. Premium revenues include health, life, and disability insurance products and are net of any performance guarantee expenses on these products.

Administrative fees include revenues from administrative services group contracts that provide for the group to be at risk for all or, with supplemental insurance arrangements, a portion of their claims experience. The Company charges self-funded groups an administrative fee, which is based on the number of members in a group or the group's claim experience. Administrative fees are recognized in accordance with the terms of the contractual relationship between the Company and the customer. All claims payments under these programs are excluded from benefit expense. Administrative fees are net of any performance guarantees on self-funded group products.

Premiums on retrospectively-rated policies are set in the same manner as other fully insured policies, with the exception of an explicit margin added to the premium to cover the uncertainty of estimated claims experience. An annual accounting is performed at the end of the contract period in order to establish if gains or losses have occurred. A rate-stabilization reserve is set up for groups in gain positions and those gains are used to offset potential losses in future years. The percent of premiums subject to this provision was 32% as of December 31, 2012 and 2011.

Washington Education Association accounted for 20% of total Company revenue in 2012 and 2011. The Federal Employees Program accounted for 15% and 14% of total Company revenue in 2012 and 2011, respectively.

Federal Income Taxes — The Company files as the common parent of an affiliated group. The liability method is used in accounting for income taxes. Accordingly, deferred tax assets and liabilities are recognized based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws expected to be in effect when the differences are anticipated to reverse, net of any applicable valuation allowances. The effect on the deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that the change is enacted.

Judgment is required in determining the Company's effective tax rate and in evaluating its tax position. The Company establishes accruals for uncertain tax positions when, despite the belief that the Company's tax return positions are fully supportable, the Company believes that its positions may not be fully sustained, primarily given the risks associated with tax litigation or disputes. The uncertain tax position accruals are adjusted in light of changing facts and circumstances such as the progress of tax audits, case law, and emerging legislation. The Company's effective tax rate includes the impact of changes to the accruals for uncertain tax positions.

Comprehensive Income — Comprehensive income includes net income, the change in unrealized gains (losses) on investments, and changes in the retirement plans due to ASC Topic 715, *Compensation — Retirement Benefits*.

Contingent Liabilities — The Company has a number of regulatory and legal matters outstanding, as discussed further in Note 11 — *Commitments and Contingencies*. Periodically, the Company reviews the status of all significant outstanding matters to assess the potential financial exposure. When (i) it is probable that an asset has been impaired or a liability has been incurred and (ii) the amount of the loss can be reasonably estimated, the estimated loss is recorded in the consolidated statements of income. The Company provides disclosure in the notes to the consolidated financial statements for loss contingencies that do not meet both of these conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the consolidated financial statements. Significant judgment is required to determine the probability that a liability has been incurred and whether such liability is reasonably estimable. Accruals made are based on the best information available at the time, which can be highly subjective. The final outcome of these matters could vary significantly from the amounts included in the accompanying consolidated financial statements.

Revision of classification of certain reinsurance receivables — The Company determined that it had incorrectly presented benefit liabilities and policy reserves of $52,380 for the Company's long term care insurance products net of reinsurance receivables in the 2011 consolidated balance sheet. The 2011 consolidated balance sheet has been revised to present benefit liability and policy reserves gross of reinsurance. Reinsurance receivables were not previously reported in a separate line item and as currently reported are $52,380. Benefit liability as previously reported was $345,827 and as currently reported is $351,618 and policy reserves as previously reported was $32,660 and as currently reported is $79,249. These changes to 2011 balances resulted in related changes to (a) certain line items within operating activities in the statement of cash flows with no impact on net cash provided by operating activities, and (b) certain line items at Note 5. The changes had no impact on the 2011 statement of income.

Reclassification — In the 2011 consolidated statement of income, other expenses of $2,725 were reclassified to a line item separate from expenses, with no impact on net income. In the 2011 consolidated balance sheet, the Company reclassified other reinsurance receivables of $11,173 out of trade receivables.

New Accounting Pronouncements — In 2012, Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*, was effective, establishing a common framework for measuring and disclosing fair value between GAAP and International Financial Reporting Standards. The measurement principles are generally consistent with GAAP. This ASU enhances the disclosure requirements by requiring the disclosure of quantitative information about significant unobservable inputs used in determining Level 3 measurements. The adoption of ASU No. 2011-04 did not have a material effect on our consolidated financial position or operating results. See the Company's fair value disclosure in Note 3.

In 2012, ASU No. 2011-05, *Presentation of Comprehensive Income*, and ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, were effective, requiring companies to present components of net income and other comprehensive income in one continuous statement or two separate, but consecutive statements. The option to present components of other comprehensive income in the statement of stockholders' equity has been eliminated. While the new guidance changes the presentation of other comprehensive income, it does not change the components that are recognized in net income and other comprehensive income under the existing guidance. The adoption of ASU No. 2011-05 and ASU No. 2011-12 did not have a material effect on our consolidated financial position or operating results.

There were no other new accounting pronouncements issued or adopted during 2012 that had or are expected to have a material effect on our consolidated financial position, operating results, or disclosures.

2. INVESTMENTS

The cost or amortized cost, gross unrealized gains and gross unrealized losses, and estimated fair values of available-for-sale investment securities as of December 31, 2012 and 2011, are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Values
December 31, 2012:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 201,874	$ 19,772	$ (201)	$ 221,445
Municipal debt securities	3,077	34	(48)	3,063
Foreign government debt securities	1,291	319	-	1,610
Corporate debt securities	321,868	30,776	(451)	352,193
Residential mortgage-backed securities	261,845	7,431	(2,307)	266,969
Commercial mortgage-backed securities	107,538	5,999	(104)	113,433
Other asset-backed securities	41,246	350	(8)	41,588
	938,739	64,681	(3,119)	1,000,301
Marketable equity securities	301,079	135,547	(1,302)	435,324
Total	$ 1,239,818	$ 200,228	$ (4,421)	$ 1,435,625

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Values
December 31, 2011:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 209,749	$ 17,838	$ (50)	$ 227,537
Municipal debt securities	1,470	-	(115)	1,355
Foreign government debt securities	3,289	303	-	3,592
Corporate debt securities	322,207	20,096	(3,946)	338,357
Residential mortgage-backed securities	241,177	8,584	(4,690)	245,071
Commercial mortgage-backed securities	88,421	5,075	(662)	92,834
Other asset-backed securities	46,415	316	(184)	46,547
	912,728	52,212	(9,647)	955,293
Marketable equity securities	297,696	80,634	(8,579)	369,751
Total	$ 1,210,424	$ 132,846	$ (18,226)	$ 1,325,044

Accumulated derivative gain as of December 31, 2012 and 2011, was $551 and $2,426, respectively. The fair value of the Company's embedded derivatives included in marketable equity securities was $25,145 and $25,784 as of December 31, 2012 and 2011, respectively.

As of December 31, 2012, the Company had pledged $39,677 in fixed-income securities at fair value and $6,517 in cash and cash equivalents to meet indemnity requirements of the State of Washington Office of the Insurance Commissioner (OIC). The Company also had pledged $18,934 in fixed-income securities at fair value and $738 in cash and cash equivalents with various other regulatory authorities.

As of December 31, 2011, the Company had pledged $25,084 in fixed-income securities at fair value and $2,057 in cash and cash equivalents to meet indemnity requirements of the OIC. The Company also had pledged $18,470 in fixed-income securities at fair value and $517 in cash and cash equivalents with various other regulatory authorities.

The Company did not have any securities on loan or related collateral as of December 31, 2012 and 2011.

