



STATE OF OREGON

DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

INSURANCE DIVISION

REPORT OF FINANCIAL EXAMINATION

OF

**VALLEY PROPERTY & CASUALTY INSURANCE COMPANY  
SALEM, OREGON**

**NAIC COMPANY CODE 10698**

AS OF

December 31, 2008

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## SALUTATION

April 8, 2010

Alfred W. Gross, Commissioner  
Chairman, NAIC Financial Condition (E) Committee  
State Corporation Commission  
Bureau of Insurance  
Commonwealth of Virginia  
PO Box 1157  
Richmond, Virginia 23218

Morris J. Chavez, Superintendent  
Secretary, NAIC Western Zone IV  
PO Drawer 1269  
Santa Fe, New Mexico 87504-1269

Honorable Cory Streisinger, Director  
Department of Consumer and Business Services  
State of Oregon  
350 Winter Street NE  
Salem, Oregon 97301-3883

Dear Commissioner, Superintendent and 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

**VALLEY PROPERTY & CASUALTY INSURANCE COMPANY**  
**4263 Commercial Street, Suite 400**  
**Salem, Oregon 97301**

**NAIC Company Code 10698**

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

## **SCOPE OF EXAMINATION**

We examined the Company's financial statements as of December 31, 2008. This examination covers the five-year period then ended. Material transactions or events subsequent to the examination cut-off date were reviewed and noted during the examination.

We considered the provisions of ORS 731.300 and the NAIC procedures and guidelines during our examination. This examination determined the Company's financial condition, ability to fulfill its obligations, nature of operations and compliance with the Insurance Code. Accounting methods, internal control procedures, records, and other supporting evidence were examined or tested. Assets, liabilities, income and expense related items were tested. Corrective actions taken by the Company in response to comments and recommendations in the December 31, 2003, report of examination were reviewed.

## **COMPANY HISTORY**

The Company is a stock property and casualty company. It was incorporated in Oregon on December 5, 1996, received a Certificate of Authority to act as an insurer on December 30, 1996, and commenced business on February 2, 1997. The Company is authorized to write the following lines of business:

Property	Surety
Casualty (including workers' compensation)	Health
Marine and transportation	

## **CAPITALIZATION**

As of December 31, 2008, the Company had 100,000 shares of common stock authorized and 12,550 shares issued and outstanding. Issued and outstanding shares are valued at \$280 par value per share. Valley Group Inc., the Company's parent, owns 100% of the issued and outstanding shares as of December 31, 2008. The Company's investment of required capitalization complies with ORS 733.580.

## MANAGEMENT AND CONTROL

A five member Board of Directors manages the Company. A majority of directors constitutes a quorum. Directors met the age, number, and resident requirements and all other provisions of ORS 732.305. Directors serving at December 31, 2008, were as follows:

<u>Member</u>	<u>Occupation</u>	<u>Current Term Ends</u>
Eric J. Draut Arlington Heights, IL	Insurance Executive Unitrin Services Company	April 2010
James A. Schulte Garland, TX	Insurance Executive Merastar Insurance Company	April 2010
Don G. Southwell Wayne, IL	Insurance Executive Unitrin Services Company	April 2010
Geoffrey T. Stewart Corvallis, OR	Insurance Executive Merastar Insurance Company	April 2010
Kirk W. Triance Salem, OR	Insurance Executive Merastar Insurance Company	April 2010

### Officers

Officers elected and serving at December 31, 2008, were as follows:

<u>Name</u>	<u>Title</u>
James A. Schulte	President
Clark H. Roberts	Vice President/Treasurer
Dorothy A Langley	Secretary
Steven C. Andrews	Senior Vice President

### Parent, Subsidiaries and Affiliates

The Company is part of an insurance holding company system in which Unitrin, Inc., is the ultimate controlling entity. A description of the Company's immediate parent and subsidiaries is as follows:

Unitrin, Inc. (Unitrin) is a Delaware corporation that is a publicly traded holding company with interests in the financial and insurance industry. Unitrin, Inc., is the ultimate parent of Valley Group Inc., which is the 100% shareholder of the Company.

