



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**PREFERRED HEALTH PLAN, INC.  
KLAMATH FALLS, OREGON**

**NAIC COMPANY CODE 11161**

AS OF

DECEMBER 31, 2006

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April 27, 2007

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

**PREFERRED HEALTH PLAN, INC.  
2909 Daggett Avenue, Suite 275  
Klamath Falls, Oregon 97603**

**NAIC Company Code 11161**

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

## **SCOPE OF EXAMINATION**

We examined the Company's financial statements as of December 31, 2006. This examination covers the four-year period then ended. Material transactions or events subsequent to the examination cut-off date were reviewed and noted during the examination.

We followed the provisions of ORS 731.300 and the procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC). This examination determined the Company's financial condition, ability to fulfill its obligations, nature of operations and compliance with the Insurance Code. Accounting methods, records and supporting evidence were examined or tested. Assets, liabilities, income and expense related items were also examined or tested. Corrective actions taken by the Company in response to comments and/or recommendations in the December 31, 2002, report were reviewed.

Molatore, Scroggin, Petersen & Co LLP (MSP), the Company's independent auditors, conducted an audit of the Company's financial statements for the year ended December 31, 2006. We incorporated their confirmations into our work papers.

David N. Ball, FSA, MAAA, and Scott L. Fitzpatrick, FSA, MAAA, life and health actuaries for the State of Oregon, Department of Consumer and Business Services, Insurance Division, evaluated claims unpaid and unpaid claims adjustment expenses for this examination. Their conclusions are included in the notes to the financial statements section of this report.

## **COMPANY HISTORY**

The Company was incorporated as FirstChoice Health Plan, Inc., on August 4, 2000. Effective January 1, 2001, the Company changed its name to Preferred Health Plan, Inc. Effective September 17, 2001, the Company changed its name to PHP Health Plan, Inc. The Company received its certificate of authority as a health care service contractor pursuant to

ORS Chapter 750 on October 5, 2001. It began operations on November 27, 2001. Effective March 29, 2006, the Company changed its name back to Preferred Health Plan, Inc.

### **CAPITALIZATION**

The Company was initially capitalized with \$1,300,000 from its parent, Merle West Medical Center (MWMC). In return, MWMC received 1,000 shares of the Company's common stock. These shares represented 100% of the Company's issued and outstanding common stock on October 23, 2000. The Company's original articles of incorporation authorized the Company to issue 10,000 shares of common stock. On September 26, 2002, the Company amended its articles of incorporation to authorize the Company to issue 5,000,000 common shares. On September 26, 2002, the Company authorized a stock split of 130 to 1 and issued an additional 129,000 shares of common stock to its parent in the form of a share dividend.

In 2003, MWMC invested an additional \$590,004 for 49,179 shares of common stock. As of December 31, 2006, MWMC owned 290,279 shares representing 87.12% of the Company's total 333,193 issued and outstanding common capital stock. Fifteen shareholders own the remaining 42,914 stocks, each holding less than 3% of the total outstanding common stocks.

MWMC paid \$1,315,000 to the Company during 2003 in exchange for four subordinated surplus notes.

On April 15, 2004, MWMC purchased 100,000 shares of the Company's common stock for \$600,000 with the understanding that the Company would repurchase those shares in the event it could raise \$2,100,000. The Company issued a subordinated surplus note of \$2,100,000 to RRW Investment Group on May 26, 2004. This note is convertible to the Company's common stock. Simultaneously the Company repurchased 100,000 of its common stock from MWMC for \$600,000 on May 26, 2004.

Each of the surplus notes has a maturity date in 2006 or January 1, 2007. The interest rate of each note is 6%. Each payment of interest on and repayment of principal may be made only with the prior approval of the Oregon Insurance Commissioner. The principal amount borrowed and any interest accrued thereon are subject to and subordinate to all other liabilities of the Company. Upon dissolution or liquidation, no payment of any kind shall be made until all other liabilities of the Company have been paid or otherwise discharged in accordance with the provisions ORS 734.360

### **MANAGEMENT AND CONTROL**

#### **Board of Directors**

Article 3 of the Company's Bylaws designates that the Board shall be comprised of not less than five or more than twelve members. In addition, the Bylaws specify that the Board shall consist of as nearly equal number of representatives as possible of MWMC, physicians licensed in Klamath County and members of the general public that are not physicians or employees of MWMC. Generally, directors serve terms of three years without limitation to the number of 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, 2006, the Company's nine members of the Board of Directors were as follows:

