

Report of Examination of

BCS Insurance Company
Worthington, Ohio

As of December 31, 2013

Table of Contents

Subject	Page
Salutation	1
Description of Company	1
Scope of Examination	1
Management and Control:	
Board of Directors	2
Officers	2
Insurance Holding Company System	3
Territory and Plan of Operations	3
Significant Operating Results	3
Reinsurance.....	4
Financial Statements:	
Statement of Assets, Liabilities, Capital and Surplus.....	6-7
Statement of Income	8
Statement of Changes in the Capital and Surplus Account	9
Notes to Financial Statements:	
Investments	9
Loss and Loss Adjustment Expense Reserves.....	9
Subsequent Events	9
Conclusion	10
Acknowledgement	11
Verification	12

Columbus, Ohio
October 31, 2014

Honorable Mary Taylor
Lt. Governor/Director
Ohio Department of Insurance
50 West Town Street
3rd Floor – Suite 300
Columbus, Ohio 43215

Dear Madam:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

BCS Insurance Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the “Company.” The examination was conducted at the Company’s home office, located at 2 Mid America Plaza, Oakbrook Terrace, Illinois.

Scope of Examination

The Company was last examined by the Department as of December 31, 2008. The current examination covers the period of January 1, 2009 through and including December 31, 2013.

The Department conducted the examination in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook. The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

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

For years covered by the examination, the certified public accounting firm of KPMG, LLP (“CPAs”) provided an unqualified opinion based on statutory accounting principles.

Relevant work performed by the CPAs during its annual audit of the Company was reviewed during the examination and incorporated into the examination work papers.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers', employees', and agents' welfare and pension plans;
4. loss experience;
5. pending litigation; and
6. Articles of Incorporation and Bylaws.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

<u>Name</u>	<u>Principal Occupation</u>
Howard Francis Beacham, III	President and Chief Executive Officer BCS Financial Corporation
Henry Alan Carpenter	Senior Vice President, General Counsel & Secretary BCS Financial Corporation
David John Jacobs	Senior Vice President, Actuarial & Underwriting BCS Financial Corporation
Susan Ann Pickar	Senior Vice President, Finance & Treasurer BCS Financial Corporation
Steven Scott Martin	President and Chief Executive Officer, Blue Cross Blue Shield of Nebraska

Officers

As of the examination date, the following officers were elected and serving in accordance with the Company's Bylaws:

<u>Name</u>	<u>Title</u>
Howard Francis Beacham, III	President and Chief Executive Officer
Henry Alan Carpenter	Senior Vice President, General Counsel & Secretary
Susan Ann Pickar	Senior Vice President, Finance & Treasurer
Steven Scott Martin	Chairman of the Board

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. BCS Financial Corporation is the ultimate controlling party of the insurance holding company system.

Territory and Plan of Operations

The Company transacts business in all states, the District of Columbia and Puerto Rico.

The Company works with broker administrators to write the commercial division products and offer Professional Liability products to Blue Cross Blue Shield Plans throughout the country.

The following schedule illustrates the Company's premium written in 2013 by line of business:

	Direct	Assumed	Ceded	Net	Percent
Group accident and health	288,195,760	7,069,933	184,222,402	111,043,291	84.2%
Other liability-claims made	39,141,084	0	18,428,360	20,712,724	15.7%
Inland marine	14,104,968	0	13,999,864	105,104	0.1%
Fidelity	65,112	0	65,112	0	0.0%
Medical professional liability-claims-made	<u>284,896</u>	<u>0</u>	<u>284,896</u>	<u>0</u>	<u>0.0%</u>
Totals	<u>341,791,820</u>	<u>7,069,933</u>	<u>217,000,634</u>	<u>131,861,119</u>	<u>100.0%</u>

Significant Operating Results

The Company reported the following net underwriting results, reported in thousands, during the examination period:

	2013	2012	2011	2010	2009
Premiums earned	\$ <u>126,131</u>	\$ <u>108,964</u>	\$ <u>110,116</u>	\$ <u>105,509</u>	\$ <u>108,140</u>
Losses incurred	78,411	60,704	63,829	65,572	75,878
Loss adjustment expenses incurred	10,101	8,422	5,118	3,862	3,517
Other underwriting expenses incurred	<u>35,719</u>	<u>36,311</u>	<u>37,408</u>	<u>35,424</u>	<u>32,148</u>
Total underwriting deductions	<u>124,230</u>	<u>105,439</u>	<u>106,355</u>	<u>104,858</u>	<u>111,543</u>
Net underwriting gain	\$ 1,900	\$ 3,527	\$ 3,761	\$ 651	(\$ 3,404)
Loss ratio	62.2%	55.7%	58.0%	62.1%	70.2%
Loss adjustment expense ratio	<u>8.0%</u>	<u>7.8%</u>	<u>4.6%</u>	<u>3.7%</u>	<u>3.2%</u>
Loss and LAE ratio	70.2%	63.5%	62.6%	65.8%	73.4%
Other underwriting expense ratio	<u>27.1%</u>	<u>32.5%</u>	<u>33.0%</u>	<u>33.1%</u>	<u>30.1%</u>
Combined ratio	<u>97.3%</u>	<u>96.0%</u>	<u>95.6%</u>	<u>98.9%</u>	<u>103.5%</u>

Reinsurance

The Company's accident and health book of business is reinsured through a stop loss program that is marketed on both a direct and assumed basis through Blue Cross Blue Shield Plans. Effective July 1, 2013, the Company began retaining an additional 50% of \$500,000 excess of \$1,000,000 and ceding 50% of this retained amount to affiliate 4 Ever Life ("4EL"). Additionally, all exposures under \$1,000,000 are ceded at a 50% quota share basis to its affiliate, 4EL. Current stop loss attachment points range from \$20,000 up to \$1,000,000 per individual contract year; exposures over \$1,250,000 are fully ceded to external reinsurers. Effective July 1, 2010, specific annual maximums were expanded to include an unlimited option.

The Company's fixed indemnity limited benefit program is aimed at hourly and part-time employees and provides limited medical dental and vision care. The limited benefit program is ceded to BCBS of South Carolina on a 50% quota share basis effective January 1, 2012.

The travel protection program is 100 % reinsured with AGA Reinsurance which was formally Mondial Assistance Internations AG.

The GeoBlue/HTH International program includes expatriate, student inbound and outbound and business and leisure travelers. This program is 100% reinsured with HTH Re Ltd.

The Company's cyber and privacy loss protection program provides coverage/reimbursement for related first-party expenses related to dealing with a cyber/privacy related incident. The policy also provides coverage for third-party liability in the event the insured is sued as a result of a cyber/privacy incident. The program is 100% reinsured with Lloyd's Syndicates.

The D&O and E&O liability coverages are 100% reinsured. The professional liability book of business is reinsured as follows: Effective July 1, 2013, Plans' Liability Insurance Company ("PLIC") agrees to reinsure the Company on its professional liability business for the first \$1,000,000 of ultimate net loss in each claim made/each policy plus 5% of \$4,000,000 in excess of \$1,000,000 of ultimate net loss in each claim made/each policy. PLIC also reinsures a loss corridor retention for the above reinsurance layer. PLIC pays the Company a ceding commission equal to 10% of gross written premium plus reimbursement of premium tax. Excess of loss reinsurance provides recovery in layers with various non-affiliated reinsurers providing 95% of \$4,000,000 excess of \$1,000,000; 100% of \$5,000,000 excess of \$5,000,000 and 100% of \$30,000,000 excess of \$10,000,000. The remaining percentage of each layer not ceded to third-party reinsurers is reinsured with PLIC. Liability coverages are reinsured under a variable quota share arrangement, with the basis of participation ranging from between 80% to 100% depending on the contract year.

