

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



**FINANCIAL EXAMINATION
OF
WASHINGTON LIFE AND DISABILITY INSURANCE
GUARANTY ASSOCIATION**

DECEMBER 31, 2004

Order No. 06-62
Washington Life and Disability
Insurance Guaranty Association
Exhibit A

SALUTATION

Seattle, Washington
November 17, 2006

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building
302-14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.32A.145, an examination was made of the corporate affairs and financial records of

Washington Life And Disability Insurance Guaranty
Association
of
Washington State

hereinafter referred to as "WLDIGA" or "the Association" at its home office located at 4771 E SR 3, Shelton, Washington. This report is respectfully submitted showing the condition of the Association as of December 31, 2004.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of Washington Life and Disability Insurance Guaranty Association. This report shows the financial condition and related corporate matters as of December 31, 2004.



Patrick H. McNaughton
Chief Examiner

11-17-06

Date

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SCOPE OF EXAMINATION

This examination covers the period January 1, 2000 through December 31, 2004 and comprises a comprehensive review of the books and records of the Association. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. The findings of the previous examination report were reviewed and any items that were not satisfactorily addressed by the Association are discussed later in the report.

Corporate records, external reference materials, and various aspects of the Association's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Association's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTION

The examiners reviewed the Association's audited financial statements as part of the statutory examination. This review was performed to determine if the Association's accounts and records were prepared and maintained in accordance with Title 48 RCW.

The following summarizes the instructions, comments and recommendations generated while performing this review.

1. Certificate of Contribution

In accordance with RCW 48.32A.085(8), "...the association shall issue to each insurer paying an assessment other than a class A assessment, a certificate of contribution..." The Association does not issue a certificate of contribution on the basis that the invoice and cancelled check constitute this certificate.

The Association is instructed to comply with RCW 48.32A.085 by issuing a certificate of contribution to the assessed companies, or by receiving OIC approval for substitution of the invoice and cancelled check in lieu of a certificate.

COMMENTS AND RECOMMENDATIONS

1. Internal Controls and Cash Receipts

The Executive Director (ED) handles all of the day-to-day administration of the Association as an independent contractor. WLDIGA does not have any other independent contractors or employees. The use of one person to perform all accounting functions does not provide for the important internal control of separation of duties and could result in an opportunity for transactions to be executed without appropriate oversight. For example, on many occasions, the ED receives large sums of cash which are directly remitted to the WLDIGA offices without going through its lock-box. Although the ED copies the checks and lists them on a summary sheet, no other person establishes control over the funds. Further, most payers do not require a receipt and there is no corresponding billing process against which the funds could be matched. This situation presents an obvious control deficiency which must be corrected. There may be other transactions where asset diversion is possible due to the lack of functional separation.

Since the operation uses one person to perform all accounting functions, for internal control purposes, it is essential to place all significant asset receipts and disbursements under outside control and accountability. Most receipts are directed to a bank lock-box, which thereby establishes external control over gross receipts. However, it is recommended that funds which are sent directly to the ED's office be placed under similar external control. For example, an outside agency could be engaged to receive and process all incoming mail, depositing any funds in the bank lock-box account. Non-monetary mail and any remittance advices can be sent directly to the ED. In addition, all potential fund remitters should be advised that such remittances must go directly to the bank lock-box. All other significant transactions should require at least retroactive approval by the Board of Directors (BOD).

2. Property Insurance

The Association does not have any property insurance. In addition, the ED backs up all financial information on transportable storage media and keeps the backup files elsewhere on the Association's premises. In the event of a disaster, these records could be destroyed with no recoverable copies.

It is recommended that property insurance be obtained for the records and equipment needed to restart operations after a catastrophe and ensure that recoverable records are maintained in the same event.

3. Invoice Due Date

Pursuant to RCW 48.32A.085(1), assessment invoices should be sent out at least 30 days prior to the due date. However, dates are not shown on the invoice.

To demonstrate compliance with RCW 48.32A.085(1), it is recommended that a due date be shown on the invoice. The due date should be at least 30 days after delivery of the invoice.

