

MIKE KREIDLER
STATE INSURANCE COMMISSIONER



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)	No. G06-53
)	
The Financial Examination of)	FINDINGS, CONCLUSIONS,
GROUP HEALTH OPTIONS, INC.)	AND ORDER ADOPTING REPORT
)	OF EXAMINATION

A Registered Health Care Service Contractor.

BACKGROUND

An examination of the financial condition of **GROUP HEALTH OPTIONS, INC.** (the Company) as of December 31, 2003, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of registration as a health care service contractor. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and recommendations was transmitted to the Company for its comments on July 18, 2006. The Company's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 17 of the report.



CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **GROUP HEALTH OPTIONS, INC.** and to order the Company to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented some of the Instructions and Comments and Recommendations prior to the date of this order. The Instructions and Comments and Recommendations in the report are appropriate responses to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 1-6.

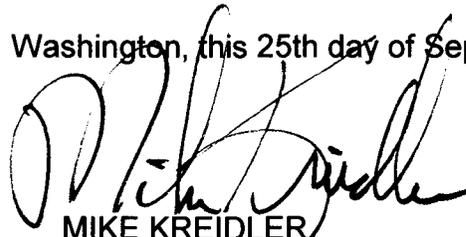
1. The Company is ordered to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs; with RCW 48.43.097 which requires the filing of its financial statements in accordance with the NAIC AP&P Manual; and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the NAIC AP&P Manual. Instruction 1, Examination Report, page 3.
2. The Company is ordered to amend its custodial agreement with BOA to include the appropriate wording and criteria as set forth in the NAIC FCEH pursuant to WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions. Instruction 2, Examination Report, page 3.
3. In connection with the incorrect statement in General Interrogatory No. 23.01, the Company is also ordered to comply with RCW 48.44.100 and file an accurate statement of its financial condition, transactions, and affairs. Instruction 2, Examination Report, page 3.
4. The Company is ordered to comply with WAC 284-07-060(2)(a) and include a SAO that is in compliance with the NAIC Annual Statement Instructions and the NAIC AP&P Manual. Instruction 3, Examination Report, page 4.

5. The Company is ordered to comply with RCW 48.31C.040 and register with the OIC, reporting all information required for all companies in the holding company system. Instruction 4, Examination Report, page 4.
6. The Company is ordered to collect funds in a bank account under its exclusive control as required by RCW 48.12.010 or to change the Administrative Service Agreement filed with OIC to allow GHC to collect and deposit funds into a fiduciary bank account that is controlled by the Company. Instruction 5, Examination Report, page 5.
7. It is ordered that the Company consider writing, testing and implementing a disaster recovery plan that includes appropriate escalation procedures to resolve operational failures of the information system (IS) in a timely manner, as recommended by the NAIC. Comments and Recommendations 1, Examination Report, page 5.
8. It is ordered that GHO consider implementing a business contingency plan to address the continuation of all significant business activities, including financial functions, telecommunication services, and data processing services in the event of a disruption of normal business activities, as recommended by the NAIC. The plan should be in written format with copies kept in relevant off-site locations. The plan should include a restoration priority for all significant business activities, a list of critical computer programs, applications and data files, and a list of supplies needed to perform manual operations. The plan must clearly describe senior management's roles and responsibilities associated with the declaration of an emergency and identify specifically the officers who are authorized to declare an emergency and to initiate implementation of the plan. The ultimate responsibility for implementing a business contingency plan resides with the Board of Directors. Comments and Recommendations 2, Examination Report, page 5.
9. It is ordered that the Company consider creating a secured region on the network for the purpose of holding changed programs prior to being migrated into the secured production region. When a changed program has been tested, reviewed, and approved, the reviewer should immediately transfer the approved program files to the secured holding region of the network, thus preventing unauthorized changes by a programmer. Currently, the reviewed and approved programs are not secured and a programmer has the ability to insert unauthorized changes after the review. The unauthorized changes would then be transferred into the secured production region without management's knowledge. Comments and Recommendations 3, Examination Report, page 6.