The cost or amortized cost and estimated fair values of available-for-sale fixed-income securities as of December 31, 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Cost or Amortized Cost	Estimated Fair Value
Due in one year or less	$ 23,346	$ 24,575
Due after one year and through five years	229,153	244,386
Due after five years and through ten years	164,636	177,822
Due after ten years	110,975	131,528
Asset-backed securities	410,629	421,990
	$ 938,739	$ 1,000,301

The major categories of net investment income for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Fixed-income securities	$ 30,241	$ 33,218
Marketable equity securities	8,008	5,781
Cash, cash equivalents, and other investments	226	1,749
Investment revenue	38,475	40,748
Investment expenses	4,885	4,511
Net investment income	$ 33,590	$ 36,237

Provided below is a summary of available-for-sale securities, which were in an unrealized loss position as of December 31, 2012 and 2011. There were 156 lots, or 2%, with $2,691 in unrealized losses that had been in a continuous loss position for 12 months or more as of December 31, 2012. There were

130 lots, or 2%, with $6,080 in unrealized losses that had been in a continuous loss position for 12 months or more as of December 31, 2011. In determining whether the unrealized losses of marketable equity securities are temporary or other than temporary, the Company considers (1) the length of time and extent to which the fair value has been less than cost or carrying value and (2) the financial strength of the issuer. In determining whether the losses of fixed-income securities are other than temporary, the Company considers (1) the present value of estimated future cash flows relative to the amortized cost of each lot and (2) whether it is more likely than not that the Company will be required to sell the security prior to a recovery of its amortized cost basis. Management does not believe that any individual unrealized loss as of December 31, 2012, represents an other-than-temporary impairment.

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2012:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 39,808	$ (201)	$ -	$ -	$ 39,808	$ (201)
Municipal debt securities	1,090	(8)	1,345	(40)	2,435	(48)
Corporate debt securities	31,513	(347)	9,640	(104)	41,153	(451)
Residential mortgage-backed securities	33,535	(206)	18,178	(2,101)	51,713	(2,307)
Commercial mortgage-backed securities	3,441	(18)	2,425	(86)	5,866	(104)
Other asset-backed securities	14,988	(8)	-	-	14,988	(8)
Marketable equity securities	16,636	(942)	1,186	(360)	17,822	(1,302)
	$141,011	$(1,730)	$32,774	$(2,691)	$173,785	$(4,421)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2011:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 13,215	$ (50)	$ -	$ -	$ 13,215	$ (50)
Municipal debt securities	-	-	1,355	(115)	1,355	(115)
Corporate debt securities	77,728	(3,297)	5,072	(650)	82,800	(3,947)
Residential mortgage-backed securities	5,626	(54)	22,290	(4,636)	27,916	(4,690)
Commercial mortgage-backed securities	5,091	(62)	4,042	(599)	9,133	(661)
Other asset-backed securities	19,092	(162)	1,363	(22)	20,455	(184)
Marketable equity securities	53,476	(8,521)	712	(58)	54,188	(8,579)
	$174,228	$(12,146)	$34,834	$(6,080)	$209,062	$(18,226)

Proceeds from disposals of available-for-sale short-term investments, fixed-income securities, marketable equity securities, and related gross realized gains and losses on those disposals for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Proceeds from sales of short-term investments	$ 12,629	$ 27,037
Proceeds from sales of fixed-income securities	776,972	634,765
Proceeds from sales of marketable equity securities	79,790	71,893
Proceeds from maturities, redemptions, calls, and paydowns	115,051	109,724
Total	$ 984,442	$ 843,419

	2012	2011
Sales of short-term investments:		
Gross realized gains	$ 3	$ 220
Gross realized losses	(13)	-
	(10)	220
Sales of fixed-income securities:		
Gross realized gains	24,277	21,828
Gross realized losses	(2,074)	(4,189)
	22,203	17,639
Sales of marketable equity securities:		
Gross realized gains	8,822	7,583
Gross realized losses	(9,867)	(1,548)
	(1,045)	6,035
Changes in fair value of embedded derivatives	(1,875)	(3,714)
Other-than-temporary decline in fair value of available-for-sale securities (a)	(5,142)	(5,853)
Net realized gain on available-for-sale investments	$ 14,131	$ 14,327

(a) Total other-than-temporary impairment losses on available-for-sale investments amounted to $5,246 and $8,474 for the years ended December 31, 2012 and 2011, respectively. Of these amounts, $5,142 and $5,853 were recognized in earnings and the remaining $104 and $2,621 were recognized in other comprehensive income in 2012 and 2011, respectively.

For the year ended December 31, 2012, the Company recognized in earnings other-than-temporary declines in fair value associated with fixed-income securities of $2,475 and equity securities of $2,667. For the year ended December 31, 2011, the Company recognized in earnings other-than-temporary declines in fair value associated with fixed-income securities of $3,409 and equity securities of $2,444.

Activity related to the credit component recognized in earnings on fixed-income securities held by the Company for which a portion of the other-than-temporary impairment loss remains in other comprehensive income as of December 31, 2012 and 2011, is as follows:

	2012	2011
Beginning balance at January 1	$ 7,296	$ 5,373
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized (initial credit impairments)	-	1,428
Additions for the credit component on debt securities in which other-than-temporary impairment was previously recognized (subsequent credit impairments)	1,510	597
Reductions for securities sold during the period	(1,508)	(102)
Reductions for securities in which amounts previously recognized in other comprehensive income were recognized in earnings because the entity intends to sell the security	(3)	-
Ending balance at December 31	$ 7,295	$ 7,296

As of December 31, 2012 and 2011, the Company held one foreign equity fund accounted for at fair value, included within marketable equity securities. The fair value and unrealized gain of this fund were $61,583 and $27,654 as of December 31, 2012. The fair value and unrealized gain of this fund were $53,034 and $18,721 as of December 31, 2011. The fund has a monthly liquidity restriction. There were no unfunded capital commitments related to this fund as of December 31, 2012 and 2011.

Private Equity Funds — The Company held four private equity funds as of December 31, 2012, each with an ownership interest of under 3%. Three funds held as of December 31, 2012, were accounted for under the equity method and one was accounted for under the fair value option. The book value of the equity method funds was $70,231 and $63,535 as of December 31, 2012 and 2011, respectively. The related equity earnings recorded in net realized gain on investments was $8,106 and $1,153 for the years ended December 31, 2012 and 2011, respectively. The fair value of the fair value option fund was $21,415 and $0 as of December 31, 2012 and 2011, respectively. The related change in fair value recorded in net realized gain on investments for the fund was $666 and $0, respectively, and the related dividend income was $1,000 and $0, respectively, for the years ended December 31, 2012 and 2011.

The Company held an unfunded capital commitment of $15,000 for a private equity fund not previously owned as of December 31, 2012. This capital commitment was funded in January 2013. No other unfunded capital commitments existed as of December 31, 2012.

Other Long-Term Investments — Other long-term investments include the Company's nonqualified defined contribution supplemental retirement program covering officers, as well as investments in business ventures where the Company has more than a minor influence. See Note 8 for a discussion on the nonqualified defined contribution retirement program, which had assets of $9,136 and $7,533 as of December 31, 2012 and 2011, respectively.

