



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

QUALIFYING EXAMINATION

OF

**PACIFIC GROCERS EMPLOYEE BENEFITS TRUST
BELLEVUE, WASHINGTON**

AS OF

FEBRUARY 29, 2004

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July 30, 2004

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 and ORS 750.327,
we have examined the business affairs and financial condition of

PACIFIC GROCERS EMPLOYEE BENEFITS TRUST
220 120TH Avenue NE, Suite D200
Bellevue, Washington 98005

hereinafter referred to as the "Trust." The following report of examination is
respectfully submitted.

SCOPE OF EXAMINATION

This qualifying examination was conducted as of February 29, 2004.

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 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.

David N. Ball, FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services, participated in this examination by evaluating claims unpaid and unpaid claims adjustment expenses.

HISTORY OF THE TRUST

Associated Grocers, Inc., formed the Trust on January 1, 1992, as a voluntary employee beneficiary association under the provisions of Federal Code 501(c)(9) and operates under the regulations thereunder, and under the requirements of the Employee Retirement Income Security Act of 1974 (ERISA). Associated Grocers, Inc., and retail grocers that are customers of Associated Grocers that have elected to participate are members of the Trust. In 1993, the Oregon State Legislature enacted statutes regulating Multiple Employee Welfare Associations. With this qualifying examination, the Trust is applying for a Certificate of Authority to conduct business as a Multiple Employer Welfare Arrangement in accordance with ORS 750.303(2) and (3).

CAPITALIZATION

The capitalization requirements of the Trust are defined by ORS 750.309(3) which requires the Trust to maintain capital and surplus of not less than \$250,000 or an amount equal to 35% of incurred claims for the preceding 12 month period, whichever is greater. However, this amount shall not exceed \$500,000. As of February 29, 2004, the Trust's surplus was \$2,836,410.

MANAGEMENT AND CONTROL

Trustor

Associated Grocers, Inc., a Washington corporation, is the Trustor.

Trustees

The Trust shall be managed by the trustees appointed by the Trustor. There shall be at least five Trustees. At least two Trustees shall be members of the Trustor. Each Trustee shall continue to serve until his or her death, incapacity, resignation or removal. Trustees have the fiduciary duty to manage the assets of the Trust. Appointed trustees serving at February 29, 2004, were as follows:

<u>Name and Address</u>	<u>Affiliation</u>	<u>Trustee Since</u>
Lisa Cole 4025 Delridge Way SW, Suite 210 Seattle, WA 98106	Director of Human Resources Food Markets NW	2001
Michael Trask 115 N. Granite Avenue Granite Falls, WA 98252	President Stanlar Foods Inc.	2000
Robert Cook* 3301 S. Norfolk Street Seattle, WA 98118	General Manager AGIC Insurance Agency, Inc.	2003
Debbie Allen 3301 S. Norfolk Street Seattle, WA 98118	Assistant Treasurer Associated Grocers Inc.	2001

<u>Name and Address</u>	<u>Affiliation</u>	<u>Trustee Since</u>
Richard Harding** 3301 S. Norfolk Street Seattle, WA 98118	Vice President Human Resources Associated Grocers Inc.	2001

*Resigned April 15, 2004
** Chairman

Management

Daily operations of the Trust are managed by the following individuals:

<u>Name</u>	<u>Responsibility</u>
Debra DeSpain	Senior Account Manager – HMA
Judy Murta	Client Service Manager – HMA
William Barnes	William Barnes Consulting (benefits, planning)
Leon F. Ficker, CPA	Leon F. Ficker, CPA (accounting)
Richard J. Birmingham	Birmingham Thorson & Barnett, PC (legal)
Ned Taylor	Columbia Trust Company (investments)

Administrative Services Agreement

The Trust is party to an administrative service agreement with Healthcare Management Administrators (HMA). Terms of the agreement name HMA as the “contract administrator” which is responsible for performing certain services with respect to the operations of the Trust. These services include: claims processing, underwriting, record maintenance, premium collection, and all services necessary to comply with applicable laws and to properly administer the benefits provided by the Trust. In consideration of the services performed, the Trust remits to HMA a per-covered-employee per-month administrative fee.

CONFLICT OF INTEREST

Trustees signed conflict of interest statements showing they had no conflicts of interest as of December 31, 2003. This is in compliance with ORS 731.302 and the NAIC Financial Examiners Handbook.