10. It is ordered that GHO consider revising the record retention and disposition standards policy to include specific detail relevant to the types of records being retained, the retention period for each type of record, and the primary holder for each type of record. Comments and Recommendations 4, Examination Report, page 6.
11. It is ordered that GHO consider preparing formal written procedures for the relocation of data processing operations to a specific alternative site and that the procedures be tested regularly to ensure data processing operations can be restored in a timely manner. Comments and Recommendations 5, Examination Report, page 6.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 25th day of September, 2006.



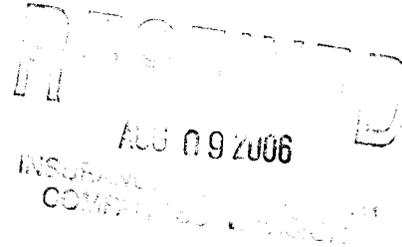
MIKE KREIDLER
Insurance Commissioner



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August 7, 2006

VIA FAX (360) 586-2022
AND U.S. MAIL



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Deputy Insurance Commissioner
Company Supervision Division
P.O. Box 40255
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**RE: Financial Examinations of Group Health Cooperative
and Group Health Options, Inc.**

Dear Deputy Commissioner Odiorne:

Thank you for the opportunity to respond to the draft financial examination report from the Office of the Insurance Commissioner (“OIC”) prepared for Group Health Cooperative (“GHC”) and Group Health Options, Inc. (“GHO”). (GHC and GHO are referred to collectively as “Group Health”). As you requested in your July 18, 2006 letters to GHC and GHO, this response includes factual corrections to be made to the draft reports. This response also includes our position on certain substantive issues, offered in rebuttal to the analysis and conclusions of the OIC. We understand that Group Health’s response to the draft financial examination will be included as part of the final report of examination for GHC and for GHO.

I. Draft Financial Examination of Group Health Cooperative

A. Instructions. We offer the following corrections and comments regarding the Instructions.

1. NAIC Annual Statement Errors

- a. SVO reporting, rating, and monitoring. GHC now reports its securities in compliance with the purposes and procedures manual of the National Association of Insurance Commissioners (NAIC) Securities Valuation Office. This commenced with the 2004 Annual Statement reporting and was achieved through subscribing to the Automated Valuation Service of the NAIC Securities Valuation Office. Additionally, securities that are not listed and are required to be submitted are now submitted to the NAIC SVO. Finally, we

have adopted a procedure to monitor Provisionally Exempt securities through the use of ratings from Nationally Recognized Statistical Rating Organizations (NRSRO's)

- b. Unearned premiums/Premiums received in advance. These amounts were reported as Premiums received in advance and Amounts withheld or retained for the account of others beginning with the 2004 Annual Statement.
- c. Contracts subject to retrospective rating. Beginning with the 2004 Annual Statement, Group Health began accruing for contracts subject to retrospective rating.
- d. General expenses due and accrued. Commissions were correctly reported on the supporting exhibit beginning with the 2004 Annual Statement.
- e. Miscellaneous payroll deductions. Payroll deductions have been reported as Amounts withheld or retained for the account of others beginning with the 2005 Annual Statement.
- f. Health care delivery assets. Health care supplies have been reported as Furniture and equipment, including health care delivery assets since the 2005 Annual Statement.
- g. Unclaimed property (outstanding checks and drafts) will be reported as an Aggregate write-in line in our 2006 reporting.
- h. Affiliated companies and transaction disclosures. All affiliated companies, including Group Health Services, Inc. (GHS) and Group Health of Washington (GHW), have been included as reporting entity members on Schedule Y Organization Chart beginning with the 2005 Annual Statement.
- i. Actual paid claim amounts. Paid claims for prior years reported on the Underwriting and Investment Exhibit have included actual payments only beginning with the 2004 Annual Statement.
- j. Active life reserves were misclassified in the 2003 NAIC Annual Statement. These have been reported as Aggregate health policy reserves beginning with the 2005 Annual Statement.

