

S5715	PDP Illinois, New Mexico, and Texas	STATUTORY-BASIS FINANCIAL STATEMENTS
S5566	PDP Oklahoma	
H3208	MA-PD New Mexico	HCSC Insurance Services Company
H3709	MA-PD Oklahoma	(A Wholly Owned Subsidiary of Health Care Service Corporation, a Mutual Legal Reserve Company)
H4531	MA-PD Texas	Years Ended December 31, 2008 and 2007
H6013	MA-PD (PFFS) Illinois, New Mexico, Oklahoma, and Texas	With Report of Independent Auditors

HCSC Insurance Services Company

Statutory-Basis Financial Statements

Years Ended December 31, 2008 and 2007

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## Report of Independent Auditors

The Board of Directors and Stockholder  
HCSC Insurance Services Company

We have audited the accompanying statutory-basis balance sheets of HCSC Insurance Services Company (the Company) a wholly owned subsidiary of Health Care Service Corporation, a Mutual Legal Reserve Company as of December 31, 2008 and 2007, and the related statutory-basis statements of income and expenses and changes in capital and surplus, and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As described in Note 2 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Illinois Department of Financial and Professional Regulation – Division of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles are described in Note 2. The effects on the financial statements of these variances are not reasonably determinable, but are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company as of December 31, 2008 and 2007, or the results of its operations or its cash flow for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flow for the years then ended, in conformity with accounting practices prescribed or permitted by the Illinois Department of Financial and Professional Regulation – Division of Insurance.

*Ernst + Young LLP*

April 30, 2009

# HCSC Insurance Services Company

## Balance Sheets – Statutory Basis

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Invested assets:		
Cash and cash equivalents	\$ 2,682,424	\$ 6,807,122
Short-term investments, at amortized cost, which approximates fair value	26,801,222	586,387
U.S. government securities, at amortized cost	3,912,649	7,496,592
Total invested assets	33,396,295	14,890,101
Accrued investment income	75,604	122,175
Premium receivables	5,477,380	2,413,400
Amounts receivable related to uninsured plans	22,657,309	123,396,520
Healthcare and other receivables	46,478,394	38,702,403
Net deferred tax asset	3,227,105	709,942
Receivable from parent	1,005,388	–
Total assets	\$ 112,317,475	\$ 180,234,541
<b>Liabilities and capital and surplus</b>		
Liabilities:		
Health claims	\$ 18,865,000	\$ 13,098,000
Health aggregate reserves	943,227	2,030,494
Contract life claims and aggregate reserves	918,000	878,000
Payable to parent	–	66,940,258
General expenses due and accrued	9,547,733	10,728,982
Reinsurance in unauthorized company	888,000	578,000
Federal income taxes payable	1,203,771	3,816,109
Total liabilities	32,365,731	98,069,843
Capital and surplus:		
Common stock, \$5,000 par value, 500 shares authorized, issued, and outstanding	2,500,000	2,500,000
Additional paid-in capital	164,264,898	164,264,898
Accumulated deficit	(86,813,154)	(84,600,200)
Total capital and surplus	79,951,744	82,164,698
Total liabilities and capital and surplus	\$ 112,317,475	\$ 180,234,541

*See accompanying notes.*

## HCSC Insurance Services Company

### Statements of Income and Expenses and Changes in Capital and Surplus – Statutory Basis

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Income</b>		
Premiums earned	<b>\$ 407,556,808</b>	\$ 397,727,478
Net investment income	<b>855,888</b>	1,359,083
Total income	<b>408,412,696</b>	399,086,561
<b>Expenses</b>		
Benefits under life, accident, and health policies	<b>333,890,504</b>	323,964,663
General and administrative expenses	<b>69,630,127</b>	64,679,488
Total expenses	<b>403,520,631</b>	388,644,151
Income from operations before federal income tax expense	<b>4,892,065</b>	10,442,410
Federal income tax expense	<b>1,199,008</b>	3,814,803
Net income	<b>3,693,057</b>	6,627,607
Other capital and surplus changes:		
Change in net deferred tax asset	<b>2,320,347</b>	316,411
Change in nonadmitted assets	<b>(7,916,358)</b>	(614,271)
Change in unauthorized reinsurance	<b>(310,000)</b>	(578,000)
Total other capital and surplus changes	<b>(5,906,011)</b>	(875,860)
(Decrease) increase in capital and surplus	<b>(2,212,954)</b>	5,751,747
Capital and surplus, beginning of year	<b>82,164,698</b>	76,412,951
Capital and surplus, end of year	<b>\$ 79,951,744</b>	\$ 82,164,698