In June 2009, the Company entered into a joint venture through one of its subsidiaries to invest in IPS, a majority shareholder in a company providing health care coverage to expatriates and students. The Company held a 9% ownership interest as of December 31, 2012. In April 2009, the Company entered into a joint venture through one of its subsidiaries to invest in WorldDoc, a corporation that provides a web-based portal with health and wellness applications to its customers. The Company held a 19% ownership interest as of December 31, 2012. In 2007, the Company entered into a joint venture through one of its subsidiaries to provide third-party administrative services in the People's Republic of China. The Company invested $3,034 and $1,335 in WPMI in 2012 and 2011, respectively, and held an ownership interest of 20% as of December 31, 2012. Investments in these joint ventures are accounted for under the equity method, as the Company has more than a minor influence over their operations through a combination of its voting, governance, and other rights. As of December 31, 2012 and 2011, the book values of these joint ventures were $8,765 and $9,420, respectively. The Company recognized $2,178 and $3,399 for its share of losses during 2012 and 2011, respectively, in net realized gain on investments. The Company recognized in earnings other-than-temporary impairment associated with the Company's investment in WPMI of $1,511 and $0 during 2012 and 2011, respectively.

In 2012, the Company invested $1,100 in the convertible preferred stock of EveryMove, a wellness company that rewards people for engaging in physical activities. The Company held a 35% ownership interest as of December 31, 2012. The Company's investment in EveryMove is accounted for under the cost method, as the Company has a noncontrolling interest in the preferred stock of EveryMove. As of December 31, 2012, the book value of this investment was $1,100.

The remaining other long-term assets consist of other noncontrolled entities and limited partnerships, which are carried at cost of $873 and $892 as of December 31, 2012 and 2011, respectively.

3. FAIR VALUE

Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by the fair value guidance, are as follows:

Level I — Quoted prices for identical assets or liabilities in active markets at the measurement date.

Level II — Other observable inputs that reflect quoted market prices for assets either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), inputs other than quoted prices that are observable, and inputs derived principally from or corroborated by other observable market data for substantially the full term of the asset or liability.

Level III — Unobservable inputs that cannot be corroborated by other observable market data at the measurement date.

The following methods and assumptions were used to determine the fair value of each class of assets and liabilities recorded at fair value in the consolidated balance sheets:

Short-Term Investments, Fixed-Income Securities, and Marketable Equity Securities — at Fair Value — Fair values are based on quoted market prices, where available. These fair values are obtained primarily from third-party pricing services, which generally use Level I or Level II inputs for the determination of fair value in accordance with the fair value guidance. Third-party pricing services normally derive the security prices through recently reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information. For securities not actively traded, the third-party pricing services may use quoted market prices of comparable instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds.

Private Equity Funds — at Fair Value — As of December 31, 2012, the Company was invested in one private equity fund accounted for under the fair value option – a commercial real estate fund that was a Level III investment. As a practical expedient to value the investment in the fund, which has attributes of an investment company and does not have a readily determinable fair value, the Company relies on its proportionate ownership interest in the underlying fund's NAV. The NAV was based on the underlying fair value of the commercial property held by the fund. The income capitalization, sales comparison, and cost approach were used to value the underlying property in the fund, depending on the type of asset or business being valued. Inputs for valuation include, but are not limited to, comparable sales in each asset's market, replacement cost, revenue and expense growth rates, terminal capitalization rates, and discount rates.

The following tables summarize fair value measurements by level as of December 31, 2012 and 2011, for assets measured at fair value on a recurring basis:

	Level I	Level II	Level III	Total
December 31, 2012:				
U.S. Treasury securities and obligations of U.S. government	$ 217,797	$ 3,648	$ -	$ 221,445
Municipal debt securities	-	3,063	-	3,063
Foreign government securities	-	1,610	-	1,610
Corporate debt securities	-	352,193	-	352,193
Residential mortgage-backed securities	-	266,969	-	266,969
Commercial mortgage-backed securities	-	113,433	-	113,433
Other asset-backed securities	-	41,588	-	41,588
Total	217,797	782,504	-	1,000,301
Marketable equity securities	348,597	86,727	-	435,324
Private equity fund — fair value option	-	-	21,415	21,415
Total	$ 566,394	$ 869,231	$ 21,415	$ 1,457,040

	Level I	Level II	Level III	Total
December 31, 2011:				
U.S. Treasury securities and obligations of U.S. government	$ 218,378	$ 9,159	$ -	$ 227,537
Municipal debt securities	-	1,355	-	1,355
Foreign government securities	-	3,592	-	3,592
Corporate debt securities	-	338,357	-	338,357
Residential mortgage-backed securities	-	245,071	-	245,071
Commercial mortgage-backed securities	-	92,834	-	92,834
Other asset-backed securities	-	46,547	-	46,547
Total	218,378	736,915	-	955,293
Marketable equity securities	290,932	78,819	-	369,751
Total	$ 509,310	$ 815,734	$ -	$ 1,325,044

A reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using Level III inputs for the years ended December 31, 2012 and 2011, is as follows:

	Level III Fair Value Measurements
	Private Equity Funds
Beginning balance at January 1, 2012	$ -
Total gains and losses:	
Realized in net income	666
Unrealized in accumulated other comprehensive income	-
Purchases, sales, issuances, and settlements — gross:	
Purchases	20,749
Sales	-
Transfers into Level III	-
Transfers out of Level III	-
Ending balance at December 31, 2012	$ 21,415
Change in unrealized gains included in net income related to assets still held	$ -

	Level III Fair Value Measurements		
	Loan-Backed Securities	Equity Securities	Total
Beginning balance at January 1, 2011	$ 353	$ 25,784	$ 26,137
Total gains and losses:			
Realized in net income	-	2,715	2,715
Unrealized in accumulated other comprehensive loss	-	(2,784)	(2,784)
Purchases, sales, issuances, and settlements — gross:			
Purchases	-	-	-
Sales	(353)	(25,715)	(26,068)
Transfers into Level III	-	-	-
Transfers out of Level III	-	-	-
Ending balance at December 31, 2011	$ -	$ -	$ -
Change in unrealized gains included in net income related to assets still held	$ -	$ -	$ -

There were no transfers between Levels I and II during 2012 or 2011, and there were no transfers in or out of Level III during 2012 or 2011. There were no nonfinancial instruments remeasured at fair value during 2012 or 2011.

4. PROPERTY AND EQUIPMENT

A summary of the cost and accumulated depreciation and amortization of property and equipment as of December 31, 2012 and 2011, is set forth below:

	2012	2011
Land and land improvements	$ 14,831	$ 14,331
Buildings and improvements	65,989	64,903
Office and computer equipment	30,029	29,988
Software	98,261	92,602
	209,110	201,824
Less accumulated depreciation and amortization	(138,453)	(129,541)
Total property and equipment	$ 70,657	$ 72,283

5. BENEFIT LIABILITY

Activity in the benefit liability as of December 31, 2012 and 2011, is summarized as follows:

	2012	2011
Unpaid benefit liability at beginning of year	$ 332,477	$ 297,197
Add incurred claims related to:		
Current year	2,738,340	2,634,036
Prior years	(15,811)	(43,391)
Total incurred claims	2,722,529	2,590,645
Deduct paid claims related to:		
Current year	(2,407,224)	(2,316,673)
Prior years	(294,985)	(238,692)
Total paid claims	(2,702,209)	(2,555,365)
Unpaid benefit liability at end of year	352,797	332,477
Life reserves	8,103	8,173
Unpaid claims processing liability	11,858	10,968
Benefit liability at end of year	$ 372,758	$ 351,618

As the benefit liability includes various actuarially developed estimates, the Company's actual claims experience may be more or less than the Company's previously developed estimates. As indicated in the foregoing reconciliation, the Company's benefit liability as of December 31, 2011 and 2010, was decreased by $15,811 and $43,391, respectively, in the following year for claims that had occurred on or prior to those balance sheet dates. These adjustments resulted from the Company's actual benefit expense related to prior years totaling less than the estimates previously made by the Company. These changes in reserves are primarily driven by lower-than-expected health system utilization levels and more efficient claims handling and processing, which results in higher completion factors. Adjustments of prior year estimates may result in additional benefit expenses or, as the Company experienced during each of the last two years, a reduction in benefit expenses may be offset as the Company establishes its accrual for current year benefit expenses. No return premiums were due as a result of the adjustments in the benefit liability. Adjustments made to the benefit liability for unpaid claims processing expense during 2012 and 2011 were immaterial. The unpaid benefit liability has been reduced by subrogation of $25,259 and $21,636 as of December 31, 2012 and 2011, respectively.

