



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**KAISER PERMANENTE HEALTH ALTERNATIVES
DBA KPHA HEALTH PLANS
PORTLAND, OREGON**

NAIC COMPANY CODE 47033

AS OF

DECEMBER 31, 2000

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November 5, 2001

Honorable Mary C. Neidig, 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, I have examined the business affairs and financial condition of

**KAISER PERMANENTE HEALTH ALTERNATIVES
DBA KPHA HEALTH PLANS
500 NE Multnomah Street, Suite 100
Portland, Oregon 97232**

NAIC Company Code 47033

hereinafter referred to as “the Plan.” The following report is respectfully submitted.

SCOPE OF EXAMINATION

The examination of the Plan was conducted as of December 31, 2000, covering the two and a half 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 Plan'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 Plan. A review was also made of the corrective actions taken by the Plan with respect to comments and/or recommendations in the initial qualifying report of examination as of June 30, 1998, by the Oregon Insurance Division.

In addition to the above, work papers were reviewed that were prepared by the Plan's independent auditors in their audit of the Plan's accounts for the year ended December 31, 2000. A portion of the auditors' work papers have been incorporated into our work papers, and have been utilized in determining the scope and areas of emphasis in conducting the examination.

PLAN HISTORY

The Plan was incorporated as a nonprofit charitable corporation under the laws of the State of Oregon on May 25, 1988, as Kaiser Dental Plan. The Plan was authorized to transact business as a health care service contractor in the State of Washington on June 16, 1988. Under the provisions of Chapter 48.44 Revised Code of Washington on December 5, 1990, the Plan's certificate was changed to operate as a limited health care service contractor. On March 25, 1996, the Plan's name was changed to Kaiser Permanente Health Alternatives. On April 8, 1996, State of Washington Insurance Commissioner's Office issued an amended Certificate of Authority, authorizing this company to transact business as a full health care service contractor in the State of Washington. Effective March 10, 1997, the Plan adopted an assumed business name of KPHA Health Plans. On June 16, 1999, the Plan received a Certificate of Authority from the State of Oregon to transact business as a health care service contractor.

MANAGEMENT AND CONTROL

Directors

The Bylaws vest the Plan's management and control in a Board of Directors consisting of three members. The directors serving the Plan on December 31, 2000 were:

| <u>Name and Address</u> | <u>Position and Affiliation</u> | <u>Representation</u> |
|---|---|------------------------------|
| Barbara A. West 500 NE Multnomah Street Portland, Oregon 97232 | Regional President Kaiser Foundation Health Plan of the Northwest | Non-Public |
| Denise L. Honzel 500 NE Multnomah Street Portland, Oregon 97232 | Vice President - Health Plan Manager Kaiser Foundation Health Plan of the Northwest | Non-Public |

throughout the United States.

Kaiser Foundation Health Plan of the Northwest

Health Plan is authorized to transact the business of accepting the prepayment of health care services as a health care service contractor under the provisions of ORS Chapter 750. On November 26, 1984, the name was changed from Kaiser Foundation Health Plan of Oregon to Kaiser Foundation Health Plan of the Northwest. Health Plan is authorized to transact business in Oregon and Washington.

KP Comp - KP Comp is an Oregon non-profit corporation that is 50% owned by Health Plan and 50% owned by Northwest Permanente, P.C., a physician group. KP Comp was created to provide worksite health management for Kaiser health plans and other outside staff-model HMOs. As of the date of this examination report, KP Comp is inactive.

Intercompany Agreements

As of December 31, 2000, the Plan was party to the following agreement with Health Plan.

Health Plan Management Agreement

Health Plan performs administrative, claims, legal and dental services for the Plan under the terms of a Management Agreement (Agreement). In return, the Plan pays Health Plan a per member per month fee that is mutually determined each year. During 2000, the Health Plan received

\$5,074,109 for services performed under the terms of the Agreement. The terms of the Agreement appear to be fair and reasonable and therefore complies with the requirements of ORS 732.574.

MANAGEMENT AFFIRMATION

CONFLICT OF INTEREST

The Plan requires officers and directors to read the corporate conflict of interest policy and then disclose any conflict of interest on a signed conflict of interest statement.

From a review of the conflict of interest statements, it appears the affected personnel performed due diligence in disclosing all and any potential conflicts of interest.

CORPORATE RECORDS

Board of Director Minutes

The minutes of the Plan are in the form of a "written consent of the Board of Directors" in which the Board conducted the business of the Plan without holding a meeting. The business reflected in the written consent was primarily the election of officers. However, the Board of Director's written consent, for the years examined, did not indicate that the Board approves investments as required by the provisions of ORS 733.730. As a result, **I recommend the Plan's Board of Director minutes include the approval of investments. This recommendation is made in accordance with the provisions of ORS 733.730.**

Articles of Incorporation

There were no amendments to the Plan's Articles of Incorporation during the period examined. The Articles of Incorporation were in conformity with Oregon statutes.

Bylaws

There were no amendments to the Plan's Bylaws during the period examined. The Bylaws were in conformity with Oregon statutes.

