



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**HEALTH MASTERS OF OREGON, INC.
PORTLAND, OREGON**

NAIC COMPANY CODE 96239

AS OF

DECEMBER 31, 2001

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June 16, 2003

Honorable Cory Streisinger, Director
Department of Consumer and Business Services
State of Oregon
350 Winter Street NE, Room 440
Salem, Oregon 97301-3883

Dear Director:

In accordance with your instructions and pursuant to ORS 731.300, we have examined the business affairs and financial condition of

**HEALTH MASTERS OF OREGON, INC.
100 SW Market Street
Portland, Oregon 97201**

NAIC Company Code 96239

hereinafter referred to as the "Company" or "HMS." The following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

The examination of the Company was conducted as of December 31, 2001, covering the three year period then ended, and included a review of material transactions or events which occurred subsequent to the examination cut-off date and were noted during the examination. The examination was conducted pursuant to ORS 731.300 and in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC) for the purpose of determining the Company's financial condition, ability to fulfill and the manner of fulfillment of its obligations, the nature of its operations, and compliance with the Insurance Code. Accounting methods, internal control procedures, records and other supporting evidence were examined or tested by appropriate methods to the extent deemed necessary and appropriate for the type, volume and complexity of the accounting system and operations utilized by the Company. A review was also made of the corrective actions taken by the Company with respect to comments and/or recommendations in the previous financial report of examination as of December 31, 1998, by the Oregon Insurance Division.

In addition to the above, work papers were reviewed that were prepared by the Company's independent auditors in their audit of the Company's accounts for the year ended December 31, 2001. A portion of the auditors' work papers has been incorporated into our work papers and has been utilized in determining the scope and areas of emphasis in conducting the examination.

COMPANY HISTORY

The Company is a federally qualified, state registered, Health Maintenance Organization. The Company was incorporated as a for-profit corporation in Oregon on February 13, 1986, and received its Certificate of Authority to transact business as a domestic health care service

contractor from the Oregon Insurance Division on April 1, 1986, under ORS Chapter 750. The Company obtained federal qualification as a health maintenance organization in 1987. It began writing health insurance in 1987. Originally the Company was a wholly owned subsidiary of Rogue Valley Physicians Service of Medford, Oregon. Effective April 1, 1992, Rogue Valley Physicians Service, Inc., merged into Blue Cross and Blue Shield of Oregon, the surviving company. Under the terms and conditions of the Plan and Agreement of Acquisition, Blue Cross and Blue Shield of Oregon transferred the stock of Health Masters of Oregon, Inc., the wholly owned subsidiary of Rogue Valley Physicians Service, Inc., to Capitol Health Care Management, Inc.

Effective January 1, 1993, all the HMS business was rewritten by HMO Oregon (formerly known as Capitol Health Care, Inc.) except a small portion of conversion policies which were assumed by HMO Oregon under a reinsurance assumption agreement. The claims liabilities of Health Masters of Oregon, Inc., were paid on a run-off basis. The Company is now an inactive shell, holding only its Certificate of Authority and the remaining assets.

On June 1, 1995, the Company's upstream parent, Blue Cross and Blue Shield of Oregon became part of The Benchmark Group, a non-profit holding company located in Portland, Oregon. On April 1, 1997, The Benchmark Group changed its name to The Regence Group (TRG) along with Blue Cross and Blue Shield of Oregon, whose name became Regence BlueCross BlueShield of Oregon (RBCBSO).

MANAGEMENT AND CONTROL

Board of Directors

The Company's Board of Directors is combined with the Board of RBCBSO. Article II of the Company's Bylaws designates that the Board shall be comprised of not less than 11 or more

than 21 members. In addition, the Bylaws specify that a majority of the Outside Directors shall be persons who are not employees of and who do not have a direct and substantial financial interest in a health care provider, and who are not members of a profession which provides health care services. Generally, directors serve terms of three years and are limited to three consecutive terms. A majority of the number of directors constitutes a quorum. The Board of Directors meets all requirements of ORS 750.015.