*See accompanying notes.*

## HCSC Insurance Services Company

### Statements of Cash Flow – Statutory Basis

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
Premiums received	<b>\$ 395,199,386</b>	\$ 400,507,440
Investment income received, net of investment expense	<b>989,832</b>	1,396,410
Claims, commissions, and other expenses paid	<b>(373,784,310)</b>	(411,597,302)
Federal income taxes paid	<b>(3,811,341)</b>	(1,755,894)
Net cash provided by (used in) operations	<b>18,593,567</b>	(11,449,346)
<b>Investing activities</b>		
Proceeds from sale or maturity of bonds	<b>6,965,000</b>	4,000,000
Purchase of bonds	<b>(3,468,430)</b>	–
Net cash provided by investments	<b>3,496,570</b>	4,000,000
Net increase (decrease) in cash and cash equivalents and short-term investments	<b>22,090,137</b>	(7,449,346)
Cash and cash equivalents and short-term investments at beginning of year	<b>7,393,509</b>	14,842,855
Cash and cash equivalents and short-term investments at end of year	<b>\$ 29,483,646</b>	\$ 7,393,509

*See accompanying notes.*

# HCSC Insurance Services Company

## Notes to Statutory-Basis Financial Statements

December 31, 2008

### 1. Organization

HCSC Insurance Services Company (HISC or the Company) is a wholly owned subsidiary of Health Care Service Corporation (HCSC), a Mutual Legal Reserve Company. HISC is domiciled in Illinois and is licensed to do business in 43 states and the District of Columbia.

In 2005, HISC began offering the Medicare Advantage PPO (Part C) business in New Mexico and Oklahoma, as well as in certain counties in Texas. The Part C business in Oklahoma is written by HISC but administered by an unrelated insurance company. The risks and rewards are shared equally between HISC and this insurance company under a 50-50 quota share reinsurance agreement.

In 2008, HISC entered into a stop-loss agreement with this unrelated insurance company for Oklahoma Medicare Part C business. If an individual member's underwriting liability is in excess of \$350,000 and up to \$5,000,000, HISC will assume 95% liability. For underwriting liabilities of \$5,000,000 and greater, the liability is shared on a 50-50 basis.

In 2006, HISC entered into an administrative contract with the state of New Mexico whereby HISC performs certain utilization review services for a contracted administrative fee.

In 2006, HISC also began offering Medicare Drug (Part D) insurance coverage in Illinois, New Mexico, Oklahoma, and Texas under a contract with the Center for Medicare & Medicaid Services (CMS). The Part D business represents approximately 91% and 94% of HISC's 2008 and 2007 net premium revenue included in the statutory-basis statements of income and expenses and changes in capital and surplus.

HISC was selected as a Medicaid carrier in the state of New Mexico with an effective date of October 1, 2008.

### 2. Accounting Policies

#### Basis of Presentation

The accompanying statutory-basis financial statements have been prepared in accordance with the National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual*, subject to any deviations prescribed or permitted by the Illinois Department of Financial and Professional Regulation – Division of Insurance (DOI). These practices differ from U.S. generally accepted accounting principles (GAAP). The Company did not have any permitted practice exceptions in 2008 or 2007.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 2. Accounting Policies (continued)

The more significant variances from GAAP are:

*Nonadmitted assets:* Certain assets designated as “nonadmitted assets” are excluded from the accompanying balance sheets and are charged directly to capital and surplus. Nonadmitted assets consist principally of certain receivables and deferred tax assets. Under GAAP, these assets are included in the balance sheets.

