



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF TARGET FINANCIAL EXAMINATION

OF

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

NAIC COMPANY CODE 11161

AS OF

OCTOBER 31, 2008

TABLE OF CONTENTS

SALUTATION	3
SCOPE OF EXAMINATION	4
CAPITALIZATION	4
COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS	6
FINANCIAL STATEMENTS.....	7
NOTES TO THE FINANCIAL STATEMENTS.....	11
<i>Note 1 - Claims Unpaid and Claims Adjustment Expenses.....</i>	<i>11</i>
EVENTS SUBSEQUENT TO OCTOBER 31, 2008.....	11
<i>Order of Supervision and Order to Increase Capital and Surplus.....</i>	<i>11</i>
<i>Subordinated Surplus Notes</i>	<i>12</i>
<i>Operating Results since October 31, 2008.....</i>	<i>13</i>
CONCLUSION	14
ACKNOWLEDGMENT	15
AFFIDAVIT	16

SALUTATION

January 30, 2009

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 guidelines in the National Association of Insurance Commissioners (NAIC) Examiners Handbook, pursuant to ORS 731.300 and 731.302, respectively, we have examined the business affairs and financial condition of

**PHP HEALTH PLAN, INC.
2909 Daggett Avenue, Suite # 275
Klamath Falls, Oregon 97601**

NAIC COMPANY CODE 11161

hereinafter referred to as the "Company" or the "Plan." The following report is respectfully submitted.

SCOPE OF EXAMINATION

This examination is limited in scope to verify assets, liabilities and surplus as of October 31, 2008. It was conducted due to the Insurance Division's concern over the Plans' declining capital and surplus and poor operating results during 2008. The Plans' financial condition and operating results for the period leading up to September 2008 caused the Plan to operate in a hazardous manner. As a result, the director signed an order of supervision and initiated this targeted financial examination. See Events Subsequent to October 31, 2008 below.

The examination was conducted in accordance with procedures and guidelines prescribed by the National Association of Insurance Commissioners (NAIC).

The Oregon Insurance Division conducted a full-scope financial examination of the Plan as of December 31, 2006. The Plans' compliance with the recommendations in the report of that examination is discussed below.

CAPITALIZATION

The Company's original articles of incorporation authorized the Company to issue 10,000 shares of common stock. The Company was initially capitalized with \$1,300,000 from its parent, Merle West Medical Center (MWMC), in exchange for 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. 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.

During 2003, MWMC invested an additional \$590,004 for 49,167 shares of common stock. 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 of additional surplus. 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 the 100,000 of its common stock from MWMC for \$600,000.

MWMC purchased 55,556 shares of the Company's common stock for \$500,004 during June 2006 and 55,556 shares of additional common stock for \$500,004 during September 2006. 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 stock.

In addition to the capital stock, the following surplus notes are in effect:

<u>Note # / Issued To</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Maturity</u>
1. Merle West Medical Center	\$ 175,000	6.00%	10-1-2006
2. Merle West Medical Center	130,000	6.00%	11-1-2006
3. Merle West Medical Center	75,000	6.00%	12-1-2006
4. Merle West Medical Center	935,000	6.00%	1-1-2007
5. RRW Investment Group LLC	2,100,000	6.00%	1-1-2007
6. Sky Lakes Medical Center *	680,000	6.00%	1-1-2012
7. Sky Lakes Medical Center **	25,675	6.00%	1-1-2012
Total	<u>\$ 4,120,675</u>		

* On May 15, 2007, Merle West Medical Center (MWMC) was renamed to Sky Lakes Medical Center (SLMC).

** Issued on November 30, 2008. See Subsequent Event portion of this report.

Each payment of interest and repayment of principal may be made only with the prior approval of the director. The principal amount borrowed and any interest accrued thereon is subject to and subordinate to all other liabilities of the Company. Upon dissolution or liquidation of the Plan, no payment of any kind shall be made to holders of the surplus notes until all other liabilities of the Plan have been paid or otherwise discharged in accordance with the provisions ORS 734.360.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

All four recommendations included in the report of examination as of December 31, 2006, have been resolved, as follows:

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

The Plan took the following actions;

- a) The Plan and CCC signed an agreement, which describes the service to be performed by Bill Guest and the respective fees to be charged for these services.
- b) The Plan and CCC signed a lease agreement on June 1, 2007. The terms of the agreement require the Plan to pay \$2,636 per month based upon \$1.42/square foot.

2. I recommend the Board of Directors approve the salaries of the Plans' officers and managers to comply with ORS 732.320.

In the Board of Director minutes of October 18, 2007, the Board approved salaries of the officers and managers.

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

The Plan and IMS finalized an investment agreement. Fees are based on a percentage of the total value of the account under management, determined by taking an average of the prior 3 month-end fair market value of assets held in the account, as described in the Statement of Alternative Fee Structure of the agreement.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Preferred Health Plans, Inc., as of October 31, 2008.

