

STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**PRUDENTIAL HOSPITAL ASSOCIATION  
PORTLAND, OREGON**

**NAIC COMPANY CODE 54992**

AS OF

December 31, 1995

## **TABLE OF CONTENTS**

	<u>Page</u>
Salutation	3
Scope of Examination	4
Company History	5
Affiliated Companies	6
Management and Control	7
Management Affirmation	9
Conflict of Interest	10
Corporate Records	10
Fidelity Bonds and Other Insurance	11
Pension Plans and Other Post Retirement Benefits	11
Territory and Plan of Operation	11
Growth of Company	12
Holding Company Registration	12
Statutory Deposit	13
Dividends to Stockholders	13
Reinsurance	13
Accounts and Records	13
Compliance with Prior Examination Recommendations	14
Statement of Assets, Liabilities, Reserves and Special Funds	15
Underwriting and Investment Exhibit	16
Notes to Financial Statements	17
Summary of Comments and Recommendations	17
Conclusion	18
Acknowledgment	19
Affidavit	20
Appendix - Organizational Chart	

January 27, 1997

Honorable Kerry Barnett, Director  
Department of Consumer and Business Services  
State of Oregon  
350 Winter Street NE, Room 440-4  
Salem, Oregon 97310

Dear Director:

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

**PRUDENTIAL HOSPITAL ASSOCIATION  
111 SW Columbia Street, Suite 600  
Portland, Oregon 97201**

**NAIC Company Code 54992**

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

## **SCOPE OF EXAMINATION**

The examination of the Company was conducted as of December 31, 1995, covering the three-year period then ended, and included a review of material transaction or events which occurred subsequent to the examination cut-off 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 report of examination as of December 31, 1992.

In addition to the above, work papers were reviewed that were prepared by Ernst & Young, the Company's independent auditors in their audit of the Company's accounts for the year ended December 31, 1995. A portion of CPA's 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.

A management affirmation attesting to the Company's compliance with Oregon Laws relating to location of accounts and records, conduct of the Company's affairs in a nonhazardous manner, and exercise of managerial control by a duly qualified and constituted Board of Directors was signed by and received from the Chairman of the Board of Directors.

## **COMPANY HISTORY**

Prudential Hospital Association was incorporated in 1913 under the laws of the State of Oregon for the purpose of operating a general hospital. The Insurance Commissioner later granted a Certificate of Authority to transact business as a medical benefits insurer under the Hospital Association Law of 1917. Centennial Life Insurance Company, an Oregon life insurer, acquired the outstanding capital stock of the Company in July, 1964 and contributed the stock to PHA Life Insurance Company which it formed that same year. As a result, the Company became a wholly owned subsidiary of PHA Life Insurance Company. The name of PHA Life Insurance Company was changed to Pacific Heritage Assurance Company on May 1, 1984.

During 1968, PHA Life Insurance Company sold all of the Company's outstanding stock to its parent company, Pacific Heritage Association, Inc., which held the stock until 1974 when ownership was transferred back to PHA Life Insurance Company (now Pacific Heritage Assurance Company).

PHA Life Insurance Company assumed by a bulk reinsurance transaction all the Company's business effective January 1, 1975. Prudential Hospital Association does not write business and has been in an inactive status since December 31, 1974. Its only income is from investments required to maintain a Certificate of Authority as a health care service contractor.

On March 16, 1982, Pacific Heritage Association, Inc., was liquidated and Beneficial Life Insurance Company, a Utah insurer, acquired all of the outstanding stock of PHA Life Insurance Company.

The Company has 2,500 shares of common stock, \$10 par value, authorized. All authorized shares are issued and outstanding.

## **AFFILIATED COMPANIES**

The Company is a health care service contractor authorized to transact business under Chapter 750. It is a wholly owned subsidiary of Pacific Heritage Assurance Company. Pacific Heritage Assurance Company is a wholly owned subsidiary of Beneficial Life Insurance Company (Beneficial). Beneficial is a stock life insurance company wholly owned by Deseret Management Corporation (DMC). DMC is a management company owned by the corporation of the president of The Church of Jesus Christ of Latter-Day Saints (the Church).