*Deferred income taxes:* Deferred tax assets and liabilities are recognized and deferred tax assets are admitted based on prescribed limitations. Changes in deferred tax assets and liabilities are recorded as a direct credit or charge to accumulated deficit.

*Investments:* Investments are stated at values prescribed or permitted by the NAIC and, therefore, are not stated in accordance with GAAP.

*Acquisition expenses:* Acquisition expenses, including commissions and other costs related to acquiring new and renewal business, are charged to operations as incurred rather than being deferred and amortized based on the premium-paying period of the related insurance policies or estimated gross profits as required by GAAP.

*Reinsurance Business:* Premiums, commissions, expense reimbursements, benefits, and reserves related to reinsurance business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Amounts applicable to reinsurance ceded for future policy benefits and claim liabilities have been reported as reductions of these items. Under GAAP, these items would be presented on a gross basis as compared to the statutory net presentation.

*Unauthorized insurance:* Certain reinsurance credits are treated as unauthorized reinsurance. This occurs when the reinsurer is not licensed in the domiciliary state of the insurer and the insurer has not received an acceptable form of security from the reinsurer. Increases in unauthorized reinsurance credits are reported as direct reductions to capital and surplus.

*Statements of cash flow:* The cash flow statements are prepared in conformity with statutory accounting practices and, therefore, are not prepared in accordance with GAAP.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined but are presumed to be material.

# HCSC Insurance Services Company

## Notes to Statutory-Basis Financial Statements (continued)

### **2. Accounting Policies (continued)**

#### **Use of Estimates**

The preparation of financial statements of insurance companies requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed therein.

#### **Premium Revenues**

Insurance premiums are recorded on the accrual basis of accounting and are recognized as income during the period of coverage.

#### **Claims Unpaid, Claims Adjustment Expenses, and Accident and Health Policy Reserves**

Claims unpaid and claims adjustment expenses on insured policies represent management's best estimate of the ultimate net cost to process and pay all reported and unreported claims incurred through December 31. The Company does not discount claims and claims adjustment expenses. Although such amounts are based on estimates, management believes that the reserves are reasonable and adequate. These estimates are continually reviewed and, as adjustments to these liabilities become necessary, such adjustments are reflected in current operations. Changes in assumptions for such things as medical cost, as well as changes in actual experience, could cause these estimates to change in the near term.

#### **Pharmacy Rebate Receivable**

The Company contracts with Prime Therapeutics, LLC (Prime), an affiliated Pharmacy Benefit Manager (PBM) for the administration of Part D pharmaceutical drug claims. Pharmacy rebate receivables are based on the PBM's estimate of the actual amounts due to the Company.

Pharmacy rebate receivables are included in healthcare and other receivables in the statutory-basis balance sheets.

# HCSC Insurance Services Company

## Notes to Statutory-Basis Financial Statements (continued)

### 2. Accounting Policies (continued)

#### Investments

Investments are stated at values prescribed or permitted by the NAIC, as follows.

Bonds not backed by other loans are principally stated at amortized cost. Cash and cash equivalents consist of cash, certificates of deposit, and cash equivalents. Certificates of deposit included in cash are those in banks or other similar financial institutions with maturity dates within one year or less of the acquisition date. Cash equivalents are short-term, highly liquid investments that are both: (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition.

Amortization of bond premium and accretion of bond discount are recognized on an effective yield-basis method. Realized gains and losses are determined on a specific-identification basis. Impairments are recognized for investments where the decline in fair value is determined to be other-than-temporary. The investment is written down to fair value as the new cost basis, and the amount of the write-down is accounted for as a realized loss on the Company's statements of income and expenses and changes in capital and surplus.

