WELLCHOICE℠ INC.

2003

annual report

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NYSE

meeting & exceeding our promise

to our stockhol

WellChoice, Inc. can proudly look back on 2003, our first full year as a public company, as a year of meeting and exceeding our promises. We promised strong financial performance, significant managed care membership growth, a flexible product portfolio, world-class customer service and a continued commitment to quality. We are pleased to report that we have fulfilled the promises we made.

WellChoice delivered solid financial performance in 2003. For the year ended December 31, 2003, total revenue was $5.4 billion compared to $5.1 billion for the year ended December 31, 2002. We reported net income for the year of $201.1 million, or $2.41 per share. Our 2003 pre-tax net income from continuing operations increased 10.9% from 2002. Cash flow from operating activities was $295.1 million for the year compared to $182.7 for the year ended December 31, 2002. This strong financial performance was the result of revenue increases from the growth in self-funded accounts, disciplined pricing and stable claims trends, especially for commercial managed care products. In addition, administrative expense control contributed to this performance. Our administrative expense ratio for the year was 16.5%, 40 basis points better than 2002. Looking at administrative expense ratios on a premium equivalent basis provides a more realistic view of the Company's administrative costs due to the increasing significance of our self-funded business, which now accounts for more than one-third of our total members. Premium equivalents are the sum of premiums, service fees and paid claims attributable to our self-funded business for which we provide a range of services, including claims administration and membership and billing services. On a premium equivalent basis, the administrative expense ratio for the full year 2003 was 10.6%, a 90 basis point improvement compared to 11.5% for the full year 2002.

We continued to grow overall enrollment and to experience real momentum in commercial managed care membership growth. As of December 31, 2003, corporate membership stood at 4.8 million, an increase of 3.2% compared to the prior year. Enrollment in the Company's core commercial managed care segment, which excludes the New York State and New York City accounts, increased by 282,000 to just over 2.3 million members, a 14% increase since year-end 2002. Membership in our entire commercial managed care segment increased by 7.9% to 4,106,000 for the year. Self-funded membership grew 12.1% to 1,736,000 for the year ended December 31, 2003 and accounts for 36.5% of our overall membership.

We recognize that in order to meet market demands, we must offer a product portfolio that is flexible and competitive, and that surrounds our customers with indispensable value, including lower total cost, service excellence, and the security of a trusted brand. Last year our primary operating subsidiary, Empire Blue Cross Blue Shield, successfully launched a new point of service product, Direct POS. Targeted to small and middle market groups, Direct POS rounded out our existing managed care

ders:

product portfolio comprised of traditional and open-access HMO products, as well as EPO and PPO plan designs. The new POS is based on our HMO provider network, the largest HMO network in our service area, and offers comprehensive hospital and medical coverage with a dozen or more flexible cost-sharing design options that enable employers to select a product that best meets their needs and the needs of their employees.

A continuing focus on delivering world-class customer service resulted in an 88.7% member satisfaction rate in 2003, one of the best in the industry. We achieved these results in part by utilizing a centralized service model that focuses on resolving claims through a single point of contact and by proactive outreach to our members. We also monitor our service levels in real-time via a corporate Intranet accessible to managers and supervisors at their desktops so that they are able to identify potential problems before they become serious issues. We use a variety of methods to help ensure member inquiries are handled quickly and effectively, including an intelligent call management system that forwards incoming calls to the first available customer service representative and call coaching techniques such as side-by-side monitoring of service calls. We also provide our key stakeholders—members, providers, employers, brokers, and, for the first time in 2003, hospital and ancillary facilities—with the ability for self service via dedicated Web portals accessible at www.empireblue.com.

We remain committed to providing our members with products and services that focus on quality care and to helping to ensure that our members receive the right care, at the right time, and in the right setting. We provide a comprehensive suite of programs and services seamlessly integrated to achieve optimal health outcomes for our members. Our programs focus on preventive care and wellness, provide savings and incentives for members and, for those members with acute or chronic conditions such as diabetes or cancer, offer case management and care coordination. For the third consecutive time, our two commercial HMO products,

$5.4b
total revenue

choice

HMO and Direct HMO, as well as Senior Plan, our Medicare+Choice HMO, earned an Excellent accreditation status from the National Committee for Quality Assurance (NCQA), further demonstrating our ongoing focus on and commitment to quality health care.

WellChoice is the health insurer of choice for groups of all sizes with varying product needs and pricing requirements. Six key marketplace differentiators continue to set us apart from our competitors:

- Through our Empire Blue Cross Blue Shield subsidiaries, we have the exclusive right to use the Blue Cross and Blue Shield names and marks in ten downstate New York counties and one or both of these names and marks in selected counties in upstate New York. Our Blue brand products convey trust and security, advantages we leverage in our highly competitive marketplace to attract additional customers and members.
- Our business is founded on a diverse customer base and a broad array of flexible products. Among our customers are large groups with over 500 employees, middle-market groups ranging from 51 to 500 employees, small groups of two to 50 employees, and individuals. We also have 1.2 million members through large national accounts, which consist of many Fortune 500 companies. We offer our products through the Empire Blue Cross Blue Shield or Blue Cross brands in 28 New York counties and the WellChoice brand in New Jersey. Our diverse product portfolio of health maintenance organizations (HMO), point of service plans (POS), exclusive provider organizations (EPO), preferred provider organizations (PPO), and indemnity products, offers customers choices in benefit and cost-sharing designs. Customers can also select from a variety of funding arrangements, including full risk and administrative services only (ASO).
- We take a disciplined approach to managing medical costs and improving quality, set upon a robust technological infrastructure. Our quality initiatives seek to

improve member health, avoid health risks and lower costs. Our use of innovative technologies helps identify high-risk members who can benefit from wellness, disease prevention, health education and early intervention programs.

- We adhere to strict underwriting standards and pricing disciplines that have been proven effective through our long experience in our principal markets. We continually review our underwriting and pricing guidelines on both a product-by-product basis and customer group-by-group basis to ensure our products remain competitive in terms of price and scope of benefits.
- We have a proven track record of responding to and meeting marketplace demands. Our commitment to flawless execution in everything we do enables us to identify market needs and rapidly respond with value-added products and services in the highly competitive New York marketplace.
- The management team at WellChoice is smart and dedicated, with in-depth knowledge about our marketplace and the broader health insurance industry. They are experienced, committed to innovation and dedicated to creating better healthcare solutions for our customers. And we think you would be hard pressed to find a better group of employees than the hard-working, creative and passionate staff at WellChoice.

WellChoice has a trusted brand in a market with high potential growth. We are positioned in the market with a solid capital base, strong networks, excellent customer service, technology leadership and the flexibility to offer new products. We understand what our members, providers, employer groups and brokers expect from us so that we not only meet, but anticipate, their health insurance needs. We are a company built around being responsive to these key constituent groups, and we are committed to providing the best health care and service in the industry.

We are proud of our accomplishments in 2003, and we believe that we are well positioned for continued growth in the year ahead.

Philip Briggs
Chairman

Michael A. Stocker, M.D.
President and Chief Executive Officer

4.8m
members

mission

We are responsible to our **stockholders**. Our business must make a sound profit and seek growth opportunities. We must be willing to make difficult decisions, experiment with new ideas, and learn from our mistakes. Our financial disclosures will be accurate and complete.

We are responsible to our **customers**. In meeting customer needs, everything we do must be operationally excellent and be of high quality. We must constantly strive to manage our costs in order to maintain reasonable prices. The information we provide must be prompt and accurate and we must provide services that improve the health of our members.

We are responsible to our **employees**. We respect their dignity and recognize the merit of their work. We endeavor to create a work environment in which employees feel free to challenge and make suggestions without hesitation. We will strive to develop and recruit a diverse workforce and management team, and we will provide equal opportunity for employment, development, and merit-based advancement. We expect competence from management, and their actions must be just and ethical.

We are responsible to the **physicians, hospitals,** and other **health care providers** for whose services we pay. There is always tension between payers and providers concerning the cost of healthcare. However, we recognize that all of our providers must be paid fairly, promptly, and accurately.

We are responsible to the **communities** we serve. We must practice good corporate citizenship.

blue

The Blue Brand

Through Empire Blue Cross Blue Shield, our primary operating subsidiary, WellChoice has the exclusive right to use the Blue Cross and Blue Shield names and marks for all health benefits products in the ten downstate New York counties and in six counties in upstate New York, as well as the non-exclusive right to use these names and marks in one upstate New York county. WellChoice also has the exclusive right to use the Blue Cross name and mark in seven upstate New York counties and the non-exclusive right to only the Blue Cross name in four upstate New York counties.

The Blue Cross and Blue Shield brands provide our Company with a significant competitive advantage. The Blue Cross and Blue Shield names and marks represent meaningful symbols of trust and quality care in the marketplace. Almost one in three Americans, or 29.6%, receives health insurance through a Blue Cross and/or Blue Shield plan. And, in our service area, 99% of group business administrators (GBAs) and 95% of consumers recognize the name Empire Blue Cross Blue Shield, providing a clear brand distinction.

The Blue brand also provides other, more tangible competitive advantages. As a licensee of the Blue Cross and Blue Shield Association, we are able to provide our PPO, EPO and indemnity members in-network access to a national network of providers through the BlueCard® program. The BlueCard network has approximately 680,000 physicians and 8,500 hospitals nationally, as well as access to benefits in over 200 foreign countries and territories, making it the largest network in the health insurance industry. The combination of these large networks and the low unit medical costs associated with them, has resulted in continued growth for the Company in our national accounts business.

In addition, large numbers of members from other Blue Cross Blue Shield plans seek care in the Company's New York service area, which has a significant number of teaching hospitals and other nationally acclaimed specialized medical institutions and physician groups. This creates an additional source of revenue for the Company under the BlueCard program as we receive a fee from other Blue plans for each of their members who receive medical care through the Empire PPO provider network.

brand

21%
leading market position

leader

Leading the Way

WellChoice has a long history of providing health insurance in New York, and for 70 years we have offered a broad array of health insurance products and services. We are the largest health insurer in the State of New York with 4.8 million members as of December 31, 2003. Our New York service area consists of the 28 counties of eastern New York, beginning at the tip of Long Island, encompassing New York City, then continuing northward on either side of the Hudson River, through Albany, and ending at the Canadian border. WellChoice holds a leading market position of over 21% in the ten downstate counties of New York. In addition, WellChoice provides health insurance coverage to groups and individuals in 16 counties in New Jersey.

Because market demands continually evolve, the ability to offer a broad array of products and services is vital to protecting and growing market share. Understanding that customers demand choice and flexibility, WellChoice offers an expansive portfolio of 27 innovative managed care and traditional indemnity and specialty products. The most popular managed care options include both a traditional HMO that requires a primary care physician to coordinate all care, as well as a "gatekeeperless" HMO that allows members to self-refer to any in-network specialist. For the most flexibility in a managed care product, the PPO allows members to self-refer to any in-network provider from the largest provider network in the market plus offers the ability to receive care out-of-network for covered services. Positioned between the HMO and the PPO in terms of cost and benefit design is the EPO, which offers members open access to the PPO network, but does not provide benefits for care received on an out-of-network basis.

In 2003, WellChoice expanded our product portfolio with the introduction of the Direct POS product. Exceeding expectations, the POS was launched ahead of schedule in June for small groups and in July for middle-market groups. Flexibility is integral in the POS plan design with a dozen cost-sharing options available to small groups and 14 options available to mid-sized employer groups. The POS

plan is an open access product and utilizes our New York HMO provider network, filling an important niche in the continuum of managed care products available through WellChoice.

WellChoice also offers specialized managed care and indemnity products for eligible Medicare beneficiaries. Senior Plan, a Medicare HMO, is available to eligible Medicare beneficiaries in the lower nine counties of New York. Senior Plan offers all the benefits of traditional Medicare, plus additional benefits, such as coverage for brand name and generic prescription drugs and, beginning in 2004, enrollees will be able to see most in-network specialists without a referral. In addition to Senior Plan, eligible Medicare beneficiaries can select from one of three Medicare Supplemental Plans to provide supplemental coverage in addition to traditional Medicare.

Traditional fee-for-service indemnity as well as pharmacy, vision and dental benefit plans and behavioral healthcare help round out the WellChoice product portfolio. The Company also participates in several government programs including Child Health Plus and Healthy New York, as well as offering the two New York State mandated HMO and HMO/POS individual products.

Key to the success of the Company's managed care products are our expansive provider networks. The commercial HMO network provides in-network access to over 60,000 provider sites and 215 hospitals, the largest HMO network in New York and bordering counties in New Jersey and Connecticut. Members who are enrolled in either the EPO or PPO have access to a network of more than 80,000 provider sites and 228 hospitals. The large size of our provider networks gives members extensive flexibility when selecting a doctor or hospital and helps control costs by ensuring that the majority of care is provided on an in-network basis.

Our broad range of product offerings and extensive provider networks enable us to serve a diverse customer base for an optimal and balanced portfolio of business across all customer segments. Our products are available to customers, individuals, small groups of 2–50 employees, middle-market groups of 51–500 employees, large employer groups with 500+ employees, and large national accounts, as well as multi-trusteed organizations under the Taft-Hartley Act.

flexibility

vision

We will become indispensable to our customers. We will accomplish this by responsibly using information that enables us to act as our members' advocate as they navigate the healthcare system and to:

- Manage our provider networks in order to deliver optimal quality and cost for services rendered.
- Offer products that meet the diverse needs of our customers at prices that provide maximum value.
- Be proactive and anticipate our customers' needs…and act on them.

Pursuing our vision will result in growth that delivers strong, sustainable financial performance and superior shareholder value.

strengths

Operating Strengths

WellChoice's operating strengths come from our employees and our processes. As a customer focused company, we are the bridge between our customers' need to manage costs and their employees' desire for choice, simplicity and comprehensive benefits. Our core competencies result from successfully implementing programs and using technology and data to provide superior customer service, improve the health of our members, and help reduce medical costs. Our company adheres to a Strategic Management and Implementation (SMI) process where a senior level operating committee, using strategic and annual plans, sets corporate direction. Strategic direction is deployed by divisional leaders and is managed by multi-week system reliability and project implementation meetings, measurement report cards at all levels and diagnosing root causes of all gaps. This continuous quality improvement process is inclusive and open, allowing any employee at any level to participate and allowing the Company to excel in all that we do.

World-Class Customer Service

WellChoice is dedicated to providing our customers with world-class service. Key to achieving this is our ability to process claims quickly and accurately. In 2003, WellChoice processed more than 34 million original claims. And, virtually all, or 99.6%, of clean claims were adjudicated in 30 days or less. Similarly, we responded to 96% of inquiries within seven days, and 97.6% of inquiries were processed accurately the first time.

When customers need to contact WellChoice, prompt, accurate, "hassle free" service is the goal for all customer experiences whether the exchange is by phone, mail, the Internet or face-to-face. To accomplish this, we take a multi-faceted approach to service excellence: a centralized service model, real-time service monitoring, and self-service. Underlying all three initiatives is an information systems infrastructure based on a single claims engine that delivers value.

80,000+

PPO provider sites

88.7%
member satisfaction

experience.

Under the centralized service model, members have a single point of contact with the Company. No matter where they are, at home, at work or on vacation, a single toll-free 800 number will help members get the information they need, when they need it. The use of virtual call centers facilitates members' seamlessly reaching a customer service representative quickly and easily.

Real-time service monitoring allows WellChoice to watch service levels at all times. Operating over the Company's Intranet, "dashboards" provide key operations and systems reliability metrics directly to a manager's computer. For example, we can monitor response times at call centers at any time, enabling us to identify—and correct—any potential service problems. Similarly, data on systems operations is available to ensure all systems are operating.

The consolidation of our claims systems has laid the foundation for us to develop a suite of e-business portals that provide members, providers, brokers and employer groups with self-service capabilities. Our Web portals offer real-time transactions and online interactive support, key points of differentiation in our industry. During 2003, registration on each of our portals increased significantly: The member portal saw an 18% increase in new users, while new registrations on the physician, broker and employer portals increased 46%, 67% and 16.5%, respectively. Not surprisingly, these sites saw not only new users during 2003 but also dramatic increases in usage: Visits to the member portal increased 44%; the physician site experienced 75% more visits; there was an 80% increase in use by brokers; and over a 200% increase in usage by employer groups.

WellChoice launched a fifth dedicated Web portal, Facility Online Services in 2003. This portal allows 1,500 hospitals and ancillary facilities that contract with us to register and conduct business, including determining patient eligibility, checking claim status, submitting pre-certification requests, viewing last approved day (LAD) and discharge summary reports and submitting HIPAA-compliant batch transactions, online.

The result of this focus on service excellence was an 88.7% member satisfaction rate in 2003, one of the highest rates in the industry. And, as a further testament to our ability to provide world-class customer service, the New York State Department of Insurance (DOI), in its *2003 New York Consumer Guide to Health Insurers,* once again ranked our HMO #1 in New York with the fewest upheld complaints and the fewest prompt pay complaints. DOI rankings are an important objective measure of health plan performance and are strong indicators of excellent service levels.

innovation

community commitment

Health Services

WellChoice offers a suite of health programs and services that are seamlessly integrated to help achieve optimal health outcomes for our members. In addition to improving the health of members, disease management programs have been shown to help control medical costs by helping members avoid acute complications and hospitalizations associated with many chronic conditions.

WellChoice's integrated approach to health services has four primary components, each one providing a more advanced level of benefits than the previous one. Under Health Resources, members have access to basic health and wellness information, including our Healthy Living Newsletter and HealthLine recordings on a variety of health topics. Health Extras provides members with perks to maximize their opportunity for better health. Some of the extras include Staying Healthy phone reminders, discounts to health clubs and related health services, as well as access to all their prescription medication needs online. For members who need medical information or help navigating the health care system, Health Guidance provides 24x7 access to a nurse call center, hospital care coordination and quality information on hospitals at HospitalIQ.net, the Company's proprietary site that provides quality information on hospitals based on the standards developed by The Leapfrog Group. And, for those members with chronic or acute conditions, WellChoice offers Health Management, a level of health services that includes disease management programs for several chronic conditions including asthma, diabetes, coronary artery disease, kidney disease and rare diseases, as well as a maternity care program and intensive care management programs for neonatal care and transplant programs.

5
dedicated web portals

quality

24 hr.

access to nurse call centers

Another part of Health Services is WellChoice's unique patient-centric disease management program, Systematic Analysis Review and Assistance, or SARA®. By combining the use of innovative technology and health care data, SARA improves care by analyzing lab, pharmacy, hospital and medical claims for members enrolled in this program and identifying potential health problems. During 2003, SARA identified almost 98,000 care considerations for members with potential health problems, such as adverse drug interactions, overlooked tests and skipped preventative screenings.

Further exemplifying our commitment to continuous quality improvement, WellChoice's principal operating subsidiary, Empire Blue Cross Blue Shield, earned an Excellent accreditation status from the National Committee for Quality Assurance (NCQA) for its two commercial HMO products—HMO and Direct HMO—and its Medicare+Choice HMO for the third consecutive time. NCQA's highest accreditation status of Excellent is granted only to plans that demonstrate levels of service and clinical quality that meet or exceed NCQA's rigorous requirements for consumer protection and quality improvement.

values

WellChoice will observe the following values in its daily business:

- The customer relies on us. *Take the customer out of the middle.*
- Create a sense of urgency around you. *Take full personal accountability.*
- Respect each other. *Work well together as a team.*
- WellChoice comes first; my unit comes second. *Nobody wins unless the company wins.*

Poised for Growth

14%

increase in core commercial managed care membership

With our broad product portfolio, trusted name and disciplined pricing, WellChoice continued to see strong membership growth during 2003 both at the corporate level and in our core managed care products. As of December 31, 2003, overall corporate membership was 4.8 million, an increase of 3.2% over the prior year. Enrollment in the Company's core commercial managed care products, which excludes membership in the New York State and New York City accounts, increased 282,000, or 14%, to 2.3 million as of December 31, 2003. Membership in the entire commercial managed care segment, including New York State and New York City PPO membership, increased by 7.9% compared to the same period one year earlier, to 4.1 million as of December 31, 2003. Highlighting our leading marketplace share and **sustained enrollment growth**, WellChoice's PPO was once again ranked the #1 PPO in the New York metropolitan area in 2003 by *Crain's New York Business.*

Membership in the other insurance products and services segment, which includes indemnity and individual products, declined by 19.3% since year-end 2002, consistent with the market shift to managed care. Self-funded membership grew 12.1% to 1,736,000 since year-end 2002, and as of December 31, 2003 accounted for 36.5% of overall membership.

Year over year, the Company continues to undergo steady growth in our national accounts business. Leading national employer groups, including Siemens Corporation, ITT Industries, Quebecor World, Sony Electronics, Sony Pictures and Monster Corporation have joined the list of nationally recognized companies covered by WellChoice. As of January 2004, total national account membership was **1.2 million** members.

Supporting this membership growth is our ability to offer customers the option of alternative funding arrangements. In addition to offering products on a fully insured basis, we also offer selected products, including PPO, EPO and traditional indemnity products, on a self-funded, or ASO, basis in the large group market.

An unwavering commitment to underwriting discipline and appropriate pricing is also integral to successful growth in the marketplace. We continually review our underwriting and pricing guidelines on a product-by-product basis in order to maintain competitive rates. Knowing what to expect from year to year, this commitment provides WellChoice customers with consistent rate expectations and helps retain customers.

growth

performan

$2.41

earnings per share

Strong Financial Performance

WellChoice delivered solid financial performance during 2003, reflecting a consistent track record of growing profitable membership; dedication to underwriting and pricing discipline which provides stable revenue growth; the ability to predict accurately medical loss ratios; and significant financial flexibility as a well-capitalized company.

WellChoice reported net income for the year ended December 31, 2003 of $201.1 million, or $2.41 per fully diluted share, based on 83.8 million weighted average shares outstanding.