Prudential Hospital Association is affiliated with Pacific Heritage Administrators, Inc., as both companies are owned by Pacific Heritage Assurance Company. Pacific Heritage Administrators, Inc., provides certain administrative services including claims processing for partially self-funded and totally self-funded employer groups.

The Board of Directors approved on May 17, 1995, the incorporation of Pacific Heritage Administrators of Nevada, Inc. (PHN), under the laws of the State of Nevada, as a subsidiary of Pacific Heritage Assurance Company. Prior to its incorporation, PHN was considered a branch office in Las Vegas, Nevada. Schedule "Y" of the 1995 annual statement reflected Pacific Heritage Administrators of Nevada as 100% owned subsidiary of Pacific Heritage Assurance Company.

The organizational chart at the end of this report depicts the composition of the rest of the group.

## MANAGEMENT AND CONTROL

### Board of Directors

The Bylaws vest management and control of the Company in a Board of Directors consisting of seven members. The directors serving at December 31, 1995, were as follows:

<u>Name and Address</u>	<u>Representation</u>	<u>Expiration Date of Term</u>
Nicolas P. Collins 4131 Colaroga Court West Linn, OR 97068	Vice-Chairman ESCO Corporation	August 1996
William R. Burke, MD 2635 Levington Terrace West Linn, OR 97068	Medical Director	August 1996
James H. Bean 1900 Davis Road Oregon City, OR 97045	Partner, Lindsay, Hart, Neil & Weigler	August 1996
Boyd K. Packer* 1850 East Forest Bend Drive Salt Lake City, UT 84121	President - Corporation of the President of The Church of Jesus Christ of Latter-Day Saints	August 1996
Thomas O. Hedford 5353 SW Bancroft Portland, OR 97221	President Pacific Heritage Assurance Company	August 1996
Merril J. Bateman 2860 Iroquois Drive Provo, UT 84604	President Brigham Young University	August 1996
Kent H. Cannon 2269 Wyoming Street Salt Lake City, UT 84109	President Beneficial Life Insurance Company	August 1996

\*Chairman of the Board

The Board is comprised of 7 directors as of December 31, 1995. The Company is in violation of their own Bylaws. The Bylaws state in part, "that the Board of Directors shall be not less than 3 nor more than 5 in number." I recommend the Company either amend its Bylaws or decrease the number of directors serving on the Board to comply with its own Bylaws. The Board of Directors serve 1 year terms and are elected each year at the annual meeting of the Company. A majority of the number of directors

constitutes a quorum. Subsequent to December 31, 1995, Mr. Boyd Packer and Merrill Bateman resigned from the Board. Mr. Packer was replaced by Harold "C" Yancy who resides at 270 W. Dunset Drive, Centerville, Utah 84014. Mr. Yancy is Chairman of Beneficial Life Insurance Company. More than one-third of the directors are non-participating doctors or employees or trustees of a participant hospital. Therefore, the Company is in compliance with the provisions of ORS 750.015(1).

**Officers**

The Company's officers at December 31, 1995, were as follows:

<b><u>Name</u></b>	<b><u>Title</u></b>
Thomas O. Hedford	President
Brian W. Newell	Vice President
David J. Hutchins	Vice President/Treasurer
Milan B. Robbins	Secretary

**MANAGEMENT AFFIRMATION**

### **CONFLICT OF INTEREST**

The Company has an established policy requiring disclosure of any material interest or affiliation on the part of any of its directors and officers which is in, or is likely to, conflict with official duties. The forms completed by management for the period under examination were reviewed and no exceptions were noted.