6. REINSURANCE

The Company reinsures with other companies portions of the accident and health risks on certain policies it underwrites and services. Premiums and claims ceded under reinsurance contracts for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Premiums	$ 22,630	$ 12,632
Claims	(18,809)	(10,468)

As of December 31, 2012 and 2011, the Company had reinsurance receivables from an unaffiliated reinsurer related to its ceded long term care insurance products of $56,872 and $52,380, respectively.

Effective July 1, 2012, the Company entered into a reinsurance contract with USAble Life ("USAble") relating to its life, disability, and accidental death and dismemberment (AD&D) business. Under the terms of the contract, the Company ceded substantially all of its life, disability, and AD&D business that was not previously ceded in the states of Alaska, Idaho, Oregon, and Washington.

Effective July 1, 2012, the Company also entered into a purchase agreement with USAble. Under the terms of the agreement, USAble agreed to purchase the Company's reinsured life, disability, and AD&D business for $6,000. The Company recognized $3,450 of the $6,000 payment in other income as of December 31, 2012. Under the terms of the agreement, the remaining $2,550 was deferred and recorded in accounts payable and accrued liabilities as of December 31, 2012. It will be recognized in income based upon membership retention targets established by the agreement.

7. FEDERAL AND STATE INCOME TAXES

The provision for federal and state income tax expense relating to continuing operations for the years ended December 31, 2012 and 2011, consists of the following:

	2012	2011
Federal income tax:		
Current	$ 20,597	$ 20,983
Deferred	7,546	4,447
	28,143	25,430
State income tax — current	102	140
Total	$ 28,245	$ 25,570

For the years ended December 31, 2012 and 2011, the rate at which the Company provides for income taxes differs from the statutory federal rate primarily due to the following:

	2012		2011	
	Amount	Rate	Amount	Rate
Provision computed at statutory rates	$ 44,225	35.0 %	$ 47,651	35.0 %
Effect of Section 833(b) and other permanent differences	(31,934)	(25.3)	(46,858)	(34.4)
Increase in federal valuation allowance	15,773	12.4	31,009	22.8
State income tax, net of federal benefit	82	0.1	112	0.1
Cumulative effect of prior years' adjustments	-	-	(6,625)	(4.9)
Other	99	0.1	281	0.2
Total	$ 28,245	22.3 %	$ 25,570	18.8 %

The Company had alternative minimum tax credit (MTC) carryforwards of $235,147 available indefinitely to reduce regular federal income taxes as of December 31, 2012. Income taxes of $19,000 and $28,000 were paid in 2012 and 2011, respectively.

Deferred federal income taxes for the years ended December 31, 2012 and 2011, consist of the following:

	2012	2011
Deferred tax assets:		
Minimum tax credit	$ 235,147	$ 223,531
Deferred compensation and accrued incentive	14,118	17,616
Postretirement benefits	11,324	10,388
Benefit liability	10,973	11,606
Impairment loss on available-for-sale investments	6,525	7,985
Unrecognized retirement benefit cost	33,615	32,323
Step-up in basis of land	738	738
Other assets	9,821	9,484
Total deferred federal income tax assets	322,261	313,671
Less valuation allowance	222,046	227,646
Deferred federal income tax assets — net	100,215	86,025
Deferred tax liabilities:		
Unrealized gain on investments	(68,913)	(40,657)
Fixed assets	(3,759)	(5,647)
Prepaid pension asset	(41,597)	(31,080)
Other	(3,414)	(3,155)
Total deferred federal income tax liabilities	(117,683)	(80,539)
Net deferred federal income tax (liabilities) assets	$ (17,468)	$ 5,486

The Company establishes a valuation allowance for deferred tax assets when uncertainty exists with respect to future realization of the assets. The assets to which a valuation allowance applies are the MTC carryforward and deferred tax assets that primarily relate to the future deductibility of deferred compensation and benefit liabilities. The valuation allowance decreased by $5,600 and increased by $21,997 in 2012 and 2011, respectively, primarily due to increases in the valuation allowance for MTCs. The Company establishes a valuation allowance against the MTC because the benefits of the MTC are not more likely than not to be realized in the foreseeable future.

There were no penalties or interest accrued as of December 31, 2012 or 2011. Uncertain tax positions are not material as of December 31, 2012 and 2011.

Tax years ended December 31, 2012, 2011, 2010, and 2009 remain subject to Internal Revenue Service (IRS) examination. A refund claim for taxes paid with respect to the tax year ended December 31, 2007, is under IRS examination.

8. EMPLOYEE BENEFITS

Defined Benefit Retirement Program/Pension Equity Plan and Nonqualified Supplemental Plans

Retirement Benefits — The Company provides a pension equity plan covering substantially all of its employees and employees of its subsidiaries. The benefits are based on years of service and an employee’s highest earnings, as defined, during five consecutive plan years in the last years of employment (excluding the plan year in which termination of employment occurs). The Company’s funding policy is to contribute annually at least the minimum amount that is required by the Employee Retirement Income Security Act of 1974 (ERISA). Contributions are intended to provide for benefits attributed to service date, but also for those expected to be earned in the future. The measurement date of this plan is December 31.

The Company also provides a nonqualified supplemental retirement benefit for its president and chief executive officer (CEO). Benefits accrue based on factors, including age, final compensation, and a benefit percentage factor. The amount of this benefit is reduced by the aggregate amount of benefits under the pension equity plan, nonqualified defined benefit supplemental retirement program, and nonqualified supplemental defined contribution retirement plan, and is subject to a maximum allowed amount. The president and CEO must be continuously employed until the executive’s retirement date and must not be terminated for cause.