TRUST RECORDS

The Trust does not have Articles of Incorporation or Bylaws. Instead, the Trust has a trust agreement which defines its purpose and sets forth the rights and responsibilities of its trustees, employers, employees, and beneficiaries with respect to the MEWA. It was amended and restated effective January 1, 2001.

Trust Minutes

Periodically, the Trust conducted meetings to discuss large claims and reinsurance coverages, and to review financial statements and other matters relating to the Trust. A review of the minutes supported the activities of the Trust. A quorum was present at all meetings.

FIDELITY BONDS AND OTHER INSURANCE

The examination of insurance coverages involved a review of the adequacy of limits and retentions and the solvency of the insurers providing the coverages.

HMA provides the Trust's insurance coverage as required in the Administrative Services Agreement. The Regence Group covers HMA under its policies, since it is an affiliate. HMA maintains fidelity coverage under a policy insuring loss from employee dishonesty for up to \$1,000,000. The fidelity coverage met the minimum limits prescribed by the National Association of Insurance Commissioners and the Trust is therefore in compliance with the requirement of ORS 750.318(3).

PENSION PLANS

The Trust does not have any employees, therefore, no liability for employee benefits was accrued.

TERRITORY AND PLAN OF OPERATION

The Trust provides health insurance to food industry employers who are members or customers of Associated Grocers, Inc., in Alaska, Washington and Oregon. There are no licensed agents. Marketing and payment of benefits are handled by the third party administrator, HMA. Bill Barnes presents the benefit packages available through the Trust to eligible grocers.

REINSURANCE

Sun Life Assurance Company of Canada provides the Trust with a stop loss policy, which has been in effect since January 1, 1999. Medical and prescription drug claims are covered up to \$2,000,000 after a \$225,000 specific benefit deductible.

Aggregate benefits and retentions in effect for 2004 for medical and prescription drugs are as follows:

Aggregate benefit maximum	\$1,000,000									
Aggregate benefit maximum eligible expenses per covered person	\$225,000									
Aggregate deductible factors (ADF)	The ADF per benefit month for each covered unit by covered benefit is as follows:									
	<table><thead><tr><th>Covered Benefits</th><th>Covered Unit</th><th>ADF</th></tr></thead><tbody><tr><td>Medical</td><td>Single employee, Employee & family</td><td>\$641.56</td></tr><tr><td>Dental</td><td>Single employee, Employee & family</td><td>\$131.66</td></tr></tbody></table>	Covered Benefits	Covered Unit	ADF	Medical	Single employee, Employee & family	\$641.56	Dental	Single employee, Employee & family	\$131.66
Covered Benefits	Covered Unit	ADF								
Medical	Single employee, Employee & family	\$641.56								
Dental	Single employee, Employee & family	\$131.66								
Minimum aggregate deductible	The minimum aggregate deductible for the current policy year is the greater of: a) \$14,103,533; or b) 100% of the monthly aggregate deductible for the first month of the policy year multiplied by 12.									

According to the general provisions of the reinsurance agreement, the bankruptcy, insolvency, dissolution, receivership or liquidation of the Trust will not result in HMA imposing upon Sun Life Assurance Company any obligations other than those set forth in the policy.

ACCOUNTS AND RECORDS

The records and source documentation that supported the amounts presented in the Trust's February 29, 2004, monthly financial statements were maintained in a manner by which the financial condition was readily verifiable as required by ORS 733.170. Leon Ficker, CPA maintains the Trust's general ledger and prepares the financial statements. HMA maintains claims records and cash accounting on its computerized system.