### **CORPORATE RECORDS**

The Company has been inactive since December 31, 1974. At that time several documents were executed for the purpose of placing it in an inactive status. These included a bulk reinsurance agreement, a bill of sale and assignment which transferred all assets except the minimum required to continue the Company's Certificate of Authority and an assumption agreement whereby Pacific Heritage Assurance Company assumed and agreed to pay and discharge any and all duties, liabilities, taxes, unemployment contributions, fees and the like that may be payable or properly assessable against Prudential Hospital Association.

The corporate records, including the Articles of Incorporation, Bylaws and minutes of the Board of Directors meetings were reviewed for the period under examination.

#### **Articles of Incorporation**

The Articles of Incorporation were in conformity with Oregon statutes. No amendments were made to the articles during the course of this examination.

#### **Bylaws**

With the exception of a recommendation noted on page 7, the Bylaws were in conformity with Oregon statutes. No amendments were made to the Bylaws during the course of this examination.

#### **Board Minutes**

No records of the Board of Directors meetings were maintained until the March 16, 1994 meeting. At that time, the minutes of the Board were incorporated with the Board

minutes of the parent company. The Board of Directors meetings are held on a quarterly basis. 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 Company 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. 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.

### **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. Most of the Company's insurance coverages are provided through its parent's insurance policies whereby the address of the Company is covered. The Company maintains fidelity coverage under a policy insuring loss from employee dishonesty for up to \$1,500,000. The fidelity coverage met the minimum limits recommended by the NAIC Examiners handbook, page I-125.

### **PENSION PLANS AND OTHER POST RETIREMENT BENEFITS**

The Company does not have any employees and, therefore, no liability for employee benefits.

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

The Company maintains Certificates of Authority to transact business as a health care service contractor in the states of Oregon and Washington.

## **GROWTH OF THE COMPANY**

The following exhibit reflects the growth of the Company since 1988. The statistics were derived from Company filed annual statements except in those years where a triennial report of examination has been filed with the Oregon Insurance Division.

<b><u>Year</u></b>	<b><u>Assets</u></b>	<b><u>Liabilities</u></b>	<b><u>Surplus</u></b>	<b><u>Net Income</u></b>
1988	\$ 78,494	\$ 217	\$ 78,227	\$ 3,501
1989*	81,597	483	81,114	2,837
1990	84,293	338	83,955	2,841
1991	521,397	1,971	519,426**	11,155
1992*	802,877	3,517	799,360**	23,452
1993	1,030,731	2,681	1,028,050**	21,475
1994	1,067,114	15,640	1,051,474	23,424
1995*	1,093,575	6,212	1,087,363	35,890

\*Per examination

\*\*Increases in surplus resulted from capital contributions from its parent company. Contributions were as follows:

<b><u>Year</u></b>	<b><u>Amount</u></b>
1992	\$450,523
1993	\$316,433
1994	\$200,624

## **HOLDING COMPANY REGISTRATION**

The holding company registration statement was filed on behalf of the Company by Beneficial Life Insurance Company in accordance with the provisions of ORS 732.551, 732.552 and OAR 836-27-021(1) for the year ending December 31, 1995. In addition, the Company has maintained a current holding company registration statement in accordance with the requirements of ORS 732.554 and OAR 836-27-020(1). The registration statement did not include the financial statement of the ultimately controlling person nor a complete organization chart pursuant to the provisions of OAR 836-27-020(1). This comment was brought to the Company's attention during the last examination. I strongly recommend the Company file a complete holding company registration statement. This recommendation is made pursuant to the provisions of OAR 836-27-020(1).

### **STATUTORY DEPOSIT**

As of the date of the examination the Company had a deposit with the Oregon Insurance Division, Department of Consumer and Business Services, in the sum of \$375,000. The deposit is in the form of a U.S. Treasury Note, for \$375,000 and a market value of \$390,000, held at U.S. National Bank, Portland, Oregon. The deposit was verified from the records of the Insurance Division.

### **DIVIDENDS TO STOCKHOLDERS**

The Board of Directors did not declare a dividend during the course of this examination.