Trinity Universal Insurance Company (Trinity) is a Texas domiciled insurer licensed for multiple property/casualty classes of insurance in Oregon and is wholly owned by Unitrin, Inc. Under a quota share reinsurance agreement, the Company cedes net of reinsurance 100% of premiums, losses and loss adjustment expenses to Trinity.

Valley Group Inc. (VGI) is an Oregon corporation that is wholly owned by Unitrin. VGI wholly owns Valley Insurance Company, the Company and Charter Group, Inc.

Valley Insurance Company (VIC) is a California domiciled insurer that is a wholly owned subsidiary of Valley Group, Inc. VIC writes property and casualty lines of business primarily in California and Washington. It was incorporated on November 10, 1982, and began business on January 1, 1984.

The Company, as a member of an insurance holding company system, has made timely holding company registration filings in accordance with ORS 732.551 and OAR 836-027-020(1).

## **INTERCOMPANY AGREEMENTS**

### **General Services Agreement with Unitrin**

The Company entered into a general service agreement with Unitrin Service Company (USC), an affiliate. According to the agreement, USC is responsible for providing the Company certain services. Terms of the agreement call for the Company to reimburse USC based on actual expenses allocated based on Company revenues, head count (for certain benefit services) or on actual costs incurred. Services provided include: executive management, trade execution and investment analysis, financial accounting and reporting,

investment accounting, cash management and bank relations, tax return preparation and advice, internal audit, benefit plan maintenance, legal support and advice, and other similar services.

#### **Computer Services Agreement**

The Company entered into a computer service agreement with USC. According to the agreement, USC agreed to provide data processing services and technical support, including consulting and related services such as equipment acquisition and software acquisition. The computer services agreement provides for the Company to pay USC the cost of services based on actual expenses of USC allocated by usage, or, in the case of consulting services, the Company will be assessed an hourly rate based on average USC salary plus benefits plus 6% administrative charge not to exceed \$200 an hour.

#### **Tax Allocation Agreement**

The Company is party to a written tax sharing agreement with Unitrin, Inc., and its eligible subsidiaries. Under this tax allocation agreement, the Company files a consolidated federal income tax return with Unitrin, Inc., and its eligible subsidiaries.

The tax sharing agreement states that each participant in the agreement shall be allocated tax as if it filed a separate company return. The tax liability can be no greater under the agreement than it would have been had a separate tax return been filed for all years in the consolidated period.

#### **General Services Agreement with Trinity**

The Company is party to a general services agreement with Trinity. According to the agreement, Trinity is responsible for providing the Company the following services: executive management, financial accounting and reporting, purchasing and accounts payable, financial planning and analysis of operations, marketing and actuarial services, and certain

MIS support and advice. Terms of the agreement call for the Company to reimburse Trinity based on hours of services provided or on actual costs incurred for out of pocket items.

**Administrative Services Agreement with VIC and Trinity**

Effective January 1, 2002, the Company entered into an administrative services agreement with VIC and Trinity. This agreement transferred all the Company's employees to VIC. According to the agreement, VIC agrees to provide certain field service administration for Oregon policies that are not currently provided pursuant to the general services agreement with Trinity. These services include: handling of regulatory filings, underwriting, accepting risks and issuing policies, billing and collecting premium, defending, adjusting, settling and arranging for the payment of claims, and other services not provided by Trinity. The agreement calls for the Company to advance to VIC each month 100% of VIC's expected average actual and reasonable monthly expenses including, but not limited to, compensation of VIC's employees and other costs.

The Oregon Insurance Division approved the above agreements.

**CONFLICT OF INTEREST**

The Company has an established policy for disclosing any material interest or affiliation on the part of any of its directors and officers, which is, or is likely to, conflict with official duties. The policy requires the Company's officers and directors to complete a conflict of interest statement on an annual basis in order to affirm continuing compliance with the provisions of the policy. Conflict of interest statements were properly completed by officers and directors for 2008.

**CORPORATE RECORDS**

All the Company's accounting records and accounting staff are at Unitrin's offices in Jacksonville FL. Accounting records were made available online. Minutes of the Board of

Directors meetings, Articles of Incorporation and Bylaws were maintained in Jacksonville FL.

### **Articles of Incorporation**

There were no amendments to the Articles of Incorporation during the course of this examination.