2. Investment Custodial Accounts

GHC has in place long-standing custodial account agreements with two large and prestigious national banks, the Bank of New York and the Bank of America (collectively referred to as “the Banks.”) These arrangements have served GHC and the Banks well and there has been no reason to restructure the agreements. Amounts on deposit with the Banks have been held safely, administrative systems at GHC and the Banks have worked well together, and the business interests of the Banks and GHC have been satisfied.

This Instruction expresses the OIC’s concerns that the written documentation of GHC’s relationships with the Banks falls short of characteristics for custodial account agreements expressed through the NAIC *Financial Conditions Examiners Handbook* “FCEH”). The OIC relies on two citations of authority as the basis for this Instruction regarding GHC’s custodial

account agreements with the banks. Neither reference has any direct bearing on the question of the content of GHC's custodial account agreements. Instead, in pertinent part, the referenced statute provides authorization to the OIC to consider certain matters when the OIC is "scheduling and determining the nature, scope, and frequency of an examination." The reference to the examiners handbook is simply a catch-all for criteria relevant to the OIC's determination as to the scheduling, nature, scope and frequency of an examination. The second reference – WAC 284-07-050(2) – addresses health carrier annual statements and is concerned with matters such as the general form of the annual report, as well as National Association of Insurance Commissioners (NAIC) Annual Statement Instructions and the Accounting Practices and Procedures Manuals promulgated by the NAIC. The NAIC Annual Statement Instructions in turn include a reference to the FCEH, which does provide some level of guidance regarding custodial account agreements.

The NAIC Annual Statement Instructions do not compel the content of a custodial account agreement, as is suggested in this Instruction. Instead, the NAIC Instructions provide alternative methods for reporting on a health carrier's custodial agreements:

NAIC Annual Statement Instructions – General Interrogatories: Investment

23. The question, regarding whether items are held in accordance with the NAIC *Financial Condition Examiners Handbook*, must be answered.

23.01 If the answer to 23 is 'yes', then list all of the agreements in 23.01. If the answer was 'no' but one or more of the agreements do comply with the NAIC Financial Condition Examiners Handbook, then list the agreements that do comply in 23.01.

23.02 If the answer to 23 is 'no' please list all agreements that do not comply with the NAIC Financial Condition Examiners Handbook. Provide a complete explanation of why each custodial agreement does not include the characteristics outlined in the NAIC Financial Condition Examiners Handbook (Part 1 General, Section IV.H Custodial or Safekeeping Agreements).

Section 23.02 implies that a health carrier may have a custodial account agreement in place that does not include the characteristics outlined in the NAIC Financial Condition Examiners Handbook ("FCEH"). Otherwise, there would be no reason to offer this alternative response to the interrogatory.

We acknowledge that since GHC's agreements with the Banks do not include all the characteristics outlined in the FCEH, we should have responded to this interrogatory with a "no" and provided an explanation for that response. Our response would have described the long-standing relationships we enjoy with the Banks and the fact that, since current arrangements are working well, there was no need to modify the agreements. Given that our reporting under General Interrogatory No. 23.01 has been in error, we intend to pursue the following in response to this Instruction.

First, pending negotiations with the Banks, we will ensure that future reports respond accurately to General Interrogatory No. 23.01, including an explanation for the "no" response. Second, we

intend to engage in negotiations with each of the Banks to modify our custodial account agreements to address the characteristics for such agreements described in the FCEH. This will involve a balancing of the desire to include those characteristics against any unforeseen administrative or financial issues that may be raised through such changes, so we must reserve the right to respond “no” to Interrogatory No. 23.01 and provide an updated explanation in the future. Our hope, however, is to restate the agreements such that we can respond “yes” to that Interrogatory.

3. The Actuary Must Opine on All Required Items

The consulting actuary has opined on the required items, including the active life reserves, beginning with our 2005 Annual Statement.

4. Health Carrier Holding Company Act Failure to Report

GHC’s initial filing under chapter 48.31C RCW was made in 2001. Our understanding at that time led to listing affiliates that were actively engaged in business, and thereafter we continued to report in that fashion. In 2005, we were advised by the OIC that all affiliates and subsidiaries – including shell corporations with no assets and no business activity – should be listed. All filings under the Holding Company Act have included all GHC affiliates and subsidiaries since the 2005 Annual Statement.