The funded status of the Company's pension equity plan and nonqualified supplemental retirement benefit and amounts recognized as of December 31, 2012 and 2011, are as follows:

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 213,663	$ 181,056
Service cost	11,676	10,788
Interest cost	10,118	9,870
Actuarial loss	20,257	20,050
Benefits paid	(11,853)	(7,526)
Administrative expenses paid	(798)	(575)
Benefit obligation at end of year	243,063	213,663
Change in plan assets:		
Fair value of plan assets at beginning of year	219,689	202,708
Actual return on plan assets	32,122	5,082
Employer contributions	30,000	20,000
Benefits paid	(11,853)	(7,526)
Administrative expenses paid	(798)	(575)
Fair value of plan assets at end of year	269,160	219,689
Overfunded status of the plan	$ 26,097	$ 6,026
Net amount included in the consolidated balance sheets:		
Prepaid expenses and deferred charges	$ 34,112	$ 12,067
Pension and postretirement benefits	(8,015)	(6,041)
Net amount at end of year	$ 26,097	$ 6,026

Net pension cost for the years ended December 31, 2012 and 2011, includes the following:

	2012	2011
Service cost	$ 11,676	$ 10,788
Interest cost	10,118	9,870
Return on assets	(16,002)	(15,938)
Net loss amortization	4,933	3,008
Prior service cost amortization	310	310
Net periodic pension cost	$ 11,035	$ 8,038

Weighted-average assumptions used to determine net pension cost as of December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.90 %	5.60 %
Expected return on plan assets	7.00	7.90
Rate of compensation increase	3.00–6.00	3.00–6.00

Weighted-average assumptions used to determine benefit obligations for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.10 %	4.90 %
Rate of compensation increase	3.00–6.00	3.00–6.00

The Company's pension equity plan asset allocation as of December 31, 2012 and 2011, and target allocation for 2013, are as follows:

	Target Allocation	Percentage of Plan Assets at December 31	
Asset Category	**2013**	**2012**	**2011**
Fixed income	30 %	27 %	30 %
Equity securities	70	69	69
Cash equivalents	-	4	1
Total	100 %	100 %	100 %

In managing the plan assets, our objective is to maintain adequate liquidity and asset value to ensure the payment of current benefits while growing plan assets over time to maintain or improve long-term funded status. The Company attempts to mitigate risk to the plan assets through our investment policy, which places limits on the overall mix, quality of investments, and concentrations in individual investments. In addition to producing a reasonable return, the investment strategy seeks to minimize the volatility in employer expense and cash flow.

Plan assets include a diversified mix of fixed maturity securities and equity securities across a range of sectors and levels of capitalization to maximize the long-term return for a prudent level of risk.

The target allocation for plan assets is 30% fixed maturity securities and 70% equity securities. Fixed maturity securities primarily include U.S. Treasury and agency securities, corporate bonds, and asset-backed investments issued by the U.S. government and corporations. Equity securities primarily include a mix of mutual funds and collective trusts invested in domestic and foreign equities. As of December 31, 2012, there were no significant concentrations of investments in the plan assets.

Fair values of our plan assets are based on quoted market prices, where available. These fair values are obtained from third-party pricing services, which obtain each fund's NAV directly from the fund sponsor. Fund sponsors use Level I or Level II inputs, based upon available market observable information, to price each fund's underlying investments and calculate the NAV of the fund as of the reporting date. All investments held in the portfolio as of December 31, 2012, are traded on retail or institutional markets.

Plan assets recorded at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The fair values of our pension benefit assets and other benefit assets as of December 31, 2012 and 2011, by asset category and level inputs, as defined by ASC Topic 820 regarding fair value measurements and disclosures (see Note 3 for additional information regarding the definition of level inputs) are as follows:

	Level I	Level II	Level III	Total
December 31, 2012:				
Common/collective trust funds:				
Fixed-income funds	$ -	$ 47,713	$ -	$ 47,713
Domestic equity funds	-	142,960	-	142,960
International equity funds	-	16,082	-	16,082
Mutual funds:	-	-	-	
Fixed-income funds	23,836	-	-	23,836
Domestic equity funds	16,776	-	-	16,776
International equity funds	10,279	-	-	10,279
Money market funds	11,514	-	-	11,514
	$ 62,405	$ 206,755	$ -	$ 269,160

	Level I	Level II	Level III	Total
December 31, 2011:				
Common/collective trust funds:				
Fixed-income funds	$ -	$ 44,149	$ -	$ 44,149
Domestic equity funds	-	118,095	-	118,095
International equity funds	-	12,428	-	12,428
Mutual funds:	-			
Fixed-income funds	21,732	-	-	21,732
Domestic equity funds	15,506	-	-	15,506
International equity funds	6,265	-	-	6,265
Money market funds	1,514	-	-	1,514
	$ 45,017	$ 174,672	$ -	$ 219,689

There were no transfers between Levels I, II, or III during 2012 or 2011.

The accumulated benefit obligation for the pension equity plan and nonqualified supplemental retirement benefit was $233,167 and $210,626 as of December 31, 2012 and 2011, respectively. The Company expects to make $20,000 in cash contributions to its pension equity plan during 2013.

Expected benefit payments during the years ending December 31 are as follows:

2013	$ 11,455
2014	12,279
2015	22,252
2016	12,936
2017	13,636
2018–2022	78,698

Supplemental Defined Benefit Retirement Plan — The Company also participates in a PREMERA-wide nonqualified defined benefit supplemental retirement program covering certain officers approved by PBC's president and the board of directors as having a significant corporate-wide impact on accomplishing the Company's strategic goals and objectives. Plan participants must satisfy a five-year vesting requirement to receive benefits under the program. Benefits under the supplemental defined benefit retirement program are based on years of service and the participant's earnings during the five years preceding termination of employment. The measurement date of this plan is December 31. The Company's funding policy is to contribute annually the amount of the previous year's expense associated with this plan. The contributions are maintained in a rabbi trust and are, therefore, not considered plan assets of the supplemental defined benefit retirement plan. In the event of the Company's insolvency, trust assets can be used to satisfy the claims of general creditors.

A summary of the assets, liabilities, obligations, and assumptions of the supplemental defined benefit retirement plan for the years ended December 31, 2012 and 2011, is as follows:

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 13,102	$ 12,096
Service cost	711	752
Interest cost	586	623
Actuarial loss	513	334
Benefits paid	(172)	(703)
Benefit obligation at end of year	14,740	13,102
Fair value of plan assets	-	-
Underfunded status of the plan	$ (14,740)	$ (13,102)
Net amount included in the consolidated balance sheets — pension and postretirement benefits at end of year	$ (14,740)	$ (13,102)

Net supplemental benefit cost for the years ended December 31, 2012 and 2011, includes the following:

	2012	2011
Service cost	$ 711	$ 752
Interest cost	586	623
Prior service cost amortization	10	19
Net loss amortization	194	152
Net supplemental defined benefit cost	$ 1,501	$ 1,546

Weighted-average assumptions used to determine the net supplemental benefit cost for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.90 %	5.60 %
Rate of compensation increase	5.00	5.00

Weighted-average assumptions used to determine benefit obligations as of December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.10 %	4.90 %
Rate of compensation increase	5.00	5.00

The fair value of the assets in the rabbi trust as of December 31, 2012 and 2011, was $14,206 and $11,404, respectively, and is composed of fixed-income and marketable equity securities.

The accumulated benefit obligation of the plan was $13,773 and $11,870 as of December 31, 2012 and 2011, respectively. The Company expects to make $1,799 in cash contributions to its supplemental defined benefit retirement plan during 2013.

Expected benefit payments during the years ended December 31 are as follows:

2013	$ 1,799
2014	1,892
2015	2,202
2016	1,547
2017	1,454
2018–2022	4,404

Other Supplemental Retirement Programs and Nonqualified Supplemental Retirement Benefit — The Company has a nonqualified defined contribution retirement program covering officers. The compensation committee of the board of directors approves eligible position titles. Certain positions are eligible for participation upon completion of one year of service and others are eligible following their first month in an eligible position. The expense related to this program was approximately $2,511 and $2,577 in 2012 and 2011, respectively.

The Company funds the deferred benefits of the defined contribution program through the establishment of a separate deferred benefit trust. The fair value of the trust assets, which are included in other long-term investments, was $9,136 and $7,533 as of December 31, 2012 and 2011, respectively. Realized and unrealized gains and losses from the assets included in the trust accrue to the participants. However, participants only have an unsecured interest in trust assets. In the event of the Company's insolvency, trust assets can be used to satisfy the claims of general creditors. Deferred benefits relating to these programs were $9,136 and $7,533 as of December 31, 2012 and 2011, respectively, recorded within pension and postretirement benefits in the consolidated balance sheets.