#### Medicare Part D Pharmacy Benefit Contract

There are six elements of payments received by the Company during the Part D plan year. These payment elements are as follows:

- CMS Premium – CMS pays a fixed monthly premium per member to the Company for the entire plan year.
- Member Premium – In addition to the CMS premium, each member pays a fixed monthly premium to the Company for the entire plan year.
- Low-Income Premium Subsidy – For qualifying low-income members, CMS pays some portion or all of the member's monthly premiums to the Company on the member's behalf.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 2. Accounting Policies (continued)

- Catastrophic Reinsurance Subsidy – CMS pays the Company a cost reimbursement estimate monthly to fund the CMS obligation to pay approximately 80% of the costs incurred by individual members in excess of the individual annual out-of-pocket maximum of \$4,050 and \$3,850 for 2008 and 2007, respectively. A settlement is made based on actual cost experience subsequent to the end of the plan year.
- Low-Income Member Cost Sharing Subsidy – For qualifying low-income members, CMS pays on the member's behalf, some portion or all of a member's cost-sharing amounts, such as deductibles and coinsurance. The cost-sharing subsidy is funded by CMS through monthly payments to the Company. The Company administers and pays the subsidized portion of the claims on behalf of CMS, and a settlement payment is made between CMS and the Company based on actual claims experience, subsequent to the end of the plan year.
- CMS Risk Share – If the ultimate per-member, per-month benefit costs of any Medicare Part D regional plan vary more than 5.0 percentage points in 2008 and 2.5 percentage points in 2007, either above or below the level estimated in the original bid submitted by the Company and approved by CMS, there is a risk-share settlement with CMS that is settled subsequent to the end of the plan year. The risk-share adjustment, if any, is recorded as an adjustment to premium revenues and health aggregate reserve liabilities or premium receivables.

The CMS Premium, the Member Premium, and the Low-Income Premium Subsidy represent payments for the Company's insurance risk coverage under the Part D program and, therefore, are recorded as premium revenues in the Company's statutory-basis statements of income and expenses and changes in capital and surplus. Premium revenues are recorded on the accrual basis of accounting and are recognized as income during the period of coverage. Premium payments received in advance of the coverage period are recorded on the Company's statutory-basis balance sheets as unearned premiums.

The Catastrophic Reinsurance Subsidy and the Low-Income Member Cost Sharing Subsidy represent cost reimbursements under the Part D program. The Company is fully reimbursed by CMS for costs incurred for these contract elements and, accordingly, there is no insurance risk to the Company. Amounts received for these subsidies are not reflected as premium revenues, but rather are accounted for as deposits and, as such, are not included in the Company's statutory-basis statements of income and expenses and changes in capital and surplus. The Company had claims and claim reimbursements related to the uninsured portion of the Part D business of \$240,300,000 and \$244,900,000 in 2008 and 2007, respectively. No gain or loss was recorded.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 2. Accounting Policies (continued)

Net insured pharmacy benefit costs and administrative costs are expensed as incurred and are recognized in benefits under life, accident, and health policies expenses, and general and administrative expenses, respectively, in the Company's statutory-basis statements of income and expenses and changes in capital and surplus.

#### Reclassifications

Certain amounts in the 2007 presentation have been reclassified to conform to the current year presentation.

#### 3. Investments

The cost or amortized cost and NAIC fair value of investments in U.S. government securities at December 31, 2008 and 2007 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	NAIC Fair Value
<b>2008</b>				
U.S. government securities	\$ 3,912,649	\$ 251,805	\$ –	\$ 4,164,454
Due in 1 year or less				
Due 1 year – 5 years	\$ 3,783,827	\$ 209,963	\$ –	\$ 3,993,790
Due 5 years – 10 years	128,822	41,842	–	170,664
	\$ 3,912,649	\$ 251,805	\$ –	\$ 4,164,454
<b>2007</b>				
U.S. government securities	\$ 7,496,592	\$ 41,211	\$ 18,581	\$ 7,519,222

At December 31, 2008 and 2007, investments with an amortized cost of \$3,509,000 and \$1,674,000, respectively, were on deposit with various states, as required. In addition, the Company is required to maintain minimal amounts in dedicated bank accounts pursuant to the requirements of the New Mexico Medicaid contract. The amount is determined as a percentage of revenues.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 3. Investments (continued)

Management regularly reviews the fair value of the Company's investments. If the fair value of any investment falls below its cost basis, the decline is analyzed to determine whether it is an other-than-temporary decline in value. The analysis considers:

- The length of time and the extent to which the fair value has been below cost.
- The financial condition and near-term prospects of the issuer of the security, including any specific events that may affect its operations or earning potential and management's intent and ability to hold the security long enough for it to recover its value.