Total revenue for the year ended December 31, 2003 was $5.4 billion compared to $5.1 billion for the year ended December 31, 2002. Insured premiums for the full year 2003 were $4.88 billion compared to $4.63 billion for the full year 2002. Service fees increased $49.6 million to $445.8 million during the same period.

Standard and Poor's (S&P) reiterated Empire's financial strength and counterparty credit ratings to an "A- Positive" during 2003. The rating reflects its significantly improved capitalization, a strong turnaround in earnings performance, stabilized enrollment trends, and conservative investment practices in an extremely competitive operating environment.

"A- Positive"

financial strength and counterparty credit rating by S&P

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financial

Selected Financial Data

The following table sets forth selected financial data and other operating information of WellChoice, Inc. and its subsidiaries. The selected financial data in the table are derived from the consolidated financial statements of WellChoice, Inc. The data should be read in conjunction with the consolidated financial statements, related notes, and other financial information included herein.

Year ended December 31	**2003**	2002	2001	2000	1999
		($ in millions except share and per share data)			
Revenue:					
Premiums earned	**$4,875.4**	$4,628.0	$4,246.2	$3,876.9	$3,362.3
Administrative service fees	**445.8**	396.2	322.0	264.9	238.9
Investment income, net	**51.2**	64.8	69.3	65.5	58.7
Net realized investment gains (losses)	**11.8**	2.6	(12.4)	22.1	0.2
Other (expense) income, net	**(1.7)**	14.0	6.1	4.3	4.8
Total revenue	**5,382.5**	5,105.6	4,631.2	4,233.7	3,664.9
Expenses:					
Cost of benefits provided	**4,162.2**	3,947.4	3,738.8	3,426.4	2,944.6
Administrative expenses	**876.7**	833.1	742.8	686.2	587.3
Conversion and IPO expenses	**—**	15.4	2.0	0.6	3.7
Total expenses	**5,038.9**	4,795.9	4,483.6	4,113.2	3,535.6
Income from continuing operations before income taxes	**343.6**	309.7	147.6	120.5	129.3
Income tax expense (benefit)[1]	**142.5**	(67.9)	0.1	(74.5)	9.1
Income from continuing operations	**201.1**	377.6	147.5	195.0	120.2
Loss from discontinued operations, net of tax	**—**	(1.1)	(16.5)	(4.6)	—
Net income	**$ 201.1**	$ 376.5	$ 131.0	$ 190.4	$ 120.2
Per share data[2]:					
Basic and diluted earnings per share	**$ 2.41**	$ 4.51	$ 1.57	$ 2.28	$ 1.44
Additional data— for the year ended:					
Medical loss ratio[3]	**85.4%**	85.3%	88.1%	88.4%	87.6%
Medical loss ratio, excluding New York City and New York State PPO[4]	**82.2%**	81.8%	86.0%	85.9%	85.1%
Administrative expense ratio[5][6]	**16.5%**	16.9%	16.3%	16.6%	16.4%
Members (000's at end of period)[7]	**4,754**	4,608	4,383	4,135	4,161
Balance sheet data:					
Cash and investments	**$2,059.3**	$1,783.0	$1,604.3	$1,400.6	$1,330.2
Premium related receivables	**378.2**	358.8	403.5	447.5	404.7
Total assets	**3,043.0**	2,777.5	2,449.6	2,252.5	1,987.4
Unpaid claims and claims adjustment expense	**609.5**	559.9	634.1	672.4	591.0
Obligations under capital lease	**48.3**	47.7	50.1	52.0	53.5
Total liabilities	**1,610.7**	1,541.2	1,620.3	1,577.8	1,484.7
Stockholders' equity[8]	**1,432.3**	1,236.3	829.3	674.7	502.7

(1) Our deferred tax asset allowance at December 31, 2001 was approximately $195.7 million. At December 31, 2002, we eliminated the valuation allowance on our deferred tax assets, based on approval of the conversion and continued, current and projected positive taxable income. As a result of the conversion, WellChoice is a for-profit entity and is subject to state and local taxes as well as federal income taxes at the statutory rate of 35% for the year ended December 31, 2002. As of December 31, 2000, we reduced our valuation allowance on our deferred tax assets by $71.9 million based on continued, current and projected positive taxable income.

(2) The weighted-average shares outstanding of 83,490,478 and the effect of dilutive securities for the period January 1 through December 31, 2003 was used to calculate 2003 basic and diluted earnings per share amounts. There were no shares or dilutive securities outstanding prior to November 7, 2002 (date of conversion and initial public offering). Accordingly, amounts prior to 2003 represent pro forma earnings per share. For comparative pro forma earnings per share presentation, shares outstanding at December 31, 2002 of 83,490,478 was used to calculate pro forma earnings per share for all periods prior to 2003. Net loss and basic and diluted net loss per common share based on the weighted-average shares outstanding for the period from November 7, 2002 (date of initial public offering) to December 31, 2002 were $38.5 million and $0.46, respectively.

(3) Medical loss ratio represents cost of benefits provided as a percentage of premiums earned.

(4) We present our medical loss ratio, excluding New York City and New York State PPO because these accounts differ from our standard PPO product in that they are hospital-only accounts which have lower premiums than accounts with full medical and hospital coverage and are retrospectively rated with a guaranteed administrative service fee. The lower premiums and the size of these accounts distort our performance when the total medical loss ratios are presented.

(5) Administrative expense ratio represents administrative and conversion and IPO expenses as a percentage of premiums earned and administrative service fees.

(6) As presented, our administrative expense ratio does not take into account a significant portion of our activity generated by self-funded, or ASO, business, which represents approximately 36.5% of our total members. Therefore, in the following table, we provide the information needed to calculate the administrative expense ratio on a "premium equivalent" basis because that ratio measures administrative expenses relative to the entire volume of insured and self-funded business serviced by us and is commonly used in the health insurance industry to compare operating efficiency among companies. Administrative expense ratio on a premium equivalent basis is calculated by dividing administrative and conversion and IPO expenses by "premium equivalents" for the relevant periods. Premium equivalents is the sum of premium earned, administrative service fees and the amount of paid claims attributable to our self-funded business pursuant to which we provide a range of customer services, including claims administration and billing and membership services.

Claims paid for our self-funded health business is not our revenue. The premium equivalents for the years indicated were as follows:

Year ended December 31	**2003**	2002	2001	2000	1999
			($ in millions)		
Revenue:					
Premiums earned	**$4,875.4**	$4,628.0	$4,246.2	$3,876.9	$3,362.3
Administrative service fees	**445.8**	396.2	322.0	264.9	238.9
Claims paid for our self-funded health business	**2,955.3**	2,347.9	1,791.9	1,328.4	1,046.4
Premium equivalents	**$8,276.5**	$7,372.1	$6,360.1	$5,470.2	$4,647.6

(7) Enrollment as of December 31, 2003 and 2002 includes 177,000 and 175,000 New York State PPO account members who reside in New York State but outside of our service areas. Prior to January 1, 2002, these members were enrolled in the New York Blue Cross Blue Shield plan licensed in the area where the members resided and, accordingly, the membership was reported by these plans and not by us. Starting in 2002, in accordance with a change to the contract with New York State under which we administer the entire plan, we began including those members enrolled outside of our service area, and all members were therefore enrolled in, and reported by, HealthChoice. New York State PPO account members who reside in New York State but outside of our service areas are excluded from enrollment totals for all other periods presented.

(8) Prior to the conversion, this line item was captioned "Total reserves for policyholders' protection."

Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Since November 8, 2002, the first day of trading following the effectiveness of our initial public offering, the Company's common stock has been traded on The New York Stock Exchange under the symbol "WC." There is no established market for the one share of Class B Common Stock outstanding.

The following table sets forth the high and low sales prices for the Company's Common Stock, as reported by The New York Stock Exchange, since November 8, 2002 for each calendar quarter indicated:

	High	Low
2002:		
Fourth Quarter (commencing November 8, 2002)	$28.50	$22.15
2003:		
First Quarter	$24.00	$17.65
Second Quarter	$30.40	$20.80
Third Quarter	$33.20	$26.80
Fourth Quarter	$36.40	$29.95
2004:		
First Quarter (through February 2, 2004)	$38.88	$34.30

On February 2, 2004, the Company had 108 holders of record of its Common Stock, which did not include beneficial owners of shares registered in nominee or street name, and one holder of its Class B Common Stock.

No cash dividends have been declared on the Common Stock or Class B Common Stock. We do not expect to pay cash dividends for the foreseeable future. We currently intend to retain future earnings, if any, to finance operations and the expansion of our business.

Our ability to pay dividends is dependent on cash dividends from our subsidiaries. Our subsidiaries are subject to regulatory surplus requirements and additional regulatory requirements, which may restrict their ability to declare and pay dividends or distributions to us.

discussion

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis presents a review of WellChoice, Inc. and its subsidiaries (collectively, "we" or the "Company") for the three-year period ended December 31, 2003. This review should be read in conjunction with the consolidated financial statements and other data presented herein.

The statements contained in this Annual Report include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, or the PSLRA. When used in this Annual Report, in future filings by the Company with the Commission, in our press releases, presentations to securities analysts or investors, and in oral statements made by or with the approval of one of our executive officers, the words or phrases "believes," "anticipates," "intends," "will likely result," "estimates," "projects" or similar expressions are intended to identify such forward-looking statements. Any of these forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the results discussed in the forward-looking statements.

The following discussion and the discussion in "Item 1—Business" of our 2003 Annual Report on Form 10-K contain certain cautionary statements regarding our business that investors and others should consider. This discussion is intended to take advantage of the "safe harbor" provisions of the PSLRA. Except to the extent otherwise required by federal securities laws, in making these cautionary statements, we are not undertaking to address or update each factor in future filings or communications regarding our business or operating results, and are not undertaking to address how any of these factors may have caused results to differ from discussions or information contained in previous filings or communications. In addition, any of the matters discussed below may have affected our past, as well as current, forward-looking statements about future results. Any or all forward-looking statements in this report and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors discussed below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from those expressed in our communications.

Overview

We are the largest health insurance company in the State of New York based on total preferred provider organization, or PPO, and health maintenance organization, or HMO, membership, which includes members under our insured and administrative services only, or ASO, plans. We offer managed care and traditional indemnity products to approximately 4.8 million members. We have licenses with the Blue Cross Blue Shield Association which entitle us to the exclusive use of the Blue Cross and Blue Shield names and marks in ten counties in the New York City metropolitan area and in six counties in upstate New York, the non-exclusive right to use the Blue Cross and Blue Shield names and marks in one upstate New York county, the exclusive right to only the Blue Cross name and mark in seven upstate New York counties and the non-exclusive right to only the Blue Cross name in four upstate New York counties. We market our products and services using these names and marks in our New York service areas. We also market our managed care products in 16 counties in New Jersey under the WellChoice brand.

We offer our products and services to a broad range of customers, including large groups of more than 500 employees; middle market groups, ranging from 51 to 500 employees; small groups, ranging from two to 50 employees and individuals. Over one million of our members are covered through our national accounts, generally large, multi-state companies, including many Fortune 500 companies.

Our revenue primarily consists of premiums earned and administrative service fees derived from the sale of managed care and traditional indemnity health benefits products to employer groups and individuals. Premiums are derived from insured contracts and administrative service fees are derived from self-funded contracts, under which we provide a range of customer services, including claims administration and billing and membership services. Revenue also includes administrative service fees earned under the BlueCard program for providing members covered by other Blue Cross and Blue Shield plans with access to our network providers, reimbursements under our government contracts with the Centers for Medicare and Medicaid Services, or CMS, to act as a fiscal intermediary for Medicare Part A program beneficiaries and a carrier for Medicare Part B program beneficiaries, and investment income.

Our cost of benefits provided expense consists primarily of claims paid and claims in process and pending to physicians, hospitals and other healthcare providers and includes an estimate of amounts incurred but not yet reported. Administrative expenses consist primarily of compensation expenses, commission payments to brokers and other overhead business expenses.

We report our operating results as two business segments: commercial managed care and other insurance products and services. Our commercial managed care segment accounted for 86.4% of our membership as of December 31, 2003. Our commercial managed care segment includes group PPO, HMO (including Medicare+Choice), EPO, and other products (principally dental-only coverage as well as POS) as well as our PPO business under our accounts with New York City and New York State. Our other insurance products and services segment consists of our indemnity and individual products. Our indemnity products include traditional indemnity products and government contracts with CMS to act as a fiscal intermediary and carrier. Our individual products include Medicare supplemental, state sponsored plans, government mandated individual plans and individual hospital-only. We allocate administrative expenses, investment income and other income, but not assets, to our segments. Except when otherwise specifically

stated or where the context requires, all references in this document to our membership include both our insured and ASO membership. Our New York City and New York State account members are covered under insured plans.

Based upon the higher level of payments we expect to receive from CMS as a result of the recently enacted Medicare Prescription Improvement and Modernization Act, subject to CMS approval, we will eliminate the additional premiums required by members of our Medicare+Choice program in Rockland and Westchester counties, reduce the additional premium required by members in Nassau and Suffolk counties and increase benefits available to New York City members. This increase in payments from CMS will not have a material impact on operations, as they will either be utilized to provide additional benefits or as a reduction in premiums required by members.

Our future results of operations will depend in part on our ability to predict and control healthcare costs through underwriting criteria, utilization management, product design and negotiation of favorable provider and hospital contracts. Our ability to contain such costs may be adversely affected by changes in utilization rates, demographic characteristics, the regulatory environment, healthcare practices, inflation, new technologies, clusters of high-cost cases, continued consolidation of physician, hospital and other provider groups, acts of terrorism and bioterrorism or other catastrophes, including war, and numerous other factors. Our inability to mitigate any or all of the above-listed or other factors may adversely affect our future profitability.

The Conversion

The conversion has been accounted for as a reorganization using the historical carrying values of HealthChoice's assets and liabilities. Immediately following the conversion, HealthChoice's unassigned reserves were reclassified to par value of common stock and additional paid-capital. Concurrently, HealthChoice became a wholly owned subsidiary of WellChoice. The costs of the conversion were recognized as an expense when incurred. We started incurring conversion-related expenses in 1998 when HealthChoice first began paying fees and expenses of advisors to the New York State Superintendent of Insurance, or Superintendent, in connection with the New York State Department of Insurance's consideration of our original draft plan of conversion. From inception of the conversion process through the completion of our initial public offering in 2002, we incurred conversion and offering expenses of $24.0 million.

We have benefited from certain favorable tax attributes over the years. HealthChoice has reported its income for tax purposes using certain beneficial rules afforded Blue Cross and Blue Shield plans under Section 833 of the Internal Revenue Code, or the Code. Among other provisions of the Code, these plans were granted a special deduction, the 833(b) deduction, for regular tax calculation purposes. As a result of this deduction, HealthChoice incurred no regular tax liability but, in profitable years, paid taxes at the alternative minimum tax rate of 20%. The 833(b) deduction is calculated as the excess of 25% of the incurred claim and claim adjustment expenses for the tax year over adjusted surplus, as defined, but limited to taxable income. The amount of 833(b) deductions utilized in each tax year is accumulated in an adjusted surplus balance. Once the cumulative adjusted surplus balance exceeds the 833(b) deduction for the current taxable year, the deduction is eliminated.

During the fourth quarter of 2002, we reevaluated our tax position for financial statement purposes related to HealthChoice's ability to utilize the Section 833(b) deduction and determined that when HealthChoice converted to a for-profit entity, its ability to utilize the Section 833(b) deduction was uncertain. No authority directly addresses whether a conversion transaction will render the 833(b) deduction unavailable. We are aware, however, that the Internal Revenue Service has taken the position related to other Blue Cross Blue Shield plans that a conversion could result in the inability of a Blue Cross Blue Shield plan to utilize the 833(b) deduction. In light of the absence of governing authority, while we intend to continue to take the deduction on our tax returns for periods after the conversion, we will assume, for financial statement reporting purposes, that the deduction will be disallowed. Accordingly, we have utilized $77.0 million of regular operating loss carryforwards for financial statement purposes in excess of those utilized for tax purposes.

We have substantial tax loss and credit carryovers. At December 31, 2003, for income tax purposes, our regular tax loss carryforwards, which expire between 2004 and 2023, were approximately $259.0 million and our alternative minimum tax credit carryforwards, which have no expiration, was approximately $191.0 million. In early 2003, we received a ruling from the Internal Revenue Service that our conversion was not viewed as a change in control and therefore did not result in limitations in the use of our net regular tax operating loss carryforwards and alternative minimum tax credits. However, subsequent sales of shares of our common stock, including sales by the Fund and/or Foundation, could result in such a limitation, which would have an impact on our cash flow.

Additional State and Local Taxes

As a result of the conversion, we became a for-profit entity and are subject to New York state and local taxes that we were not previously required to pay. These include premium taxes on most non-HMO insured business and sales and use taxes (which are recorded as administrative expenses), as well as state and local income taxes.

As a result of the New York State Budget Legislation enacted in May 2003, which eliminated the net income portion of the New York State franchise tax applicable to our New York accident and health insurance subsidiary, we expect to incur federal, state and local income taxes at the rate of approximately 39% of pre-tax net income.

Discontinued Operations

In February 2002, we discontinued the operations of NexxtHealth, Inc., a development stage subsidiary formed in March 2000 to develop Internet portal software to market to other health benefit companies. We discontinued these operations as part of our overall strategy to outsource certain technology functions.

Capitated Provider Arrangements

Our cost of benefits provided under capitated arrangements is not significant. Payments under capitated arrangements totaled $102.5 million for the year ended December 31, 2003, representing 2.5% of total cost of benefits provided.

We currently maintain a single global capitation arrangement to provide hospital and medical benefits for approximately 1,000 members enrolled in our Medicare+Choice product. Payments made under this arrangement totaled $8.4 million for the year ended December 31, 2003. The premiums earned in excess of costs of benefits provided under this arrangement was approximately $0.8 million for the year ended December 31, 2003.

Other capitated arrangements are in place to manage and assume risk for certain benefits covered under specific products. The following sets forth the membership and respective benefits under these capitated arrangements at December 31, 2003:

Benefit	Membership
	(in thousands)
Mental health	1,601
Laboratory services	425
Vision	349
Hearing	119
Dental	84

We also have capitated arrangements with service providers for certain disease management programs. At December 31, 2003, we had approximately 79,000 members under capitated disease management programs.

Approximately 34.0% of our membership is provided one or more benefits under a capitated program.

Selected Membership Data and Results of Operations

The following table sets forth selected membership data as of the dates set forth below:

December 31	**2003**	2002	2001
	(members in thousands)		
Products and services:			
Commercial managed care:			
Group PPO, HMO, EPO and other[1][2]	**2,301**	2,019	1,752
New York City and New York State PPO[3]	**1,805**	1,786	1,563
Total commercial managed care	**4,106**	3,805	3,315
Other insurance products and services:			
Indemnity	**428**	567	804
Individual	**220**	236	264
Total other insurance products and services	**648**	803	1,068
Overall total	**4,754**	4,608	4,383
Customers:			
Large group[3]	**2,931**	2,903	2,695
Small group and middle market	**444**	394	366
Individuals	**269**	290	323
National accounts	**1,110**	1,021	999
Overall total	**4,754**	4,608	4,383
Funding type:			
Commercial managed care:			
Insured[3]	**2,620**	2,597	2,441
Self-funded	**1,486**	1,208	874
Total commercial managed care	**4,106**	3,805	3,315
Other insurance products and services:			
Insured	**398**	463	691
Self-funded	**250**	340	377
Total other insurance products and services	**648**	803	1,068
Overall total	**4,754**	4,608	4,383

(1) Our HMO product includes Medicare+Choice. As of December 31, 2003, 2002 and 2001, we had approximately 50,000, 55,000 and 59,000 members, respectively, enrolled in Medicare+Choice.

(2) "Other" principally consists of our members enrolled in dental only coverage and includes POS members.

(3) Enrollment as of December 31, 2003 and 2002 includes 177,000 and 175,000 New York State PPO account members who reside in New York State but outside of our service areas. Prior to January 1, 2002, these members were enrolled in the New York Blue Cross Blue Shield plan licensed in the area where the members resided and, accordingly, the membership was reported by these plans and not by us. Beginning January 1, 2002, in accordance with a change to the contract with New York State under which we administer the entire plan, we began including those members enrolled outside of our service area, and all members were therefore enrolled in, and reported by, us. New York State PPO account members who reside in New York State but outside of our service areas are excluded from enrollment totals for all other periods presented.

The following table sets forth results of operations for each of our segments for the periods set forth below:

Year ended December 31	**2003**	2002	2001
		($ in millions)	
Commercial Managed Care:			
Total revenue	**$4,425.0**	$4,000.6	$3,448.3
Income from continuing operations before income tax expense	**$ 292.6**	$ 253.4	$ 121.1
Medical loss ratio:			
Commercial managed care total	**85.9%**	86.0%	88.6%
Commercial managed care, excluding New York City and New York State PPO[1]	**82.1%**	81.6%	85.8%
Administrative expense ratio[2]	**14.0%**	13.9%	13.0%
Other Insurance Products and Services:			
Total revenue	**$ 957.5**	$1,105.0	$1,182.9
Income from continuing operations before income tax expense	**$ 51.0**	$ 56.3	$ 26.5
Medical loss ratio	**82.7%**	82.4%	86.2%
Administrative expense ratio[2]	**28.0%**	27.8%	25.0%

(1) We present commercial managed care medical loss ratio, excluding New York City and New York State PPO, because these accounts differ from our standard PPO product in that they are hospital-only accounts which have lower premiums than accounts with full medical and hospital coverage and are retrospectively rated with a guaranteed administrative service fee. The lower premiums and the size of these accounts distort our performance when the total medical loss ratios are presented.