Statement of Assets
Statement of Liabilities, Capital and Surplus
Statement of Revenues and Expenses

PREFERRED HEALTH PLAN, INC.
STATEMENT OF ASSETS
As of October 31, 2008

	BALANCE PER COMPANY	EXAM ADJUSTMENT	BALANCE PER EXAM	NOTE
Assets				
Bonds	\$ 276,240	\$ -	\$ 276,240	
Stocks				
Preferred stock	-	-	-	
Common stock	1,814,693	-	1,814,693	
Cash and short-term investments	3,332,999	-	3,332,999	
Receivable for securities	164,993	-	164,993	
Aggregate write-ins for invested assets	-	-	-	
Subtotal, cash and invested assets	<u>\$ 5,588,925</u>	<u>\$ -</u>	<u>\$ 5,588,925</u>	
Investment income due and accrued	5,029	-	5,029	
Premiums and considerations:				
Uncollected premiums and agent's balances in the course of collection	5,719	-	5,719	
Amounts recoverable from reinsurers	70,000	-	70,000	
EDP equipment and software	3,523	-	3,523	
Furniture and equipment	10,321	(10,321)	-	
Health care and other amounts receivable	9,318	-	9,318	
Aggregate write-ins for other than invested assets	50,883	(50,883)	-	
Total Assets	<u><u>\$ 5,743,718</u></u>	<u><u>\$ (61,204)</u></u>	<u><u>\$ 5,682,514</u></u>	

PREFERRED HEALTH PLAN, INC.
STATEMENT OF LIABILITIES, CAPITAL AND SURPLUS
As of October 31, 2008

	BALANCE PER COMPANY	EXAM ADJUSTMENT	BALANCE PER EXAM	NOTE
Liabilities, Capital and Surplus				
Claims unpaid	\$ 2,111,055		\$ 2,111,055	1
Unpaid claims adjustment expense	84,442		84,442	1
Premiums received in advance	637,721		637,721	
General expenses due or accrued	130,021		130,021	
Amounts withheld or retained for account of others	2,106		2,106	
Payable for securities	126,497		126,497	
Aggregate write-ins for liabilities	6,481	-	6,481	
Total Liabilities	\$ 3,098,323	\$ -	\$ 3,098,323	
Common capital stock	3,373,480		3,373,480	
Gross paid in and contributed surplus	526,569			
Surplus notes	4,095,000		4,095,000	
Unassigned funds (surplus)	(5,410,858)		(5,410,858)	
Total capital and surplus	2,584,191	-	2,584,191	
Total liabilities, capital and surplus	\$ 5,682,514	\$ -	\$ 5,682,514	

PREFERRED HEALTH PLAN, INC.
STATEMENT OF REVENUE AND EXPENSES
For the Period Ended October 31, 2008

	BALANCE PER COMPANY	EXAM ADJUSTMENT	BALANCE PER EXAM	NOTE
Net premium income	\$ 12,097,960	\$ -	\$ 12,097,960	
Aggregate write-in for health care revenue	-	-	-	
Total Revenues	12,097,960	-	12,097,960	
Hospital and Medical:				
Hospital/medical benefits	10,196,942		10,196,942	
Other professional services	950,801		950,801	
Outside referrals	-		-	
Emergency room and out-of-area	-		-	
Prescription drugs	1,579,949		1,579,949	
Aggregate write-ins for other hospital and medical	-	-	-	
Subtotal:	12,727,692	-	12,727,692	
Less:				
Net reinsurance recoveries	286,300	-	286,300	
Total medical and hospital	12,441,392	-	12,441,392	
Non-health claims	-	-	-	
Claim adjustment expenses	(326,432)	-	(326,432)	
General administrative expenses	1,309,175	-	1,309,175	
Increase in reserves for life and accident and health contracts	-	-	-	
Total underwriting deductions	13,424,135	-	13,424,135	
Net underwriting gain or loss	(1,326,175)	-	(1,326,175)	
Net investment income earned	84,690	-	84,690	
Net realized capital gains or (losses)	(118,889)	-	(118,889)	
Net investment gains or (losses)	(34,199)	-	(34,199)	
Net gain from premium balances charged off	-		-	
Aggregate write-ins for other income or expense	-		-	
Net income or (loss) before federal income taxes	(1,360,374)	-	(1,360,374)	
Federal and foreign income taxes incurred	-	-	-	
Net Income (loss)	\$ (1,360,374)	\$ -	\$ (1,360,374)	

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - 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 of October 31, 2008. Their findings are as follows:

The Company's actuarial liabilities were found to be sufficient to cover their liabilities for the stated items at the end of October 31, 2008.

EVENTS SUBSEQUENT TO OCTOBER 31, 2008

Order of Supervision and Order to Increase Capital and Surplus

The Insurance Division responded to the continuing decline in operating results during 2008 by issuing an IMMEDIATE ORDER OF SUPERVISION AND ORDER TO INCREASE CAPITAL AND SURPLUS, on November 6, 2008. The order was issued pursuant to ORS 734.043 and placed the following requirements upon the Plan.