PACIFIC GROCERS EMPLOYEE BENEFIT TRUST
BALANCE SHEET
AS OF FEBRUARY 29, 2004

<u>ASSETS</u>	<u>Per Company</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>
Bonds (Note 1)	\$2,369,219	\$	\$2,369,219
Cash (Note 2)	<u>1,462,903</u>	<u>(38,850)</u>	<u>1,424,053</u>
Subtotal cash and invested assets	3,832,122	(38,850)	3,793,272
Premiums due and unpaid	211,537		211,537
Accounts receivable – others	0		0
Interest income due and accrued	0		0
Prepaid expenses (Note 3)	<u>12,906</u>	<u>(12,906)</u>	<u>0</u>
Total Assets	<u>\$4,056,565</u>	<u>\$(51,756)</u>	<u>\$4,004,809</u>
<u>LIABILITIES</u>			
Claims unpaid (Note 4)	\$846,853	\$188,291	\$1,035,144
Unpaid claims adjustment expense (Note 4)	0	39,434	39,434
Unearned premiums	0		0
Premiums received in advance	0		0
General expenses due or accrued (Note 5)	<u>79,479</u>	<u>14,342</u>	<u>93,821</u>
Total Liabilities	<u>926,332</u>	<u>242,067</u>	<u>1,168,399</u>
<u>CAPITAL AND SURPLUS</u>			
Unassigned funds	<u>3,130,233</u>	<u>(293,823)</u>	<u>2,836,410</u>
Total capital and surplus	<u>3,130,233</u>	<u>(293,823)</u>	<u>2,836,410</u>
Total Liabilities, Capital and Surplus	<u>\$4,056,565</u>	<u>\$(51,756)</u>	<u>\$4,004,809</u>

PACIFIC GROCERS EMPLOYEE BENEFIT TRUST
INCOME STATEMENT
AS OF FEBRUARY 29, 2004

<u>UNDERWRITING INCOME</u>	<u>Per Company</u>	<u>Examination Changes</u>	<u>Per Examination</u>
Premiums earned	<u>\$1,555,113</u>	<u>\$ 0</u>	<u>\$1,555,113</u>
Claims incurred net of reinsurance (Note 4)	1,056,522	202,533	1,259,055
Expenses incurred:			
Claim adjustment (Note 4)	97,543	39,434	136,977
Administrative	10,137	12,587	22,724
Soliciting		23,325	23,325
Reinsurance expense	<u>31,738</u>	<u>0</u>	<u>31,738</u>
Total underwriting deductions	<u>1,195,940</u>	<u>277,879</u>	<u>1,473,819</u>
Net underwriting gain or (loss)	<u>359,173</u>	<u>(277,879)</u>	<u>81,294</u>
 <u>INVESTMENT INCOME</u>			
Net investment income earned	33,036	(3,038)	29,998
Net realized capital gains (losses)	<u>0</u>	<u>0</u>	<u>0</u>
Net investment gain (loss)	<u>33,036</u>	<u>(3,038)</u>	<u>29,998</u>
 <u>OTHER INCOME</u>			
Net gain or (loss) before federal income taxes	392,209	(280,917)	111,292
Federal Income Taxes incurred	<u>0</u>	<u>0</u>	<u>0</u>
Net gain or (loss)	<u>\$392,209</u>	<u>\$(280,917)</u>	<u>\$ 111,292</u>
 <u>SURPLUS AND SPECIAL FUNDS</u>			
Surplus and special funds December 31, 2003	<u>\$2,738,024</u>	<u>\$ 0</u>	<u>\$2,738,024</u>
 <u>GAINS AND LOSSES</u>			
Net gain or (loss)	392,209	(280,917)	111,292
Net unrealized capital gains or (losses)	0		0
Change in nonadmitted assets	<u>0</u>	<u>(12,906)</u>	<u>(12,906)</u>
Change in surplus for the year	<u>392,209</u>	<u>(293,823)</u>	<u>(98,386)</u>
Surplus and special funds February 29, 2004	<u>\$3,130,233</u>	<u>\$(293,823)</u>	<u>\$2,836,410</u>

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Bonds

Bond values were stated at market value as shown on the asset listing from Well Fargo Bank as of February 29, 2004. A quality distribution of bonds is presented below:

<u>Year</u>	<u>Total Book Value</u>	<u>Market Value</u>	<u>Noninvestment Grade Securities*</u>	<u>Percentage of Portfolio</u>
February 2004	\$2,369,219	\$2,369,219	0	0.00%
Total Assets	\$4,004,809	\$4,004,809	0	0.00%

*Investment grade is defined by the NAIC as those securities with an NAIC Security Valuation Office (SVO) rating of "1" or "2." Noninvestment grade securities are those with an (SVO) rating of "3" to "6."

**All amounts were derived from the Trust's investment listing from Wells Fargo Bank as of February 29, 2004.

Investments are required to be valued at amortized value pursuant to ORS 731.302 and guidelines promulgated by the NAIC. However, since the difference between the market value and the cost was immaterial and the amortized value would be between market value and cost, no adjustment was made to the financial statements.