(2) As presented, our administrative expense ratio does not take into account a significant portion of our activity generated by self-funded, or ASO, business, which represents approximately 36.2% and 38.6% of our managed care and other insurance products and services members, respectively. Therefore, in the following table, we provide the information needed to calculate the administrative expense ratio on a "premium equivalent" basis because that ratio measures administrative expenses relative to the entire volume of insured and self-funded business serviced by us and is commonly used in the health insurance industry to compare operating efficiency among companies. Administrative expense ratio on a premium equivalent basis is calculated by dividing administrative and conversion and IPO expenses by "premium equivalents" for the relevant periods. Premium equivalents is the sum of premium earned, administrative service fees and the amount of paid claims attributable to our self-funded business pursuant to which we provide a range of customer services, including claims administration and billing and membership services. Claims paid for our self-funded health business is not our revenue. The premium equivalents for the years indicated were as follows:

Year ended December 31	**2003**	2002	2001
		($ in millions)	
Commercial Managed Care:			
Premiums earned	**$4,099.5**	$3,723.0	$3,247.8
Administrative service fees	**274.1**	212.2	154.1
Claims paid for our self-funded health business	**2,408.0**	1,696.8	1,102.5
Premium Equivalent	**$6,781.6**	$5,632.0	$4,504.4
Other Insurance Products and Services:			
Premiums earned	**$ 775.9**	$ 905.0	$ 998.4
Administrative service fees	**171.7**	184.0	167.9
Claims paid for our self-funded health business	**547.3**	651.1	689.4
Premium Equivalent	**$1,494.9**	$1,740.1	$1,855.7

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

As of December 31, 2003, total enrollment was 4.8 million members, a 3.2% increase from December 31, 2002 to December 31, 2003. The increase in enrollment was driven by a 7.9% increase in commercial managed care enrollment. Our commercial managed care enrollment at December 31, 2003 was 4.1 million and represents 86.4% of our total enrollment. The increase in commercial managed care enrollment was the result of the following:

- Enrollment growth of 13.6%, or 240,000 members, in group PPO, EPO and other due primarily to a combination of new national account customers in our PPO and EPO products and the migration of members enrolled in our indemnity products to our commercial managed care products; and
- Enrollment growth of 16.7%, or 42,000 members, in group HMO primarily related to new small group and middle market customers.

The increase in commercial managed care enrollment was offset by a 19.3% decline in other insurance product and services enrollment. This decrease of approximately 155,000 members was due, in part, to the continued migration of members to commercial managed care products discussed above.

Our self-funded enrollment increased 12.1% in 2003 and at December 31, 2003 represented approximately 36.5% of our total enrollment; 36.2% of commercial managed care enrollment; and 38.6% of other insurance product and services enrollment. The migration of fully-insured business to self-funded arrangements as well as new self-funded enrollment resulted in the increase in self-funded enrollment. The migration to self-funded enrollment was most noticeable in insured large group PPO and indemnity products. New self-funded national account enrollment accounted for 149,000 new members. We expect self-funded enrollment to continue to increase in 2004 through the continued migration of fully-insured business to self-funded arrangements and new self-funded accounts. Although the trend to self-funded business will reduce our insured premium and claim volume, we do not expect the trend to materially impact net income.

As of December 31, 2003, our New York State account covered approximately 989,000 members, or 20.8% of our total membership and 24.1% of our commercial managed care membership, and our New York City account covered approximately 816,000 members, or 17.2% of our total membership and 19.9% of our commercial managed care membership. We provide hospital-only coverage under both of these accounts. The pricing of our products provided to New York State and New York City has historically been renegotiated annually. With respect to the New York State account, effective January 1, 2003, we agreed to new pricing covering a three-year period through December 31, 2005, though both parties retain the right to terminate the contract on six months' notice. With respect to the New York City account, for approximately two years, the New York City account has been subject to a competitive bid process in which we have participated, relating to a five-year contract. In October 2003, we agreed to new rates with the New York City account for the period from July 1, 2003 through June 30, 2004. We expect the New York City account to complete the competitive bid process regarding the five-year contract, sometime in the first half of 2004. The loss of one or both of the New York State and New York City accounts would result in reduced membership and revenue and require us to reduce, reallocate or absorb administrative expenses associated with these accounts.

Total revenue increased 5.4%, or $276.9 million, to $5,382.5 million for the year ended December 31, 2003, from $5,105.6 million for the year ended December 31, 2002 primarily due to an increase in premium and administrative service fee revenue, offset by decreases in investment and other income.

Premium revenue increased $247.4 million, or 5.3%, to $4,875.4 million for the year ended December 31, 2003, from $4,628.0 million for the year ended December 31, 2002. The increase in premium revenue was primarily due to growth in our commercial managed care segment. Commercial managed care premium revenue was $4,099.5 million for the year ended December 31, 2003, a 10.1% increase compared to the year ended December 31, 2002. The increase in commercial managed care premium revenue was primarily attributable to increased cost of benefits provided and retention on our retrospectively rated contracts of approximately $209.0 million. The remaining increase was due to rate increases and membership growth.

The premium growth in commercial managed care was partially offset by the anticipated decline in our other insurance products premium. The decrease in other insurance products premium was the

result of the migration of insured indemnity contracts to self-funded contracts and premium refunds for prior years related to our Medicare Supplemental product.

On a PMPM basis, premium for the year ended December 31, 2003 increased 10.0%, to $137.17, from $124.65 for the year ended December 31, 2002. Commercial managed care PMPM premium increased to $133.01 for the year ended December 31, 2003, from $120.90 for the year ended December 31, 2002 due to premium rate and retention increases. Excluding the New York City and New York State PPO, commercial managed care PMPM premium increased to $277.21 for the year ended December 31, 2003, compared to $250.72 for the year ended December 31, 2002 due to premium rate increases. Other insurance products and services PMPM premium increased to $164.30 for the year ended December 31, 2003, from $142.89 for the year ended December 31, 2002, due primarily to declining membership in unprofitable experience rated products.

Administrative service fee revenue increased 12.5%, or $49.6 million, to $445.8 million for the year ended December 31, 2003, from $396.2 million for the year ended December 31, 2002. The increase was primarily due to growth in self-funded commercial managed care membership and increased BlueCard fees, reduced in part by lower administrative service fees attributable to our CMS contracts for the Medicare Part A and Part B programs. Approximately $49.1 million of the increase was a result of 149,000 new national account customers and the migration of approximately 50,000 insured large group PPO and indemnity contracts to self-funded contracts. Total BlueCard fees increased 14.6% or $6.5 million, to $51.1 million for the year ended December 31, 2003, from $44.6 million for the year ended December 31, 2002 due to an increase in transaction volume. Administrative service fees attributable to our CMS contracts for the Medicare Part A and Part B programs decreased $6.0 million or 4.7% to $121.3 million for the year ended December 31, 2003 from $127.3 million for the year ended December 31, 2003. The decrease was attributable to lower expenses attributable to administration of the CMS contract.

Investment income, net of investment expenses, which consists predominantly of interest and dividend income, decreased 21.0%, or $13.6 million, to $51.2 million for the year ended December 31, 2003, from $64.8 million for the year ended December 31, 2002 due to lower interest rates. Net realized gains of $11.8 million for the year ended December 31, 2003 were primarily the result of net gains on corporate bond sales and a net increase in the market value of warrants classified in our balance sheet as other long-term equity investments. Net realized gains of $2.6 million for the year ended December 31, 2002 were primarily the result of net gains on government and corporate bond sales and the sale of common stock.

Other expenses, net of $1.7 million for the year ended December 31, 2003, decreased $15.7 million from other income, net of $14.0 million for the year ended December 31, 2002, due to non–recurring transactions during 2002. Specifically, the year ended December 31, 2002 included a gain of $8.0 million relating to insurance settlements for property and equipment lost at our World Trade Center headquarters, a $5.4 million gain related to the recovery of amounts previously recorded against net income, interest earned on advances to hospitals of $2.5 million, interest received on outstanding hospital advances previously considered uncollectible of $1.9 million and late payment fee income of $0.7 million.

Total cost of benefits provided increased 5.4%, or $214.8 million, to $4,162.2 million for the year ended December 31, 2003, from $3,947.4 million for the year ended December 31, 2002. This reflects a 10.1% increase in costs of benefits provided on a PMPM basis, offset by a 4.3% decline in member months due to the migration of membership from fully-insured to self-funded contracts. Total cost of benefits provided on a PMPM basis for the year ended December 31, 2003 increased to $117.10 from $106.32 for the year ended December 31, 2002. Commercial managed care cost of benefits provided on PMPM basis increased 9.9% to $114.23 for the year ended December 31, 2003, from $103.97 for the year ended December 31, 2002. Excluding the New York City and New York State PPO accounts, the commercial managed care cost of benefits provided on a PMPM basis increased 11.2% to $227.58 for the year ended December 31, 2003, from $204.67 for the year ended December 31, 2002. Costs of benefits provided in our other insurance products and services segment for the year ended December 31, 2003 increased 15.4%, on a PMPM basis, to $135.85 from $117.72 for the year ended December 31, 2002.

The total medical loss ratio increased to 85.4% for the year ended December 31, 2003, from 85.3% for the year ended December 31, 2002, resulting from a 10.1% increase in PMPM cost of benefits provided, offset by a 10.0% increase in average premium yield, which is the change in PMPM premium revenue. Cost of benefits provided for the years ended December 31, 2003 and 2002 included $57.0 million and $47.8 million, respectively, of favorable prior period reserve development on prospectively rated contracts. The prior period development during 2003 included $34.9 million for the New York State Market Stabilization Pool. The medical loss ratio in our commercial managed care segment decreased to 85.9% for the year ended December 31, 2003, from 86.0% for the year ended December 31, 2002. Excluding the New York City and New York State PPO accounts (see note 1 to the table on page 30 of this report), the medical loss ratio in our commercial managed care segment increased to 82.1% for the year ended December 31, 2003, from 81.6% for the year ended December 31, 2002 due to increases in the ratio for our commercial products offset, in part, by a decrease in the ratio for our Medicare+Choice product. The medical loss ratio for other insurance products and services increased to 82.7% for the year ended December 31, 2003, from 82.4% for the year ended December 31, 2002. The increase was due to higher loss ratios for the indemnity and direct pay products, offset by net recoveries from the New York State Market Stabilization Pool which impacted premiums and claims in 2003.

Administrative expenses increased 5.2%, or $43.6 million, to $876.7 million for the year ended December 31, 2003, from $833.1 million for the year ended December 31, 2002 due to the following:

- Premium sales and use taxes, included as a component of administrative expense, increased $61.3 million, to $70.5 million for the year ended December 31, 2003, from $9.2 million for the year ended December 31, 2002, substantially due to increased premium taxes. As a result of our for-profit conversion, all of our health insurance premiums (other than HMO premiums) became subject to premium tax in November 2002. Therefore, the volume of premiums subject to premium taxes significantly increased in 2003 compared to 2002. In addition, as a result of the New York State budget legislation enacted in May 2003, the premium tax rate for accident and health insurers increased to 1.75% from 1.0%, retroactive to January 1, 2003.

- Salary and benefit expense decreased $76.2 million due to the reduction of staffing levels and a reduction in restructuring expenses. The reduction in staffing levels is a result of the IBM outsourcing agreement and our efforts to streamline operations.
- Professional service fees increased $14.0 million as a result of the IBM outsourcing agreement. The outsourcing commenced on July 1, 2002; therefore 2003 reflects a full year of professional fees related to the agreement whereas 2002 reflects six months of professional fees.
- Corporate insurance expense increased $9.4 million. As a result of our for-profit conversion, the cost of our directors and officers liability insurance significantly increased effective November 2002.
- Increased occupancy costs of $7.7 million relating to the transition from several leased properties, which temporarily replaced our World Trade Center office, to a long-term leased facility in Brooklyn, New York.
- Unoccupied leased office space resulted in a $13.4 million charge in 2003. We concluded that certain unoccupied leased office space would not be utilized in the future. As a result, in accordance with SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," administrative expenses include a charge of $13.4 million, representing the difference between the market value of potential sublease rental income and the remaining lease obligations for the three floors.
- Administrative expense for the year ended December 31, 2002 reflected a gain of $19.3 million resulting from the settlement of our business property protection and blanket earnings and extra expense insurance claim related to the loss of our headquarters located at the World Trade Center.

Income from continuing operations before income taxes increased 10.9%, or $33.9 million, to $343.6 million for the year ended December 31, 2003, from $309.7 million for the year ended December 31, 2002. This improvement was primarily driven by increased self-funded commercial managed care membership and improved underwriting performance. The income tax expense of $142.5 million reduced income from continuing operations and net income to $201.1 million for the year ended December 31, 2003. The income tax benefit of $67.9 million (as described in note 6 to the financial statements) increased income from continuing operations to $377.6 million for the year ended December 31, 2002. Taking into account our loss from discontinued operations during 2002, our net income for the year ended December 31, 2002 was $376.5 million.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

As of December 31, 2002, total enrollment was 4.6 million members and commercial managed care enrollment was 3.8 million members (82.6% of total enrollment). If we add to the December 31, 2001 enrollment the 167,000 New York State PPO account members who reside in New York State but outside of our service areas, total enrollment and commercial managed care enrollment increased 1.3% and 9.3%, respectively, from December 31, 2001 to December 31, 2002. Enrollment in our group PPO, HMO, EPO and other products increased 15.2%, or 267,000 members. This growth was attributable to the migration of members enrolled in our indemnity products to our commercial managed care products,

new large group and national accounts business in our PPO and EPO products and increased enrollment by small group and middle market customers in our HMO and EPO products. The enrollment growth in self-funded products of 23.7% was the result of both new membership and the migration from insured business, most noticeably in the large group PPO and national EPO membership. Enrollment in other insurance products and services declined 24.8% to approximately 0.8 million members due, in part, to the continued migration of members to commercial managed care products.

As of December 31, 2002, our New York State account covered approximately 985,000 members, or 21.4% of our total membership and 25.9% of our commercial managed care membership, and our New York City account covered approximately 801,000 members, or 17.4% of our total membership and 21.1% of our commercial managed care membership.

Total revenue increased 10.2%, or $474.4 million, to $5,105.6 million for the year ended December 31, 2002, from $4,631.2 million for the year ended December 31, 2001 primarily due to an increase in premium and administrative service fee revenue.

Premium revenue increased $381.8 million, or 9.0%, to $4,628.0 million for the year ended December 31, 2002, from $4,246.2 million for the year ended December 31, 2001. The increase in premium revenue was primarily due to growth in our commercial managed care segment. Commercial managed care premium revenue was $3,723.0 million for the year ended December 31, 2002, a 14.6% increase compared to the year ended December 31, 2001. The increase in commercial managed care premium revenue was attributable to enrollment growth and premium rate increases, particularly in our HMO and PPO products. Premium revenue growth was partially offset by the anticipated decline in our other insurance products and services enrollment, the cancellation of unprofitable EPO contracts and the migration of insured EPO national and large group indemnity contracts to self-funded contracts. On a per member per month, or PMPM basis, premium for the year ended December 31, 2002 increased 7.2%, to $124.65, from $116.29 for the year ended December 31, 2001. Commercial managed care PMPM premium increased to $120.90 for the year ended December 31, 2002, from $115.22 for the year ended December 30, 2001. Excluding the New York City and New York State PPO, commercial managed care PMPM premium increased to $250.72 for the year ended December 31. 2002, compared to $226.59 for the year ended December 31, 2001.

Administrative service fee revenue increased 23.0%, or $74.2 million, to $396.2 million for the year ended December 31, 2002, from $322.0 million for the year ended December 31, 2001. The increase was primarily due to growth in self-funded group PPO, HMO, EPO and other membership, expanded volume of services provided under our CMS contract is for Medicare Part A and Part B programs and increased BlueCard fees. Approximately $52.7 million of the increase was driven by the migration of approximately 45,000 members from insured EPO national account contracts and approximately 137,000 members from insured large group indemnity contracts to self-funded contracts and approximately 69,000 members from new national and large group customers. Administrative service fee revenue from our CMS contracts increased 10.6%, or $12.2 million to $127.3 million for the year ended December 31, 2002, from $115.1 million for the year ended December 31, 2001. Total BlueCard

fees increased 26.3%, or $9.3 million, to $44.6 million for the year ended December 31, 2002, from $35.3 million for the year ended December 31, 2001 due to an increase in transaction volume.

Investment income, net of investment expenses, decreased 6.5%, or $4.5 million, to $64.8 million for the year ended December 31, 2002, from $69.3 million for the year ended December 31, 2001 due to lower interest rates. Net realized gains of $2.6 million for the year ended December 31, 2002 was primarily the result of net gains on government and corporate bond sales and the sale of common stock. The net realized loss of $12.4 million for the year ended December 31, 2001 was primarily due to a $10.5 million impairment loss recorded on our holdings of WebMD Corp. common stock.

Other income, net of $14.0 million for the year ended December 31, 2002 consisted primarily of a gain of $8.0 million resulting from insurance settlements in excess of estimated recoveries recorded as of December 31, 2001 for property and equipment lost at our World Trade Center headquarters, $5.4 million related to the recovery of amounts previously recorded against net income, interest received on outstanding hospital advances of $1.9 million and late payment fee income of $0.7 million. Other income, net of $6.1 million for the year ended December 30, 2001 primarily consisted of a gain of $6.8 million resulting from insurance recovery estimates in excess of book values for property and equipment lost at our World Trade Center headquarters, proceeds of $1.6 million from the demutualization of MetLife, Inc., the life insurance carrier for our employees, late payment fee income of $0.6 million and interest income earned on advances to hospitals of $1.2 million, offset in part by a charge of $3.7 million due to the restructuring of an outstanding provider note receivable and other miscellaneous expenses of $0.4 million.

Total cost of benefits provided increased 5.6%, or $208.6 million, to $3,947.4 million for the year ended December 31, 2002, from $3,738.8 million for the year ended December 31, 2001, reflecting a 1.7% increase in member months and a 3.8% increase in PMPM benefit costs. The increase in benefit costs was due to increases in unit costs, offset in part by decreases in utilization. Cost of benefits provided for the year ended December 31, 2002 included a $3.3 million premium deficiency reserve charge related to our New Jersey PPO business, offset in part by net litigation reserve related activity of $13.7 million. Overall, benefit expense on a PMPM basis for the year ended December 31, 2002 increased to $106.32, from $102.39 for the year ended December 31, 2001.

The total medical loss ratio decreased to 85.3% for the year ended December 31, 2002, from 88.1% for the year ended December 31, 2001. This decrease was attributable to, in part, $40.1 million of prior period reserve development on the prospectively rated book of business. Excluding prior period development and the litigation reserve release, the total medical loss ratio for the year ended December 31, 2002, was 86.3%. The medical loss ratio in our commercial managed care segment decreased to 86.0% for the year ended December 31, 2002, from 88.6% for the year ended December 31, 2001. Excluding New York City and New York State PPO accounts, the medical loss ratio in our commercial managed care segment decreased to 81.6% for the year ended December 31, 2002, from 85.8% for the year ended December 31, 2001 due to better than anticipated claim experience. The medical loss ratio for other insurance products and services decreased to 82.4% for the year ended December 31, 2002, from 86.2% for the year ended December 31, 2001.

Administrative expenses increased 12.2%, or $90.3 million, to $833.1 million for the year ended December 31, 2002, from $742.8 million for the year ended December 31, 2001. This increase was attributable to increased broker commissions of $18.8 million due to premium revenue growth in small group and middle market customers, increased employee benefit expense of $15.6 million, increased professional services related to our technology outsourcing strategy of $23.1 million, increased premium taxes of $6.2 million, employee-related transition costs of $9.5 million incurred as part of our outsourcing agreement with IBM in June 2002, restructuring charges of $13.7 million related to our plan to streamline operations and other miscellaneous expenses. This increase was offset in part by a gain of $19.3 million resulting from the settlement of our business property protection and blanket earnings and extra expense insurance claim related to the loss of our headquarters located at the World Trade Center. Conversion and IPO expenses increased $13.4 million to $15.4 million for the year ended December 31, 2002, from $2.0 million for the year ended December 31, 2001 due to the increased conversion and IPO related activities as we reached the effective date of the conversion and completed our initial public offering.

Income from continuing operations before income taxes increased 109.8%, or $162.1 million, to $309.7 million for the year ended December 31, 2002, from $147.6 million for the year ended December 31, 2001. This improvement was primarily driven by increased commercial managed care membership and improved underwriting performance. The tax benefit of $67.9 million increased income from continuing operations to $377.6 million for the year ended December 31, 2002. The tax expense of $0.1 million reduced income from continuing operations to $147.5 million for the year ended December 31, 2001. Taking into account our loss from discontinued operations, our net income for the year ended December 31, 2002 was $376.5 million and for year ended December 31, 2001 was $131.0 million.

Liquidity and Capital Resources

WellChoice is a holding company and depends on its subsidiaries for cash and working capital to pay expenses. WellChoice receives cash from its subsidiaries from administrative and management service fees, as well as tax sharing payments and dividends. On January 22, 2004, the New York State Superintendent of Insurance, or Superintendent, approved the payment of a dividend to WellChoice from Empire in the amount of $120.0 million, which will be paid during the first quarter of 2004. On June 17, 2003, the Superintendent approved the payment of a dividend to WellChoice from Empire in the amount of $140.0 million, which was paid on June 30, 2003. Dividends paid to WellChoice from its subsidiaries in 2002 totaled $225.0 million. These dividends have been accounted for as an equity transfer from a subsidiary to the parent of a consolidated group. In 2002, we received net proceeds of approximately $28.0 million, after deducting the underwriting discount, from the exercise of the underwriters' over-allotment option in our initial public offering. We used these proceeds from the exercise of the over-allotment option to pay offering and conversion expenses and for general corporate purposes.

At December 31, 2003, total investments and cash and cash equivalents at WellChoice (the parent holding company) was $363.2 million. A stand-alone condensed balance sheet of WellChoice, Inc. is presented in Schedule II of the supplemental schedules to our financial statements. See page F-36 of our 2003 Annual Report on Form 10-K.