<b><u>Name and Address</u></b>	<b><u>Principal Occupation</u></b>	<b><u>Elected</u></b>
Paul R. Stewart 2865 Daggett Avenue Klamath Falls, OR 97601	President and CEO Merle West Medical Center	2001
Charles R. Taylor 3250 Lakeport Blvd. Klamath Falls, OR 97601	Safety Manager/Vice President Jeld-Wen Inc. Window Manufacturing	2001
Michael J. Casey MD 2200 Bryant Williams Drive, Suite 1 Klamath Falls, OR 97601	MD, President/Physician Klamath Orthopedic Clinic	2005

<b><u>Name and Address</u></b>	<b><u>Principal Occupation</u></b>	<b><u>Elected</u></b>
Kevin G. Palmer 401 Harbor Isles Blvd. Klamath Falls, OR 97601	Controller Jeld-Wen, Inc.	2005
Roderick C. Wendt 3250 Lakeport Blvd. Klamath Falls, OR 97601	President & CEO Jeld-Wen, Inc.	2004
Andrew C. Brandsness 411 Pine Street Klamath Falls, OR 97601	Attorney at Law Brandsness, Brandsness and Rudd	2001
John M. Bell 528 Main Street Klamath Falls, OR 97601	President Bells Hardware	2001
William Guest III 2909 Daggett Avenue, Suite 200 Klamath Falls, OR 97601	President and CEO Cascade Comprehensive Care	2001
James Novak, MD 1905 Main Street Klamath Falls, OR 97601	MD/Partner Klamath Medical Clinic	2002

### **Officers**

Principal officers serving at December 31, 2006, were as follows:

Paul R. Stewart	President/Chairman
Andrew C. Brandsness	Secretary-Treasurer Vice Chairman
Kenneth E. Webb-Bowen	Chief Financial Officer/Investment Officer

### **Affiliated Companies**

The Company is a member of an insurance holding company system in which MWMC is the ultimate parent. MWMC is a hospital organized as a Nonprofit Oregon Corporation governed by a nine member Board of Directors. MWMC is the majority shareholder with 87.12% of the Company's issued and outstanding common stock as of December 31, 2006. In addition, MWMC is one-third owner of Cascade Comprehensive Care, Inc. (CCC). CCC is a for profit corporation that provides utilization management services to the Company.

**Intercompany Agreements**

**Cascade Comprehensive Care - Utilization Services**

The Company entered into an agreement with CCC, in which CCC provides utilization management and case management services to the Company. The Company pays CCC a monthly fee per member for these services in accordance with Schedule A of the agreement. In addition, the Company pays CCC an hourly fee for case management of people not covered under the per member per month portion of the agreement.

Ted Dicken, the Company's CEO, retired effective November 1, 2006. At that time the Board appointed Mr. Bill Guest, President and CFO of Cascade Comprehensive Care, to provide management services to the Company. CCC is charging the Company for the services Mr. Guest provides to the Company. There is no formal agreement in place stating the services to be provided by Mr. Guest to the Company or the charges to be paid to CCC for these services.

Additionally, CCC rents office space to the Company for \$3,485 per month. Currently there is no rental agreement specifying the amount of space rented or the monthly rental expense to be paid by the Company.

**I recommend the Company and CCC enter into an agreement describing the services Bill Guest will provide the Company and the fees to be charged for his services. Additionally, the Company should enter into a rental agreement with CCC that specifies the amount of space rented and the monthly rental expense to be paid by the Company. These recommendations are made pursuant to ORS 732.320(1) and (2).**

#### Merle West Medical Center - Lease Agreement

The Company leased office space from its parent, Merle West Medical Center, under a month-to-month operating lease agreement ending November 8, 2006. Rental expense for 2006 and 2005 was \$42,982 and \$39,850, respectively. The Company also leases equipment under various non-cancelable operating leases that expire through December 2009. Rental expense for 2006 and 2005 was \$19,274 and \$15,813, respectively.

#### Merle West Medical Center - Participating Hospital Agreement

On November 1, 2001, the Company entered into an agreement with MWMC whereby MWMC agrees to provide services and supplies to the Company's members. The Company agrees to pay a percentage of billed charges for inpatients and outpatients to MWMC for covered services within thirty days of receipt of a complete and accurate claim. The agreement contained a hold harmless provision.