B. Comments and Recommendations. We offer the following corrections and comments regarding the Comments and Recommendations:

1. Disaster Recovery Plan

Disaster Recovery Plan. GHC Information Services has a formal written disaster recovery plan for its Storage Area Network System, Enterprise Resource Management System, Clinical Information System, and Electronic Mail System. Installation and unit testing of these systems is scheduled for completion by the end of the third quarter, 2006.

2. Business Contingency Plan

Group Health has developed initial business continuity plans that provide the basis for continued service with the financial and data services functions. Elements of these plans include the following actions:

- Purchased the Strohl Business Continuity & Recovery software program development and management tool.
- Conducted Business Impact Analysis within each pilot service line & pilot site (including financial and data services).
- Developed initial continuity and recovery plans in each pilot service line.
- Conducted initial continuity drill in data services, others planned for fourth quarter, 2006.
- Group Health will finalize the plans in the financial & data service functions by the fourth quarter, 2006, and will regularly drill on an ongoing basis.

The Emergency/Continuity management plans are maintained in both hard copy and electronic formats :

- Core plans are produced and located at each site.
- Core plans are also located at each Emergency Operation Center & Incident Management Center.
- Core plans are produced and provided to key leaders to maintain in office, car and home.
- Strohl planning tool contains the electronic inventory of significant business activities, critical programs & supplies.
- Group Health will produce a hard copy of the final version of the significant business activities, critical programs and supplies and will be added to hard copy plans by fourth quarter, 2006.

The plans clearly describe senior management roles and responsibilities, including the declaration of an emergency:

- All Hazard Plans are developed using the Incident Management Systems (EICS-Executive Incident Command System).
- Crisis Management Plan provides program overview, guidance and process/actions for the declaration of an emergency.
- Job Actions sheet within the plans describe roles and responsibilities for all levels of leadership and staff.
- Leader-On-Call program provides access to the designated senior leader 24 hours a day, seven days a week, 365 days a year.

3. Secured Program Holding Region

As of 2003, GHC programmers can browse files after the change has been reviewed and approved, but can no longer update them.

4. Record Retention Plan

As part of ongoing efforts to adapt business processes to the methods and technology that supports these processes, an initiative is underway to evaluate appropriate methods for managing the wide variety of paper and electronic records related to Group Health's business. An expected product of this effort is improvement to existing policy statements such as the recommended changes specified in the draft examination.

5. Alternative Data Processing Site

GHC has selected our Administrative Conference Center, North - 5615 W. Sunset Highway Spokane, WA 99210-0204 as the company's alternative data processing site. The Storage Area Network, Enterprise Resource Planning System, and Clinical Information Systems are installed in this location. Data replication has been tested over the network link.

C. Other Corrections. The remaining sections of the draft report include some errors. First, the “Company History” paragraph at page 8 should be amended to reflect the effective date of the change in Group Health Cooperative’s name as December 31, 2002. The draft report notes the date GHC filed its Articles of Amendment with the Secretary of State (December 13, 2002), but those Articles provided for an advance effective date of December 31 2002, in accord with RCW 24.03.180.

Second, the “Intercompany Agreements” section of the draft report describes the Medical Services Agreement between GHC and GHO at page 10. The reference to “enrollees who are assigned to GHC” should be amended to state “enrollees who elect to receive care from GHC” (or similar language). The correction is that neither GHC nor GHO involuntarily “assigns” GHO enrollees to the GHC health care delivery system; enrollees have the right to choose any provider in most GHO plans.

Third, the “Management and Control” section of the draft report includes a section entitled “Fidelity Bond and Other Insurance” that includes an error. The description of GHC’s self-insurance program at page 12 should be corrected. The final sentence includes the language “to indemnify the independent contractor GHP as an agent” and this should be changed by inserting the words “employees of” after the word “indemnify” and “as agents of GHC” should replace “as an agent.” GHC’s program provides indemnity in favor of Group Health Permanente (GHP) physicians and other providers when acting as agents of GHC, but not in favor of GHP as a corporate entity. As revised, the sentence would read: “The professional liability risk includes an amount to indemnify employees of the independent contractor GHP as agents of GHC.”