Our subsidiaries' primary source of cash is from premiums and fees received and investment income. The primary uses of cash include healthcare benefit expenses, brokers' and agents' commissions and administrative expenses. We generally receive premium revenues in advance of anticipated claims for related healthcare services.

Our investment policies are designed to provide liquidity to meet anticipated payment obligations and to preserve principal. We believe the composition of our marketable investment portfolio is conservative, consisting primarily of high-rated, fixed income securities with the objective of producing a consistently growing income stream and maximizing risk-adjusted total return. Our fixed income portfolio is comprised of U.S. government securities, corporate bonds, asset-backed bonds and mortgage-related securities. The average credit rating of our fixed income portfolio as of December 31, 2003 was "AA+." A portion of the fixed income portfolio is designated as short-term and is intended to cover near-term cash flow needs. Our marketable equity portfolio as of December 31, 2003 consisted of an investment in a mutual fund indexed to the S&P 500, our common stock investment in WebMD, our investment in non-redeemable preferred stock of several companies and equity investments held in our nonqualified deferred compensation plans. As of December 31, 2003 our marketable equity portfolio was 4.5% of the total marketable investment portfolio.

In October 2003, we renewed our existing credit and guaranty agreement with The Bank of New York, as Issuing Bank and Administrative Agent, and several other financial institutions as agents and lenders, which provides us with a credit facility. We are able to borrow under the credit facility, subject to customary conditions, for general working capital purposes. The total outstanding amounts under the credit facility cannot exceed $100.0 million. The facility has a term of 364 days with a current maturity date of October 15, 2004, subject to extension for additional periods of 364 days with the consent of the lenders. Borrowings under the facility will bear interest, at our option, at The Bank of New York's prime commercial rate (or, if greater, 0.50% plus the federal funds rate) as in effect from time to time plus a margin of between zero and 1.0%, or LIBOR plus a margin of between 1.125% and 2.250%, with the applicable margin to be determined based on our financial strength rating. As of December 31, 2003, there were no funds drawn against this line of credit.

The credit facility contains covenants that limit our ability to issue any equity interest which is not issued on a perpetual basis or in respect of which we shall become liable to purchase, redeem, retire or otherwise acquire any such interest, including any class of redeemable preferred stock. However, the credit facility does not restrict us from paying dividends on our common stock or repurchasing or redeeming shares of our common stock. Covenants under the credit facility also impose limitations on the incurrence of secured debt, creation of liens, mergers, asset sales, transactions with affiliates and material amendments of material agreements, as defined in the credit facility without the consent of the lenders. In addition, the credit facility contains certain financial covenants. Failure to comply with any of these covenants will result in an event of default, which could result in the termination of the credit facility.

We believe that cash flow from our operations and our cash and investment balances, including the proceeds of the dividends mentioned above, will be sufficient to fund continuing operations and capital expenditures for the foreseeable future based on current assets and projected future cash flows.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Cash from operating activities increased $112.4 million to $295.1 million for the year ended December 31, 2003, from $182.7 million for the year ended December 31, 2002. The increase in operating cash flow was primarily due to the following:

- Increased premiums and administrative fees collected resulting from increases in membership and rates partially offset by an increase in cost of benefits paid contributed approximately $153.8 million in additional cash flow for the year ended December 31, 2003 when compared to December 31, 2002.
- We made premium tax payments of $69.0 million for the year ended December 31, 2003 compared to premium tax payments of $1.6 million for the year ended December 31, 2002. The increase is attributed to the Company's for-profit conversion and an increase in the premium tax rate.
- Income tax payments for the year ended December 31, 2003 were $79.9 million compared to $90.5 million for the year ended December 31, 2002. The decrease is attributable to a federal tax payment made in 2002 of approximately $22.0 million relating to 2001 partially offset by a $15.4 million increase in state income tax payments in 2003 compared to 2002. The increase in state income tax payments is related to the Company's for-profit conversion.
- For the year ended December 31, 2003, we returned advanced premium relating to our New York State account of $36.3 million compared to $75.8 million returned for the year ended December 31, 2002. The reduction in the amount returned is due to the fact that we were holding a smaller amount of advanced premium, which is available to be returned to the state.
- In 2002, operating cash flow reflects $46.5 million in World Trade Center insurance proceeds, net of recovery expense.
- Our managed cash overdraft liability (outstanding check liability) increased to $198.0 million at December 31, 2003 from $170.3 million at December 31, 2002.
- In 2003, we received approximately $44.1 million in Market Stabilization Pool recoveries. The increase is attributable to distributions for prior years. The distributions were offset by approximately $19.7 in premium refunds related to the distributions received.
- In 2003, we made payments totaling $20.5 million relating to outsourcing and restructuring initiatives undertaken in 2002, compared to $2.2 million paid in 2002. These payments were primarily severance and stay bonus related.
- Group and other contract liabilities resulted in approximately $0.7 million in operating cash outflow in 2003 compared to an inflow of $16.3 million in 2002. This decrease is primarily attributable to activity related to our New York City account.

Cash used in investing activities decreased $43.9 million to $85.6 million for the year ended December 31, 2003, from $129.5 million for the year ended December 31, 2002. This decrease is primarily due to agency bonds in our investment portfolio being called due to declining interest rates. Cash

received for these bonds were reinvested in cash equivalents. Fixed asset purchases for the year ended December 31, 2003 were $43.5 million, of which $26.9 million was spent on leasehold improvements and capital expenditures to prepare our facility in Brooklyn, New York, for occupancy beginning September 2003. Fixed asset purchases for the year ended December 31, 2002 were $33.7 million, of which $2.0 million was spent on capital expenditures to prepare Metrotech for occupancy.

Net cash provided by financing activities of $0.6 million for the year ended December 31, 2003, represents new capital leases related to office equipment, offset in part by payments for existing capital lease obligations. Net cash provided by financing activities of $25.6 million includes net proceeds from the sale of common stock in the initial public offering of $28.0 million and payments made on capital lease obligations of $2.4 million for the year ended December 31, 2002.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Cash from operating activities decreased $31.6 million to $182.7 million as of December 31, 2002, from $214.3 million as of December 31, 2001. The decrease in cash from operating activities is principally due to a $75.8 million return of advanced premium held related to our New York State account compared to an increase of premium held of approximately $24.4 million in 2001 and an increase of $74.0 million in taxes paid. This decrease was partially offset by $46.5 million in World Trade Center insurance proceeds, net of recovery expense, and positive operating results net of non-cash items. Some of the non-cash items impacting net income include the net deferred income tax benefit of $151.4 million, litigation reserve releases of $15.4 million related to the settlement of a large case and prior year "at risk" claim reserve adjustments, offset in part by depreciation and amortization expense of $34.5 million and accrued restructuring expenses of $20.9 million.

Net cash used in investing activities of $129.5 million for the year ended December 31, 2002, was consistent with cash used in investing activities of $129.3 million for the year ended December 31, 2001.

Net cash provided by financing activities of $25.6 million includes net proceeds from the sale of common stock in the initial public offering of $28.0 million and payments made on capital lease obligations of $2.4 million for the year ended December 31, 2002. Cash used in financing activities of $1.9 million for the year ended December 31, 2001 reflects payments for capital lease obligations.

Market Stabilization Pools

The New York State Community Rating Law requires insurers and HMOs writing small employer (groups with less than 50 eligible employees) and individual (non-group) business to participate in certain market stabilization pools. Under the Community Rating Law there are two major Pools: a pool for direct pay and small group contracts excluding Medicare Supplemental contracts ("non-Med Supp Pool") and a pool for Medicare Supplemental contracts ("Med Supp Pool"). Both Pools operate on a calendar year basis.

For Pool years prior to 1996, payments to and from the Pools were based on demographic data submitted by insurers. The non-Med Supp Pool also contained a component that reimbursed insurers for a portion of claim costs related to certain specified medical conditions. Effective January 1, 1996, the Community Rating Law was amended. The Community Rating Law, as amended, changed the pooling

mechanism from one based on demographics and specified medical conditions to a method based on the experience for approximately fifty medical markers on medical conditions.

The revised Community Rating Law required that the demographic and specified medical conditions approach be phased out over a four-year period. The revised methodology is complex and, as a result, implementing regulations were not issued until 2002. During this period, an interim method to distribute the portion of the Pools based on the new methodology for non-Med Supp Pool funds was developed for Pool years 1996 through 1998. Also during this time, the New York State Insurance Department determined that the demographic approach was permissible under the 1996 law and would continue to be the method used for the Med Supp Pool.

Distributions from the non-Med Supp Pool have been made through 1998 and distributions for the Med Supp Pool have been made for years through 1996 and for the years 2000 through 2003. In 2002, we received a distribution for non-Med Supp Pool year 1998 of $1.7 million. In 2003, we received a distribution from the Pool for Med Supp Pool years 2000, 2001, 2002 and 2003 of $12.6 million, $12.8 million, $12.8 million and $5.9 million, respectively.

As of December 31, 2003, we had not established a receivable or payable for non-Med Supp Pool years 1999 through 2003 and Med Supp Pool years 1997 through 1999, due to the general uncertainty surrounding the ultimate disposition of payments to or receipts from the Pools and the lack of data necessary to appropriately estimate such amounts. Our ultimate payment to or receipts from these Pools may have a material impact to our financial statements.

As result of the Med Supp Pool distributions received in 2003 for Med Supp Pool years 2000, 2001 and 2002, our Medicare Supplemental product loss ratio fell below the minimum medical loss ratio allowed under New York insurance regulations. As a result, we were required to issue premium refunds totaling $19.7 million.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of and for the year ended December 31, 2003 that had or could have a material impact to our financial statements.

Contractual Obligations

We are contractually obligated to make future minimum payments as follows:

	2004	2005	2006	2007	2008	Thereafter
Lease commitments:						
Operating leases	$35.6	$30.5	$31.8	$31.4	$31.5	$275.8
Capital leases	12.4	12.7	12.9	13.1	13.4	23.8
IBM agreement	99.7	102.1	84.7	72.0	66.4	206.0
Other purchase obligations	11.5	7.8	7.5	7.2	6.7	1.8
Projected other postretirement benefits[1]	7.9	8.4	8.8	9.2	9.2	47.3

(1) Projected benefit payments in the "Thereafter" column reflect projected payments from 2009–2013.

Operating and Capital Leases

Our lease terms generally range from one to 27 years with certain early termination or renewal provisions. The schedule above includes rent commitments for our Staten Island facility. However, as part of the information technology outsourcing agreement with IBM, we entered into a sublease agreement with IBM for this property. The Company expects to receive net sublease income of approximately $1.4 million per year until 2012.

IBM Agreement

In June 2002, we entered into a ten-year agreement with IBM to enhance and modernize our systems applications and operate our data center and technical help desk. Our payments to IBM for operating our data center and technical help desk will be based upon actual utilization of services billed at the rates established in the agreement. We estimate that our payments to IBM for operating our data center and technical help desk and providing certain core applications software development will total approximately $586.1 million over the remaining term of the agreement, which we anticipate to be less than the costs which we would have otherwise incurred had we continued to operate the data center and technical help desk ourselves.

Pursuant to the IBM agreement, we have undertaken to work jointly with IBM to enhance and modernize our systems applications. Some of the systems application software development will be performed overseas from IBM's offices in Bangalore, India or, in the event this facility becomes unavailable during the life of the agreement, services will be provided from a replacement facility. These applications include technological enhancements based on the ongoing requirements of our business and solutions developed based upon our specifications. We will own the software developed by IBM under the agreement, other than the claims payment system described below.

We anticipate that the systems applications will be integrated with a new claims payment system being developed by deNovis, a privately-held, start-up company, in coordination with IBM. The new claims payment system will be licensed to us when it is completed. The development of the system has been delayed by deNovis and as a result we do not expect the system to be ready for acceptance by us in accordance with its specifications any earlier than 2006—an approximate two-year delay from the original July 2004 date we had agreed upon with IBM in June 2002. We do not believe this delay will

have any material impact on our operations because our existing claims payment system is adequate to meet our needs.

Subject to the successful completion and acceptance of the claims payment system, we will pay $50.0 million for a perpetual license granted by IBM, which includes custom development fees. Under the agreement with IBM, we are scheduled to pay $25.0 million of this fee in four equal installments upon the achievement of the following milestones: (1) receipt of the production ready claims payment system; (2) installation of the production ready claims payment system; (3) completion of testing of the production ready claims payment system; and (4) our acceptance of the production ready claims payment system. None of these milestones have been completed and we do not expect any of them to be achieved before 2006. The remaining $25.0 million will be paid one year following the date we accept the claims payment system. Following the expiration of the one-year warranty period that begins upon the payment of the final installment, we will pay IBM an annual fee of $10.0 million for maintenance and support services.

We had agreed to purchase $65.0 million in modernization and other additional services from IBM (including integration services provided by IBM in connection with the claims payment system) over a five-year period beginning in 2002, with annual target purchase rates through 2006. In September 2003, IBM and we agreed to reduce our commitment by $10.0 million to $55.0 million and to spread out the annual target purchase rate over a seven-year period ending in 2008. In addition, we accelerated the repayment of $7.3 million of price concessions granted under the original contract.

We may defer the purchase of services beyond the target date, provided that to the extent we delay purchases more than one year beyond the target year, the aggregate purchase commitment will be increased by an amount equal to 10% per annum of purchases so delayed. The amount that we will actually spend for these additional services could be less or greater than the annual target purchase rate. We expect that our spending on modernization and additional IBM services will continue to be at levels consistent with our overall expectations of administrative expenses as a percentage of premiums earned and administrative service fees.

Our outsourcing agreement with IBM contains standard indemnification clauses which reduce the risks associated with a variety of claims and actions, including certain failures of IBM to perform under the agreement. We have the right to terminate certain services if IBM fails to meet our quality and performance benchmarks and we may terminate our relationship with IBM in its entirety upon the occurrence of material breaches under the agreement, IBM's entrance into the health insurance business, changes of control and certain other events which are damaging to us. We can terminate the outsourcing agreement without cause after June 1, 2004, or at any time within twelve months following a change of control of WellChoice, provided that we pay IBM a termination fee. The termination fee includes a lump sum payment which decreases over the life of the agreement. For any WellChoice termination without cause, the lump sum decreases from $25.0 million beginning in June 2004 to $0.9 million in January 2012. We have the right to pay only a portion of this lump sum payment if we choose not to terminate the entire agreement but only certain discrete portions of IBM's services. Any termination following a change of control of WellChoice requires a similar lump sum payment which decreases over the life of the agreement and which is approximately 80% of the payment described in the previous sentence, although we

do not have the similar right to terminate only portions of IBM's services, as allowed with a termination without cause. In addition, upon termination we must reimburse certain of IBM's costs, subject to reduction to the extent we purchase equipment, assume licenses and leases and hire employees used by IBM to provide the services. We also have the right to terminate the agreement at no cost within six months following a change of control of IBM.

Under the terms of the agreement we cannot perform or engage a third party to perform any of the data center or technical help desk services, or more than 20% of the core applications software development services, outsourced to IBM without the written consent of IBM. For purposes of completing the contractual commitments table on page 41 of this report, we have included an estimate of all services relating to the data center, technical help desk and core applications software development as well as our purchase commitment related to modernization and other additional services.

Other Purchase Obligations

Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

Regulatory and Other Developments

Empire is subject to capital and surplus requirements under the New York insurance laws and the capital and surplus licensure requirements established by the Blue Cross Blue Shield Association. Each of these standards is based on the NAIC's RBC Model Act, which provides for four different levels of regulatory attention depending on the ratio of a company's total adjusted capital (defined as the total of its statutory capital, surplus, asset valuation reserve and dividend liability) to its risk-based capital. The capital and surplus level required to meet the minimum requirements under the New York insurance laws and Blue Cross Blue Shield Association licensure requirements applicable to Empire is 200% of Risk-Based Capital Authorized Control Level. Empire exceeds the New York minimum capital and surplus requirements and the Blue Cross Blue Shield Association capital and surplus licensure requirements.

Capital and surplus requirements for Empire HealthChoice HMO, Inc., our HMO subsidiary which is directly owned by Empire, are regulated under a different method set forth in the New York Department of Health's HMO regulations. The regulations require that Empire HealthChoice HMO currently maintain reserves of five percent of its annual premium income. Empire HealthChoice HMO, with respect to its operations in New York, meets the financial reserve standards of the New York Department of Health. The Department of Health is currently redrafting its regulations and proposes to increase the required reserves gradually over the next six years to twelve and one half percent of annual premium income. If that requirement changes it will affect all HMOs and we expect we will meet those revised standards. In November 2002, Empire HealthChoice HMO received a $50.0 million capital contribution from Empire, which was made in connection with the transfer of our New York HMO business from HealthChoice to Empire HealthChoice HMO during 2002 in order to ensure compliance with New York capital and surplus requirements. Empire HealthChoice HMO is also licensed in New Jersey and there are minimum net worth standards established under New Jersey laws and regulations. Empire HealthChoice

HMO, with respect to its operations in New Jersey, meets the minimum net worth standards established under New Jersey law. Empire HealthChoice HMO is also subject to the Blue Cross Blue Shield Association capital and surplus licensure requirement which is applicable to Empire and satisfies that requirement.

Our New Jersey operations are not subject to the Blue Cross Blue Shield Association capital and surplus licensure requirement. At December 31, 2003, WellChoice Insurance of New Jersey met the minimum capital and surplus requirements of the New Jersey Department of Banking and Insurance.

Regulation of financial reserves for insurers and HMOs is a frequent topic of legislative and regulatory scrutiny and proposals for change. It is possible that the method of measuring the adequacy of our financial reserves could change and that could affect our financial condition. However, any such change is likely to affect all companies in the state.

The ability of our insurance and HMO subsidiaries to pay dividends to us is subject to regulatory requirements, including state insurance laws and health department regulations and regulatory surplus or admitted asset requirements, respectively. These laws and regulations require the approval of the applicable state insurance department or health regulators in order to pay any proposed dividend over a certain amount. For example, any proposed dividend to WellChoice from Empire, which, together with other dividends paid within the preceding twelve-month period, exceeds the lesser of 10% of its surplus to policyholders or 100% of adjusted net investment income will be subject to approval by the New York Department of Insurance. The provisions of our Blue Cross and Blue Shield licenses also may limit our ability to obtain dividends or other cash payments from our subsidiaries as they require our licensed subsidiaries to retain certain levels of minimum surplus and liquidity.

Critical Accounting Estimates

The following is an explanation of our accounting policies considered most significant by management. These accounting policies require us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information is known. Actual results could differ materially from those estimates.

Revenue Recognition

Our membership contracts generally have one year terms and are subject to cancellation upon 60 days written notice. Premiums are generally due monthly and are recognized as revenue during the period in which we are obligated to provide services to our members. We record premiums received prior to such periods as unearned premiums. We record premiums earned net of an allowance for doubtful accounts. Premiums recorded for groups with retrospectively rated arrangements are based upon the actual and estimated claims experience of these groups. Future adjustments to the claims experience of these groups will result in changes in premium revenue. Our estimated claim experience is based on a number of factors, including prior claims experience. We continually review theses estimates and adjust them based on actual claims experience. Any changes in these estimates are included in current period results. Funds received from these groups in excess of premiums recorded are reflected as liabilities on our balance sheet.

We recognize administrative service fees during the period in which the related services are performed. Administrative service fees consist of revenues from the performance of administrative services for self-funded contracts, reimbursements from our contracts with CMS under which we serve as an intermediary for the Medicare Part A program and a carrier for the Medicare Part B program, and fees earned under the BlueCard program. We record the revenue earned under our contracts with CMS net of an allowance for an estimate of disallowed expenses.

Cost of Benefits Provided

Cost of benefits provided includes claims paid, claims in process and pending, and an estimate for unreported claims for charges for healthcare services for enrolled members during the period. These costs include payments to primary care physicians, specialists, hospitals, pharmacies, outpatient care facilities and the costs associated with administering such care. Costs of benefits are recorded net of pharmacy rebates, coordination of benefits and pool recoveries.

We are required to estimate the total amount of claims that have not been reported or that have been received, but not yet adjudicated, during any accounting period. These estimates, referred to as unpaid claims on our balance sheet, are recorded as liabilities.

We estimate claim reserves in accordance with Actuarial Standards of Practice promulgated by the Actuarial Standards Board, the committee of the American Academy of Actuaries that establishes the professional guidelines and standards for actuaries to follow. A considerable degree of judgment is involved in estimating reserves. We make assumptions regarding the propriety of using existing claims data as the basis for projecting future payments. Factors we consider include medical cost trends, the mix of products and benefits sold, internal processing changes and the amount of time it took to pay all of the benefits for claims from prior periods. To the extent the actual amount of these claims is greater than the estimated amount based on our underlying assumptions, these differences would be recorded as additional cost of benefits provided in subsequent accounting periods and our future earnings would be adversely affected. To the extent the claims experience is less than estimated based on our underlying assumptions, these differences would be recorded as a reduction in cost of benefits provided in subsequent accounting periods.

The Unpaid Claims and Claims Adjustment Expense shown in our balance sheet as of December 31, 2003 consisted of the following components:

	($ in millions)
Pending and incurred but not yet reported, or IBNR, claims	$571.2
Claims adjustment expense reserve	18.9
Other claim related reserves	19.4
Total	$609.5

As reflected in this table, approximately 94% of the liability for Unpaid Claims and Claims Adjustment Expense is for pending and IBNR claims. Of the estimate for pending and IBNR claims, approximately 79% is for claims incurred in the most recent three months. Estimates of these three months' claims are based on projected per member per month, or PMPM, costs and the actual member

counts during this period. The following table presents the impact on Unpaid Claims and Claims Adjustment Expense of changes in the annualized cost trend underlying the projected PMPM costs for the most recent three months.