Deferred Compensation Retirement Savings Plan — The Company has a deferred contribution retirement savings plan pursuant to Section 401(k) of the Internal Revenue Code, in which its employees are automatically enrolled within 30 days following the date of hire, unless they have affirmatively elected not to participate. Participants may contribute a portion of their compensation up to a maximum percentage, with the Company providing a matching contribution equal to 50% of the participant's eligible elective deferrals, up to 6% of the participant's compensation, as defined by the plan. Employees must be employed for three or more years to receive matching contribution benefits under this plan. The Company made total contributions of $5,108 and $4,607 to the plan in 2012 and 2011, respectively.

Other Postretirement Benefits — The Company maintains a postretirement benefit plan, which provides certain health care benefits for eligible retired employees. Substantially, all employees hired prior to 2007 may become eligible for these benefits if they reach retirement age while working for the Company. The cost of these benefits is shared by the Company and the retiree. The Company's policy is to fund the cost of these benefits in amounts determined at the discretion of management. The measurement date of this plan is December 31.

The funded status of the postretirement benefit plan and the amounts recognized in the Company's consolidated financial statements as of December 31, 2012 and 2011, are as follows:

	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 39,547	$ 31,294
Service cost	1,156	1,019
Interest cost	1,900	1,789
Actuarial loss	4,837	6,210
Benefits paid	(734)	(765)
Benefit obligation at end of year	46,706	39,547
Fair value of plan assets	-	-
Underfunded status of the plan	$ (46,706)	$ (39,547)
Net amount included in the consolidated balance sheets — pension and postretirement benefits at end of year	$ (46,706)	$ (39,547)

The net periodic benefit cost for the years ended December 31, 2012 and 2011, includes the following:

	2012	2011
Service cost	$ 1,156	$ 1,019
Interest cost	1,900	1,789
Net loss amortization	601	260
Prior service cost amortization — net of plan amendments	(250)	(250)
Net periodic benefit cost	$ 3,407	$ 2,818

Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.90 %	5.70 %
Health care cost trend rates	7.50	8.00

Weighted-average assumptions used to determine benefit obligations for the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Discount rate	4.20 %	4.90 %
Health care cost trend rates	7.00	7.50

Health care cost trend rates are assumed to decrease over future years, ending at 5.50% in 2016. Assumed health care cost trend rates have a significant effect on the amounts reported for the non-pension postretirement benefit plans.

The Company does not hold plan assets for the postretirement benefit plan and expects to contribute $1,314 to this plan in 2013.

Expected benefit payments during the years ended December 31 are as follows:

2013	$ 1,314
2014	1,343
2015	1,388
2016	1,401
2017	1,414
2018–2022	7,481

Amounts Recognized in Accumulated Other Comprehensive Income — The amounts included in accumulated other comprehensive income that have not been recognized as components of net period benefit costs as of December 31, 2012 and 2011, are as follows:

	Pension Equity Plan and Nonqualified Supplemental Retirement Plan		Supplemental Defined Retirement Plan		Other Postretirement Benefits	
	2012	2011	2012	2011	2012	2011
Balance at beginning of year	$79,583	$51,996	$2,902	$2,739	$ 9,867	$3,668
Amounts amortized during the year:						
Net loss	(4,932)	(3,008)	(194)	(152)	(601)	(261)
Net prior service (cost) credit	(310)	(310)	(10)	(18)	250	250
Occurring during year:						
Net loss	4,138	30,905	513	333	4,837	6,210
Accumulated other comprehensive income recognized at December 31	$78,479	$79,583	$3,211	$2,902	$14,353	$9,867

	Pension Equity Plan and Nonqualified Supplemental Retirement Plan		Supplemental Defined Retirement Plan		Other Postretirement Benefits	
	2012	2011	2012	2011	2012	2011
Net transition obligation	$ -	$ -	$ -	$ -	$ -	$ -
Net prior service cost (credit)	937	1,247	31	41	(1,821)	(2,071)
Net loss	77,542	78,336	3,180	2,861	16,174	11,938
Accumulated other comprehensive income recognized at December 31	$78,479	$79,583	$3,211	$2,902	$14,353	$ 9,867

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit costs over the next year are as follows:

	Pension Equity Plan and Nonqualified Supplemental Retirement Plan	Supplemental Defined Retirement Plan	Other Postretirement Benefits
Amortization of net prior service cost (credit)	$ 310	$ 10	$(250)
Amortization of net loss	6,602	203	878

9. PHYSICIANS' DEFERRED COMPENSATION PLAN

The Company maintained a nonqualified deferred compensation plan for participating physicians. The plan allowed for reductions of the physicians' earnings prior to 1994 and included an unsecured contractual promise to pay specified amounts at the occurrence of specific events. The Company recorded an asset for funds invested in a group-flexible premium insurance contract, insurance annuity contracts with Mutual Benefit Life Insurance Company, and a corresponding liability for payment of estimated amounts to both retired and active physicians participating in the plan.

10. LEASES

The Company has contractual obligations in the form of operating leases for office space and related office equipment for which the related expense is recorded on a monthly basis. Certain leases contain various provisions for periodic rent escalation adjustments, renewal options, sublease agreements, and lease cancellations with nominal penalties. Operating lease obligations expire at various dates with the latest maturity in 2018. The Company's rental expense for 2012 and 2011 was $3,931 and $3,478, respectively.

Future minimum lease payments under noncancelable operating leases as of December 31, 2012, are as follows:

Years Ending December 31	Total Leases
2013	$ 4,344
2014	3,493
2015	1,047
2016	363
2017	368
Thereafter	33
Total	$ 9,648

11. COMMITMENTS AND CONTINGENCIES

Legal Proceedings — The Company is involved from time to time in claims, proceedings, and litigation, including the following:

PREMERA is named as a defendant in *Alaska Native Tribal Health Consortium, d/b/a Alaska Native Medical Center v. Premera* and a companion case, *Southcentral Foundation v. Premera*. Both cases were filed in a federal court in Alaska and concern the reimbursement rate paid for medical care received by PREMERA members at the Alaska Native Medical Center (ANMC) that is co-owned and operated by plaintiffs Alaska Native Tribal Health Consortium and Southcentral Foundation. The complaint alleges that PREMERA has failed to reimburse ANMC pursuant to the requirements of the Indian Health Care Improvement Act (IHCIA) over the entire 11-year period of time that ANMC was a contracted facility and now that it is an out-of-network provider. The changes to the IHCIA upon which plaintiffs rely as the basis for their underpayment claim did not go into effect until March 2010, a year before they terminated their contract with PREMERA. The parties have both filed motions for summary judgment asking the court to resolve the case in their favor. Those motions are both pending before the court.

In January 2013, the court granted PREMERA's motion for summary judgment and dismissed plaintiffs' claims alleging that they were entitled to the highest reimbursement rate paid by PREMERA for similar services in any other geographic area in the United States. However, plaintiffs' claim that they are being underpaid by PREMERA even under the court's more restrictive reading of the IHCIA statute survived summary judgment and plaintiffs continue to prosecute that claim.