Holding Company Registration Statement

In consideration of an amendment made to the year 2000 holding company registration statement, dated September 30, 2001, the Plan has complied with the provisions of ORS 732.552, ORS 732.554, and Oregon Administrative Rule (OAR) 836-27-020(1).

FIDELITY BONDS AND OTHER INSURANCE

The Plan is self-insured against most hazards and insured by outside carriers at higher limits above its retentions. As of December 31, 2000, the Plan 's fidelity bond coverage was determined to be adequate based on the coverage recommended by the NAIC Examiners Handbook. In addition, the Plan has other coverages, limits and retentions as follows:

| Coverage | Self Insured Primary layer or Deductible, per Occurrence | Limits Provided by Insurers Above Plan's Self Insurance |
|------------------------------------|---|--|
| Directors and officers liability | \$1,000,000 | \$100,000,000 through 5 layers |
| General and professional Liability | \$5,000,000 | \$410,000,000 through 6 layers |

The funds available for the Plan's self-insurance is based on the financial resources of the entire Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospital group of companies (Group).

In consideration of the Group's combined net worth at December 31, 2000, it appears the Plan has the financial resources to self-insure for the limits specified above. In addition, the liability established by the Plan for its self-insurance was adequate in all material respects as of December 31, 2000. This determination was made as a result of an analysis conducted by DCBS actuary, Rae M. Taylor, FCAS, MAAA.

In general, considering the financial strength of the group, the limits on all coverages were considered adequate for purposes of this examination.

RETIREMENT PLANS AND OTHER POST-RETIREMENT BENEFITS

The Plan has no employees or allocation for employee expenses. Therefore, as of December 31, 2000, there was no liability for employee benefits.

TERRITORY AND PLAN OF OPERATION

The Plan provides medical and dental services in Clark, Cowlitz, Lewis, Skamania and Waukiam counties in Washington State. The Plan operates by arranging medical and dental services for its members through a management agreement with Kaiser Foundation Health Plan of the Northwest (Health Plan). Under the terms of this agreement, Health Plan performs or provides all health care, dental care and related services that the Plan is contractually obligated to provide for its members under its membership contracts. The Plan's members receive medical and dental services at the same facilities and from the same personnel as Health Plan's members. The contracts between Health Plan and its healthcare providers state that if Health Plan fails to pay for covered healthcare services, the subscriber is not liable to the healthcare provider for amounts owed by Health Plan. As of the date of this examination, the Plan did not write business in the State of Oregon.

GROWTH OF THE PLAN

The growth of the Plan since the qualifying examination is reflected in the following schedule. The stated amounts were derived from Plan's filed annual statements.

Net Income

| <u>Year</u> | <u>Assets</u> | <u>Liabilities</u> | <u>Net Worth</u> | <u>(Loss)</u> |
|-------------|---------------|--------------------|------------------|---------------|
| 1998 | \$3,390,379 | \$ 86,376 | \$3,304,003 | \$124,904 |
| 1999 | 3,492,381 | 144,001 | 3,348,380 | 44,570 |
| 2000* | 3,462,844 | 110,634 | 3,352,210 | 3,398 |

*Per examination

LOSS EXPERIENCE

The following exhibit reflects the relationship of the Plan's medical expenses to revenues since 1998.

The amounts were compiled from copies of the Plan's filed annual statements.

| <u>Year</u> | (1) <u>(a)Premiums Earned</u> | (2) <u>(b)Total Claims & Expense</u> | (2/1) <u>Ratio</u> |
|-------------|----------------------------------|---|-----------------------|
| 1998 | \$2,159,375 | \$2,053,228 | 95.1% |
| 1999 | 4,012,921 | 4,130,240 | 103.0% |
| 2000* | 5,028,072 | 5,198,624 | 103.4% |

*Per examination

(a) Page 4, lines 1, 2, 3, and 4 of the annual statements.

(b) Page 4, line 21 of the annual statements.

A ratio of less than 100% typically indicates an underwriting gain. As indicated from the table above, the Plan had an underwriting loss in two of the three years covered by this examination.

REINSURANCE

Through the management agreement with Health Plan, medical and dental services are provided to members on a per member per month basis. Due to this arrangement, the Plan has limited its risk to the per member per month amount. For out-of-network products, the Plan is covered under an excess of loss agreement. Under the terms of the agreement, the Plan cedes 90% of eligible hospital expenses that exceed \$100,000 per member. It was determined that the

Plan's reinsurance agreement clearly specified the risk taken by the reinsurer with no unusual provisions reducing the reinsurer's risk. In addition, the Plan is in compliance with ORS 731.504(1) by not retaining risk on any one subject of insurance in an amount exceeding 10% of its surplus.

ACCOUNTS AND RECORDS

In general, the Plan's records and source documentation supported the amounts presented in the Plan's December 31, 2000, 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.