As of December 31, 2001, the Company was governed by a 13 member Board of Directors as follows:

<u>Name and Address</u>	<u>Principal Occupation</u>	<u>Expiration Date of Term</u>
Thomas A. Bailey, MD 2775 Holiday Drive South Salem, Oregon 97301	Physician (retired)	April 2003
Gerry B. Cameron 6902 NE Par Lane Vancouver, Washington 98662	Chairman US Bancorp (retired)	April 2003
Peggy Y. Fowler 121 SW Salmon Street, 17 th Floor Portland, Oregon 97204	President & CEO Portland General Electric	April 2003
Mark B. Ganz 200 SW Market, Suite 1200 Portland, Oregon 97201	President Regence BlueCross BlueShield of Oregon	April 2003
Robert W. Graham, MD 1000 Pine Street Klamath Falls, Oregon 97601	Physician	April 2003
John G. King 1919 NW Lovejoy Portland, Oregon 97209	President and CEO (retired) Legacy Health Care Systems	April 2003
Charles D. McGee, MD 700 Bellevue SE, #220 Salem, Oregon 97301	Physician	April 2003
Richard G. Reiten 1 Pacific Square 220 NW 2 nd Ave, #1300 Portland, Oregon 97209-3991	President NW Natural	April 2003

<u>Name and Address</u>	<u>Principal Occupation</u>	<u>Expiration Date of Term</u>
John R. Segerstrom PO Box 2115 Lake Oswego, Oregon 97035	PQM Research, Inc.	April 2003
William R. Lee, MD 2275 NE Doctors Dr. Suite #7 Bend, Oregon 97701	Physician	April 2003
Bob L. Smith 280 Liberty SE, Suite 300 Salem, Oregon 97301	Chairman & CEO VIP's Industries, Inc.	April 2003
T.R. Winnowski 1 SW Columbia Street, Ste 900 Portland, Oregon 97258	President & CEO Centennial Bank	April 2003
Richard L. Woolworth 200 SW Market, E15A Portland, Oregon 97201	Chairman of the Board The Regence Group & BlueCross BlueShield of Oregon	None

Officers

Operating management of the Company as of December 31, 2001, was under the direction of the following principal officers:

<u>Officer</u>	<u>Office</u>
Mark Ganz	President and Chief Executive Officer
Michael T. Mudrow	Vice President Legal, General Counsel and Secretary
Lisa Johnson	Vice President, Chief Financial Officer & Treasurer

Affiliated Companies

The Company is part of a holding company system in which TRG is the ultimate parent. TRG is a Nonprofit Oregon Corporation governed by a 13-member board of directors. TRG is the sole member of RBCBSO, Regence BlueShield (RBS), and Regence BlueCross BlueShield

of Utah (RBCBSU). In addition, TRG manages the operations of Regence BlueShield of Idaho (RBSI) under the terms of a long-term management services agreement.

RBCBSO is the sole voting member of Regence HMO Oregon (RHO). RHO's wholly owned subsidiary is Capitol Health Care Management, Inc., which wholly owns the Company and Regence Health Maintenance of Oregon, Inc. (RHMO). The Company is affiliated with Regence Life and Health Insurance Company (RLH), Preferred Health Northwest, Inc., and Associated Administrators, Inc., which are wholly owned subsidiaries of RBCBSO. RLH wholly owns Regence Coordinated Services, Inc. In addition, the Company is affiliated with Patrick A. Toohy & Associates, a wholly owned subsidiary of Associated Administrators Inc. The following is a description of these companies:

RBCBSO is authorized to conduct business as a health care service contractor in the states of Oregon and Washington. Also, RBCBSO is licensed as a foreign corporation by the Secretary of State of Idaho. RBCBSO's only Idaho business is Part "A" of Medicare. The company operates as a Blue Cross and Blue Shield plan subject to operational and performance standards established by the national Blue Cross and Blue Shield Association.

Regence Life and Health Insurance Company is licensed to conduct the business of life and accident and health insurance in the states of Oregon, Idaho, Montana, Washington, Alaska, Utah, and Wyoming.

Regence HMO Oregon is an Oregon health care service contractor and is federally qualified as a health maintenance organization. RHO is the immediate parent of Capitol Health Care Management, Inc. RHO conducts business throughout the State of Oregon.

Capitol Health Care Management, Inc. is an Oregon business corporation which functions as a down stream holding company to own all the stocks of RHO subsidiaries and to consolidate the income tax results of the subsidiaries of RHO.