4. Assessment Limitation

Pursuant to RCW 48.32A.085(5)(a)(i), the total assessments authorized by the Association may not exceed 2% of a member's average domestic annual premiums during the three calendar years prior to an insurer's impairment or insolvency. The ED reviews each assessment to make sure that the average premium does not exceed the 2% limitation, but normal business practice presumes written corroboration of important computations.

In order to document compliance with RCW 48.32A.085(5)(a)(i), it is recommended that the computations required by that section be documented in writing.

5. Contracts

The Association uses several third parties to perform various services. Written contracts for some of the arrangements were available, but the contracts for one third party administrator (TPA) and a consulting firm could not be located. WLDIGA stated that these agreements were contracted between the TPA/Consultant and the insolvent company's receiver or the National Association of Life and Health Insurance Guaranty Associations (NOLHGA).

In order to ensure that the appropriate services are being provided at the correct price, it is recommended that the Association obtain a copy of the contract with any TPAs or consultants.

6. Custodial Agreement

The Association utilizes The Bank of America as the custodian for a part of its securities. After a review of the agreement, the following departures from the NAIC Financial Condition Examiners Handbook (FCEH) were noted:

1. The agreement does not state that registered custodial securities shall be registered in the name of the company or its nominee, the custodian or its nominee, or a clearing corporation or its nominee.
2. The agreement does not have a provision that the assets of the account are withdrawable upon demand.

3. Confirmation of all transfers is not explicitly required.
4. There is no written requirement that if the custodian gains entry into a clearing corporation through an agent, there must be a written agreement making the agent equally subject to custodian's liability for loss of the securities.
5. Bank of America is not responsible for securing insurance to cover the loss of the custodial property.

It is recommended that the Association adhere to the FCEH requirements and execute a satisfactory custodial agreement with the Bank of America.

7. Conflict of Interest

WLDIGA has a conflict of interest resolution, a statement of policy, and a certification that should be signed by the BOD members, employees, agents and representatives of WLDIGA. The ED was unable to find any certifications.

In order to document that there are no conflicts of interest, it is recommended that WLDIGA obtain annual certifications from Board members, employees, agents or representatives and retain them for future reference.

8. Bank Fees

The ED does not track investment fees paid to banks and the investment custodian. He believes that the Association is paying a reasonable amount but does not categorize the exact dollar amount paid.

In order to negotiate the best possible terms for investment services, the OIC recommends that the ED should obtain fee schedules and select providers accordingly.

ASSOCIATION PROFILE

Association History

The Association was established pursuant to Chapter 259 of the laws of the 1971 Washington State Legislature and is administered under Chapter 48.32A RCW, the Washington Insurance Code.

The purpose of this Act and the function of the Association are to assure that the insurance contractual obligations to insureds and claimants shall be performed on behalf of any insurer authorized to transact business in the state of Washington which is subsequently adjudged insolvent and unable to honor its insurance commitments.

The Act provides that the Association shall be a non-profit, unincorporated, legal entity (RCW 48.32A.055(1)). Membership is composed of the Insurance Commissioner, and of each insurer authorized to transact business in this state, as specified in RCW 48.32A.025(2)(a). The authority for any insurance company offering this type of business is conditioned upon maintaining membership in this Association.

The first recorded meeting of the Association's Board of Directors was June 17, 1974.

Relationships

National Association of Life and Health Insurance Guaranty Associations (NOLHGA) – Coordinates the efforts of the member guaranty associations involved in multi-state liquidations and bills its members for services. Functions performed by NOLHGA include the legal and actuarial review of proposed plans for disposition of in-force policies, development of liquidating plans, and coordination of funding by member associations.

Northwest Administrators – Pays and tracks claims for various insolvencies.

Navigant Consulting – Performs valuation work on various insolvencies. Navigant also bills the Association on behalf of NOLHGA for the Reliance Life Insurance Company insolvency.

Philadelphia American Life Insurance Company (PALIC) – NOLHGA contracted with PALIC to act as TPA for the policies received from the London Pacific Life and Annuity Company insolvency.

AIA Insurance – Processes the claims received under a group of non-cancelable health policies. These claims are paid and tracked by Northwest Administrators.