### **REINSURANCE**

The Company does not write business and has been in an inactive status since December 31, 1974; therefore, there was no reinsurance agreement in effect as of December 31, 1995.

### **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the December 31, 1995, annual statement and were maintained in manner by which the financial condition was readily verifiable as required by ORS 733.170. As of December 31, 1995, the Company did not have a management contract or exclusive agency contract in effect in conformity with the provisions of ORS 732.215 and ORS 732.220.

The Company's books and records are maintained manually by its officers and the staff of the parent company.

The Company has a system in place to account for the funds, subject to escheat (a reserve for unclaimed checks), in accordance with the provisions of ORS 98.352.

The Company is in compliance with the provision of ORS 733.580, which relates to "investment of required capitalization." The following exception was noted during the current examination.

## **Bonds**

At December 31, 1995, the Company owned two U.S. Treasury Notes which were reflected in the custodial account of the parent company. Interest payments on these securities was received by the parent company, and an intercompany agreement was set up by the parent company. Subsequent to the date of the examination, the Company has opened a new custodial account with U.S. National Bank and has requested the two U.S. Treasury Notes be transferred to its own account. As a result, no recommendation with respect to the two notes is necessary for purposes of this examination. The custodial agreement at U.S. National Bank does not provide for the replacement of securities by the custodian in the event that the custodian loses them due to negligence or dishonesty. I recommend the Company amend its current custodial agreements to include language that would require the custodian to indemnify the Company for loss of securities due to the negligence or dishonesty of the custodian. This recommendation is made pursuant to the requirements of the NAIC Examiners Handbook, Section 2G-8 (II -A 1&2) and ORS 731.574(6).

## **COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

As of December 31, 1995, the Company has complied with the majority of all recommendations made in the 1992 report with the following exceptions:

It was recommended the Company obtain a custodial agreement with U.S. National Bank of Oregon and comply with the provisions of ORS 733.210.

It was recommended the Company obtain the necessary insurance coverages in accordance with the NAIC Examiners Handbook and the provisions of ORS 733.210. As of this date of examination, no corrective measures have been taken. As a result, I have made these recommendations again. (see page 17)

**PRUDENTIAL HOSPITAL ASSOCIATION**  
**STATEMENT OF ASSETS, LIABILITIES, RESERVES AND SPECIAL FUNDS**  
**As of December 31, 1995**

<u>ASSETS</u>	<u>Ledger Assets</u>	<u>Nonadmitted/ non-ledger Assets</u>	<u>Net Admitted Assets</u>
Bonds ( <b>Note 1</b> )	\$1,022,311		\$1,022,311
Cash on hand and on deposit ( <b>Note 1</b> )	31,301		31,301
Interest and investment income due and accrued	11,643		11,643
Receivable from parent, subsidiary	<u>28,320</u>		<u>28,320</u>
<b>TOTAL ASSETS</b>	<u><b>\$1,093,575</b></u>	<u><b>\$ 0</b></u>	<u><b>\$1,093,575</b></u>
 <b><u>LIABILITIES</u></b>			
Taxes licenses and fees			\$1,999
Federal income taxes			<u>4,213</u>
<b>TOTAL LIABILITIES</b>			<u><b>\$6,212</b></u>
 <b><u>RESERVES AND SPECIAL FUNDS</u></b>			
Aggregate write-ins for reserves and special funds			947,906
Unassigned funds			<u>139,457</u>
<b>TOTAL RESERVES AND UNASSIGNED FUNDS</b>			<u><b>1,087,363</b></u>
<b>TOTAL LIABILITIES, RESERVES AND SPECIAL FUNDS</b>			<u><b>\$1,093,575</b></u>

**PRUDENTIAL HOSPITAL ASSOCIATION  
UNDERWRITING AND INVESTMENT EXHIBIT  
STATEMENT OF INCOME  
For the Year Ended December 31, 1995**