Using the results of this analysis, management makes a judgment as to whether the loss is other-than-temporary. If management determines that the loss is other-than-temporary, an impairment charge is recorded in net realized investment gains (losses) in the accompanying statements of revenues and expenses in the period the determination was made.

The major categories of net investment income are summarized below:

	Year Ended December 31	
	2008	2007
U.S. government securities	\$ 230,505	\$ 338,463
Short-term investments, cash, and cash equivalents	625,854	1,021,362
Gross investment income	856,359	1,359,825
Investment expenses	(471)	(742)
Net investment income	\$ 855,888	\$ 1,359,083

The Company does not engage in any off-balance sheet, derivative, or hedging activities. There is no significant industry or other concentrations.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 4. Pharmacy Rebate Receivable

The total pharmacy rebate receivable at December 31, 2008 and 2007, was approximately \$43,500,000 and \$36,500,000, respectively. These receivables were confirmed by the PBM as owed, and as such, were treated as an admitted asset.

In 2008 and 2007, the Company collected pharmacy rebates of approximately \$79,200,000 and \$66,500,000, respectively. The chart below contains further detail regarding pharmacy rebate receivables. Amounts in the chart are shown in millions of dollars.

Quarter	Estimated Pharmacy Rebates as Reported on Financial Statements	Pharmacy Rebates as Invoiced/ Confirmed	Actual Rebates Collected Within 90 Days of Invoicing Confirmation	Actual Rebates Collected Within 91 to 180 Days of Invoicing/ Confirmation	Actual Rebates Collected More Than 180 Days After Invoicing/ Confirmation
12/31/2008	\$ 21.3	\$ 21.3	\$ —	\$ —	\$ —
09/30/2008	21.0	21.0	—	—	—
06/30/2008	20.9	—	—	19.7	—
03/31/2008	21.2	—	—	21.2	—
12/31/2007	18.1	18.1	—	17.9	—
09/30/2007	18.1	18.1	—	18.0	—
06/30/2007	18.8	—	—	18.5	0.4
03/31/2007	16.9	—	—	16.9	2.0
12/31/2006	15.0	15.0	—	15.1	—

#### 5. Income Taxes

The Company is included in the consolidated federal income tax return of HCSC and other eligible subsidiaries. The method of allocation between the companies is subject to a written agreement approved by HCSC's Board of Directors, which sets forth the manner in which the total combined federal income tax is allocated to each entity that is a party to the agreement.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 5. Income Taxes (continued)

The components of the net deferred tax asset recognized in the statutory-basis balance sheets are as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Gross deferred tax assets	<b>\$ 6,983,909</b>	\$ 4,634,054
Gross deferred tax liabilities	<b>(246,906)</b>	(217,398)
Net deferred tax asset	<b>6,737,003</b>	4,416,656
Deferred tax asset nonadmitted	<b>3,509,898</b>	3,706,714
Net admitted deferred tax asset	<b>\$ 3,227,105</b>	\$ 709,942
 (Decrease) increase in nonadmitted deferred tax asset	<b>\$ (196,817)</b>	\$ 196,750

The tax effects of the change in temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Deferred tax assets</b>		
Unpaid losses	<b>\$ 53,628</b>	\$ (16,410)
Administrative deficiency reserve	<b>(520,764)</b>	209,575
Nonadmitted assets	<b>2,809,734</b>	130,409
Other	<b>7,257</b>	5,255
Total change in deferred tax assets	<b>2,349,855</b>	328,829
Change in nonadmitted deferred tax assets	<b>196,817</b>	(165,731)
Change in admitted deferred tax assets	<b>2,546,672</b>	163,098
 <b>Deferred tax liabilities</b>		
Accrued market discount	<b>(5,835)</b>	(3,551)
Subrogation	<b>35,344</b>	15,969
Total change in deferred tax liabilities	<b>29,509</b>	12,418
Change in net admitted deferred tax asset	<b>\$ 2,517,163</b>	\$ 150,680