The Company reinsures a Group Accident Protection Plan that is a single limit Accident Medical, Accident Disability, Accidental Death and Dismemberment coverage with RGA at either a 40 % or 70 % quota share. The Company cedes 100% of all other accidental death and dismemberment coverages to 4EL.

In 2012, the professional legal liability program is reinsured under a 100 % excess of loss arrangement which attaches at \$500,000 up to a limit of \$2,000,000 for each claim arising under each policy. Coverages in excess of \$2,000,000 up to \$5,000,000 are 100% reinsured. For all risks above \$1,000,000 reinsurance is provided at a facultative basis.

Other liability coverages are reinsured under an excess of loss arrangement with attachment points of \$350,000 per individual per contract year.

Both medical malpractice and specific loss medial coverages are reinsured on a facultative basis.

The contracts contain an insolvency clause, intermediary clause, errors and omission clause and an arbitration clause, which meet the guidelines prescribed by the NAIC.

Financial Statements

The financial condition and the results of its operations for the five year period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors, are reflected in the following:

Statement of Assets, Liabilities, Capital and Surplus
Statement of Income
Statement of Changes in the Capital and Surplus Account

**Statement of Assets
December 31, 2013**

Admitted assets

Bonds	\$ 173,575,421
Common stocks	15,471,653
Cash and short-term investments	13,226,915
Other invested assets	<u>6,316,755</u>
Total cash and invested assets	208,590,744
Investment income due and accrued	1,770,881
Uncollected premiums and agents' balances in the course of collection	36,910,997
Amounts recoverable from reinsurers	8,337,981
Funds held by or deposited with reinsured companies	400,000
Net deferred tax asset	3,896,399
Aggregate write-ins for other than invested assets	
Unapplied claim payments	6,344,285
Intercompany reinsurance asset	1,612,740
Continuity credit receivable	17,693
State income tax and premium tax recoverable	<u>9,645</u>
Total admitted assets	<u>\$ 267,891,365</u>

**Statement of Liabilities, Capital and Surplus
December 31, 2013**

Liabilities

Losses	\$ 34,579,367
Loss adjustment expenses	8,864,481
Commission payable, contingent commissions and other similar charges	125,549
Other expenses	373,202
Taxes, licenses and fees	3,294,471
Current federal and foreign income taxes	1,579,944
Unearned premiums	23,748,443
Ceded reinsurance premiums payable	29,083,189
Funds held by company under reinsurance treaties	68,750
Remittances and items not allocated	4,512,537
Provision for reinsurance	987,000
Payable to parent, subsidiaries and affiliates	5,672,178
Aggregate write-ins for liabilities	2,134,111
Allowance for doubtful accounts	1,736,000
Retroactive reinsurance reserve assumed	418,718
Miscellaneous liability	35,263
Retroactive reinsurance reserve ceded	<u>(55,870)</u>
Total liabilities	115,023,222

Capital and Surplus

Common capital stock	3,000,000
Gross paid in and contributed surplus	36,484,581
Unassigned funds	<u>113,383,562</u>
Surplus as regards policyholders	<u>152,868,143</u>
Total liabilities, capital and surplus	<u>\$ 267,891,365</u>

Statement of Income
As of December 31, 2013

Premiums earned	<u>\$ 126,130,721</u>
Losses incurred	78,410,494
Loss adjustment expenses	10,100,976
Other underwriting expenses	<u>35,718,844</u>
Net underwriting gain	1,900,407
Net investment income earned	6,162,631
Net realized capital gain less capital gains tax	<u>636,811</u>
Net investment gain	<u>6,799,442</u>
Aggregate write-ins for miscellaneous income	
Allowance for doubtful accounts	289,000
Miscellaneous income	277,333
Retroactive reinsurance assumed	(95,949)
Retroactive reinsurance ceded	<u>(24,622)</u>
Total other income	<u>445,762</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	<u>9,145,611</u>
Federal and foreign income taxes incurred	<u>2,789,975</u>
Net income	<u>\$ 6,355,636</u>