PREMERA, along with the Blue Cross Blue Shield Association (BCBSA) and the majority of all of the other Blue Plans, has been named as a defendant in multiple suits that make up the *In re Blue Cross Blue Shield Antitrust Litigation* matter that is being handled by a federal court judge in Birmingham, Alabama. This matter is part of a process called multidistrict litigation, where there are multiple cases filed by plaintiffs in different jurisdictions across the country, all alleging the same basic set of operative facts and causes of action. For purposes of judicial economy and convenience, the various lawsuits are all transferred and consolidated with one court. Here, plaintiffs across the country have filed multiple lawsuits alleging violation of antitrust law based on an alleged conspiracy among the Blue Plans and the BCBSA to restrain trade via the service area restrictions in the parties' license agreements. Those cases have all been transferred and consolidated under Judge Proctor in federal district court in Alabama.

The BCBSA, which has defended similar suits in the past, has been coordinating the defense of these cases at these early stages. PREMERA has retained its own independent counsel to defend it in these suits; counsel has been coordinating and cooperating in the joint defense with the BCBSA and the other plans' counsel.

PREMERA, along with multiple other Blue Plans, is named as a defendant in *Innova Hospital San Antonio & Victory Medical Center Houston v. Premera Blue Cross, et al.,* filed in April 2012 in a state court in Texas. The plaintiffs are two out-of-network hospitals in Texas contesting the adequacy of the compensation they have received for medical care provided to members of the defendant Blue Plans. Plaintiffs seek recovery from PREMERA for alleged underpayments related to medical claims for two PREMERA members. PREMERA has retained defense counsel in Texas, who is jointly representing multiple Blue Plans that have a similarly small number of claims at issue in the lawsuit. The matter was removed to federal court and is ongoing; PREMERA is actively defending the lawsuit.

PREMERA, along with multiple other Blue Plans and employer groups, is named as a defendant in *Pomona Valley Hospital Medical Center v. Premera Blue Cross, et al.,* filed in August 2012 in a federal court in California. Plaintiff is an out-of-network hospital in Pomona, California, alleging that Blue Plans and employer groups have underpaid the facility for the following services: (i) emergency services; (ii) poststabilization care; and (iii) nonemergent care. The complaint alleges multiple violations of ERISA, breach of contract, breach of implied contract, and violations of California's consumer protection act. PREMERA has retained defense counsel in California that has represented PREMERA in similar matters in this jurisdiction. That defense is on behalf of multiple Blue Plans and is ongoing.

PREMERA is named as a defendant in *J.P., et al. v. Premera Blue Cross, et al.,* filed in October 2012 in the Washington state court. This is a new class complaint filed on behalf of PREMERA members insured through non-ERISA-governed health plans since 1996 who have a diagnosed mental disorder (DSM-IV) and have been wrongfully denied coverage for applied behavior analysis (ABA) therapy due to PREMERA's alleged failure to maintain an adequate network of ABA providers. Plaintiffs seek injunctive relief to ensure coverage moving forward and retroactive relief for claims plaintiffs believe were wrongfully denied under Washington's Mental Health Parity Act. PREMERA has retained defense counsel and is aggressively defending this suit.

PREMERA and its subsidiary, LWW, are named as defendants in *R.H. et al. v, Premera Blue Cross, et al.,* filed in a federal district court in Seattle, Washington, on January 16, 2013. This lawsuit is a companion case to the previously filed *A.G., et al. v. Premera Blue Cross, et al.* case filed in Washington state court against PREMERA in 2011 (discussed below). The lawsuit seeks certification of a class of PREMERA members located in Washington who are insured under ERISA-governed medical group medical plans issued and insured by PREMERA and have allegedly been (or will be) denied benefits for mental health conditions by PREMERA in violation of the Washington Mental Health Parity Act. Specifically, plaintiffs allege that when members with diagnosed mental disorders seek neurodevelopmental therapy to treat those conditions, those services are mental health benefits that are subject to Washington's Mental Health Parity Act. As such, plaintiffs argue that PREMERA's medical plans violate Washington's Mental Health Parity Act because they impermissibly impose age limits on those mental health benefits. This question is already on appeal before the Washington Court of Appeals in the above mentioned *A.G.* case. PREMERA had retained the same counsel that represents it in *A.G.*

Other matters which have previously been reported, but are still ongoing, are:

PREMERA and its subsidiary, LWW, are named as defendants in *McCarthy Finance, Inc. et al. v. Premera, et al.,* filed in January 2012 in Superior Court for the State of Washington in King County. The suit also names as defendants the Washington Alliance for Healthcare Insurance (WAHIT), an association that contracts with PREMERA companies for health benefits for the association's members, and WAHIT's trustee. The lawsuit seeks certification of a class that would include all of PREMERA's insured members and groups in Washington for the past four years. Plaintiffs have filed a notice of appeal and the matter will proceed in front of the Washington Court of Appeals, with an expected 12- to 18-month time frame for resolution.

PREMERA is named as a defendant in *Slaughter v. Premera Blue Cross*, filed in December 2011 in Superior Court for the State of Washington in King County. The complaint alleges discrimination and retaliation in violation of state and federal law. Plaintiff has engaged defense counsel and is actively defending this suit.

PREMERA, along with 33 other Blue Plans, is named as a defendant in *Cedars-Sinai Medical Center v. Premera Blue Cross, et al.,* filed in October 2011 in a federal court in Los Angeles, California. Plaintiff is a network provider with Blue Shield of California alleging that the defendant Blue Plans have both underpaid and improperly denied claims from plaintiff in violation of plaintiff's alleged agreements with the defendants. Plaintiffs allege they are owed approximately $175,000 by PREMERA for claims that were underpaid or wrongly denied payment. The case is ongoing and PREMERA is actively defending this suit.

PREMERA and its subsidiary, LWW, are named as defendants in *A.G., et al. v. Premera Blue Cross, et al.,* filed in September 2011 in Superior Court for the State of Washington in King County. The lawsuit seeks certification of a class of PREMERA members located in Washington who are insured under plans, individual and group, not subject to ERISA, and have allegedly been (or will be) denied benefits for mental health conditions by PREMERA in violation of the Washington Mental Health Parity Act. This case is one of several filed by the same law firm against all of the major carriers operating in Washington State, challenging the administration of benefits for certain health conditions, including benefits for services for individuals with autism.

The named plaintiff in this case, A.G., is a 13-year-old diagnosed with autism. PREMERA denied coverage for occupational and speech therapy that allegedly was needed to treat the member's autism because the member's plan, issued through PREMERA's subsidiary, LWW, does not include coverage for neurodevelopmental therapy. The plaintiff challenges the denial of benefits and PREMERA's application of age and visit limits for its neurodevelopmental therapy benefits when the member has been diagnosed with a mental disorder. In March 2012, the court issued an order in this case requiring PREMERA to pay the named plaintiff's neurodevelopmental claims as mental health benefits, not subject to any age limits, moving forward. PREMERA has appealed that decision to the Washington Court of Appeals. That appeal is ongoing and is not expected to be concluded until the end of this year or early next year.

PREMERA is named as a defendant in *Comprehensive Pain Management, et al. v. Premera Blue Cross,* filed in August 2011 in Alaska state court. Plaintiff is a former network provider in Alaska that was the subject of an audit by PREMERA's special investigations unit. As a result of that audit, PREMERA sought recovery for overpayments made to plaintiff. Plaintiff terminated their network agreement with PREMERA and sued the Company regarding its efforts to recoup the overpayments made to the plaintiff. Plaintiff alleges PREMERA violated state law and the terms of the parties' network agreement in recovering the overpayments made to the plaintiff. The parties resolved this matter via settlement in early 2012.