#### *Nonaffiliate Agreement*

##### QVI Risk Solutions Inc. - TPA Services Agreement

Effective January 1, 2004, the Company entered into an agreement with QVI Risk Solutions Inc. (QVI) for claims administration. QVI's responsibilities under the terms of the agreement include: receiving and reviewing claims-related documents, calculating amounts payable under the Company's plan, preparing and mailing explanation of benefits and benefit checks, performing the necessary correspondence with claimants and/or their providers, and providing periodic reports to the Company. In return for these services, the Company pays QVI a per-member per-month fee. The Company has the final discretionary authority to settle claims and determine a member's eligibility. As a result, the agreement complies with the provisions of ORS 732.215.

## **CONFLICT OF INTEREST**

The Company's conflict of interest policy requires all employees and directors to report conflicts of interest to the Company. All those required to complete a conflict of interest statement did so. From a review of the completed conflict of interest affirmation, it appeared that the affected personnel performed due diligence in completing the conflict of interest statements and reporting potential conflicts of interest.

## **CORPORATE RECORDS**

### **Board Minutes**

Regular Board meetings are held monthly. 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 investment transactions are approved by the Board of Directors pursuant to the provisions of ORS 733.730. However, the Board of Directors does not authorize the salaries of officers and managers as required by ORS 732.320(3).

**I recommend the Board of Directors approve the Company officers and managers salaries to comply with ORS 732.320.**

### **Articles of Incorporation**

At the December 15, 2005 Board of Directors meeting, a new Article 1 was adopted changing the Company's name to Preferred Health Plan, Inc. The Articles of Incorporation conformed with Oregon statutes.

### **Bylaws**

The Bylaws conformed with Oregon statutes.

### **Insurance Holding Company Registration Statement**

An insurance 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) 830-27-0020(1).

### **FIDELITY BOND AND OTHER INSURANCE**

All the insurance policies cover both the Company and MWMC. Under these policies the Company is insured for up to \$1,300,000 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 \$1,000,000 per single loss with a \$5,000,000 annual aggregate limit. Other insurance coverages in force at December 31, 2006, included property, managed care errors and omissions liability, and commercial general liability. All coverages appeared adequate as of December 31, 2006.

### **TERRITORY AND PLAN OF OPERATION**

The Company transacts business as a health care service contractor throughout Oregon, with most of its business written in Klamath and Lake counties. The Company offers individual, small group (2-50 employees) and large group (50 employees and above) health, vision and dental coverage. Policy deductibles typically range between \$500 and \$5,000 with an 80% coverage and 20% co-pay. Eligible expenses are covered up to a maximum of \$2,000,000 lifetime per person. The Company contracts with licensed independent agents and brokers to market its products.

## **PENSION PLANS AND OTHER EMPLOYEE BENEFITS**

### **Employee Retirement Plan**

The Company has a matching defined contribution plan under Internal Revenue Section 401(k) covering all full time employees. Under the terms of the plan, the Company matches 3% of a participant's contributions. Benefits under the plan are provided through a trust fund.

It was modified in 2006 to allow automatic rollover of lump sum distributions from the 401(k) into an Individual Retirement Account (IRA) if an individual terminates employment with the Company. The Company's contributions for 2006 and 2005 were \$10,098 and \$10,115, respectively.

### **Flexible Benefits Account**

The Company has a Flexible Benefits Plan with American Family Life Assurance Company of Columbus (AFLAC). Under this plan all employees are eligible to enroll the first day of the month following 90 days of employment. Individuals participate by signing a Salary Redirection Agreement (SRA) on which they can elect one or more of the Benefit Plans or policies available under the Plan, as well as agree to a salary redirection to pay for those benefits elected. The purpose of the plan is to allow eligible employees to pay for certain benefits offered under the Plan with pre-tax dollars called "Pre-tax Contributions."

## **GROWTH OF THE COMPANY**

Growth of the Company since the last financial examination is reflected in the following schedule. Amounts were derived from the Company's annual statements, except in those years where the Oregon Insurance Division published a report of examination.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Net Income (Loss)</u>
2002*	\$1,738,416	\$ 998,235	\$ 740,181	(\$564,841)
2003	4,127,359	2,571,290	1,556,069	(1,510,671)
2004	5,796,267	2,484,862	3,311,405	(775,806)
2005	7,298,909	3,086,342	4,212,567	791,898
2006*	6,407,387	2,579,094	3,828,293	(1,294,122)

\*Per examination

Though the Company lost money every year but 2005, it was able to maintain an active Certificate of Authority through the issuance of subordinated surplus notes totaling \$3,415,000, the sale of common capital stock totaling \$1,546,911, and an increase in gross paid in and contributed surplus totaling \$526,569.