### **Bylaws**

In 2004 the number of directors was increased to six. Effective January 3, 2006, the Bylaws were changed again setting the minimum number of Directors at five. The Articles of Incorporation and Bylaws conform to Oregon Statutes.

### **Board Minutes**

The annual meeting of the shareholders of the corporation shall be held each year as designated by the Board of Directors. The Bylaws state that special meetings may be called at any time by the president or by the members of the Board of Directors. Board minutes are recorded in sufficient detail to determine the actions taken by the Board. The minute books also contained accompanying documentation that supported the minutes. A quorum met at all Board meetings held during the period under examination.

The Board of Directors approves investment guideline revisions and investment transactions pursuant to the provisions of ORS 733.730. Investments were properly recorded pursuant to the provisions of ORS 733.740.

### **Statutory Deposit**

As of December 31, 2008, the Company maintained a \$125,000 security deposit (US Treasury Note) with the Oregon Insurance Division pursuant to the provisions of ORS 731.628.

## **FIDELITY BONDS AND OTHER INSURANCE**

### **Fidelity Bonds**

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

Unitrin, Inc., purchased financial institution bond coverage for itself and its subsidiaries, including the Company. This bond covers losses from forgery or alteration, securities, computer systems, trading losses and extortion up to \$25,000,000. The Company's fidelity coverage met the minimum limits recommended by the NAIC.

## **PENSION PLANS**

The Company has no employees, therefore, no direct liability for employee benefits. All the employees work for VIC or Trinity in accordance with the general services agreement with Trinity and the administrative services agreement by and between VIC, Trinity and the Company.

## **TERRITORY AND PLAN OF OPERATION**

The Company markets personal and commercial package policies through independent agents in Oregon and Washington. It is authorized to write business in Wisconsin, but it hasn't written there yet.

Business written in Washington was not a material portion of the total written premium during the examination period. A breakdown of premium written by line of business is shown below:

<u>Line of Business</u>	<u>Amount Written</u>	<u>Percent of Total Written</u>
Fire	\$ 847,929	3.53%
Allied lines	540,800	2.25%
Homeowners multiple peril	6,186,936	25.74%
Ocean marine	133,408	0.55%
Inland marine	163,601	0.68%
Earthquake	518,169	2.16%
Other liability - occurrence	671,108	2.79%
Products liability – occurrence	30,313	0.13%
Private passenger auto liability	9,328,415	38.81%
Commercial auto liability	77,607	0.32%
Auto physical damage	<u>5,540,299</u>	<u>23.05%</u>
Total	<u>\$24,038,585</u>	<u>100.00%</u>

### **GROWTH OF THE COMPANY**

Growth of the Company since December 31, 2003, is reflected below. Amounts were compiled from copies of the Company's filed annual statements and, where indicated, from the current or a previous examination report.

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Policyholders Surplus</u>	<u>Net Income</u>
2003*	\$ 8,591,148	\$ 814,012	\$7,777,135	\$439,624
2004	8,175,464	113,402	8,062,062	415,173
2005	13,494,959	5,080,367	8,414,591	362,585
2006	15,081,507	6,236,615	8,844,892	464,256
2007	15,619,465	6,420,500	9,198,965	437,524
2008*	16,677,048	6,983,781	9,693,267	395,367

\*Per examination

### **REINSURANCE**

Under a quota share reinsurance agreement effective June 1, 1999, the Company cedes net of (third party) reinsurance 100% of premiums, losses and loss adjustment expenses to Trinity.

The Company is included in the group of companies named as ceding insurers on the following reinsurance treaties in effect as of December 31, 2008.