Fourth, the “Subsequent Events” section at page 15 of the draft report should reflect GHC’s acquisition of control of “KPS Health Plans” (and not “Kitsap Physicians Services health plans.”)

This concludes our response to the draft financial examination of GHC and we now turn to the substantially similar draft report related to GHO.

II. Draft Financial Examination of Group Health Options, Inc.

A. Instructions. We offer the following corrections and comments regarding the Instructions.

1. NAIC Annual Statement Errors

- a. Unearned premiums/Premiums received in advance. These amounts have been reported as Premiums received in advance beginning with the 2004 Annual Statement.
- b. Contracts subject to retrospective rating. Beginning with the 2004 Annual Statement, GHO began accruing for contracts subject to retrospective rating.

- c. Unclaimed property (outstanding checks and drafts) will be reported as an Aggregate write-in line in GHO's 2006 reporting.
- d. Interest due and accrued. This was reported correctly on the supporting schedule in the 2004 Annual Statement and thereafter.
- e. Long term bond reported as short term bond. This was reported correctly on the supporting schedule in the 2004 Annual Statement and thereafter.
- f. Acquisition date reported incorrectly. This was reported correctly on the supporting schedule in the 2004 Annual Statement and thereafter.
- g. Affiliated companies and transaction disclosures. Group Health Services, Inc. (GHS) and Group Health of Washington (GHW) are now included as reporting entity members on Schedule Y Organization Chart in the 2005 Annual Statement.

2. Investment Custodial Agreement

This Instruction relates directly to Instruction 2 in the draft GHC report. Please see our response in section II.A.2. above, which is incorporated into this section by reference.

3. The Actuary Must Opine on All Required Items

This Instruction relates directly to Instruction 3 in the draft GHC report. Please see our response in section II.A.3. above, which is incorporated into this section by reference.

4. Health Carrier Holding Company Act Failure to Report

This Instruction relates directly to Instruction 4 in the draft GHC report. Please see our response in section II.A.4. above, which is incorporated into this section by reference.

5. Collection of Funds by an Affiliate Company has not been Approved.

We intend to amend the Administrative Services Agreement (ASA) between GHO and GHC to meet the requirements of RCW 48.12.010. (This action does not constitute Group Health's agreement that chapter 48.12 RCW is applicable to GHO and GHC more generally, or in this specific instance.) We note, however, that the statute does not require the ASA to provide as described in the OIC's Instruction. Instead, we will amend the ASA to provide that funds collected by GHC on behalf of GHO will be held in such a way that the funds will "belong wholly and exclusively" to GHO, as provided in the statute cited by the OIC.

B. Comments and Recommendations. We offer the following corrections and comments regarding the Comments and Recommendations. The Comments and Recommendations in the draft GHO report are substantially identical to those set forth in the draft GHC report. Please see our responses above in the subsections II.A.1-5, above, noted as "1. Disaster Recovery Plan," "2. Business Contingency Plan," "3. Secured Program Holding Region," "4. Record Retention Plan," and "5. Alternative Data Processing Site" which are incorporated into this section by reference.

C. Other Corrections. The remaining sections of the draft report include some errors. First, as noted in part I.C. above regarding the GHC report, the "Intercompany Agreements" section of the draft report describes the Medical Services Agreement between GHC and GHO at page 9. The reference to "enrollees who are assigned to GHC" should be amended to state "enrollees who elect to receive care from GHC" (or similar language). The correction is that neither GHC nor GHO involuntarily "assigns" GHO enrollees to the GHC health care delivery system; enrollees have the right to choose any provider in most GHO plans.

This concludes our comments regarding the draft GHO report.

Thank you for the opportunity to review and respond to your findings. Please feel free to contact me if you have questions. I can be reached at (206) 448-5816.

Sincerely,



Carrie Jennison
Acting Chief Financial Officer and Assistant Treasurer, Group Health Cooperative
Treasurer, Group Health Options, Inc.