### CLAIMS EXPERIENCE

The following exhibit reflects the underwriting results of the Company since 2002. The amounts were compiled from the Company's filed annual statements, except in those years where the Oregon Insurance Division published a report of examination.

<u>Year</u>	<u>Administrative, Hospital &amp; Medical Expenses</u>	<u>Net Premiums</u>	<u>Loss Ratio</u>
2002*	\$ 3,774,437	\$ 3,221,746	117%
2003	15,441,780	13,910,425	111%
2004	18,877,391	18,036,957	105%
2005	17,950,112	18,315,757	98%
2006*	23,023,802	21,368,498	108%

\* Per examination

Typically a ratio greater than 100% indicates an underwriting loss. Losses were offset by the issuance of subordinated surplus notes totaling \$3,415,000, the sale of common capital stock totaling \$1,546,911, and additional gross paid in and contributed surplus totaling \$526,569.

## REINSURANCE

The Company cedes reinsurance premium under an Excess Risk Reinsurance Agreement to Reliastar Life Insurance Company (Reliastar) of Minneapolis, Minnesota. All the commercial health insured members are covered. The current agreement is effective December 1, 2006 through November 30, 2007, with terms similar to the prior reinsurance agreement with ReliaStar. This is a 100% coinsurance per member per the agreement period for all eligible services. The maximum retained liability and maximum reinsurance coverage are as follows:

Layer 1. Losses up to \$2,000,000 in excess of \$125,000 retention per member.

Layer 2. Losses up to \$2,000,000 in excess of \$2,125,000 retention per member.

In addition, the Company has a Multiple Loss Reinsurance Agreement with Reliastar effective December 1, 2006, terminating November 30, 2007. It covers the same groups of commercial health insured members for all eligible services. It covers losses involving more than one covered member. The Multiple Loss Reinsurance Agreement covers losses up to \$1,000,000 per agreement period maximum limit with a \$500,000 retention. It has a \$250,000 maximum on any one life.

The reinsurance contract contained an insolvency clause in accordance with ORS 731.508(3), such a clause is required to take reserve credits for reinsurance ceded. In addition, it was determined that the Company's reinsurance contract provided for risk transfer in accordance with the requirements of SSAP No. 62.

## **ACCOUNTS AND RECORDS**

The Company's accounting and corporate records were maintained in a manner in which the financial condition was readily verifiable as required by the provisions of ORS 733.170. In addition, the Company has a system in place to account for unclaimed funds. However, the following issues were noted as a result of this examination.

### **Investments**

In May 2004, the Company issued a \$2,100,000 subordinated surplus note to RRW Investment, LLC. Most of this money received in exchange for this surplus note was deposited into an investment account at IMS Capital Management of Portland, Oregon. An investment agreement was prepared but never finalized.

**I recommend the Company finalize an investment agreement with IMS, specifying IMS' obligations and the fees charged to the Company under the agreement. This recommendation is made pursuant to the provisions of ORS 731.302(1).**

## **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

The Company complied with the recommendations made in the examination report dated December 31, 2002.

**PREFERRED HEALTH PLAN, INC.**  
**STATEMENT OF ASSETS, LIABILITIES, CAPITAL AND SURPLUS**  
**As of December 31, 2006**