MANAGEMENT AND CONTROL

Plan of Operation

RCW 48.32A.095 requires that the Association submit to the commissioner a plan of operation to ensure the fair, reasonable, and equitable administration of the Association.

The Association's plan of operation was adopted November 2, 2001 and revised June 26, 2003.

Board of Directors

RCW 48.32A.065 provides that the BOD consist of the commissioner and not less than five nor more than nine member insurers serving terms as established by the plan of operation. The insurer members of the BOD are selected by member insurers subject to the commissioner's approval.

The plan of operation requires an annual meeting of the BOD immediately following the June annual meeting of member insurers.

As of December 31, 2004, the Association was controlled by an eight-member BOD.

Name	Member Company
John R. Patton – Chairman	Farmers New World Life Ins Co
C. Robert Ogden – Sec/Treas	North Coast Life Ins Co
Roger F. Harbin	Symetra Financial Corp
James B. Harbolt	Standard Insurance Co
Kathryn Kremin	Regence Life and Health Ins Co
Stephen D. Melton	Lifewise Assurance Co
Mark Webb	AIG
James T. Odiorne	Office of Insurance Commissioner

Committees

The Association has an executive committee and a nominating committee.

Conflict of Interest

All directors, employees, agents and representatives are required to sign a policy statement and certification to disclose conflicts of interest. However, no certifications could be located. See Recommendation #8.

Fidelity Bond and Other Insurance

The Association has a commercial crime policy that meets the suggested minimum amounts of fidelity insurance shown in the FCEH. However, WLDIGA does not have any property or liability insurance. The need for such coverage to protect the Association in the event of disasters or claims should be investigated. See Recommendation #2.

CORPORATE RECORDS

The corporate records were reviewed for the period under examination. All Board meetings were conducted with a quorum present. There have been two revisions to the plan of operation since the last examination.

ACCOUNTING RECORDS AND SYSTEMS

The Association prepares its financial statements on a modified cash basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP). WLDIGA is audited annually by the certified public accounting firm of Sweeny Conrad, PS and received an unqualified opinion for all years under review. During the planning and testing phase of the examination the accounting procedures, internal controls, and transaction cycles were reviewed by the OIC.

The ledger and transaction journal are maintained on a personal computer using Quick Books.

SUBSEQUENT EVENTS

None

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

There were no examination findings on the previous examination.

FINANCIAL STATEMENTS

Statements of Assets, Liabilities and Guaranty Fund
Statements of Revenues, Expenses and Guaranty Fund
Statement of Changes in Guaranty Fund Accounts

**WASHINGTON LIFE AND DISABILITY INSURANCE
 GUARANTY ASSOCIATION
 STATEMENTS OF ASSETS, LIABILITIES AND GUARANTY FUND
 YEAR ENDED
 DECEMBER 31, 2004**

	<u>BALANCE</u> <u>PER ASSOCIATION</u>	<u>REF</u>	<u>EXAM</u> <u>ADJ</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
ASSETS				
Cash and cash equivalents	\$3,358,381			\$3,358,381
Short-term investments	23,933,745			23,933,745
Investment income due and accrued	52,916			52,916
Assessments receivable	<u>1,880,429</u>			<u>1,880,429</u>
Total Assets	<u>29,225,471</u>		<u>\$0</u>	<u>29,225,471</u>
 LIABILITIES AND GUARANTY FUND				
LIABILITIES:				
Accounts Payable	7,921			7,921
NOLHGA expense reimbursement payable	<u>93,467</u>			<u>93,467</u>
Total Liabilities	101,388			101,388
 GUARANTY FUND:				
Disability account	2,951,587			2,951,587
Life and annuity account	20,204,897			20,204,897
General account (unrestricted)	<u>5,967,599</u>			<u>5,967,599</u>
Total Guaranty Fund	29,124,083			29,124,083
 Total Liabilities and Guaranty Fund	 <u>\$29,225,471</u>		 <u>\$0</u>	 <u>\$29,225,471</u>

**WASHINGTON LIFE AND DISABILITY INSURANCE
 GUARANTY ASSOCIATION
 STATEMENTS OF REVENUES, EXPENSES AND GUARANTY FUND
 YEAR ENDED
 DECEMBER 31, 2004**