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 5. Income Taxes (continued)

The change in net deferred taxes is comprised of the following:

	December 31		Change
	2008	2007	
Gross deferred tax assets	\$ 6,983,909	\$ 4,634,054	\$ 2,349,855
Gross deferred tax liabilities	(246,906)	(217,398)	(29,508)
Net deferred tax asset	\$ 6,737,003	\$ 4,416,656	2,320,347
Change in unrealized capital gains			—
Change in net deferred income taxes			\$ 2,320,347

The provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate to income before income taxes. The significant items causing this difference for 2008 and 2007, are as follows:

	Effective Tax Rate Percentage	
	2008	2007
Provision computed at statutory rate	35.0%	35.0%
Change in nonadmitted assets	(57.8)	(1.2)
Other	(0.1)	(0.3)
Total	(22.9)%	33.5%
Federal income tax	24.5%	36.5%
Change in net deferred income taxes	(47.4)	(3.0)
Total statutory income taxes	(22.9)%	33.5%

At December 31, 2008, the Company had \$10,672,962 in tax-effected operating loss and tax credit carryforwards originating in 2003 through 2005, which expire, if unused, in years 2023 to 2028.

The amount of federal income taxes incurred in 2008 and 2007 of \$5,015,144 is available for recoupment in the event of future net losses.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### **6. Related-Party Transactions**

The Company does not have any employees. HCSC provides management, administrative, and investment services and pays certain expenses on behalf of the Company. The senior management and officers of the Company also serve as senior management and officers of HCSC. Additionally, certain officers of HCSC also serve on the Board of Directors of the Company. Expenses allocated from HCSC to HISC were \$29,977,000 and \$19,834,000 in 2008 and 2007, respectively.

The amount due from parent is \$1,005,388 at December 31, 2008, for receipts collected by HCSC on behalf of HISC. These balances are generally settled within 90 days.

The Company offers reinsurance coverage to FDL for a specific group's life claims that exceed a predetermined amount. FDL ceded premiums to the Company of \$1,361,870 and \$967,000 in 2008 and 2007, respectively, for this coverage. The contract life claim aggregate reserves related to the FDL group business are \$918,000 and \$878,000 at December 31, 2008 and 2007, respectively. The Company paid claims of \$323,000 and \$1,205,000 in 2008 and 2007, respectively. The contract life claims and aggregate reserves were reduced by \$142,000 in 2008 and were reduced by \$1,958,000 in 2007. This contract was terminated on January 1, 2009.

In connection with the 2005 application to offer Part C programs in certain areas of Texas and all of New Mexico, HISC represented to the CMS that HISC will be funded by HCSC, as needed, to meet Illinois state risk-based capital (RBC) requirements.

The Company has a contract with TMG Health, Inc, a third-party administrator wholly owned by HCSC, to perform certain claims processing and customer services for HISC's Medicare Part C business.

#### **7. Reinsurance**

In the normal course of business, the Company cedes insurance in order to limit its exposure to loss on any single insured event by ceding risks to reinsurers under various types of contracts. To the extent that any reinsuring companies are unable to meet obligations under reinsurance agreements, the Company would be liable for the reinsured risk.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 7. Reinsurance (continued)

The effect of reinsurance with related parties and third parties on premiums written and earned are as follows:

	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
Direct and assumed premiums	<b>\$415,513,762</b>	\$403,045,926
Premiums ceded	<b>(7,956,954)</b>	(5,318,448)
Net premiums earned	<b><u>\$407,556,808</u></b>	<b><u>\$397,727,478</u></b>