Increase/(Decrease) in Claim Cost Trend	Increase/(Decrease) in Unpaid Claim Estimate
	($ in millions)
(3)%	$(27.3)
(2)%	(18.2)
(1)%	(9.1)
1%	9.1
2%	18.3
3%	27.4

Estimates of the remaining pending and IBNR claims for those claims incurred more than three months prior to the reporting date were based on claims actually paid during this period and completion factors developed from historical payment lag patterns. A completion factor is the ratio of the claims for a given month that are paid to date as of the reporting date to the ultimate amount expected to be paid for that month. The following shows the impact on Unpaid Claims and Claims Adjustment Expense of changes in the completion factors used in projecting the ultimate cost for claims incurred over three months prior to the reporting date.

Increase/(Decrease) in Completion Factor	Increase/(Decrease) in Unpaid Claim Estimate
	($ in millions)
(0.3)%	$ 40.9
(0.2)%	27.2
(0.1)%	13.6
0.1%	(10.3)
0.2%	(17.0)
0.3%	(22.6)

It should be noted that the dollar amounts shown in the tables above would not necessarily flow directly to income from continuing operations. In prospectively rated business, we are at risk for negative experience—where actual claim costs and other expenses are greater than those expected—and benefit from positive experience—where claim costs and other expenses are less than those expected. By contrast, in retrospectively rated business, the customer is at risk. Generally speaking only the portion of the reserve change which affects prospectively rated business impacts income from continuing operations. At December 31, 2003, approximately 48.0% of the $571.2 million of reserve for Pending and IBNR claims were held for prospectively rated business.

We believe that the recorded unpaid claim liability is adequate to cover our ultimate liability for unpaid claims as of December 31, 2003. Actual claim payments and other items may differ from our estimates. Assuming a hypothetical 1% difference between our December 31, 2003 estimates of unpaid claims and actual claims payable for our prospectively rated business, net income from continuing operations

for the year ended December 31, 2003, would increase or decrease by approximately $1.7 million and earnings per share would increase or decrease by approximately $0.02 per share.

As shown in Note 5 of the Notes to the Consolidated Financial Statement, there was $82.1 million of favorable reserve development in 2003 for claims incurred in 2002 and prior years. Our revised estimate of the liability on 2002 and prior years' claims was lower than our original estimate at December 31, 2002. This favorable development was the result of:

- $34.9 million related to amounts we received with respect to the New York State Medicare Supplemental Stabilization Pool for years 2000, 2001 and 2002;
- $44.3 million favorable development of general claim liability; and
- $2.9 million amortization of premium deficiency reserve in one of our subsidiaries.

Of the $44.3 million favorable development of general claim liability, $23.8 million relates to 2002, $14.8 million to 2001, and $5.7 million to 2000 and prior. As a result of the $34.9 million net Pool receipts, we distributed approximately $19.7 million of premium refunds to Medicare Supplemental contract holders during the fourth quarter of 2003.

Taxes

We account for income taxes using the liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the financial reporting and tax basis of assets and liabilities. We record a valuation allowance to reduce our deferred tax asset to the amount we believe is more likely than not to be realized. This determination, which requires considerable judgment, is based on a number of assumptions including an estimate of future taxable income. If future taxable income or other factors are not consistent with our expectations, an adjustment to our deferred tax asset may be required in the future. Any such adjustment would be charged or credited to income in the period such determination was made.

Retirement Benefits

Pension Benefits

We sponsor defined benefit cash-balance pension plans for our employees. As discussed in Note 14 of the Notes to the Consolidated Financial Statements, we account for these plans in accordance with Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* ("FAS 87"). FAS 87 requires us to make significant assumptions including estimating the expected return on pension plan assets and the discount rate used to determine the current pension obligation. Changes to these assumptions will affect pension expense.

One important factor in determining our pension expense is the assumption for expected return on plan assets. As of December 31, 2003, our expected long-term rate of return on plan assets was 7.5% (which was reduced from 8.0% for our 2002 expense recognition). The expected rate of return assumption is determined by taking into account our expectations regarding future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and

historical rates of return for each class. A 0.5% decrease (increase) in the expected return on plan assets would increase (decrease) pension expense by approximately $2.3 million.

We apply this assumed long-term rate of return on assets to a calculated value of plan assets, which recognizes changes in the fair value of plan assets in a systematic manner over five years. This produces the expected return on plan assets that we include as a component of pension expense. Each year, the gain or loss from asset performance, which is measured as the difference between this expected return and the actual return on plan assets for that year, is deferred and recognized in the market related value of assets as 20% increments for each of the five years following the gain or loss. The net deferral of past asset gains and losses affects the calculated value of plan assets and, ultimately, future pension expense.

Our pension plans have $59.9 million of cumulative unrecognized losses as of the December 31, 2003 measurement date. Generally, these losses are amortized into expense each year on a straight-line basis over the remaining expected future-working lifetime of active participants (currently approximately 12 years), to the extent that such losses exceed 10% of the greater of the projected benefit obligation and the market related value of assets. The estimated impact to the 2004 pension expense as a result of the amortization of these losses is approximately $1.3 million.

The discount rate reflects the current rate at which the pension liabilities could be effectively settled at the end of the year based on our measurement date. At our last measurement date (December 31, 2003), we lowered our discount rate to 6.0% (from 6.5% as of December 31, 2002 and 7.0% as of December 31, 2001). Changes in the discount rates over the past three years have resulted in an increase to pension expense from what it otherwise would have been. The net effect on liabilities attributable to changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, have been deferred and amortized as a component of pension expense in accordance with FAS 87.

At December 31, 2003, our prepaid benefit cost for the qualified and supplemental pension plans combined was $53.5 million compared to $45.2 million at December 31, 2002. The prepaid benefits cost represents the end of period excess of the fair value of plan assets over the benefit obligation plus or minus amounts not yet recognized. Net pension income included as a component of administrative expense was $7.4 million, $6.0 million and $8.7 million for the years ended December 31, 2003, 2002 and 2001, respectively. For the year ended December 31, 2003, we did not contribute any funding into our cash balance pension plans and based on the current funded status, do not anticipate any contributions during 2004.

Other Postretirement Benefits

We provide most employees certain life, medical, vision and dental benefits upon retirement. As discussed in Note 2 to the Notes to the Consolidated Financial Statements we account for these plans in accordance with Financial Accounting Standards No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* ("FAS 106"). In accordance with FAS 106, we use various actuarial assumptions including the discount rate and the expected trend in healthcare costs to estimate the costs and benefit obligations for our retiree health plan.

At December 31, 2003, we lowered our discount rate to 6.0% (from 6.5% for our 2003 expense recognition). The assumed healthcare cost trend rate used in measuring the other benefit obligations was 10% in 2003 for all participants under age 65, 30.7% for participants in Medicare HMOs and 9.0% for participants age 65 and over in indemnity plans, decreasing gradually each year until ultimately leveling out at 4.5% in 2009.

At December 31, 2003, our liability for postretirement benefits other than pensions was $142.7 million compared to $143.7 million at December 31, 2002. Expected future benefit payments with respect to liabilities under these plans can be found in the "Liquidity and Capital Resources" section of this report.

Recent Accounting Pronouncements

In December 2003, the Financial Accounting Standard Board issued SFAS No. 132 (Revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. This Statement amends Statements No. 87, Employers' Accounting for Pensions, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. However, the Statement does not change the recognition and measurement requirements of those Statements. This Statement retains the disclosure requirements contained in SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which it replaces and requires additional disclosure. Additional new disclosure includes actual mix of plan assets by category, a description of investment strategies and policies used, a narrative description of the basis for determining the overall expected long-term rate of return on asset assumption and aggregate expected contributions.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003, or MMA, was signed into law. The MMA introduced a voluntary Medicare part D prescription drug benefit and created a new 28% federal subsidy for the sponsors of the postretirement prescription drug benefits that are at least actuarially equivalent to the new Medicare Part D benefit. Under SFAS No. 106-1, *Accounting for Postretirement Benefits Other Than Pensions*, sponsors must consider the two new features in measuring the Accumulated Postretirement Benefit Obligation ("APBO") and net periodic postretirement benefit cost. In accordance with SFAS No. 106-1, the Company made a one-time election to defer recognition of the impact on SFAS No. 106-1 accounting. Any measures of APBO and net periodic postretirement benefit cost in the financial statements and the related footnotes for the year ended December 31, 2003 do not reflect the effects of the MMA. Currently, specific authoritative guidance on accounting for the federal subsidy is pending and that guidance when issued could require the Company to change previously reported information. The Company does not anticipate that the adoption of SFAS 106-1 will materially affect the financial statements.

Investments

We classify all of our fixed maturity and marketable equity investments as available for sale and, accordingly, they are carried at fair value. The fair value of investments in fixed maturities and marketable

equity securities are based on quoted market prices. Unrealized gains and losses are reported as a separate component of other comprehensive income, net of deferred income taxes. The factors used to determine whether unrealized losses are considered other than temporary are the length of time the security has been in an unrealized loss position, the market to book value ratio and other relevant qualitative considerations. The amortized cost of fixed maturities, including certain trust preferred securities, is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in investment income. Amortization of premiums and discounts on collateralized mortgage obligations are adjusted for prepayment patterns using the retrospective method. Investment income is shown net of investment expenses. The cost of securities sold is based on the specific identification method. When the fair value of an investment is lower than its cost and such a decline is determined to be other than temporary, the cost of the investment is written down to fair value and the amount of the write down is charged to net income as a realized loss.

Short-term investments are carried at fair value, and consist principally of U.S. Treasury bills, commercial paper and money market investments. We consider securities with maturities greater than three months and less than one year at the date of purchase as short-term investments. The fair value of short-term investments is based on quoted market prices.

Other long-term equity investments include joint ventures and warrants. Joint ventures are accounted for under the equity method. Our warrants are considered derivatives and are carried at fair value. Our warrants are not classified as hedging instruments. Fair values of warrants are determined using the Black Scholes Options Valuation Model. Changes in the fair values of warrants are recorded as realized gains or losses.

We are subject to state laws and regulations that require diversification of our investment portfolios and limit the amount our insurance company subsidiaries may invest in certain investment categories, such as below-investment-grade fixed income securities, mortgage loans, real estate and equity investments. Failure to comply with these laws and regulations might cause investments exceeding regulatory limitations to be treated as non-admitted assets for purposes of measuring statutory surplus and risk-based capital and, in some instances, require the sale of those investments.

Quantitative and Qualitative Disclosures About Market Risk

Our fixed maturity and marketable equity securities are subject to the risk of potential losses from adverse market conditions. To manage the potential for economic losses, we regularly evaluate certain risks, as well as the appropriateness of the investments, to ensure the portfolio is managed within its risk guidelines. The result is a portfolio that is well diversified. Our primary risk exposures are changes in market interest rates, credit quality and changes in equity prices. The market value of our investments varies from time to time depending on economic and market conditions. Our investment portfolio is not significantly concentrated in any particular industry or geographic region.

Interest Rate Risk

Interest rate risk is defined as the potential for economic losses on fixed-rate securities due to an adverse change in market interest rates. Our fixed maturity portfolio consists exclusively of U.S.

dollar-denominated assets, invested primarily in U.S. government securities, corporate bonds, asset-backed bonds and mortgage-related securities, all of which represent an exposure to changes in the level of market interest rates. We manage interest rate risk by maintaining a duration commensurate with our insurance liabilities and policyholders' surplus. Further, we do not engage in the use of derivatives to manage interest rate risk. A hypothetical increase in interest rates of 100 basis points would result in an estimated decrease in the fair value of the fixed income portfolio at December 31, 2003 of approximately $44.8 million.

Credit Quality Risk

Credit quality risk is defined as the risk of a credit downgrade to an individual fixed income security and the potential loss attributable to that downgrade. We manage this risk through our investment policy, which establishes credit quality limitations on the overall portfolio as well as dollar limits for individual issuers. The result is a well-diversified portfolio of fixed income securities, with an average credit rating of approximately "AA+."

Fixed Maturity Securities Quality Distribution

The following chart shows the quality distribution of our fixed maturity securities portfolio as of December 31, 2003 and December 31, 2002 (at fair value):

	December 31, 2003	Percent of Total	December 31, 2002	Percent of Total
		(dollars in millions)		
Total fixed maturity				
Aaa	$ 995.3	78.4%	$ 892.3	72.9%
Aa	72.7	5.7	70.7	5.8
A	193.1	15.2	251.3	20.6
Baa	8.6	0.7	8.5	0.7
Total fixed maturity	$1,269.7	100.0%	$1,222.8	100.0%
Total fixed maturity corporate securities:				
Industrial	$ 28.8	6.7%	$ 37.2	10.1%
Finance	347.5	80.8	251.3	68.2
Utility	5.3	1.2	20.4	5.5
Asset-backed securities	13.5	3.1	30.0	8.2
Other	35.1	8.2	29.5	8.0
Total fixed maturity corporate securities	$ 430.2	100.0%	$ 368.4	100.0%
Total mortgage-related securities:				
Mortgage pass through certificates	$ 6.3	3.0%	$ 12.0	6.9%
Collateralized mortgage obligations	203.6	97.0	162.6	93.1
Total mortgage-related securities	$ 209.9	100.0%	$ 174.6	100.0%

Equity Price Risk

Equity price risk for stocks is defined as the potential for economic losses due to an adverse change in equity prices. Equity risk exposure is managed through our investment in an indexed mutual fund. Specifically, we are invested in the ML S&P 500 Index LLC, which is an S&P 500 index mutual fund, resulting in a well-diversified and liquid portfolio that replicates the risk and performance of the broad U.S. stock market. We also hold a direct common stock investment in WebMD and investments in non-redeemable preferred stock of several companies. Our investment in non-redeemable preferred stock is managed in conjunction with our fixed maturity portfolio. We estimate our equity price risk from a hypothetical 10% decline in the S&P 500 and the relative effect of that decline in the value of our marketable equity portfolio at December 31, 2003 to be a decrease in fair value of $5.0 million.

Fixed Income Securities

Our fixed income strategy is to construct and manage a high quality, diversified portfolio of securities. Additionally, our investment policy establishes minimum quality and diversification requirements resulting in an average credit rating of approximately "AA+." The average duration of our portfolio as of December 31, 2003 was 3.1 years.

Report of Independent Auditors

To the Board of Directors of
WellChoice, Inc.

We have audited the accompanying consolidated balance sheets of WellChoice, Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of WellChoice, Inc. and subsidiaries at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

New York, New York
February 2, 2004

Consolidated Balance Sheets

December 31	2003	2002
	(in thousands, except share and per share data)	
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost: $1,036,747 and $846,617)	**$1,037,255**	$ 863,290
Marketable equity securities, at fair value (cost: $52,890 and $47,022)	**60,414**	44,548
Short-term investments	**232,474**	359,490
Other long-term equity investments	**31,686**	28,220
Total investments	**1,361,829**	1,295,548
Cash and cash equivalents	**697,518**	487,431
Total investments and cash and cash equivalents	**2,059,347**	1,782,979
Receivables:		
Billed premiums, net	**92,399**	111,082
Accrued premiums	**285,773**	247,729
Other amounts due from customers, net	**107,062**	94,475
Notes receivable, net	**12,410**	12,059
Advances to hospitals, net	**10,788**	124
Accrued investment income	**9,613**	9,829
Miscellaneous, net	**51,333**	70,644
Total receivables	**569,378**	545,942
Property, equipment and information systems, net of accumulated depreciation	**113,526**	100,790
Prepaid pension expense	**53,515**	45,209
Deferred taxes, net	**216,534**	268,948
Other	**30,693**	33,587
Total assets	**$3,042,993**	$2,777,455

See notes to consolidated financial statements.

December 31	2003	2002
	(in thousands, except share and per share data)	
Liabilities and stockholders' equity		
Liabilities:		
Unpaid claims and claims adjustment expense	$ 609,491	$ 559,924
Unearned premium income	134,174	127,503
Managed cash overdrafts	197,995	170,270
Accounts payable and accrued expenses	104,526	111,842
Advance deposits	113,843	137,762
Group and other contract liabilities	112,204	112,870
Postretirement benefits other than pensions	142,743	143,736
Obligations under capital lease	48,345	47,700
Other	147,315	129,586
Total liabilities	1,610,636	1,541,193
Stockholders' equity:		
Class A common stock, $0.01 per share value, 225,000,000 shares authorized; shares issued and outstanding: 2003—83,676,446; 2002—83,490,477	837	835
Class B common stock, $0.01 per share value, one share authorized; one share issued and outstanding	—	—
Preferred stock, $0.01 per share value, 25,000,000 shares authorized; none issued and outstanding	—	—
Additional paid-in capital	1,262,222	1,255,566
Retained earnings (deficit)	162,584	(38,542)
Unearned restricted stock compensation	(6,027)	—
Accumulated other comprehensive income	12,741	18,403
Total stockholders' equity	1,432,357	1,236,262
Total liabilities and stockholders' equity	$3,042,993	$2,777,455

See notes to consolidated financial statements.

balance

ncome

Consolidated Statements of Income

December 31	2003	2002	2001
		(in thousands, except share and per share data)	
Revenue:			
Premiums earned	**$4,875,380**	$4,628,035	$4,246,168
Administrative service fees	**445,865**	396,203	321,984
Investment income, net	**51,235**	64,806	69,356
Net realized investment gains (losses)	**11,799**	2,604	(12,403)
Other (loss) income, net	**(1,724)**	14,012	6,101
Total revenue	**5,382,555**	5,105,660	4,631,206
Expenses:			
Cost of benefits provided	**4,162,246**	3,947,382	3,738,821
Administrative expenses	**876,687**	833,160	742,777
Conversion and IPO expenses	**—**	15,350	2,043
Total expenses	**5,038,933**	4,795,892	4,483,641
Income from continuing operations before income taxes	**343,622**	309,768	147,565
Income tax (expense) benefit	**(142,496)**	67,847	(135)
Income from continuing operations	**201,126**	377,615	147,430
Loss from discontinued operations, net of taxes of $0	**—**	(1,056)	(16,452)
Net income	**$ 201,126**	$ 376,559	$ 130,978
Basic net income per common share	**$ 2.41**		
Diluted net income per common share	**$ 2.41**		
Shares used to compute basic earnings per share based on weighted-average shares outstanding.	**83,490,478**		
Shares used to compute diluted earnings per share based on weighted-average shares outstanding.	**83,518,167**		
Net loss for the period from November 7, 2002 (date of conversion and initial public offering) to December 31, 2002		$ (38,542)	
Basic and diluted net loss per common share for the period from November 7, 2002 (date of conversion and initial public offering) to December 31, 2002		$ (0.46)	
Shares used to compute earnings per share, based on weighted-average shares outstanding November 7, 2002 (date of conversion and initial public offering) to December 31, 2002		83,333,244	

See notes to consolidated financial statements.

equity

Consolidated Statements of Changes in Stockholders' Equity

	Common Stock							
	Number of Shares	Par Value	Additional Paid In Capital	Unassigned Reserves	Retained (Deficit) Earnings	Unearned Restricted Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity[1]
	(in thousands, except share and per share data)							
Balance at January 1, 2001				$ 682,332			$ (7,654)	$ 674,678
Net income				130,978				130,978
Other comprehensive income							23,589	23,589
Comprehensive income								154,567
Balance at December 31, 2001				813,310			15,935	829,245
Initial public offering of common stock	83,490,478	$835	$1,255,566	(1,228,411)				27,990
Net income (loss)				415,101	$ (38,542)			376,559
Other comprehensive income							2,468	2,468
Comprehensive income								379,027
Balance at December 31, 2002	83,490,478	835	1,255,566	—	(38,542)		18,403	1,236,262
Net income					201,126			201,126
Other comprehensive loss							(5,662)	(5,662)
Comprehensive income								195,464
Issuance of common stock for stock incentive plan	185,969	2	6,656			$(6,027)		631
Balance at December 31, 2003	**83,676,447**	**$837**	**$1,262,222**	**$ —**	**$162,584**	**$(6,027)**	**$12,741**	**$1,432,357**

(1) In 2001, Reserve for Policyholders' Protection prior to for profit conversion

See notes to consolidated financial statements.

cash flow

Consolidated Statements of Cash Flows

December 31	2003	2002	2001
		(in thousands)	
Cash flows from operating activities			
Net income	**$ 201,126**	$ 376,559	$ 130,978
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**39,453**	34,502	26,741
Net realized (gain) loss on sales of investments	**(11,799)**	(2,604)	12,403
Provision (credit) for doubtful accounts	**937**	1,284	(1,702)
Accretion of discount, net	**5,537**	(2,733)	(5,005)
Equity in (earnings) loss of other long-term equity investments	**(1,364)**	229	571
Deferred income tax expense (benefit)	**55,806**	(151,372)	(34,828)
Insurance recovery gain	**—**	—	8,943
Other	**(8,306)**	(5,763)	(8,428)
Changes in assets and liabilities:			
Billed and accrued premiums receivable	**(17,854)**	43,372	42,328
Other customer receivable	**(14,431)**	(24,956)	2,787
Notes receivable	**(352)**	(1,610)	(3,102)
Advances to hospitals	**(10,666)**	1,757	3,920
Accrued investment income	**217**	(383)	3,523
Insurance proceeds receivable	**—**	13,716	(13,716)
Miscellaneous receivables	**3,087**	(8,212)	10,390
Other assets	**2,894**	(6,207)	(5,976)
Unpaid claims and claims adjustment expenses	**49,567**	(74,205)	(38,289)
Unearned premium income	**6,670**	7,321	14,441
Managed cash overdrafts	**27,725**	(4,332)	8,686
Accounts payable and accrued expenses	**(8,854)**	(9,608)	34,350
Advance deposits	**(23,919)**	(73,494)	24,427
Group and other contract liabilities	**(666)**	16,315	(8,971)
Postretirement benefits other than pensions	**(993)**	5,530	1,888
Other liabilities	**1,261**	47,584	7,938
Net cash provided by operating activities	**295,076**	182,690	214,297
Cash flows from investing activities			
Purchases of property, equipment and information systems	**(43,519)**	(33,691)	(33,822)
Proceeds from sale of property, equipment and information systems	**1,803**	1,349	—
Purchases of available-for-sale investments	**(1,568,589)**	(1,757,657)	(818,465)
Proceeds from sales and maturities of available-for-sale investments	**1,524,670**	1,660,541	722,951
Net cash used in investing activities	**(85,635)**	(129,458)	(129,336)
Cash flows from financing activities			
Increase in capital lease obligations	**646**	(2,379)	(1,933)
Net proceeds from common stock issued in the initial public offering	**—**	27,990	—
Net cash provided by (used in) financing activities	**646**	25,611	(1,933)
Net change in cash and cash equivalents	**210,087**	78,843	83,028
Cash and cash equivalents at beginning of period	**487,431**	408,588	325,560
Cash and cash equivalents at end of period	**$ 697,518**	$ 487,431	$ 408,588
Supplemental disclosure:			
Income taxes paid	**$ 79,901**	$ 90,473	$ 13,349

See notes to consolidated financial statements.

notes

Notes to Consolidated Financial Statements

(dollars in thousands, except share and per share data)

1. Organization and For-Profit Conversion

WellChoice, Inc. ("WellChoice") was formed in August 2002 as a Delaware corporation to be the for-profit parent holding company for Empire HealthChoice, Inc. ("EHC") following the for-profit conversion. WellChoice owns a health maintenance organization ("HMO") and two health insurance companies through its investment in WellChoice Holdings of New York, Inc. ("WellChoice Holdings").