Regence Health Maintenance of Oregon, Inc. is an Oregon health care service contractor and is federally qualified as a health maintenance organization. RHMO was originally owned by the Company and was transferred to RHO in 1988. RHMO primarily markets its managed care products in the southwest portion of Washington.

Preferred Health Northwest, Inc. is a for-profit health care service contractor. PHN was originally owned by Capitol Health Care Management, Inc. and was transferred to RBCBSO in 1994. At present, PHN does not write any business.

Regence Coordinated Services, Inc. (RCS) The insurance agency business of four TRG affiliate plans was combined by merging three out-of-state insurance agency subsidiaries into RCS. In consideration of this transaction, each of the affiliated plans (RBS, RBCBSU, and RBSI) received shares of RLH stock.

Associated Administrators, Inc. is a wholly owned Washington corporation licensed to do business as a third party administrator.

Patrick A. Toohey & Associates is a California corporation licensed to do business as a third party administrator.

CONFLICT OF INTEREST

The Company's provision for conflict of interest disclosure is in the form of a questionnaire that is completed by the Company's Board of Directors and management on an annual basis.

All subject personnel performed due diligence in completing the questionnaire. From a review of the questionnaires, there were no material conflicts of interest reported by any of the officers or directors.

CORPORATE RECORDS

Board Minutes

The Company's Board minutes are consolidated with those of its parent. Regular Board meetings are held quarterly in addition to quarterly meetings by the Board's committees. It was noted that the Board minutes were recorded in sufficient detail to determine the actions taken by the Board. A review of all minutes for the period under examination revealed no acts inconsistent with the Company's Articles of Incorporation or Bylaws. Investment guideline revisions and approval of investments are conducted by the Board of Directors pursuant to the provisions of ORS 733.730. In addition, the minutes indicated the Board approves officer salaries in accordance with the provisions of ORS 732.320(3). A quorum was achieved at all meetings held during the period under examination. Overall, the minutes supported the transactions of the Company and the actions taken by its officers.

Articles of Incorporation

The Company's Articles of Incorporation were not amended during the period examined. The Articles of Incorporation were in conformity with Oregon statutes.

Bylaws

The Company's Bylaws were amended on April 21, 1999, at the annual Board meeting . The amendment changed the Board size and instituted mandatory Board retirement at age 70.

The Company's Bylaws were again amended at a Board meeting held on July 24, 2002, subsequent to the period covered by this examination. Some of the major changes were as follows:

- Article II now establishes two classes of directors - outside and inside. In addition, it sets a director term as three years and limits the number of terms to three consecutive terms. However, Article II also allows the Board to waive provisions regarding term of directors and mandatory retirement with a two-thirds majority vote of directors.
- Article III establishes three standing committees: Organizational and Governance Committee, Provider Affairs and Quality Improvement Committee, and the Audit and Compliance Committee. Article III also defines the composition and responsibilities of these three committees.
- Article XIV was added to the Bylaws and defines Books and Records requirements and Governance Procedures.

The Bylaws were in conformity with Oregon statutes.

Holding Company Registration Statement

A Holding Company Registration Statement was filed by the Company in accordance with the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-27-020(1).

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on the TRG corporate insurance policies. Under these policies, the Company is insured for up to \$10,000,000 per occurrence against losses from acts of dishonesty and fraud by its employees. Fidelity bond coverage was found to meet the minimum coverage recommended by the NAIC. In addition, the Company is insured for directors and officers liability for losses up to \$50,000,000 per single loss through three layers of coverage. Other insurance coverages in force at December 31, 2001, included property, managed care liability, commercial general liability, umbrella liability, fiduciary

liability, business automobile, excess earthquake coverage, and computer crime. The Company is self-insured for workers' compensation. All coverages appeared adequate as of December 31, 2001.

TERRITORY AND PLAN OF OPERATION

The Company is licensed as a Health Maintenance Organization in the State of Oregon. The Company is inactive and did not written any business during the period examined.

GROWTH OF THE COMPANY

The growth of the Company since the last financial examination is reflected in the following schedule. The stated amounts were derived from Company's filed annual statements, except in those years where a triennial report of examination has been filed with the Oregon Insurance Division.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Net Income (Loss)</u>
1998*	\$1,517,270	\$29,050	\$1,488,220	\$47,135
1999	1,560,281	28,371	1,531,910	43,690
2000	1,622,413	35,613	1,586,799	54,889
2001*	1,655,309	25,412	1,629,897	43,098

*Per examination

As noted in the Territory and Plan of Operation section of this report, the Company is not currently writing business. The only growth has occurred from investment income.