Kemper/Direct Property Excess per Risk Reinsurance Treaty  
 Lines reinsured: 65% of Homeowners, 50% of Auto Physical Damage  
 Comprehensive and 25% of Boat-owners

	Section A	Section B
Company Retention	\$1,500,000	\$5,000,000
Reinsurance each Risk Limit (100% of)	\$3,500,000	\$5,000,000
Reinsurance each Loss Occurrence Limit (100% of)	\$3,500,000	\$5,000,000
Reinsurers all Loss Occurrence Limit for contract term	\$10,500,000	\$10,000,000
Reinsurer all Loss Occurrences Limit for "runoff period" if any	\$7,000,000	\$5,000,000

Kemper Property Catastrophe Excess of Loss Reinsurance Contract  
 Lines reinsured: 65% of Homeowners, 50% of Auto Physical Damage Comprehensive  
 and 25% of Boat-owners

	First Excess of Loss	Second Excess of Loss	Third Excess of Loss
Company Retention	\$40,000,000	\$70,000,000	\$150,000,000
Reinsurance each Loss Occurrence Limit (100% of)	\$30,000,000	\$80,000,000	\$150,000,000
Reinsurers all Loss Occurrence Limit for contract term	\$60,000,000	\$160,000,000	\$200,00,000

The Company does not retain risk on any one subject of insurance in excess of 10% of its surplus in accordance with ORS 731.504(1). All treaties contain insolvency clauses as required by ORS 731.508(3)(a).

### **ACCOUNTS AND RECORDS**

In general, the Company's records and source documentation supported the amounts presented in the Company's 2008 annual statement and were maintained in a manner by which the financial condition was readily verifiable in accordance with the provisions of ORS 733.170.

However, the following matters require correction:

**Board Approval of Intercompany Agreements**

The Company submitted its agreements to the Oregon Insurance Division for approval. They were all approved; however, the Company neglected to get its Board of Directors approval of the agreements.

**I recommend the Company require its Board of Directors to review and approve any intercompany agreements prior to implementation as required by procedures outlined in the NAIC Examiners Handbook and ORS 731.302.**

**COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS**

The Company complied with all the recommendations made in the 2003 examination report.

**VALLEY PROPERTY & CASUALTY INSURANCE COMPANY**  
**BALANCE SHEET**  
**AS OF DECEMBER 31, 2008**

<b><u>ASSETS</u></b>	<b><u>Per Company</u></b>	<b><u>Examination Adjustments</u></b>	<b><u>Per Examination</u></b>
Bonds (Note 1)	\$8,186,359	\$ 0	\$8,186,359
Cash & short-term investments	2,093,062		2,093,062
Investment income due & accrued	74,305		74,305
Uncollected premium	836,894		836,894
Accrued retrospective premium	5,346,101		5,346,101
Amounts recoverable from reinsurers (Note 2)	46,506		46,506
Receivable from parent subs & affiliates	<u>93,821</u>	<u>0</u>	<u>93,821</u>
Total Assets	<u>\$16,677,048</u>	<u>\$ 0</u>	<u>\$16,677,048</u>
 <b>LIABILITIES, SURPLUS AND OTHER FUNDS</b>			
Losses (Note 3)	\$ 0	\$ 0	\$ 0
Commissions payable	469,832		469,832
Other expenses	25,100		25,100
Taxes, licenses and fees	23,011		23,011
Advance premium	260,131		260,131
Ceded reinsurance premiums payable	6,187,400		6,187,400
Provision for reinsurance (Note 4)	18,301		18,301
Aggregate write-ins for liabilities	<u>6</u>	<u>0</u>	<u>6</u>
Total Liabilities	<u>6,983,781</u>	<u>0</u>	<u>6,983,781</u>
Common capital stock	3,514,000		3,514,000
Gross paid in and contributed surplus	4,225,000		4,225,000
Unassigned funds	<u>1,954,267</u>	<u>0</u>	<u>1,954,267</u>
Surplus as regards policyholders	<u>9,693,267</u>	<u>0</u>	<u>9,693,267</u>
Total Liabilities & Surplus	<u>\$16,677,048</u>	<u>\$ 0</u>	<u>\$16,677,048</u>

**VALLEY PROPERTY & CASUALTY INSURANCE COMPANY**  
**INCOME STATEMENT**  
**FOR THE YEAR ENDING DECEMBER 31, 2008**

**UNDERWRITING INCOME**

Net Underwriting Gain or Loss (Note 5) \$ 0

**INVESTMENT INCOME**

Net investment income earned 395,373  
Net realized capital gains or (losses) (5)  
Net investment gain 395,367