PREMERA, along with 28 other Blue Plans, is named as a defendant in *Center for Restorative Breast Surgery, et al. v. Premera Blue Cross, et al.,* filed in April 2011 in a federal court in Louisiana. The plaintiffs are a group of providers in New Orleans, Louisiana, contesting the adequacy of the compensation they have received for medical care provided to members of the defendant Blue Plans. Plaintiffs seek recovery from PREMERA for alleged underpayments related to claims for four of PREMERA's members. PREMERA has retained defense counsel in Louisiana who has represented the Company in previous litigation involving some of the same plaintiffs. This matter is ongoing and PREMERA is actively defending the lawsuit.

PREMERA is named as a defendant in *Rickman v. Premera Blue Cross,* filed in December 2010 in Superior Court for the State of Washington in Snohomish County. The complaint alleges claims for retaliation and wrongful termination in violation of public policy. PREMERA has engaged defense counsel and is defending this suit. To date, there has been limited activity by the plaintiff's counsel in this case.

PREMERA is named as a defendant in *Hoppel v. Premera Blue Cross,* filed in August 2010 in Superior Court for the State of Washington in Snohomish County. The complaint, filed by the ex-wife of a recently-deceased former CEO of PREMERA, alleges that PREMERA owes more than $1 million for alleged retirement funds and insurance policies PREMERA is holding, that belonged to her ex-husband. In May 2011, the court granted summary judgment to PREMERA and dismissed the plaintiff's lawsuit. However, plaintiff has appealed the dismissal with the Ninth Circuit Court of Appeals. The appeal is currently pending before the court.

PREMERA is named as a defendant in *Dixon v. Premera Blue Cross,* filed in June 2008 in Superior Court for the State of Washington in Snohomish County. The complaint alleges claims for age and disability discrimination, retaliation, and constructive discharge. The plaintiff resigned from PREMERA after eight years of employment. There has been limited activity in this case and no trial date has been set.

PREMERA is named as a defendant in *Pennsylvania Chiropractic Association v. Blue Cross and Blue Shield Association, et al.,* filed in September 2009 in a federal court in Chicago by three state chiropractic associations and 14 individual chiropractors as a national class action of chiropractors, against the Blue Cross and Blue Shield Association and 22 Blue Plans. The court has not certified the case as a class action. The complaint asserted violations of ERISA based on allegations that plans wrongly recovered payments made to chiropractors. The claims against PREMERA are: (i) the company inappropriately recovered a $313 payment made to plaintiff Larry Miggins on the basis that Medicare was the primary payer, and (ii) it participated in antifraud coalitions, such as the National Health Care Anti-Fraud Association. Based on these allegations, plaintiffs seek the return of all amounts PREMERA has recovered from any of the putative class members since 2003. PREMERA was dismissed as a defendant from this case in early 2011, so PREMERA'S involvement in this ongoing lawsuit has ended.

PREMERA is named as a defendant, along with 38 other Blue Plans, in five separate lawsuits filed in late 2010 in a federal district court by Prime Healthcare Services, Inc. ("Prime"), on behalf of five California hospitals owned by Prime. The complaints allege two violations of ERISA based on allegations that the Blue Plans pay inappropriately low reimbursement to the individual hospitals for emergency medical services provided to members of the Blue Plans. The specific claims against PREMERA are: (i) failure to pay benefits under ERISA plan benefits; and (ii) failure to properly handle claims. The complaint refers only generally to underpayments and does not specify alleged damages or specific claims at issue against any defendant, including PREMERA. One of the five matters was dismissed in October 2011. The remaining four lawsuits were subsequently dismissed in 2012 and these five matters are now resolved.

However, a sixth Prime lawsuit filed against PREMERA as the sole defendant, in July 2011 in California state court regarding the Shasta Medical Center in Northern California, is still ongoing. The allegations in this complaint track those in the other five cases, but plaintiff's claims in this case are brought under state law causes of action to avoid removal to federal court. PREMERA has engaged the same defense counsel for this lawsuit and is actively defending this suit.

In May 2009, PREMERA received a demand letter from the United States Postal Service (USPS) for repayment of the entire postal discount PREMERA obtained on all of its presorted first-class mail sent from western Washington between February 1, 2008, and January 31, 2009 (the "Revocation Period"). The amount of the demand is $1.35 million.

USPS regulations authorize a sender to receive the presort discount on first class mail when the sender attests that it is auditing its address list against the USPS National Change of Address (NCOA) database every 90 days and, accordingly, changing any addresses within the Company database that have been updated by USPS. The USPS alleges that PREMERA did not comply with those requirements during the Revocation Period based on the volume of returned mail and the number of addresses in PREMERA's source systems that were no longer valid according to the USPS NCOA database. During the relevant time period, PREMERA used a vendor, PSI, to perform presort services in western Washington. PREMERA filed an appeal of USPS's demand in June 2009. The appeal was based on the fact that the alleged deficiency was the result of the failure of USPS's own software that was used by PREMERA's vendor in sorting PREMERA's mail.

USPS denied PREMERA's appeal in May 2011 and reasserted its demand for the full deficiency amount. In May 2012, PREMERA entered into a settlement with USPS agreeing to pay $520,000 in exchange for resolution of the USPS' revenue deficiency claim.

The Company disputes the allegations of the foregoing claims and intends to vigorously defend against them; however, litigation is subject to inherent uncertainties and the ultimate outcome of these matters cannot presently be determined and the Company cannot estimate the range of possible losses. An unfavorable outcome in any of these matters could have a material adverse effect on the Company's consolidated financial position and the results of operations.

The Company is subject to other claims and legal actions that arise in the ordinary course of business. Although the ultimate outcome of these additional proceedings cannot be ascertained at this time, it is reasonably possible that some of them could be resolved unfavorably to the Company. Management believes that any liabilities that may arise from such proceedings would not be material in relation to the Company's consolidated financial position and results of operations as of December 31, 2012. Potential contingent liabilities arising from litigation, income taxes, and other matters are not considered material in relation to the consolidated financial position, results of operations, or cash flows of the Company.

12. STATE HEALTH POOL ASSESSMENT

The Company makes payments to the Washington, Oregon, and Alaska state health insurance pools, which were created to provide health insurance coverage to all state residents who are denied individual health insurance. Payments for assessments recorded as part of benefit expense were $24,191 and $19,886 in 2012 and 2011, respectively.

13. STATUTORY RESERVES AND NET INCOME

PBC, Academe, LWO, LWAC, and LWW (the "Companies") file regulatory reports and financial statements with various state insurance commissioners in accordance with statutory accounting practices prescribed or permitted by the respective domiciliary state insurance department. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed. The Companies held a permitted statutory accounting practice as of December 31, 2011, to admit investment assets within specified investment limits. The prescribed practice was repealed effective July 1, 2012. PBC also has a permitted statutory accounting practice as of December 31, 2012 and 2011, to admit the statutory capital and surplus of Ucentris' audited insurance subsidiaries. Differences between statutory reserves/unassigned surplus and statutory net income and net worth and net income as determined on a GAAP-basis primarily relate to differences in accounting for net income of subsidiaries; unrealized gain or loss on available-for-sale fixed-income securities; postretirement benefits; and nonadmitted assets such as prepaid expenses and certain furniture, equipment, and software. Assets nonadmitted by the Companies under prescribed and permitted practices were $15,151 and $79,668 for the years ended December 31, 2012 and 2011, respectively.

The Companies met the surplus regulatory requirements as of December 31, 2012 and 2011.

14. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the date the consolidated financial statements were available to be issued on March 18, 2013, and no events, other than those described in these notes, have occurred that require disclosure pursuant to such guidance.

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