1. The Plan must reduce, suspend or limit the volume of business being accepted or renewed by discontinuing policies or revising policy rates in order to create acceptable loss ratios. The Plan must take the necessary steps to achieve a combined loss ratio not to exceed 100% by the expiration date of the order.

2. The Plan must budget its operations for the next 60 days to eliminate unnecessary or excessive expenses.

3. The Plan must obtain an infusion of capital sufficient to increase its aggregate capital and surplus to \$2,500,000 by the expiration date of the order.

The Order prohibits the Plan from taking any of the following actions without the approval of the supervisor appointed by the director:

1. Disposing of, conveying or encumbering any of the Plans' assets or its business in force.
2. Withdrawing from any of the Plans' bank accounts.
3. Lending any of the Plans' funds.
4. Investing any of Plans' funds.
5. Transferring any of the Plans' property.
6. Incurring any debt, obligation or liability on behalf of the Plan.
7. Merging or consolidating the Plan with any other insurer or person.
8. Entering into any new reinsurance contract or treaty on behalf of the Plan.
9. Approving any new premium or renewing any policies of the Plan.
10. Terminating, surrendering, forfeiting, converting or lapsing any insurance policy, certificate or contract, except for nonpayment of premium.
11. Releasing, paying or refunding premium deposits, unearned premiums, or other reserves on any insurance policy, certificate or contract.
12. Making any material change in management.
13. Increasing salaries and benefits of officers or directors.
14. Making or increasing preferential payment of bonuses, dividends or other payments determined by the supervisor to be preferential.
15. Any other action affecting the business or condition of the Plan.

Subordinated Surplus Notes

On October 31, 2008, the Plan secured an additional surplus note of \$680,000 from Sky Lakes Medical Center. The receipt of these funds allowed the Plan to maintain the minimum requirement of capitalization. The note is payable on demand by SLMC, but not prior to January 1, 2012. All repayment of principal and payment of interest require the prior written

approval of the director and are fully subordinated and subject to the right of prior payment of all other obligations of the Plan, irrespective of the time or order that such obligations were incurred. The Plans' surplus at the end of October was \$2,584,191.

Operating Results since October 31, 2008

The Plan has increased premiums charged to renewing groups, when possible, based upon consultation with its actuaries.

The Plan continued to show, however, a net operating loss for November, which required an additional surplus note of \$25,675 to maintain its surplus at \$2,500,001. Surplus notes at November 30, 2008, total \$4,120,675.

The Plan received a commitment from SLMC to ensure the Plan's capital and surplus does not fall below \$2.5 million. The commitment states, in part, that, "The board supports ensuring that Preferred Health Plans' capital level does not fall below the statutory minimum of \$2.5 million through the balance of this fiscal year, i.e., September 30, 2009."

CONCLUSION

Capital and surplus reported by the Plan as of October 31, 2008, was \$2,584,191, which exceeded the \$2,500,000 requirement imposed by the Order of Supervision. A major contributor is the \$680,000 Subordinated Surplus Note issued to SLMC in October 2008.

During the one-year and ten month examination period, the Plan's capital and surplus decreased \$1,244,102. Capital and surplus decreased from \$3,828,293 as presented in the December 31, 2006, examination report to \$2,584,191 as shown in this examination report.

Below are the comparative assets and liabilities:

	<u>Oct 31, 2008</u>	<u>Dec 31, 2006</u>	<u>Change</u>
Assets	\$ 5,682,514	\$ 6,407,387	\$ (724,873)
Liabilities	<u>3,098,323</u>	<u>2,579,094</u>	<u>(519,229)</u>
Surplus	<u>\$ 2,584,191</u>	<u>\$ 3,828,293</u>	<u>\$ (1,244,102)</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, Greg A. Lathrop, CFE, Supervising Insurance Examiner, Scott Fitzpatrick, FSA, MAAA, and David N. Ball, FSA, MAAA, Life and Health Actuaries for the State of Oregon, Department of Consumer Business Services, participated in the examination.

Respectfully submitted,

Timothy R. Hurley, CFE
Insurance Examiner
Insurance Division
Department of Consumer and Business Services
State of Oregon

AFFIDAVIT

STATE OF OREGON)
) ss
County of Marion)

Timothy R. Hurley, CFE, being duly sworn, states as follows:

1. I have authority to represent the state of Oregon in the examination of Preferred Health Plans, Inc.

2. The Insurance Division of the Department of Consumer and Business Services of 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 Plans, Inc., was performed in a manner consistent with the standards and procedures required by the Oregon Insurance Code.

The affiant says nothing further.

Timothy R. Hurley, CFE
Insurance Examiner
Department of Consumer and Business Services
State of Oregon

Subscribed and sworn to me this _____ day of _____, 2009.

Notary Public for the State of Oregon

My Commission Expires: _____