	<u>BALANCE PER ASSOCIATION</u>	<u>REF</u>	<u>EXAM ADJ</u>	<u>BALANCE PER EXAMINATION</u>
<u>REVENUES</u>				
Assessments of member insurers	\$11,995,725			\$11,995,725
Recoveries from liquidating companies	8,981,173			8,981,173
Interest and other investment income	249,979			249,979
Premiums collected	138,044			138,044
Total Revenues	<u>21,364,921</u>		<u>\$0</u>	<u>21,364,921</u>
<u>EXPENSES</u>				
Policyholder claims	7,992,460			7,992,460
Assessment refunds	0			0
NOLHGA expense reimbursement	372,131			372,131
General and administrative	142,020			142,020
Write-off of amount due from insolvent member insurers	127,756			127,756
Professional fees	30,190			30,190
NOLHGA dues	35,535			35,535
Insurance	6,757			6,757
Total Expenses	<u>8,706,849</u>		<u>0</u>	<u>8,706,849</u>
Revenues over (under) expenses	12,658,072			12,658,072
Guaranty Fund:				
Beginning of year	16,466,011			16,466,011
End of year	<u>\$29,124,083</u>		<u>\$0</u>	<u>\$29,124,083</u>

**WASHINGTON LIFE AND DISABILITY
INSURANCE GUARANTY FUND
STATEMENT OF CHANGES IN GUARANTY FUND ACCOUNTS**

	<u>Disability Account</u>	<u>Life and Annuity Account</u>	<u>General Account</u>	<u>Totals</u>
Balances, December 31, 2002	\$3,184,366	\$10,360,469	\$5,886,689	\$19,431,524
Assessments of member insurers	224,959	2,131,776	0	2,356,735
Recoveries from liquidating companies	66,138	150,141	15,306	231,585
Interest and other investment income	0	0	233,847	233,847
Policyholder claims	(247,606)	(2,220,217)	0	(2,467,823)
Assessment refunds	(201,675)	(2,627,028)	0	(2,828,703)
NOLHGA expense reimbursement	(18,254)	(193,096)	(71,722)	(283,072)
General and administrative		0	(141,723)	(141,723)
Other	(8,030)	(601)	(57,728)	(66,359)
Balances, December 31, 2003	<u>2,999,898</u>	<u>7,601,444</u>	<u>5,864,669</u>	<u>16,466,011</u>
Assessments of member insurers	0	11,995,725	0	11,995,725
Recoveries from liquidating companies	111,764	8,699,385	170,024	8,981,173
Interest and other investment income	137,611	433	0	138,044
Policyholder claims	0	0	249,979	249,979
Assessment refunds	(250,148)	(7,732,312)	(10,000)	(7,992,460)
NOLHGA expense reimbursement	(3,879)	(263,355)	(104,897)	(372,131)
General and administrative	(9,606)	(458)	(131,956)	(142,020)
Other	(34,053)	(95,965)	(70,220)	(200,238)
Balances, December 31, 2004	<u><u>\$2,951,587</u></u>	<u><u>\$20,204,897</u></u>	<u><u>\$5,967,599</u></u>	<u><u>\$29,124,083</u></u>

NOTES TO FINANCIAL STATEMENTS

The Association has no special consents, permitted practices or orders from the state of Washington.

ACKNOWLEDGEMENT

The cooperation and assistance of the Association and the Executive Director during the examination are hereby acknowledged.

In addition to the undersigned, John Gaynard, CFE, CPA, FLMI, Life and Disability Supervisor, and Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Susan Campbell, CPA, AFE, FLMI
State of Washington

AFFIDAVIT

State of Washington)
) ss
County of King)

Susan Campbell, being duly sworn, deposes and says that the foregoing report subscribed by her is true to the best of her knowledge and belief.

Susan Campbell
Susan Campbell, CPA, AFE, FLMI
Examiner in Charge
State of Washington

Subscribed and sworn to before me on this 17th day of November,
2006.

Colleen Jansen
Notary Public in and for the
State of Washington