On November 7, 2002, EHC converted from a not-for-profit health service corporation to a for-profit accident and health insurer under the New York State insurance laws and the converted EHC issued all its authorized capital stock to the New York Public Asset Fund (the "Fund") and The New York Charitable Asset Foundation (the "Foundation"). The Fund and the Foundation then received their respective shares of WellChoice common stock in exchange for the transfer of all the outstanding shares of EHC to WellChoice Holdings. Pursuant to the plan of conversion, WellChoice issued 82,300,000 shares to the Fund and the Foundation and completed an initial public offering of 19,199,000 shares of common stock, consisting of 18,008,523 shares that were sold by the Fund and Foundation and 1,190,477 newly issued shares of common stock sold by WellChoice. After deducting the underwriting discount, net proceeds to WellChoice were approximately $27,990.

WellChoice Holdings is a non-insurance holding company which wholly-owns Empire HealthChoice Assurance Inc. ("EHCA") d/b/a, Empire Blue Cross Blue Shield. In connection with EHC's conversion to a for-profit entity, EHC merged with EHCA. EHCA wholly-owns Empire HealthChoice HMO, Inc. ("EHC HMO") and WellChoice Insurance of New Jersey, Inc. ("WCINJ"). EHC HMO is an HMO licensed under Article 44 of the New York Public Health Law and is also licensed to operate an HMO in the State of New Jersey. WCINJ is a credit, life, accident and health insurance company licensed in eleven states, which currently writes business only in New Jersey. Prior to its dissolution in February 2002, NexxtHealth, Inc. was a wholly-owned subsidiary of EHC primarily engaged in the development of software to link healthcare systems to the Internet.

EHCA and its subsidiaries offer a comprehensive array of insurance products to employer groups and individuals. Products include traditional comprehensive indemnity health coverage and managed care products and services offered through an HMO, preferred provider organization ("PPO") and exclusive

provider organization ("EPO"). EHCA and its subsidiaries also process claims for self-insured employers and government programs. EHCA and EHC HMO are members of the Blue Cross Blue Shield Association ("BCBSA") which provides EHCA and EHC HMO the ability to participate with other Blue Cross Blue Shield plans in BCBSA sponsored programs and entitles it to use the Blue Cross and Blue Shield names and marks in the New York City metropolitan area and one or both of these names and marks in select upstate New York counties.

WellChoice also has, through a subsidiary investment, a 24.97% interest in National Accounts Service Company, LLC ("NASCO"), a limited liability company, which processes national account claims for the Company and other Blue Cross Blue Shield plans. See footnote 9.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The consolidated financial statements include the accounts of WellChoice and its wholly-owned subsidiaries (collectively, the "Company"). All significant intercompany transactions have been eliminated.

The preparation of financial statements requires management to make estimates and assumptions that affect the 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 herein.

Conversion

The conversion was accounted for as a reorganization using the historical carrying values of EHC and its subsidiaries assets and liabilities. Immediately following the conversion, EHC's unassigned reserves were reclassified to par value of common stock and additional paid-in capital. The costs of the conversion were recognized as an expense.

Investments—Fixed Maturities and Marketable Equity Securities

The Company has classified all of its fixed maturity and marketable equity security investments as available for sale and, accordingly, they are carried at fair value. The fair value of investments in fixed maturities and marketable equity securities are based on quoted market prices. Unrealized gains and losses are reported as a separate component of other comprehensive income, net of deferred income taxes. The amortized cost of fixed maturities, including certain trust preferred securities, is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in investment income. Amortization of premiums and discounts on collateralized mortgage obligations are adjusted for prepayment patterns using the retrospective method. Investment income is shown net of investment expenses. The cost of securities sold is based on the specific identification method. When the fair value of an investment is lower than its cost and such a decline is determined to be other than temporary, the cost of the investment is written down to fair value and the amount of the write down is charged to net income as a realized loss.

Short-Term Investments

Short-term investments are carried at fair value, and consist principally of U.S. Treasury bills, commercial paper and money market investments. The Company considers securities with maturities greater than three months and less than one year at the date of purchase as short-term investments. The fair value of short-term investments is based on quoted market prices.

Other Long-Term Equity Investments

Other long-term equity investments include joint ventures and warrants. Joint ventures are accounted for under the equity method. The Company's warrants are considered derivatives and are carried at fair value. The warrants are not classified as hedging instruments. Fair values of warrants are determined using the Black-Scholes options valuation model. Changes in the fair values of warrants are recorded as realized gains or losses.

Cash and Cash Equivalents

The Company considers all bank deposits, highly liquid securities and certificates of deposit with maturities of three months or less at the date of purchase to be cash equivalents. These cash equivalents are carried at cost which approximates fair value.

Pharmaceutical Rebate Sharing Program

The Company participates in pharmaceutical rebate sharing programs with drug manufacturers through a third party pharmacy benefit manager. Rebates for fully insured groups are recorded as a reduction to the cost of benefits provided. Rebates for self-funded groups are recorded as administrative service fee revenue. The Company records an estimate for pharmacy rebates earned but not yet received. These estimates are adjusted as new information becomes known and such adjustments are included in current period operations. Pharmacy rebates included in miscellaneous receivables were $15,813 and $19,004 at December 31, 2003 and 2002, respectively.

Market Stabilization and Stop Loss Pools

The Company is required to participate in Market Stabilization and Stop Loss Pools ("Pools") as established by the State of New York. Contributions and recoveries under the Pools are estimated based on interpretations of applicable regulations and are recorded as an addition or a reduction to cost of benefits provided. These estimates are adjusted as new information becomes known and such adjustments are included in current period operations. In 2003, the Company received a distribution from the Pool for Medicare Supplemental Pool years 2000 through 2002 and 2003 of $34,882 and $5,972, respectively. The distribution was recorded as a reduction to cost of benefits provided. The Company was required to issue premium refunds of approximately $19,663 related to the distribution received for years 2000 through 2003. Pool recoverables included in miscellaneous receivables were $23,877 and $18,390 at December 31, 2003 and 2002, respectively.

Receivables

Receivables are reported net of allowance for doubtful accounts of $14,661 and $13,724 at December 31, 2003 and 2002, respectively. The allowance for doubtful accounts calculation is based upon historical experience, which takes into consideration the length of time the receivable has been outstanding.

Property, Equipment and Information Systems

Property, equipment and information systems are reported at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are not greater than twenty-one years for property and improvements and three to ten years for equipment and furniture. Purchased software is capitalized and depreciated for a period not to exceed three years. The Company capitalizes certain costs incurred during the application development stage related to developing internal use software. These capitalized costs are amortized over a three-year period beginning when the software is placed into production. Computer software costs that are incurred in the preliminary project stages and post-implementation/operation stages, are expensed as incurred.

Unpaid Claims and Claims Adjustment Expenses

The cost of unpaid claims, both for reported claims and claims incurred but not yet reported to the Company, is calculated based upon claim history, claim inventory, number of claims received, changes in product mix, number of contracts in force, recent trend experience, unit costs and the regulatory environment. The estimated expense of processing these claims is also included in the consolidated financial statements as a component of administrative expense. These estimates are subject to the effects of medical claim trends and other uncertainties. Although considerable variability is inherent in such estimates, management believes that the reserves for claims and claims adjustment expenses are adequate. The estimates are continually reviewed and adjusted as experience develops or new information becomes known. Such adjustments are included in current period operations.

Advance Deposits

Under certain funding arrangements, customers are contractually obligated to remit funds on a paid claims basis. Funds received prior to payment of claims are classified as advance deposits.

Retirement Benefits

Retirement benefits represent outstanding obligations for certain retiree healthcare and life insurance benefits and any unfunded liabilities related to defined benefit pension plans. Unfunded liabilities for pension benefits are accrued in accordance with SFAS No. 87, *Employers' Accounting for Pensions.* Medical and life insurance benefits for retirees are accrued in accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*

Revenue

Membership contracts are generally for a period of one year and are subject to cancellation by the employer group upon 60 days written notice. Premiums are normally due monthly and are recognized as revenue during the period in which the Company is obligated to provide services to members. Premiums received prior to such periods are recorded as unearned premiums. Premiums on retrospectively rated

group contracts are accrued by making estimates based on past claims experience on such contracts. Premiums collected on retrospectively rated group contracts in excess of premiums earned are classified as group and other contract liabilities.

Administrative service fees are recognized in the period the related services are performed. All benefit payments under these programs are excluded from revenue and cost of benefits provided.

Cost of Benefits Provided

Cost of benefits provided includes claims paid, claims in process and pending, and an estimate of unreported claims for healthcare service provided to enrolled members during benefits and pool recoveries. Costs of benefits are reported net of pharmacy rebates, coordination of benefits and pool recoveries.

Acquisition Costs

Marketing and other costs associated with the acquisition of membership contracts are expensed as incurred.

Income Taxes

The Company accounts for income taxes using the liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the financial reporting and tax bases of assets and liabilities.

Premium Deficiency

A premium deficiency reserve is established when expected claim payments or incurred costs, claims adjustment expenses and administrative costs exceed the premiums to be collected for the remainder of a contract period. For purposes of determining if a premium deficiency reserve exists, contracts are grouped in a manner consistent with how policies are marketed, serviced and measured. Anticipated investment income is not utilized in the premium deficiency reserve calculation. At December 31, 2003 and 2002, a premium deficiency reserve of $402 and $3,300, respectively, is included in group and other contract liabilities.

Stock-Based Compensation

The Company has an incentive stock plan that provides for stock-based compensation, including stock options, restricted stock awards, restricted stock units and an employee stock purchase plan. Stock options are granted for a fixed number of shares with an exercise price equal to the fair value of the shares at the date of the grant. Restricted stock awards and restricted stock units are valued at the fair value of the stock on the grant date, with no cost to the grantee. The employee stock purchase plan, in accordance with the Section 423 of the Internal Revenue Code, allows for a purchase price per share to be 85% of the lower of the fair value of a share of common stock on (i) the first trading day of the offering period, or (ii) the last trading day of the offering period. The Company accounts for stock-based compensation using the intrinsic method under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and, accordingly, if the exercise price is equal to the fair market value of the shares at the date of the grant, the Company recognizes no compensation expense related to stock options. For grants of restricted stock and restricted stock units, unearned compensation, equivalent to the fair

value of the shares at the date of grant, is recorded as a separate component of shareholders' equity and subsequently amortized to compensation expense over the vesting period. The Company has adopted the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation,* as amended.

Earnings Per Share

For 2003, earnings per share amounts, on a basic and diluted basis, have been calculated based upon the weighted-average common shares outstanding for the year. For 2002, earnings per share amounts, on a basic and diluted basis, have been calculated based upon the weighted-average common shares outstanding for the period from November 7, 2002, the date of the for-profit conversion and initial public offering, to December 31, 2002.

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share include the dilutive effect of all stock options, and restricted stock awards, using the treasury stock method. Under the treasury stock method, the exercise of stock options and restricted stock unit awards is assumed, with the proceeds used to purchase common stock at the average market price for the period. The difference between the number of shares assumed issued and number of shares assumed purchased represents the dilutive shares.

Pro Forma Disclosure

The pro forma information regarding net income and earnings per share has been determined as if the Company accounted for its stock-based compensation using the fair value method. The fair value for the stock options was estimated at the date of grant using a Black-Scholes option valuation model with the following weighted-average assumptions:

	2003
Risk-free interest rate	3.47%
Volatility factor	42%
Dividend yield	—
Excepted life	5 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock option grants have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock option grants.

For purposes of pro forma disclosures, compensation expense is increased for the estimated fair value of the options amortized over the options' vesting periods and for the difference between the

market price of the stock and discounted purchase price of the shares on the purchase date for the employee stock purchases. The Company's pro forma information is as follows:

Year ended December 31	**2003**	2002	2001
Reported net income	**$201,126**	$376,559	$130,978
Total stock-based employee compensation determined under fair value based method for stock options, net of tax	**(255)**	—	—
Pro forma net income	**$200,871**	$376,559	$130,978

	2003 As Reported	**2003 Pro Forma**
Earnings per share:		
Basic net income per common share	**$ 2.41**	**$ 2.41**
Diluted net income per common share	**$ 2.41**	**$ 2.41**
Weighted-average fair value of options granted during the year	**—**	**$12.92**
Weighted-average fair value of restricted stock awards granted during the year	**$31.03**	**$31.03**
Weighted-average fair value of restricted stock unit awards granted during the year	**$31.03**	**$31.03**

Recent Accounting Pronouncements

In December 2003, the Financial Accounting Standard Board issued SFAS No. 132 (Revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits.* This Statement amends Statements No. 87, *Employers' Accounting for Pensions,* No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* However, the Statement does not change the recognition and measurement requirements of those Statements. This Statement retains the disclosure requirements contained in SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits,* which it replaces and requires additional disclosure. Additional new disclosure includes actual mix of plan assets by category, a description of investment strategies and policies used, a narrative description of the basis for determining the overall expected long-term rate of return on asset assumption and aggregate expected contributions.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("Modernization Act") was signed into law. The Modernization Act introduced a voluntary Medicare part D prescription drug benefit and created a new 28% federal subsidy for the sponsors of the postretirement prescription drug benefits that are at least actuarially equivalent to the new Medicare Part D benefit. Under SFAS No. 106-1, *Accounting for Postretirement Benefits Other Than Pensions,* sponsors must consider the two new features in measuring the Accumulated Postretirement Benefit Obligation ("APBO") and net periodic postretirement benefit cost. In accordance with SFAS No. 106-1, the Company made a one-time election to defer recognition of the impact on SFAS No. 106 accounting. Any measures of APBO and net periodic postretirement benefit cost in the financial statements and the related footnotes for the year ended December 31, 2003 do not reflect the effects of the Modernization Act. Currently, specific authoritative guidance on accounting for the federal subsidy is pending and

that guidance when issued could require the Company to change previously reported information. The Company does not anticipate that the adoption of SFAS 106-1 will materially affect the financial statements.

3. Investments

Available-for-sale investments are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2003				
Fixed maturities:				
U.S. Treasury Notes	$ 94,032	$ 518	$ (54)	$ 94,496
U.S. Government Agency obligations	457,514	987	(6,197)	452,304
U.S. Government Agency mortgage-backed securities	84,812	242	(797)	84,257
Public utility bonds	5,361	—	(26)	5,335
Corporate securities	395,028	7,299	(1,464)	400,863
Total fixed maturities	1,036,747	9,046	(8,538)	1,037,255
Marketable equity securities:				
Common stock	42,834	7,354	(172)	50,016
Non-redeemable preferred stock	10,056	342	—	10,398
Total marketable equity securities	52,890	7,696	(172)	60,414
Total fixed maturities and marketable equity securities investments	$1,089,637	$16,742	$(8,710)	$1,097,669
At December 31, 2002				
Fixed maturities:				
U.S. Treasury Notes	$ 76,042	$ 2,081	$ —	$ 78,123
U.S. Government Agency obligations	234,300	2,011	(156)	236,155
U.S. Government Agency mortgage-backed securities	129,522	1,299	(127)	130,694
Public utility bonds	20,000	368	(4)	20,364
Corporate securities	386,753	13,059	(1,858)	397,954
Total fixed maturities	846,617	18,818	(2,145)	863,290
Marketable equity securities:				
Common stock	31,966	—	(2,724)	29,242
Non-redeemable preferred stock	15,056	250	—	15,306
Total marketable equity securities	47,022	250	(2,724)	44,548
Total fixed maturities and marketable equity securities investments	$ 893,639	$19,068	$(4,869)	$ 907,838

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2003:

	Less Than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury notes and U.S. Government Agency obligations	$213,595	$(6,251)	$ —	$ —	$213,595	$(6,251)
U.S. Government Agency mortgage-backed securities	57,764	(797)	—	—	57,764	(797)
Public utility bonds	5,335	(26)	—	—	5,335	(26)
Corporate securities	108,603	(1,130)	11,444	(334)	120,047	(1,464)
Total fixed maturities	385,297	(8,204)	11,444	(334)	396,741	8,538
Common stock	522	(172)	—	—	522	(172)
Total temporarily impaired securities	$385,819	$(8,376)	$11,444	$(334)	$397,263	$(8,710)

The amortized cost and fair value of fixed maturities, by contractual maturity, are shown below:

December 31, 2003	Amortized Cost	Fair Value
Due in 1 year or less	$ 72,347	$ 73,144
Due after 1 year through 5 years	259,288	261,377
Due after 5 years through ten years	70,337	70,895
Due after ten years	634,775	631,839
Total	$1,036,747	$1,037,255

Mortgage-backed securities do not have a single maturity date and have been included in the above table based on the year of final maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of available-for-sale securities for the years ended December 31, 2003, 2002 and 2001 were $268,062, $231,840 and $154,137, respectively. The Company's investment portfolio is not significantly concentrated in any particular industry or geographic region.

Investment income, net is summarized as follows:

Year ended December 31	**2003**	2002	2001
Fixed maturities	**$41,759**	$57,507	$61,690
Marketable equity securities	**1,100**	1,081	1,200
Short-term investments and cash equivalents	**8,237**	7,775	15,583
Other long-term equity investments	**23**	117	—
Interest and dividend income	**51,119**	66,480	78,473
Equity in earnings (losses) of joint ventures	**1,364**	(229)	(571)
Less investment expenses including interest on advance deposits	**(1,248)**	(1,445)	(8,546)
Investment income, net	**$51,235**	$64,806	$69,356

Realized and unrealized gains and losses on investments were as follows:

Year ended December 31	**2003**	2002	2001
Realized gains:			
Fixed maturities	**$ 9,480**	$ 4,447	$ 2,351
Equity securities	**2,602**	375	—
Short-term investments and cash equivalents	**4**	6	3,994
Total realized gains	**12,086**	4,828	6,345
Realized losses:			
Fixed maturities	**—**	(1,747)	(2,402)
Equity securities	**(287)**	(476)	(10,816)
Short-term investments and cash equivalents	**—**	(1)	(5,530)
Total realized losses	**(287)**	(2,224)	(18,748)
Net realized gains (losses)	**11,799**	2,604	(12,403)
Changes in unrealized (losses) gains:			
Fixed maturities	**(16,236)**	6,305	23,249
Equity securities	**7,300**	(2,531)	11,193
Short-term investments	**(119)**	23	(9)
Net unrealized (losses) gains	**(9,055)**	3,797	34,433
Total realized and unrealized gains (losses)	**$ 2,744**	$ 6,401	$ 22,030

In 2001, the Company recorded a loss of $10,521 due to management's determination that the decline in value of a common stock investment was other than temporary.

The components of other comprehensive (loss) income are as follows:

Year ended December 31	**2003**	2002	2001
Unrealized gains from investments, net of taxes of $(118), $(2,186), and $(6,503)	**$ 857**	$ 4,059	$15,527
Reclassification adjustment for (gains) losses included in net income, net of taxes of $3,511, $857 and $(4,341)	**(6,519)**	(1,591)	8,062
Other comprehensive (loss) income	**$(5,662)**	$ 2,468	$23,589

In 2003, the Company participated in a security lending program, whereby certain securities from its portfolio are loaned to qualified brokers in exchange for cash collateral, equal to at least 102% of the market value of the securities loaned. The securities lending agent indemnified the Company against loss in the event of default by the borrower. Income generated by the securities lending program is reported as a component of net investment income. As of December 31, 2003, fixed maturity securities of $191,958 were loaned under the program.

The Company is required by BCBSA to maintain a deposit for the benefit and security of out-of-state policyholders. At December 31, 2003, the fair value and amortized cost of the investment on deposit were $8,530 and $8,404, respectively. The Company also maintains a deposit to satisfy the requirements of its workers' compensation insurance carrier. At December 31, 2003, the fair value and amortized cost of the investment on deposit were $1,855 and $1,846, respectively.

4. Property and Equipment

Property and equipment, including capitalized lease arrangements, are as follows:

December 31	**2003**	2002
Buildings and improvements	**$126,466**	$102,600
Equipment and furniture	**68,719**	52,575
Software systems	**66,777**	57,807
Total property and equipment	**261,962**	212,982
Less accumulated depreciation and amortization	**148,436**	112,192
Net property and equipment	**$113,526**	$100,790

All property and equipment is used by the Company for its operations and includes two facilities and certain equipment leased under agreements, which are accounted for as capital leases. Depreciation expense, including depreciation on assets held under capital leases totaled $38,870, $34,168 and $27,332 for the years ended December 31, 2003, 2002 and 2001, respectively.