**UNDERWRITING**

Premiums earned	\$ 0
Deductions:	
Expenses incurred	0
Claims adjustment	0
Administrative	0
Soliciting	<u>0</u>
Total Underwriting Deductions	<u>0</u>
Net Underwriting Loss	<u>0</u>

**INVESTMENT**

Net investment income earned	48,589
Net realized capital gains	<u>0</u>
Net Investment Gain	<u>48,589</u>

**OTHER INCOME**

Net gains (loss) from agents or premium balances	0
Net gain (loss) before federal income tax	48,589
Federal income taxes incurred	<u>12,699</u>
Net Gain	<u>\$35,890</u>

**RESERVES AND UNASSIGNED FUNDS  
As of December 31, 1995**

Reserves and unassigned funds - December 31, 1994	\$1,051,474
Net gain (loss)	35,890
Net unrealized capital gains	0
Aggregate write-ins for changes to reserves	0
Change in reserves and unassigned funds for 1995	<u>\$ 35,809</u>
Reserves and unassigned funds - December 31, 1995	<u>\$1,087,364</u>

**THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS**

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Physical Address of Invested Assets

The cash and invested assets of the Company comprise 96.3% of the total assets. Invested assets and cash by book value, are held at the following locations:

#### Bonds

US National Bank PO Box 3168 Custody Service Plan Portland, Oregon 97208	\$376,370
US National Bank Investment Safekeeping T-9 Portland, Oregon 97208	494,832
Bank of New York Western Company Two Union Square, Suite. 520 601 Union Street Seattle, Washington 98011-2321	151,108
Total Bonds*	<u>\$1022,311</u>

#### Cash

US National Bank 1340 SW 2nd Portland, Oregon 97201	<u>31,301</u>
Total Cash and Invested Assets	<u>\$1,053,612</u>

\*Market Value of Bonds: \$1,035,313

### SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following are issues and concerns that the examiner believes should be brought to management's attention as a result of this examination.

#### Page

- 7 I recommend the Company either amend its Bylaws or decrease the number of directors serving on the Board to comply with its own Bylaws.
- 12 I recommend the Company file a complete holding company registration statement. This recommendation is made pursuant to the provisions of OAR 836-27-020(1).

Page

- 14 I recommend the Company amend its current custodial agreements to include language that would require the custodian to indemnify the Company for loss of securities due to the negligence or dishonesty of the custodian. This recommendation is made pursuant to the requirements of the NAIC Examiners Handbook, Section 2G-8 (II -A 1&2) and ORS 731.574(6).

**CONCLUSION**

During the three year period covered by this examination, the surplus of the Company increased from \$799,360 as presented in the December 31, 1992, report of examination to \$1,087,363 as shown in this report of examination.

The comparative assets and liabilities are shown below:

	<b>December 31,</b>		
	<b><u>1995</u></b>	<b><u>1992</u></b>	<b><u>Change</u></b>
Assets	\$1,093,575	\$802,877	\$290,698
Liabilities	<u>6,212</u>	<u>3,517</u>	<u>2,695</u>
Surplus	<u>\$1,087,363</u>	<u>\$799,360</u>	<u>\$288,003</u>

### **ACKNOWLEDGMENT**

The examiners wish to express their appreciation for the cooperation extended by the officers and employees of the Company during the course of the examination.

In addition to the undersigned, Thomas Farrelly, CFE, and David L. Daulton, AFE, examiners for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in the examination.

Respectfully submitted,

---

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

**AFFIDAVIT**

STATE OF OREGON            )  
  )  ss  
County of Marion            )

Timothy R. Hurley, being duly sworn, deposes and says that the foregoing report of examination as of December 31, 1995, of Prudential Hospital Association, Portland, Oregon, subscribed by him is true to the best of his knowledge and belief.

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

Subscribed and sworn before me this \_\_\_\_\_ day of \_\_\_\_\_, 1997.

\_\_\_\_\_  
Notary Public in and for the State of Oregon  
My commission expires \_\_\_\_\_