**OTHER INCOME**

Total other income 0  
Net income before dividends to policyholders  
& before Federal income tax 395,367  
Dividends to policyholders 0  
Net income, after dividends to policyholder but  
before Federal income taxes 395,367  
Federal income tax incurred 0  
Net income \$ 395,367

**CAPITAL AND SURPLUS ACCOUNT**

Surplus as regards policyholders, December 31, 2007 \$9,198,965

Net income 395,367  
Change in net deferred income tax 392,508  
Change in non-admitted assets (377,458)  
Change in provision for reinsurance 83,885  
Change in surplus as regards policyholders for the year 494,302

Surplus as regards policyholders, December 31, 2008 \$9,693,267

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Bonds

Bonds were stated at amortized cost using the scientific method. The Company's bond portfolio was invested in primarily high quality US government, state, territory, and possession, and special revenue bonds. 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>
2003	\$7,725,427	\$7,919,015	-0-	-0-
2004	7,194,405	7,568,594	-0-	-0-
2005	7,514,415	7,854,936	-0-	-0-
2006	8,637,348	8,932,631	-0-	-0-
2007	8,269,471	8,535,266	-0-	-0-
2008	8,186,359	8,310,511	-0-	-0-

\*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."

Bond investments comprise 49% of the Company's total assets at December 31, 2008.

### Note 2 - Amounts Recoverable from Reinsurers

This reinsurance recoverable remained uncollected for three years. The Company should report this item as a nonadmitted asset pursuant to ORS 733.010, SSAP 4, and SSAP 62. No adjustment was made to this item as a result of this examination because the item is immaterial to the financial condition of the Company.

**I recommend the Company report as a nonadmitted asset any asset that is not available for the payment of losses and claims in accordance with ORS 733.010 and SSAP 4 and 62.**

### Note 3 - Losses and Loss Adjustment Expenses (LAE)

David Dahl, FCAS, MAAA, Oregon Insurance Division actuary, reviewed the Company's loss reserves at December 31, 2008. His findings and scope of review are contained in a memorandum. Work papers supporting his conclusions are also included. He concluded that the Company's reserves were reasonably stated at zero. In light of his finding, no adjustment or comments with respect to loss reserves is considered necessary for purposes of this examination.

**Note 4 - Provision for Reinsurance**

The Company should have nonadmitted \$9,301 of this balance as a result of reporting as a nonadmitted asset the Amounts Recoverable from Reinsurers described above in Note 2. The account balance reflected by the Company would, therefore, be \$9,000. No adjustment was made to this item as a result of this examination because the item is immaterial to the financial condition of the Company.

**Note 5 - Underwriting Income**

No underwriting gain or loss is shown since the Company ceded net of reinsurance with non-affiliates 100% of its premiums and losses to Trinity under a quota share reinsurance agreement. See details under the Reinsurance section.

**CONCLUSION**

During the five years covered by this examination, the Company's surplus increased from \$7,777,135, as of December 31, 2003, to \$9,693,267, as shown in this report of examination.

Comparative assets, liabilities and surplus changes from December 31, 2003 to December 31, 2008, are shown below:

	<b>2008</b>	<b><u>December 31,</u></b>	<b>2003</b>	<b><u>Change</u></b>
Assets	\$16,677,048		\$8,591,148	\$8,085,900
Liabilities	<u>6,983,781</u>		<u>814,013</u>	<u>6,169,768</u>
Surplus	<u>\$ 9,693,267</u>		<u>\$7,777,135</u>	<u>\$1,916,132</u>

**COMMENTS AND RECOMMENDATIONS**

Page

- 13 I recommend the Company require its Board of Directors to review and approve any intercompany agreements prior to implementation as required by procedures outlined in the NAIC Examiners Handbook and ORS 731.302.
- 16 I recommend the Company report as a nonadmitted asset any asset that is not available for the payment of losses and claims in accordance with ORS 733.010 and SSAP 4 and 62.

## 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 Dahl, FCAS, MAAA, actuary, for the State of Oregon, Department of Consumer and Business Services, Insurance Division, participated in this examination.

Respectfully submitted,

---

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 Valley Property & Casualty Insurance Company.
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 Valley Property & Casualty Insurance Company 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 \_\_\_\_\_, 2010.

\_\_\_\_\_  
Notary Public in and for the State of Oregon

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