For the year ended December 31, 2003, the cost and accumulated depreciation of assets retired were $5,639 and $3,480, respectively. Of these retirements, cost and accumulated depreciation of $1,681 and $638, respectively, was for information system equipment and personal computers.

For the year ended December 31, 2002, the cost and accumulated depreciation of assets retired were $2,278 and $1,077, respectively. Of these retirements, cost and accumulated depreciation of $2,213 and $1,036, respectively, was for information system equipment and personal computers.

For the year ended December 31, 2001, the cost and accumulated depreciation of assets retired were $16,463 and $6,770, respectively. Of these, the cost and accumulated depreciation of the World Trade Center assets that were written-off were $14,703 and $5,761, respectively. The cost and accumulated depreciation of all other assets retired, all of which was for information systems equipment and personal computers, was $1,760 and $1,009, respectively.

5. Claim Reserves

Activity in unpaid claims and certain claims adjustment expenses is summarized as follows:

Year ended December 31	**2003**	2002	2001
Balance as of January 1	**$ 563,224**	$ 634,130	$ 672,419
Incurred related to:			
Current period	**4,244,356**	3,993,607	3,792,241
Prior periods	**(82,110)**	(46,225)	(53,420)
Total incurred	**4,162,246**	3,947,382	3,738,821
Paid related to:			
Current period	**3,693,619**	3,493,244	3,257,090
Prior periods	**421,958**	525,044	520,020
Total paid	**4,115,577**	4,018,288	3,777,110
Balance at end of period	**$ 609,893***	$ 563,224*	$ 634,130

*Includes $402 and $3,300 of premium deficiency reserve in WCINJ included in group and other contract liabilities as of December 31, 2003 and 2002, respectively.

The provision for claims and claims adjustment expenses attributable to prior year incurrals had a favorable development of $82,110, $46,225, and $53,420 in 2003, 2002 and 2001 respectively, due to healthcare trends being lower than anticipated when the reserves were established. Moreover, actual claims payment lags were shorter than assumed in determining the reserves, due to continued improvement in the claim adjudication process. The favorable development in 2003 included $34,882 of recoveries from the New York Market Stabilization Pools for Medicare Supplemental policies for Pool Years 2000, 2001 and 2002, and $2,898 of amortization of the premium deficiency reserve in WCINJ. Additionally, the development of the prior years' claim liability impacts premiums for retrospectively rated contracts. Accordingly, the Company's favorable (unfavorable) development of $25,118, ($1,532) and $46,416 in 2003, 2002, and 2001, respectively, on such contracts, was largely offset by decreases (increases) in premiums.

6. Income Taxes

The significant components of the provision for income tax (expense) benefit are as follows:

Year ended December 31	**2003**	2002	2001
Current tax expense	**$ (86,690)**	$ (83,526)	$(34,963)
Deferred tax (expense) benefit	**(55,806)**	151,373	34,828
Income tax (expense) benefit	**$(142,496)**	$ 67,847	$ (135)

A reconciliation of income tax computed at the federal statutory tax rate of 35% to total income tax is as follows:

Year ended December 31	**2003**	2002	2001
Income tax at prevailing corporate tax rate applied to pre-tax income	**$(120,268)**	$(108,049)	$(45,890)
Increase (decrease):			
Change in valuation allowance	**—**	195,698	1,147
IRC Sec. 833(b) special deduction	**—**	—	54,249
State and local income taxes, net of federal income tax benefit	**(8,933)**	(5,077)	(88)
Other	**(13,295)**	(14,725)	(9,553)
Income tax (expense) benefit	**$(142,496)**	$ 67,847	$ (135)

WellChoice and its subsidiaries file a consolidated federal income tax return. WellChoice currently has a tax sharing agreement in place with all of its subsidiaries. In accordance with the Company's tax sharing agreement, the Company's subsidiaries pay federal income taxes to WellChoice based on a separate company calculation.

Prior to 2002, EHC maintained a valuation allowance on its regular tax net operating loss carryforwards and certain other temporary differences due to uncertainty in its ability to utilize these assets within an appropriate period. The use of these assets was largely dependent on the conversion and future positive taxable income. Because the approval of EHC's plan of conversion by the New York State Insurance Department (the "Department"), removed the uncertainty of the conversion, the Company concluded in the third quarter of 2002 that the valuation allowance related to these assets was no longer necessary. Accordingly, the income tax benefit for 2002 includes the reversal of the valuation allowance of $174,977 related to the Company's regular tax operating loss carryforwards.

As a result of the conversion to a for-profit accident and health insurance company in 2002, the Company adjusted its deferred tax assets for temporary differences related to Empire HealthChoice Assurance, Inc.'s liability for state and local taxes which resulted in the recognition of a $5,374 deferred tax asset. In May 2003, the New York State Legislature enacted budget legislation that eliminates the net income portion of the New York State franchise tax applicable to every insurance company other than life insurance companies effective January 1, 2003. As a result, the Company's tax provision for 2003 was increased by $5,374, reflecting the reversal of the previously recorded deferred tax asset.

Prior to January 1, 1987, EHC was exempt from federal income taxes. With the enactment of the Tax Reform Act of 1986, EHC, and all other Blue Cross and Blue Shield plans, became subject to federal

income tax. Among other provisions of the Internal Revenue Code, these plans were granted a special deduction (the "833(b) deduction") for regular tax calculation purposes. As a result of the 833(b) deduction, EHC has incurred no regular tax liability but in profitable years, has paid taxes at the alternative minimum tax rate of 20%.

The 833(b) deduction is calculated as the excess of 25% of the incurred claims and claims adjustment expenses for the tax year over adjusted surplus, as defined, limited to taxable income. The amount of 833(b) deductions utilized in each tax year is accumulated in an adjusted surplus balance. Once the cumulative adjusted surplus balance exceeds the 833(b) deduction for the current taxable year, the deduction is eliminated.

During the fourth quarter of 2002, the Company reevaluated its tax position for financial statement purposes related to EHC's ability to utilize the Section 833(b) deduction and determined that when EHC converted to a for-profit entity, its ability to utilize the Section 833(b) deduction was uncertain. No authority directly addresses whether a conversion transaction will render the 833(b) deduction unavailable. The Company is aware, however, that the IRS has taken the position related to other Blue Cross Blue Shield plans that a conversion could result in the inability of a Blue Cross Blue Shield plan to utilize the 833(b) deduction. In light of the absence of governing authority, while the Company intends to continue to take the deduction on its tax returns after the conversion, the Company has assumed, for financial statement reporting purposes, that the deduction will be disallowed. Accordingly, the Company has utilized $77,000 of regular operating loss carryforwards for financial statement purposes in excess of those utilized for tax purposes.

The Company's position with gross deferred tax assets and liabilities are as follows:

December 31	**2003**	2002
Deferred tax assets:		
Regular tax operating loss carryforwards	**$ —**	$ 57,593
Alternative minimum tax credit carryforward	**149,801**	134,064
Fixed assets	**7,387**	4,807
Loss reserve discounting	**3,982**	4,933
Post-retirement benefits other than pensions	**49,960**	50,308
Post-employment benefits	**3,834**	3,901
Bad debts	**5,523**	5,621
Deferred compensation	**6,003**	6,250
Unpaid expense accruals	**14,339**	10,858
Other temporary differences	**5,739**	21,366
Total deferred tax assets	**246,568**	299,701
Deferred tax liabilities:		
Unrealized gains on investments	**8,705**	12,339
Pension income adjustment	**20,352**	17,264
Bonds and bond discount	**977**	1,150
Total deferred tax liabilities	**30,034**	30,753
Net deferred tax assets	**$216,534**	$268,948

The Company's regular tax loss carryforwards for income tax purposes of $259,000 expire between the years 2004 and 2023. The Company's alternative minimum tax credit carryforward for income tax purposes of $191,000 has no expiration date.

The Company completed a study of the intangible assets, which existed at January 1, 1987 and has filed amended returns for 1989 and 1990 and 1996 claiming a refund for taxes paid. The Company is aware that the IRS and other Blue Cross Blue Shield plans are currently in litigation to determine whether intangible assets that existed at January 1, 1987 are entitled to tax basis and therefore are deductible in future years' tax returns. If the Company prevails, these potential future tax benefits of up to $100,000 will be available to the Company. As of December 31, 2003 the Company has not recognized this potential benefit in its financial statements.

The Company paid federal income taxes of $58,000, $84,000 and $13,349 in 2003, 2002 and 2001, respectively.

7. Information Technology Outsourcing

In June 2002, the Company entered into a ten-year outsourcing agreement with International Business Machines Corporation ("IBM"). Under the terms of the contract, IBM is responsible for operating the Company's data center, a portion of the core applications development and technical help desk. IBM has entered into a separate agreement to sublease the Company's data center. IBM's charges under the contract include personnel, calculated as a function of IBM's cost for personnel dedicated to the outsourcing; computer equipment, based on equipment usage rates; space, based on actual usage rates; and certain other costs.

IBM is expected to invoice the Company approximately $586,100 over the remaining term of the agreement for operating the Company's data center and technical help desk as follows:

2004	$ 84,900
2005	88,000
2006	74,800
2007	67,200
2008	65,200
2009	62,900
2010	60,400
2011	58,600
2012	24,100
Total	$586,100

The agreement provides for IBM to assist the Company in developing new IT systems. The original agreement required the Company to purchase $65,000 of enhancement and modernization services and equipment from IBM over a five-year term. Effective September 2003, the agreement was amended and the Company's purchase obligation was reduced to $55,000 and the term extended to seven years with a remaining target purchase rate as follows:

2004	$14,826
2005	14,100
2006	9,900
2007	4,800
2008	1,200
Total	$44,826

The Company may defer the purchase of services beyond the target date, provided that to the extent purchases are delayed more than one year beyond the target year, the Company shall pay a premium to IBM of 10% per annum of purchases so delayed.

In addition, the Company accelerated the repayment of price concessions of $7,339 granted under the original contract. The refunding of the price concessions had no impact on the income statement. At December 31, 2003 and 2002 other liabilities include $10,000 and $11,143, respectively of cash flow concessions the Company has taken on monthly invoices from IBM. In accordance with the terms of the IBM contract the Company is required to repay these amounts in the future.

Additionally, IBM, in coordination with deNovis, Inc. ("deNovis"), has agreed to develop a new claims payment software system and to license it to the Company. Subject to the successful completion and acceptance of the claims payment system, the Company will pay a development and license fee of $50,000. Under the terms of the contract with IBM, the Company will pay $25,000 of this fee in four equal installments upon the achievement of specified milestones, the last of which is the Company's acceptance of the claims payment system. The achievement of these milestones is anticipated to occur in 2006. The remaining $25,000 will be paid one year following the date the Company accepts the claims payment system. Following the expiration of the one-year warranty period that begins upon the payment of the final installment, the Company will pay IBM an annual fee of $10,000 for maintenance and support services. Under the terms of the contract, the Company is entitled to 2% of IBM's gross revenues from licensing the claims payment system to third parties for the term of the IBM outsourcing contract, including any extensions. The Company will have no obligation to pay the development and license fee and the annual fee if the successful completion and delivery of the claims payment system does not occur.

The Company will own all software developed by IBM under the agreement, other than the claims payment system. All such software in which the Company will have all rights, title and interest will be accounted for in accordance with SOP 98-1, *"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."*

During 2002, in connection with the agreement, the Company sold computer equipment with a net book value of $1,736 to IBM. No gain or loss on the sale of the computer equipment was recognized. Also in connection with the agreement, the Company licensed to IBM its Internet portal technology for an upfront initial license fee of $2,000. In accordance with SOP 98-1, the Company applied the proceeds from the license of the Internet portal technology to the book value of the assets and no gain or loss was recorded. Under the agreement, IBM has the right to sublicense the Internet portal technology to third parties and the Company will receive 4% of IBM's gross revenues from its licensing for fifteen years. The Company received no licensing revenue for the years ended December 31, 2003 and 2002.

The outsourcing agreement can be terminated by either the Company or IBM in certain circumstances for cause without penalty. The Company can terminate the contract without cause after two years or if it experiences a change in control and, in such instances, would be obligated to pay certain termination costs, which vary based on the duration of the contract but are significant in the early years, to IBM. During the term of the agreement, the Company may not perform the outsourced services itself or through a third party without the consent of IBM.

During the second quarter of 2002, in connection with the IBM outsourcing, the Company began the implementation of a restructuring plan relating to its information technology personnel. Certain employees were involuntarily terminated in accordance with a plan of termination, certain employees were retained by the Company and certain employees were transitioned to IBM. Severance and other costs accrued at June 30, 2002 relating to the plan of termination were $5,351. Payments related to these costs of approximately $4,889 were made through December 31, 2003. To help retain its employees and to help IBM retain its newly transitioned employees, the Company offered stay bonuses for these individuals. The estimated maximum cost of these bonuses assuming all individuals remain with the Company or IBM through the required dates, which range from 2003 to 2004, is approximately $8,518. The Company recognizes the cost of these stay bonuses as these employees provide service. For the years ended December 31, 2003 and 2002, approximately $4,571 and $3,889, respectively, was expensed for these bonuses. Through December 31, 2003, payments of $3,993 were made.

8. Restructuring

In November 2002, as part of the Company's continuing focus on increasing overall productivity, and in part as a result of the implementation of the technology outsourcing strategy, the Company continued streamlining certain operations and adopted a plan to terminate approximately 500 employees across all segments of its business. Severance and other costs of $13,472 were accrued relating to the plan for the year ended December 31, 2002. Through December 31, 2003, payments related to these costs of $13,180 were made. In an effort to facilitate the restructuring plan certain employees were offered stay bonuses. The Company recognizes the cost of these stay bonuses as these employees provide service. For the years ended December 31, 2003 and 2002, approximately $788 and $243, respectively, was expensed for these bonuses. Through December 31, 2003, payments of $501 were made.

9. Statutory Information

Insurance companies, including HMOs are subject to certain Risk-Based Capital ("RBC") requirements as specified by the National Association of Insurance Commissioners (the "NAIC"). Under those requirements, the amount of capital and statutory-basis surplus maintained by an insurance company is to be determined based on the various risk factors related to it. At December 31, 2003, EHCA and each of its wholly-owned insurance subsidiaries met the RBC requirements.

EHCA and its subsidiaries are subject to minimum capital requirements under the state insurance laws. Combined statutory-basis surplus of EHCA and its subsidiaries at December 31, 2003 and 2002 of $935,995 and $819,756, respectively, exceeded their respective requirements. Combined statutory-basis net income of EHCA and its subsidiaries was $259,340, $316,936 and $114,462, for the years ended December 31, 2003, 2002 and 2001, respectively.

In accordance with the rules of the Department, the maximum amount of dividends which can be paid by the Company's subsidiaries without approval of the Department is subject to restrictions relating to statutory surplus and adjusted net income or adjusted net investment income.

On June 30, 2003 and November 8, 2002 WellChoice received a dividend payment from its subsidiary, EHCA, in the amount of $140,000 and $225,000 respectively. The dividend payments were approved by the Department. No dividends were received or paid during the year ended December 31, 2001.

EHCA made cash contributions to its HMO and insurance subsidiaries of approximately, $65,000 and $10,000 during 2002 and 2001, respectively. The capital contributions were made to ensure that each subsidiary had sufficient surplus under applicable BCBSA and state licensing requirements. There were no cash contributions made during 2003.

In 2003, WellChoice began the process of dissolving ENASCO. In connection with the dissolution, WellChoice transferred the investment interest in NASCO to EHCA in the form of a capital contribution. EHCA immediately transferred the NASCO investment interest to WCINJ in the form of a capital contribution.

10. Contingencies

The Company is subject to a number of lawsuits, investigations and claims, some of which are class actions arising out of the conduct of its business. The Company believes that it has meritorious defenses in all of these matters and intends to vigorously defend its respective positions. The outcome of these matters is not currently predictable and the damages, if any, are also uncertain. The Company is also involved in and is subject to numerous claims, contractual disputes and uncertainties in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial condition or results of operations.

In June 2002, the Company settled a class action lawsuit for an estimated $23,000 in claims and legal fees. During the period from June 2002 to September 2002, the members of the class were informed of their right to receive payment, were required to respond, and the payments due to respondents were determined. Based on the number of respondents to the class action mailing through August 24, 2002 and the Company's estimate of the number of late respondents to the mailing, the Company revised its

best estimate of the ultimate liability for this action to $14,600. This change in estimate has been recorded in the consolidated financial statements for year ended December 31, 2002. At December 31, 2003 unpaid claims and claims adjustments expense included $150 related to this estimate.

In October 2003, the Company renewed its existing credit and guaranty agreement with The Bank of New York, as Issuing Bank and Administrative Agent, and several other financial institutions as agents and lenders, which provides the Company with a credit facility. The Company is able to borrow under the credit facility for general working capital purposes. The total outstanding amounts under the credit facility cannot exceed $100,000. The facility has a term of 364 days with a current maturity date of October 15, 2004, subject to extension for additional periods of 364 days with the consent of the lenders. Borrowings under the facility will bear interest, at the Company's option, at The Bank of New York's prime commercial rate (or, if greater, the federal funds rate plus 0.50%) as in effect from time to time plus a margin of between zero and 1.0%, or LIBOR plus a margin of between 1.125% and 2.250%, with the applicable margin to be determined based on our financial strength rating. As of December 31, 2003, there were no funds drawn against this line of credit.

The Company also maintains a $607 secured letter of credit from HSBC Bank USA to support one of its rental lease obligations.

11. Commitments

The Company leases office facilities and equipment under capital and operating lease arrangements. Future minimum payments for capital leases and noncancelable operating leases, including escalation clauses, as of December 31, 2003 are as follows:

	Capital Leases	Operating Leases
2004	$12,401	$ 35,602
2005	12,686	30,494
2006	12,882	31,780
2007	13,126	31,385
2008	13,418	31,499
Future years	23,752	275,844
Net minimum lease payment	88,265	$436,604
Less:		
Interest	26,902	
Maintenance, taxes, etc.	13,018	
Present value of minimum lease payments	$48,345	

The average imputed interest rate on the capital leases was 14% in 2003. Rent expense under operating leases was $46,762, $54,082 and $50,540 for the years ended December 31, 2003, 2002 and 2001, respectively.

The schedule above includes rent commitments for the Company's Staten Island facility. However, as part of the information technology outsourcing agreement with IBM (see footnote 7), the Company

entered into a sublease agreement with IBM for this property. The Company expects to receive net sublease income of approximately $1,436 per year until 2012.

During the third quarter of 2003, management determined that based on current and projected occupancy requirements, the Company would not receive economic benefit from certain unoccupied leased office space.

The Company recognized an administrative expense of $13,367 for the year ended December 31, 2003, representing the net present value difference between the fair value of estimated sublease rentals and the remaining lease obligation for this space. At December 31, 2003, $12,764 of these costs are included in other liabilities.

12. Related Party Transactions

Administrative expenses incurred related to NASCO services totaled $17,818, $14,673 and $13,281 for the years ended December 31, 2003, 2002 and 2001, respectively. Accounts payable as of December 31, 2003 and 2002, includes amounts due to NASCO of $1,919 and $3,515, respectively.

Active Health Management, Inc., ("AHM") an entity in which the Company has a 0.8% ownership interest, provides certain medical management services to the Company. Administrative expenses incurred related to AHM services totaled $3,521, $5,882 and $4,869 for the years ended December 31, 2003, 2002 and 2001, respectively. There are no accounts payable as of December 31, 2003 and 2002, due to AHM.

An Executive Vice President of a labor union account was a member of the Company's Board of Directors until June 2003. For the years ended December 31, 2003, 2002 and 2001, the Company earned premium revenue $17,793, $18,019 and $16,280, respectively from the union. Billed premiums receivable at December 31, 2003 and 2002 includes amounts due from the union of $2,058 and $2,730, respectively. In addition, the Company recorded administrative service fees revenue of $2,384, $2,957 and $2,863 for the years ended December 31, 2003, 2002, and 2001. Other amounts due from customers at December 31, 2003 and 2002 includes $829 and $856 for service fees due from the union.

A member of the Company's Board of Directors is an Executive Vice President and Chief Operating Officer of a provider in our network. For the years ended December 31, 2003, 2002 and 2001, the Company made payments to the provider in the amount of $130,605, $101,998 and $82,523, respectively, for the reimbursement of claims to this provider.

A physician in a group practice, which is a provider in our network, was a member of the Company's Board of Directors until June 2003. For the years ended December 31, 2003, 2002 and 2001, the Company made payments in the amount of $309, $313 and $330, respectively, to this group practice for the reimbursement of claims.

13. Insurance Proceeds

In December 2002, the Company and its insurance carrier settled the Company's business property protection and blanket earnings and extra expense claim related to loss of the Company's offices located at the World Trade Center for $74,000. During 2002 and 2001, the Company recorded gains

related to the business property portion of the claim of $7,959 and $6,784, respectively, which were included in other income. Administrative expense for the year ended December 31, 2002 includes a gain of $19,300 representing extra expense settlement proceeds for items expensed in 2001 and extra expenses that have not yet been incurred. Administrative expense for the year ended December 31, 2001 includes expenses of $3,535 related to the Company's recovery efforts.

14. Pension Benefits

The Company had several noncontributory, defined benefit pension plans covering substantially all of its employees. In May 1998, the Company's Board of Directors approved a consolidation of the Company's defined benefit pension plans into one "cash balance" defined benefit plan (the "Cash Balance Plan"). The redesigned plan, effective January 1, 1999, provides employees with an opening balance based on the previous benefits attributed to the employee under prior plans with increases through contributions by the Company based on the employee's age and length of service. The benefit provided at retirement is the sum of all contributions and interest earned.