REINSURANCE

The Company did not have any reinsurance in effect as of the date of this report. Because the Company does not currently write business, it does not retain a risk on any one subject of insurance in an amount exceeding ten percent of its net worth as required by the provisions of ORS 731.504.

ACCOUNTS AND RECORDS

The Company's records and source documentation supported the amounts presented in the Company's December 31, 2001 annual statement and were maintained in a manner by which the financial condition was readily verifiable pursuant to the provisions of ORS 733.170. In addition, books, records and investments were held within the State of Oregon pursuant to the provisions of ORS 732.245.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

There were no recommendations made in the 1998 report of examination.

HEALTH MASTERS OF OREGON, INC.
STATEMENT OF ASSETS, LIABILITIES, CAPITAL & SURPLUS
As of December 31, 2001

	<u>Per Company</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>
<u>ASSETS</u>			
Cash and short-term investments	\$1,391,833		\$1,391,833
Bonds	257,626		257,626
Investment income due and accrued	<u>5,850</u>		<u>5,850</u>
Total Assets	<u><u>1,655,309</u></u>		<u><u>1,655,309</u></u>
<u>LIABILITIES</u>			
General expenses	2,253		2,253
Federal income tax payable	13,233		13,233
Amounts due to affiliates	<u>9,926</u>		<u>9,926</u>
Total Liabilities	25,412		25,412
<u>CAPITAL AND SURPLUS</u>			
Common stocks	1,000,000		1,000,000
Paid in surplus	239,976		239,976
Aggregate write-ins for other than special surplus funds	250,000		250,000
Unassigned funds	<u>139,921</u>		<u>139,921</u>
Total Capital and Surplus	<u><u>1,629,897</u></u>		<u><u>1,629,897</u></u>
Total Liabilities, Capital & Surplus	<u><u>\$1,655,309</u></u>		<u><u>\$1,655,309</u></u>

HEALTH MASTERS OF OREGON, INC.
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended December 31, 2001

	<u>Per Company</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>
<u>REVENUES</u>			
Net investment gain	\$68,509		\$68,509
<u>EXPENSES</u>			
General administrative expenses	<u>2,252</u>		<u>2,252</u>
Net income before taxes	66,257		66,257
Provision for federal income tax	<u>23,159</u>		<u>23,159</u>
Net Income	<u>\$43,098</u>		<u>\$43,098</u>

CAPITAL AND SURPLUS ACCOUNT

Capital and surplus prior year	\$1,586,799
Net income	<u>43,098</u>
Capital and surplus end of year	<u>\$1,629,897</u>

CONCLUSION

During the three year period covered by this examination, the capital and surplus of the Company has increased from \$1,488,220 as presented in the December 31, 1998, report of examination to \$1,629,897 as shown in this report of examination. The comparative assets and liabilities are shown below:

	<u>2001</u>	<u>December 31,</u>	<u>1998</u>	<u>Change</u>
Assets	\$1,655,309		\$1,517,270	\$138,039
Liabilities	<u>25,412</u>		<u>29,050</u>	<u>(3,638)</u>
Surplus	<u>\$1,629,897</u>		<u>\$1,488,220</u>	<u>\$141,677</u>

ACKNOWLEDGMENT

The cooperation and assistance extended by the officers and employees of the Company during the examination process are gratefully acknowledged.

In addition to the undersigned, David L. Daulton, CFE, Thomas T. Farrelly, CFE, Mark A. Giffin, CFE, and Michael P. Phillips, CFE, CPA, AES, Timothy R. Hurley, CFE, Travis C. Carter, AFE, insurance examiners for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

D. Patrick Huth, CFE
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
)
County of Marion) ss

D. Patrick Huth, CFE, being duly sworn, deposes and says that the preceding report of financial examination as of December 31, 2001, of Health Masters of Oregon, Inc., Portland, Oregon, subscribed by him is true and correct to the best of his knowledge and belief.

D. Patrick Huth, CFE
Supervising Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to before me this _____ day of _____, 2003.

Notary Public for the State of Oregon

My Commission Expires: _____