<b><u>ASSETS</u></b>	<b><u>Per Company</u></b>	<b><u>Examination Adjustments</u></b>	<b><u>Per Examination</u></b>
Bonds	\$ 255,555	\$ 0	\$ 255,555
Common stocks (Note 1)	2,987,659		2,987,659
Cash and short-term investments (Note 1)	2,820,891		2,820,891
Investment income due and accrued	7,388		7,388
Uncollected premium due and accrued	3,601		3,601
Amounts recoverable from reinsurers	306,000		306,000
Electronic data processing equipment	12,827		12,827
Health care and other receivables	<u>13,516</u>	<u>0</u>	<u>13,516</u>
 Total Assets	 <u>\$6,407,387</u>	 <u>\$ 0</u>	 <u>\$6,407,387</u>
 <b><u>LIABILITIES</u></b>			
Claims (Note 2)	\$2,071,424	\$ 0	\$2,071,424
Unpaid claims adjustment expenses (Note 2)	82,857		82,857
Premium received in advance	249,968		249,968
General expenses due and accrued (Note 3)	134,156		134,156
Amounts withheld or retained for others (Note 3)	<u>17,234</u>	<u>0</u>	<u>17,234</u>
 Total Liabilities	 <u>2,579,094</u>	 <u>0</u>	 <u>2,579,094</u>
 <b><u>CAPITAL AND SURPLUS</u></b>			
Common capital stock	3,373,480		3,373,480
Gross paid in and contributed surplus	526,569		526,569
Surplus notes (Note 4)	3,415,000		3,415,000
Unassigned funds	<u>(3,486,756)</u>	<u>0</u>	<u>(3,486,756)</u>
 Total Capital and Surplus	 <u>3,828,293</u>	 <u>0</u>	 <u>3,828,293</u>
 Total Liabilities, Capital and Surplus	 <u>\$6,407,387</u>	 <u>\$ 0</u>	 <u>\$6,407,387</u>

**PREFERRED HEALTH PLAN, INC.**  
**STATEMENT OF REVENUES AND EXPENSES**  
**For the Year Ended December 31, 2006**

	<u>Per Company</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>
Member Months	191,289		191,289
Net premium income	<u>\$21,368,498</u>	\$ 0	<u>\$21,368,498</u>
<u>Hospital and Medical:</u>			
Hospital/medical benefits	19,212,330	0	19,212,330
Prescription drugs	<u>2,721,071</u>	<u>0</u>	<u>2,721,071</u>
Subtotal	21,933,401		21,933,401
<u>Less:</u>			
Net reinsurance recoveries	<u>1,378,114</u>	<u>0</u>	<u>1,378,114</u>
Total hospital and medical	20,555,287	0	20,555,287
Claims adjustment expense	1,035,128		1,035,128
General administrative expense	<u>1,433,387</u>	<u>0</u>	<u>1,433,387</u>
Total underwriting deductions	<u>23,023,802</u>	<u>0</u>	<u>23,023,802</u>
Net underwriting gain or (loss)	<u>(1,655,304)</u>	<u>0</u>	<u>(1,655,304)</u>
Net investment income earned	85,499		85,499
Net realized capital gain (losses)	<u>275,683</u>	<u>0</u>	<u>275,683</u>
Net investment gains (losses)	<u>361,182</u>	<u>0</u>	<u>361,182</u>
Net income (loss)	<u><u>\$(1,294,122)</u></u>	<u><u>\$ 0</u></u>	<u><u>\$(1,294,122)</u></u>

**CAPITAL AND SURPLUS ACCOUNT**

Capital and surplus prior reporting period	<u>\$4,212,567</u>
Net income	(1,294,122)
Change in net unrealized capital gains (losses)	(127,246)
Change in nonadmitted assets	(7,914)
Examination changes	0
Capital Changes:	
Paid in	<u>1,045,008</u>
Net change in capital & surplus	<u>(384,274)</u>
Capital and surplus end of reporting period	<u><u>\$3,828,293</u></u>

## **NOTES TO FINANCIAL STATEMENTS**

### **Note 1 – Invested Assets**

Common stocks, cash, and short-term investments comprise 90.7% of the Company's total assets. Common stocks are invested in many different companies, with none of the shares exceeding the 10% of total assets limitation of ORS 733.770. U.S Treasury Bills and notes comprise the \$2,396,516 invested in short-term investments.

### **Note 2 - Claims Unpaid and Claims Adjustment Expenses**

David N. Ball, FSA, MAAA, and Scott Fitzpatrick, FSA, MAAA, life and health actuaries for the Department of Consumer and Business Services, Insurance Division, reviewed the actuarial liabilities for the Company as prepared by James L. Reed, MAAA, of Milliman, Inc., as of December 31, 2006. They also reviewed other documentation provided by the Company, insurance examiners, and Mr. Reed. They performed independent calculations for the actuarial liability as of December 31, 2006. Their conclusions are as follows:

Our total estimate for actuarial liabilities is less than the company's estimate by just \$55,000. The statement of the actuarial liabilities at year end for the annual statement was conservative to the proper degree for this company, and the company's reserves were sufficient to cover their liabilities for the stated items at the end of 2006.