Prior to the redesign, the Company's pension benefits were provided through three plans. Although the manner in which these plans were funded differed, the benefits relating to each were similar.

As part of the consolidation of the plans, the Cash Balance Plan assumed the assets and benefit obligations of the previous plans, some of which were previously retained by an insurer under an annuity purchase contract. As a result of the consolidation of the plans, the Company is amortizing the amount of the plan assets in excess of the benefit obligation assumed from the insurer, $116,865 over the average remaining service life of plan participants (10.5 years).

The effect of the change in pension benefits reduced the benefit obligation by $20,606 which will be amortized over the remaining service life of the Cash Balance Plan members (13 years).

The Company also has an unfunded, nonqualified supplemental plan to provide benefits in excess of ERISA limitations on recognized salary or benefits payable from the qualified pension plans and the Company's Deferred Compensation Plan and Executive Savings Plan. This supplemental plan is accounted for using the projected unit credit actuarial cost method.

The following table sets forth the plans' change in the actuarially determined benefit obligation, plan assets and information on the plan's funded status.

December 31	2003	2002
Change in benefit obligation		
Benefit obligation at beginning of period	$400,268	$368,042
Service cost	16,307	15,977
Interest cost	23,760	26,144
Plan amendments	—	11
Actuarial (gain) loss	(7,806)	33,563
Benefits paid	(39,458)	(43,469)
Benefit obligation at end of period	393,071	400,268
Change in plan assets		
Fair value of plan assets at beginning of period	450,977	467,523
Actual return on plan assets	33,916	27,641
Administrative expenses	(870)	(900)
Employer contributions	945	182
Benefits paid	(39,457)	(43,469)
Fair value of plan assets at end of period	445,511	450,977
Information on funded status and amounts recognized		
Funded status	$ 52,440	$ 50,709
Unrecognized net transition asset	(525)	(715)
Unrecognized prior service credits	(58,263)	(70,951)
Unrecognized net loss from past experience different from that assumed	59,863	66,166
Prepaid benefit cost	$ 53,515	$ 45,209

Based on the funded status of the pension plan, the Company does not anticipate any contributions to be made during 2004 for the Cash Balance Plan. The Company expects to contribute approximately $126 to the non-qualified plan in 2004.

Actuarial assumptions used were as follows:

December 31	2003	2002
Discount rate	6.5%	7.0%
Rate of increase in future compensation levels	4.0	4.0
Expected long-term rate of return	7.5	8.0

As of December 31, 2003 measurement date the expected long-term rate of return on assets assumption is 7.5%. As defined in SFAS No. 87, this assumption represents the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the benefit obligation. The assumption has been determined by reflecting expectations regarding future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class.

The following table sets forth the percentage of total plan assets for each major category of assets:

December 31	**2003**	2002
Asset allocation by asset class		
Equity securities	**25.4%**	21.3%
Debt securities	**74.6**	78.7
Total	**100.0%**	100.0%

The plan is diversified across three broad asset classes—large cap equity, international equity and domestic fixed income with the target allocation of 20% to large cap, 5% to international equities and the remaining 75% to fixed income. The Pension committee has retained the services of investment managers to implement the Plan's strategies.

Net pension income for the actuarially developed plans included the following components:

Year ended December 31	**2003**	2002	2001
Service cost	**$ 16,307**	$ 15,977	$ 14,443
Interest cost on projected benefit obligation	**23,760**	26,144	23,783
Expected return on plan assets	**(34,590)**	(36,054)	(33,984)
Net amortization and deferral	**(12,836)**	(12,070)	(12,894)
Net pension income	**$ (7,359)**	$ (6,003)	$ (8,652)

The Company administers two noncontributory defined contribution plans offering employees the opportunity to accumulate funds for their retirement. The Deferred Compensation Plan, which is closed to new contributions, and the Executive Savings Plan are nonqualified plans designed to provide executives with an opportunity to defer a portion of their base salary and/or incentive compensation. At December 31, 2003, the plan assets of $16,515 are included as components of cash and investments and an offsetting liability to plan participants is included in other liabilities.

The Company also administers a contributory 401(k) Deferred Savings Plan which is offered to all eligible employees. The Company matches contributions of participating employees; 50% of the first 6% of employee contributions or $5,247, $5,921 and $5,880 for the years ended December 31, 2003, 2002 and 2001, respectively.

15. Other Postretirement Employee Benefits

In addition to pension benefits, the Company provides certain healthcare and life insurance benefits for retired employees. Substantially all employees may become eligible for those benefits if they reach retirement age while working for the Company.

The change in benefit obligation, plan assets and information on the plans' funded status and the components of the net periodic benefit cost are as follows:

December 31	**2003**	2002
Change in benefit obligation		
Benefit obligation at beginning of period	**$ 120,726**	$ 124,481
Service cost	**1,597**	1,500
Interest cost	**6,975**	7,686
Actuarial gain	**(2,457)**	(7,154)
Benefits paid	**(9,030)**	(5,787)
Benefit obligation at end of period	**117,811**	120,726
Change in plan assets		
Fair value of plan assets at beginning of period	**—**	—
Employer contributions	**9,030**	5,787
Benefits paid	**(9,030)**	(5,787)
Fair value of plan assets at end of period	**—**	—
Information on funded status and amounts recognized		
Funded status	**(117,811)**	(120,726)
Unrecognized net actuarial gain	**(63,647)**	(66,027)
Unrecognized transition obligation	**38,715**	43,017
Accrued postretirement benefit cost	**$(142,743)**	$(143,736)

December 31	**2003**	2002	2001
Components of net periodic benefit cost			
Service cost	**$ 1,597**	$ 1,500	$ 1,639
Interest cost	**6,975**	7,686	8,434
Amortization of transition obligation	**4,302**	4,301	4,302
Amortization of actuarial gain	**(4,837)**	(4,699)	(4,738)
Net periodic postretirement benefit cost	**$ 8,037**	$ 8,788	$ 9,637

Actuarial gains or losses for postretirement life and health benefits are recorded separately when they exceed 10% of their respective accumulated postretirement benefit obligations and, at that time, the entire amount of the gain is amortized over the period in which eligibility requirements are fulfilled (20 years).

The actuarial assumptions used for determining the accumulated postretirement benefit obligation as measured on December 31, 2003 and 2002 are as follows:

December 31	**2003**	2002
Weighted-average discount rate	**6.5%**	7.0%
Healthcare trend rates:		
Participants under age 65 in EPO and PPO Plans	**10.0%–4.5%**	11.0%–4.5%
Participants under age 65 in other plans	**10.0%–4.5%**	11.0%–4.5%
Participants age 65 and over in Medicare HMOs	**30.7%–4.5%**	21.9%–4.5%
Participants age 65 and over in Indemnity Plans	**9.0%–4.5%**	10.0%–4.5%
Caps on Company paid portion of healthcare premiums for participants who retire on or after May 1, 1996 (in whole dollars):		
Participants age 65 and older with Medicare Carve-out Plans	**$2,358**	$2,358
Participants under age 65 with POS—Point of Service Plans	**$4,926**	$4,926

The trend rate ranges shown indicate the trend rates will decrease 1.0% annually, other than the Medicare HMO and the Indemnity Plan, until ultimately leveling out at 4.5%. The annual trend rate for the Medicare HMO is 30.7%, 22.8%, and 10.1% for the next three years and then decreases annually until ultimately leveling out at 4.5%. The annual trend rate for the Indemnity Plan is 9.0% and 8.0% for the next two years and then decreases 1.0% annually until ultimately leveling out at 4.5%.

The healthcare cost trend rate assumptions have a significant effect on the amounts reported. Increasing and decreasing the assumed healthcare cost trend rates by one percentage point in each year would increase and decrease the postretirement benefit obligation as of December 31, 2003 by $6,890 and $6,174, respectively, and increase and decrease the service and interest cost components of net periodic postretirement benefit cost for December 31, 2003 by $445 and $405, respectively.

16. Concentration of Business

The Company's business is concentrated in New York and New Jersey, with more than 98% of its premium revenue received from New York business. As a result, future acts of terrorism, changes in regulatory, market or healthcare provider conditions in either of these states, particularly New York, could have a material adverse effect on the Company's business, financial condition or results of operations.

The Company earns revenue from its contracts with the Center for Medicare and Medicaid Services (CMS), the federal agency that administers the Medicare program. Specifically, the Company has a contract with CMS to provide HMO Medicare+Choice coverage to Medicare beneficiaries in certain New York counties and the Company has a contract to serve as fiscal intermediary for the Medicare Part A program and a carrier for the Medicare Part B program (collectively, referred to as "Medicare Services"). The Company's Medicare+Choice product and Medicare Services represented 9% and 27% of total premium earned and administrative service fee revenue, respectively, during 2003.

The Company earns revenue from its contracts to provide healthcare services to New York State and New York City employees. The New York State and New York City PPO business represented approximately 18% and 14% of total premium earned, respectively, during 2003.

17. Segment Information

WellChoice has two reportable segments: commercial managed care and other insurance products and services. The commercial managed care segment includes group PPO, HMO (including Medicare+Choice), EPO and other products, as well as the Company's New York City and New York State PPO business. The other insurance products and services segment consists of the Company's traditional indemnity products, Medicare supplemental, individual hospital only, state sponsored individual plans, government mandated individual plans and government contracts with CMS to act as a fiscal intermediary for Medicare Part A program beneficiaries and as a carrier for Medicare Part B program beneficiaries.

Income from continuing operations before income tax expense for the period ended December 31, 2003 include administrative expenses of $10,717 and $2,650, for the managed care and other insurance products and services segments, respectively, related to unoccupied leased office space, see footnote 11.

The reportable segments follow the Company's method of internal reporting by products and services. The financial results of the Company's segment are presented consistent with the accounting policies described in Note 2. Administrative expenses, investment income, and other income, but not assets, are allocated to the segments. There are no intersegment sales or expenses.

The following table presents information by reportable segment:

	Commercial Managed Care	Other Insurance Products and Services	Total
Year ended December 31, 2003			
Revenues from external customers	**$4,373,643**	**$ 947,602**	**$5,321,245**
Investment income and net realized gains	**52,885**	**10,149**	**63,034**
Other loss	**(1,450)**	**(274)**	**(1,724)**
Income from continuing operations before income tax expense	**292,667**	**50,955**	**343,622**
Year ended December 31, 2002			
Revenues from external customers	3,935,234	1,089,004	5,024,238
Investment income and net realized gains	54,047	13,363	67,410
Other revenue	11,272	2,740	14,012
Income from continuing operations before income tax expense	253,424	56,344	309,768
Year ended December 31, 2001			
Revenues from external customers	3,401,900	1,166,252	4,568,152
Investment income and net realized gains	41,704	15,249	56,953
Other revenue	4,667	1,434	6,101
Income from continuing operations before income tax expense	121,113	26,452	147,565

The following table presents our revenue from external customers by products and services:

Year ended December 31	**2003**	2002	2001
Revenues from external customers:			
Commercial managed care:			
Premiums earned:			
PPO	**$2,561,614**	$2,349,911	$2,016,580
HMO	**1,231,239**	1,133,637	948,865
EPO	**297,891**	234,112	250,651
Other	**8,764**	5,343	31,719
Administrative service fees	**274,135**	212,231	154,085
Total commercial managed care	**4,373,643**	3,935,234	3,401,900
Other insurance products and services			
Premiums earned:			
Indemnity	**312,519**	397,175	489,947
Individual	**463,353**	507,857	508,406
Administrative service fees	**171,730**	183,972	167,899
Total other insurance products and services	**947,602**	1,089,004	1,166,252
Total revenues from external customers	**$5,321,245**	$5,024,238	$4,568,152

18. Stock Compensation

The Company's incentive plan provides for the grant of stock options, stock appreciation rights, restricted stock awards, restricted stock units and cash awards. On March 26, 2003, the Company's Board of Directors adopted the 2003 Omnibus Incentive Plan (the "2003 Incentive Plan"). In accordance with the 2003 Incentive Plan the maximum of 6,250,000 shares of common stock may be issued, including 1,875,000 shares solely for issuance under grants of restricted stock awards and restricted stock units. A maximum of 500,000 shares may be issued to non-employee Directors. Awards are granted by the Compensation Committee of the Board of Directors. Options vest and expire over terms set by the Committee at the time of grant.

Stock Option Grants

In accordance with the 2003 Incentive Plan, the Company's Compensation Committee granted options to purchase shares of common stock to the Company's Officers and Directors at the fair market value at the date of grant. These options generally vest over a three-year vesting period and expire ten years after the grant date. A summary of the stock option activity for the year ended December 31, 2003 is as follows:

	Number of Options	Weighted-Average Exercise Price per share
Balance at January 1, 2003	—	—
Granted	790,981	$31.05
Balance at December 31, 2003	**790,981**	**$31.05**

There were no options exercised, forfeited or expired for the year ended December 31, 2003. No stock options were granted or outstanding prior to 2003.

Information about stock options outstanding at December 31, 2003 is summarized as follows:

Range of Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$31.03–$34.85	790,981	9.88	$31.05

There were no options exercisable as of December 31, 2003.

Restricted Stock Awards

During 2003, the Company granted 185,969 shares of the Company's stock as restricted stock awards to certain eligible executives valued at the fair value of the stock on the grant date with no cost to the employee. Restricted stock awards generally vest over a three-year period. The fair value of these awards is being amortized to compensation expense over the vesting period. Administrative expense for the year ended December 31, 2003 includes $497 of compensation expense related to these awards. Unearned restricted stock compensation as of December 31, 2003 includes $5,274 related to the restricted stock awards.

Restricted Stock Unit Awards

In 2003, the Company granted 27,076 shares of common stock as restricted unit awards to non-employee members of the Board of Directors. Stock Units are settled in shares of WellChoice common stock and dividend equivalents. The restricted stock unit award will 100% vest on February 1, 2005 provided the grantee serves as a Director and has not terminated other than due to retirement prior to the vesting date. The fair value of the restricted unit awards is being amortized to compensation expense over the vesting period. Administrative expense for the year ended December 31, 2003 includes $87 of compensation expense related to these awards. Unearned restricted stock compensation as of December 31, 2003 includes $753 related to the restricted stock units.

19. Earnings Per Share

The denominator for basic and diluted earnings per share for 2003, and for the period from November 7, 2002 (date of for-profit conversion and initial public offering) through December 31, 2002 is as follows:

	2003	2002
Denominator for basic earnings per common share—weighted-average shares	**83,490,478**	83,490,478
Effect of dilutive securities—employee and director stock options and non-vested restricted stock awards	**27,689**	—
Denominator for diluted earnings per common share	**83,518,167**	83,490,478

Weighted-average shares used for basic earnings per share assumes that shares issued in the initial public offering were issued on the effective date of the initial public offering. Weighted-average shares used for basic earnings per share also assumes that adjustments, if any, to the common stock issued in the initial public offering occurred at the beginning of the quarter in which changes were identified.

There were no shares or dilutive securities outstanding prior to the for-profit conversion and initial public offering. For comparative pro forma earnings per share presentation, the weighted-average shares outstanding and the effect of dilutive securities for the period from November 7, 2002 to December 31, 2002, are shown above.

Stock options, restricted stock awards, and restricted stock units are not considered outstanding in computing the weighted-average number of shares outstanding for basic earnings per share. Stock options and restricted stock awards are included, from the grant date, in determining diluted earnings per share using the treasury stock method. The stock options are dilutive in periods when the average market price exceeds the grant price. The restricted stock unit awards are dilutive when the aggregate fair value exceeds the amount of unearned compensation remaining to be amortized.

20. Quarterly Financial Data (Unaudited)

The following unaudited quarterly financial data are presented on a consolidated basis for each of the years ended December 31, 2003 and 2002.

Quarter ended	March 31	June 30	September 30	December 31
2003 Data				
Total revenues	**$1,292,078**	**$1,374,511**	**$1,339,339**	**$1,376,627**
Income from continuing operations before income tax expense	**82,983**	**85,436**	**87,461**	**87,742**
Net income	**47,741**	**48,775**	**52,058**	**52,552**
Basic and diluted net income per common share	**$0.57**	**$0.59**	**$0.62**	**$0.63**
Shares used to compute basic earnings per share, based on weighted-average shares outstanding for the quarter	**83,490,478**	**83,490,478**	**83,490,478**	**83,490,478**
Shares used to compute dilutive earnings per share, based on weighted-average shares outstanding for the quarter	**83,490,478**	**83,490,478**	**83,490,478**	**83,892,582**
2002 Data				
Total revenues	$1,280,100	$1,321,642	$1,221,204	$1,282,714
Income from continuing operations before income tax expense	79,704	60,092	87,224	82,748
Income from continuing operations	79,681	60,095	254,409	(16,570)
Loss from discontinued operations	(1,050)	(6)	—	—
Net income (loss)	78,631	60,089	254,409	(16,570)
Net loss for the period from November 7, 2002 (date of initial public offering) to December 31, 2002				(38,542)
Basic and diluted net loss per common share for the period from November 7, (date of initial public offering) to December 31, 2002				(0.46)
Shares used to compute earnings per share, based on weighted-average shares outstanding November 7, 2002 (date of conversion and initial public offering) to December 31, 2002				83,333,244

For the quarter ended September 30, 2002, income from continuing operations includes a deferred tax benefit of $167,185 primarily resulting from the reversal of the valuation allowance for deferred tax assets. For the quarter ended December 31, 2002, loss from continuing operations includes income tax expense of $99,318 primarily resulting from the elimination of the section 833(b) deduction that had previously been assumed during the first three quarters of 2002. Refer to footnote 6.

Chief Executive Officer's Section 302 Certification

I, Michael A. Stocker, M.D., Chief Executive Officer of WellChoice, Inc., certify that:

1. I have reviewed this Annual Report on Form 10-K of WellChoice, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

(a) Designed such disclosure controls and procedures, or caused disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions based upon the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

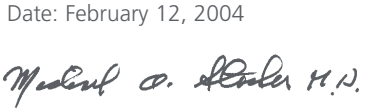
(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 12, 2004



Michael A. Stocker, M.D.
Chief Executive Officer

Chief Financial Officer's Section 302 Certification

I, John W. Remshard, Chief Financial Officer of WellChoice, Inc., certify that:

1. I have reviewed this Annual Report on Form 10-K of WellChoice, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

(a) Designed such disclosure controls and procedures, or caused disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions based upon the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 12, 2004

John W. Remshard
Chief FInancial Officer

team

Board of Directors of WellChoice, Inc.

Philip Briggs
Chairman of the Board
WellChoice, Inc.

Hermes L. Ames, III
Retired President and Chief Executive Officer
Fleet National Bank Upstate New York Region

John R. Gunn
Executive Vice President and Chief Operating Officer
Memorial Sloan-Kettering Cancer Center

Peter Hutchings
Retired Executive Vice President and
Chief Financial Officer
Guardian Life Insurance Company

Susan L. Malley, Ph.D.
President and Chief Investment Officer
Malley Associates Capital Management
(asset management firm)

Edward J. Malloy
President
Building and Construction Trades Council
of Greater New York

John F. McGillicuddy
Retired Chairman of the Board and
Chief Executive Officer
Chemical Bank Corporation

Robert R. McMillan, Esq.
Partner
Fischbein Badillo Wagner Harding

Stephen Scheidt, M.D.
Professor of Clinical Medicine;
Director, Cardiology Training Program
New York Weill Cornell Medical Center

Michael A. Stocker, M.D.
President and Chief Executive Officer
WellChoice, Inc.

Frederick O. Terrell
Managing Partner and Chief Executive Officer
Provender Capital Group, LLC
(private investment firm)

Louis R. Tomson
Principal Officer
Rad Consulting, Inc.
(business consulting firm)

Faye Wattleton
President
Center for the Advancement of Women

John E. Zuccotti
Chairman
Brookfield Financial Properties
(real estate development firm)

Executive Management Team

Michael A. Stocker, M.D.
President and Chief Executive Officer

Gloria M. McCarthy
Executive Vice President and
Chief Operating Officer

Deborah Loeb Bohren
Senior Vice President
Communications

Jason N. Gorevic
Senior Vice President
Chief Marketing Officer and
Acting Head of Sales

Robert W. Lawrence
Senior Vice President
Human Resources and Services

John W. Remshard
Senior Vice President
and Chief Financial Officer

Linda V. Tiano, Esq.
Senior Vice President and
General Counsel

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Corporate Information

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New York, NY 10038
(212) 936-5100

WellChoice SEC Filings
All WellChoice SEC Filings are available on WellChoice's online investor information center at **www.wellchoice.com/investors/.**

Investor and Shareholder Information
Shareholders may receive, without charge, a copy of WellChoice's Annual Report on Form 10-K for the year ended December 31, 2003, including financial statements and financial statement schedules as filed with the Securities and Exchange Commission, by contacting Deborah Loeb Bohren, Senior Vice President, Communications, at the Company's headquarters.

Stock Listing
Common stock of WellChoice, Inc. is traded on the New York Stock Exchange under the symbol WC.

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Except where specifically defined, the terms "WellChoice," "Company," "we," "us," and "our" refer to WellChoice, Inc. and/or its subsidiaries, or to one or more of them, depending on the context in each instance.

The New York insurance and HMO operations are conducted through:

Empire HealthChoice Assurance, Inc., d/b/a Empire Blue Cross Blue Shield and Empire HealthChoice HMO, Inc., d/b/a Empire Blue Cross Blue Shield HMO, which are licensees of the Blue Cross and Blue Shield Association, an association of independent Blue Cross and Blue Shield plans.

The New Jersey PPO and HMO Operations are conducted through:

WellChoice Insurance of New Jersey, Inc. and Empire HealthChoice HMO, Inc., d/b/a WellChoice HMO of New Jersey.
BlueCross®, BlueShield®, the Cross and Shield symbols and BlueCard® which are registered service marks of the Blue Cross and Blue Shield Association. SARA® is a registered service mark of WellChoice, Inc.

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