Note 2 - Cash

Outstanding checks totaling \$38,850 were misclassified as general expenses due and accrued on the Trust's balance sheet. NAIC annual statement instructions require that all cash amounts be presented as an asset on the balance sheet. Therefore, the outstanding checks were offset against the company cash balance. The resulting net cash balance is shown on the accompanying balance sheet.

Note 3 - Prepaid Expenses

Prepaid expenses are not allowed as an admitted asset under ORS 733.020.

Note 4 - Claims Liabilities

David N. Ball, FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services, increased the reserves and set up an additional unpaid claims adjustment expense reserve in his actuarial report.

He reviewed the calculations of actuarial liabilities for the company performed by Gary W. Massingill, FSA, MAAA, of Milliman USA as of February 29, 2004. He also reviewed the statement of actuarial opinion signed by Mr. Massingill as of December 31, 2003, and other monthly statements, supporting documentation, spreadsheets, and verbal information provided by the company. He performed independent calculations for the

claims liability as of February 29, 2004. His estimates for the company's liabilities are as follows:

	<u>Company Balance</u>	<u>Examination Balance</u>	<u>Difference</u>
Claims Unpaid	\$846,853	\$1,035,144	\$188,291
Unpaid Adjustment Expenses	\$ 0	\$ 39,434	\$ 39,434

In addition to the difference noted above for claims unpaid, a search for unrecorded liabilities addressed in Note 5 revealed additional claims expenses totaling \$14,242. This results in adjustments to claims incurred net of reinsurance totaling \$202,533.

Note 5 - General Expenses Due or Accrued

As addressed in Note 2, the balance reported by the company was overstated by \$38,850 because outstanding checks were reported as general expenses due or accrued, instead of reflected in the company's cash balance. Additionally, this examination included a search for unrecorded liabilities. The search revealed expenses totaling \$53,192 that were not recorded by the company. The effect of these adjustments is a net increase in the liability totaling \$14,342 and an outstanding balance of general expenses due or accrued totaling \$93,821.

MARKET CONDUCT

An initial qualifying market conduct review was conducted to determine the Trust's ability to comply with applicable requirements in several areas of operation. The examination consisted of interviewing employees of the Trust's Third Party Administrator (TPA), HMA, and reviewing documentation presented by the Trust including the TPA Agreement, Trust Agreement, and Employer Participation Agreement.

The following deficiency was noted as a result of this limited review. It should be noted a comprehensive market conduct examination was not conducted.

Company Operations/Management

ORS 744.740 requires the Trust to conduct a review of the operations of the TPA at least annually. The Trust did not conduct an annual review of the TPA, nor did it

provide any other documentation showing how it monitors the TPA's activities performed on behalf of the Trust.

I recommend the Trust adequately monitor the activities of its TPA, or any other entity that contractually assumes a business function or is acting on behalf of the Trust in compliance with ORS 744.700 through 744.740 and OAR 836-075-0050(3).

Management of the Trust is aware of the market conduct comment and recommendation contained in this report and the expectation that the Trust will comply with the Oregon Insurance Code.

CONCLUSION

The Trust has completed its application and substantially conforms to the financial requirements of the Oregon Insurance Code and is aware of the expectation that it will comply with the applicable market conduct requirements of the Insurance Code.

SUBSEQUENT EVENTS

Effective April 15, 2004, Robert Cook resigned from the Board of Trustees.

ACKNOWLEDGMENT

The cooperation and assistance extended by the trustees and employees of HealthCare Management Associates during the examination process are gratefully acknowledged.

In addition to the undersigned, Gary Stephenson, AIE, market conduct insurance examiner and David N. Ball FSA, MAAA, actuary for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

Michael P. Phillips, CFE, CPA, AES
Supervising IS Specialist
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Michael P. Phillips, CFE, CPA, AES, being duly sworn, deposes and says the preceding report of financial examination as of February 29, 2004, of Pacific Grocers Employee Benefits Trust, Bellevue, Washington, subscribed by him is true and correct to the best of his knowledge and belief.

Michael P. Phillips, CFE, CPA, AES
Supervising IS Specialist
Insurance Division
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to before me this _____ day of _____, 2004.

Notary Public for the State of Oregon