KAISER PERMANENTE HEALTH ALTERNATIVES
STATEMENT OF ASSETS, LIABILITIES AND NET WORTH
As of December 31, 2000

| <u>ASSETS</u> | <u>Per Plan</u> | <u>Examination Adjustments</u> | <u>Per Examination</u> |
|---|---------------------------|---|-----------------------------------|
| Short-term investments | \$3,258,048 | | \$3,258,048 |
| Uncollected premiums | 50,060 | | 50,060 |
| Federal income taxes recoverable | 22,953 | | 22,953 |
| Investment income due & accrued | 21,876 | | 21,876 |
| Receivable from parent & affiliates | <u>109,907</u> | | <u>109,907</u> |
| TOTAL ASSETS | <u>\$3,462,844</u> | | <u>\$3,462,844</u> |
| | | | |
| <u>LIABILITIES, RESERVES & OTHER FUNDS</u> | | | |
| Claims unpaid | \$ 10,278 | | \$ 10,278 |
| Unearned premiums | 92,771 | | 92,771 |
| Taxes, licenses and fees | 7,400 | | 7,400 |
| Other expenses due or accrued | <u>185</u> | | <u>185</u> |
| TOTAL LIABILITIES | <u>110,634</u> | | <u>110,634</u> |
| | | | |
| Surplus notes (Note 1) | 1,500,000 | | 1,500,000 |
| Aggregate write-ins for reserves | 400,000 | | 400,000 |
| Unassigned funds | <u>1,452,210</u> | | <u>1,452,210</u> |
| TOTAL RESERVES & UNASSIGNED FUNDS | <u>3,352,210</u> | | <u>3,352,210</u> |
| TOTAL LIABILITIES & UNASSIGNED FUNDS | <u>\$3,462,844</u> | | <u>\$3,462,844</u> |

KAISER PERMANENTE HEALTH ALTERNATIVES
STATEMENT OF REVENUE, EXPENSES AND NET WORTH
For the Year Ended December 31, 2000

| <u>UNDERWRITING INCOME</u> | <u>Per Plan</u> | <u>Examination Adjustments</u> | <u>Per Examination</u> |
|---|------------------------|---|-------------------------------|
| Premiums earned | \$5,028,072 | | \$5,028,072 |
| Claims incurred | 5,109,814 | | 5,109,814 |
| Expenses incurred: | | | |
| Administrative | <u>88,810</u> | | <u>88,810</u> |
| Total underwriting deduction | 5,198,624 | | 5,198,624 |
| Net underwriting gain or loss | <u>(170,552)</u> | | <u>(170,552)</u> |
| <u>INVESTMENT INCOME</u> | | | |
| Net investment income earned | <u>180,375</u> | | <u>180,375</u> |
| Net investment gain | <u>180,375</u> | | <u>180,375</u> |
| <u>OTHER INCOME</u> | | | |
| Net gain before Federal income tax | 9,823 | | 9,823 |
| Federal income tax incurred | <u>6,425</u> | | <u>6,425</u> |
| Net gain | <u>\$ 3,398</u> | | <u>\$ 3,398</u> |
| <u>RESERVES & UNASSIGNED FUNDS</u> | | | |
| Reserves and unassigned funds, December 31, 1999 | \$3,348,380 | | \$3,348,380 |
| Net gain | 3,398 | | 3,398 |
| Change in nonadmitted assets | 432 | | 432 |
| Change in reserves and unassigned funds for the period | <u>3,830</u> | | <u>3,830</u> |
| Reserves and other funds, December 31, 2000 | <u>\$3,352,210</u> | | <u>\$3,352,210</u> |

NOTES TO FINANCIAL STATEMENTS

Note 1 – Subordinated Surplus Notes

The Plan has a \$50,000 subordinated surplus note with Kaiser Foundation Hospitals dated November 30, 1995. The Plan also has a \$1,450,000 subordinated surplus note with Kaiser Foundation Health Plan dated April 30, 1996. The Oregon Insurance Division approved the subordinated surplus notes on July 27, 1998.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Page

- 9 I recommend the Plan's Board of Director minutes include the approval of investments. This recommendation is made in accordance with the provisions of ORS 733.730.

CONCLUSION

During the two and a half year period covered by this examination, the net worth of the Plan has increased from \$3,304,003, as presented in the June 30, 1998, report of qualifying financial examination, to \$3,352,210, as shown in this report of examination. The comparative assets and liabilities are shown below:

| | <u>December 31, 2000</u> | <u>June 30, 1998</u> | <u>Change</u> |
|-------------|--------------------------|----------------------|-----------------|
| Assets | \$3,462,844 | \$3,390,379 | \$72,465 |
| Liabilities | <u>110,634</u> | <u>86,376</u> | <u>24,258</u> |
| Net worth | <u>\$3,352,210</u> | <u>\$3,304,003</u> | <u>\$48,207</u> |

ACKNOWLEDGMENT

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

In addition to the undersigned, Mark A. Giffin, CFE, Michael P. Phillips, CFE, CPA, AES, insurance examiners, and Rae M. Taylor, FCAS, MAAA, Property and Casualty Actuary 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, 2000, of Kaiser Permanente Health Alternatives, dba KPHA Health Plans, 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 _____, 2002.

Notary Public for the State of Oregon

My Commission Expires: _____