### **Note 3 – Amounts Withheld or Retained for Account of Others**

State workers' compensation payable, state unemployment tax payable and federal unemployment taxes payable totaling \$1,104 should be reclassified from general expenses due and accrued to amounts withheld or retained for account of others. This is required by the NAIC Annual Statement Instructions. No adjustment was made to the accompanying financial statements because the amount is immaterial.

#### **Note 4 – Surplus Notes**

The Company issued surplus notes for cash during the exam period as follows:

<b><u>Issue Date</u></b>	<b><u>Entity</u></b>	<b><u>Interest Rate</u></b>	<b><u>Par Value</u></b>	<b><u>Carrying Value</u></b>	<b><u>Total Interest Accrued</u></b>
9/30/2003	Merle West Med Ctr	6.00%	175,000	175,000	34,147
11/13/2003	Merle West Med Ctr	6.00%	130,000	130,000	24,426
12/15/2003	Merle West Med Ctr	6.00%	75,000	75,000	13,697
12/23/2003	Merle West Med Ctr	6.00%	935,000	935,000	169,530
5/26/2004	RRW Investment Group LLC	6.00%	<u>2,100,000</u>	<u>2,100,000</u>	<u>327,600</u>
Total Surplus Notes			<u>3,415,000</u>	<u>3,415,000</u>	<u>569,400</u>

Interest is reported as an expense and a liability only after payment has been approved by the Department of Consumer and Business Services (DCBS). Accrued interest of \$569,400 has not been approved for payment by DCBS, and accordingly has not been recognized as an expense or a liability as of December 31, 2006.

Under the terms of the surplus notes, the repayment of principal or payment of interest requires the approval of the director of DCBS. In addition, the terms also specify that payment of the principal or interest is subordinate to the payment of the claims and general liabilities of the Company. All surplus note issued by the Company have been approved by the director of DCBS.

#### **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The following is a summary of the comments and recommendations made in this report of examination:

##### **Page**

- 8 I recommend the Company and CCC enter into an agreement describing the services Bill Guest will provide the Company and the fees to be charged for his services. Additionally, the Company should enter into rental agreement with CCC specifying the amount of space rented and the monthly rental expense to be paid by the Company. These recommendations comply with ORS 732.320(1) and (2).

Page

- 10 I recommend the Board of Directors approve the Company officers' and managers' salaries to comply with ORS 732.320.
- 15 I recommend the Company finalize an investment agreement with IMS, specifying IMS' obligations and the fees charged to the Company under the agreement. This recommendation is made pursuant to the provisions of ORS 731.302(1).

**CONCLUSION**

During this four-year examination period, the Company's capital and surplus increased from \$740,181 as presented in the December 31, 2002 examination report to \$3,828,293 as shown in this examination report. Below are the comparative assets and liabilities:

	<b>December 31,</b>		
	<b><u>2006</u></b>	<b><u>2002</u></b>	<b><u>Change</u></b>
Assets	\$6,407,387	\$1,738,416	\$4,668,971
Liabilities	<u>2,579,094</u>	<u>998,235</u>	<u>1,580,859</u>
Surplus	<u>\$3,828,293</u>	<u>\$ 740,181</u>	<u>\$3,088,112</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, Timothy R. Hurley, CFE, insurance examiner, and David N. Ball, FSA, MAAA and Scott Fitzpatrick, FSA, MAAA, life and health actuaries, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

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Mike P. Phillips, CFE, CPA, AES  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

**AFFIDAVIT**

STATE OF OREGON            )  
  )  ss  
County of Marion            )

Mike P. Phillips, CFE, CPA, AES, being duly sworn, states as follows:

1.     I have authority to represent the state of Oregon in the examination of Preferred Health Plan, Inc.
  
2.     The state of Oregon is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
  
3.     I have reviewed the examination work papers and examination report, and the examination of Preferred Health Plan, Inc., was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

\_\_\_\_\_  
Mike P. Phillips, CFE, CPA, AES  
Supervising Insurance Examiner  
Insurance Division  
Department of Consumer and Business Services  
State of Oregon

Subscribed and sworn to before me this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

\_\_\_\_\_  
NOTARY PUBLIC for the State of Oregon

My Commission Expires: \_\_\_\_\_