Statement of Changes in the Capital and Surplus Account (in thousands)

<u>Capital and Surplus</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Capital & surplus, prior year end	\$151,879	\$146,616	\$142,045	\$140,423	\$140,557
Net income	6,356	8,193	7,339	5,150	3,069
Change in net unrealized capital gains less capital gains tax	130	808	(178)	299	60
Change in net deferred income tax	837	541	(25)	1,246	(1,065)
Change in non-admitted assets	(1,403)	(718)	(229)	(1,032)	1,844
Change in provision for reinsurance	69	346	1,164	(541)	(781)
Cumulative effect of changes in accounting principles	-	93	-	-	238
Dividends to stockholders	(5,000)	(4,000)	(3,500)	(3,500)	(3,500)
Net change in capital and surplus	989	5,263	4,571	1,622	(134)
Capital and surplus, current year end	<u>\$152,868</u>	<u>\$151,879</u>	<u>\$146,616</u>	<u>\$142,045</u>	<u>\$140,423</u>

Notes to Financial Statements

Investments

The Company's investment portfolio primarily consists of fixed income bonds, mutual funds and an income fund and is in compliance with Section 3925.08 of the ORC. The investments were valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Loss and Loss Adjustment Expense Reserves

The Company's Board of Directors appointed Charles C. Emma, FCAS, MAAA, of EVP Advisors, Inc. to render a Statement of Actuarial Opinion ("Opinion") on the total reserves. Mr. Emma prepared an Actuarial Report supporting the Opinion in conjunction with the preparation of the Company's December 31, 2013 Annual Statement.

Thomas Botsko, ACAS, MAAA, the Department's Chief Property and Casualty Actuary, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the loss and loss adjustment expense ("LAE") reserves. Mr. Botsko concluded the reserves fall within a reasonable range of reserve estimates at December 31, 2013.

Subsequent Events

There are no material subsequent events.

Conclusion

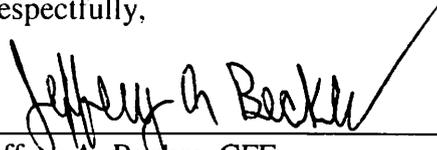
The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2013, and is summarized as follows:

Total Admitted Assets	<u>\$ 267,891,365</u>
Liabilities	115,023,222
Surplus as Regards Policyholders	<u>152,868,143</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$ 267,891,365</u>

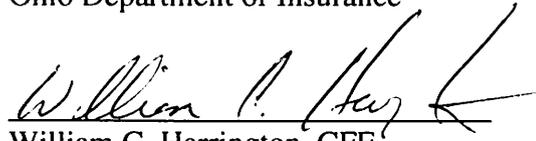
Acknowledgement

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: Edward Nagorny, CISA, CFE, CPA; Kim Somogyi, AES, CPA and Bradley Schroer.

Respectfully,



Jeffery A. Becker, CFE
Examiner-In-Charge
Office of Risk Assessment
Ohio Department of Insurance



William C. Harrington, CFE
Chief Examiner
Office of Risk Assessment
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the ORC, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2013.

Jeffery A. Becker
Examiner-In-Charge

11/13/14
Date

William C. Harrington
Chief Examiner

11/13/14
Date

State of Ohio

County of Franklin

Personally appeared before me the above named, Jeffery A. Becker, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 13 day of November 2014.

Elizabeth Chase
(Notary Public)

ELIZABETH CHASE

NOTARY PUBLIC, STATE OF OHIO

~~MY COMMISSION EXPIRES MAY 22, 2017~~
My Commission Expires

State of Ohio

County of Franklin

Personally appeared before me the above named, William C. Harrington, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 13 day of November, 2014.

Elizabeth Chase
(Notary Public)

ELIZABETH CHASE

NOTARY PUBLIC, STATE OF OHIO

~~MY COMMISSION EXPIRES MAY 22, 2017~~
My Commission Expires