The effect of reinsurance with related parties and third parties on reserves is as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Direct and assumed:		
Policy reserves	<b>\$ 26,000</b>	\$ 128,000
Claim reserves	<b>20,826,388</b>	14,910,407
Amounts ceded	<b>(1,069,388)</b>	(1,062,407)
Net reserves	<b><u>\$19,783,000</u></b>	<b><u>\$13,976,000</u></b>

#### 8. Unpaid Claims and Claim Adjustment Expenses

The Company accrues liabilities for unpaid claims and claim adjustment expenses for insured life and health claims. These liabilities represent the estimated ultimate cost of settling claims relating to insured events that occurred on or before December 31. The estimated liability includes amounts that will be required for future payments of: (a) claims that have been reported to the insurer; (b) claims related to insured events that have occurred, but that have not been reported to the insurer as of year-end; and (c) claim adjustment expenses. Claim adjustment expenses include costs incurred in the claim settlement process, such as legal fees and costs to record, process, and adjust claims. Provisions for unpaid claim adjustment expenses are included in general expenses due and accrued in the statutory-basis balance sheets.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 8. Unpaid Claims and Claim Adjustment Expenses (continued)

Activity in the liability for unpaid claims and claim adjustment expenses, net of reinsurance ceded, is summarized as follows:

	<b>2008</b>	<b>2007</b>
Balance at January 1	<b>\$ 14,490,000</b>	\$ 17,968,000
Incurred expenses related to:		
Current year	<b>401,322,437</b>	392,994,249
Prior years	<b>(1,323,843)</b>	(9,458,496)
Total incurred	<b>399,998,594</b>	383,535,753
 Paid expenses related to:		
Current year	<b>381,058,437</b>	378,583,432
Prior years	<b>12,577,157</b>	8,430,321
Total paid	<b>393,635,594</b>	387,013,753
Balance at December 31	<b>\$ 20,853,000</b>	\$ 14,490,000

The provision for unpaid claims and claim adjustment expenses related to prior underwriting years decreased by approximately \$1,324,000 in 2008, principally due to the actual rebates received being more favorable than expected.

The provision for unpaid claims and claim adjustment expenses related to prior underwriting years decreased by approximately \$9,458,000 in 2007, principally due to a favorable reserve adjustment made to the insured claims related to the 2006 annual Medicare Part D settlement with CMS.

#### 9. Capital and Surplus

The insurance departments of various states, including Illinois, impose RBC requirements on insurance enterprises. The RBC calculation serves as a benchmark for the regulation of insurance companies by state insurance regulators. The requirements apply various weighted factors to financial balances or activity levels based on their perceived degree of risk. The RBC guidelines define specific capital levels where regulatory intervention is required based on the ratio of the Company's actual total adjusted capital to control levels determined by the RBC formula. At December 31, 2008, the Company had total adjusted capital in excess of the regulatory RBC requirements.

## HCSC Insurance Services Company

### Notes to Statutory-Basis Financial Statements (continued)

#### 9. Capital and Surplus (continued)

The Company is subject to limitations on the payment of dividends to the stockholder. Generally, dividends during any year may not be paid without prior regulatory approval in excess of the greater of: (a) 10% of statutory surplus as of the preceding December 31, or (b) the statutory gain from operations for the preceding year. The Company did not pay dividends in 2008 or 2007.

#### 10. Reconciliation to Statutory Filing

There were no adjustments to the 2008 Annual Statement. The information identified subsequent to the filing of the 2007 Annual Statement resulted in adjustments of the following account balances:

	<b>Net Income</b>	<b>Capital and Surplus</b>
Year ended December 31, 2007:		
Per annual statement	\$ 5,628,829	\$ 82,164,698
Adjustment to amounts receivable related to uninsured plans	(547,002)	—
Adjustment to healthcare and other receivables	4,585,865	—
Adjustment to contract health claims and aggregate reserves	(2,550,000)	—
Adjustment to federal income taxes payable	(490,085)	—
Per accompanying statutory-basis financial statements	\$ 6,627,607	\$ 82,164,698