



OFFICE OF  
INSURANCE COMMISSIONER

In the Matter of	)	No. 08-108
	)	
The Financial Examination of	)	FINDINGS, CONCLUSIONS,
<b>KPS HEALTH PLANS</b>	)	AND ORDER ADOPTING REPORT
	)	OF FINANCIAL EXAMINATION
	)	
A Domestic Health Care Service	)	
Contractor.	)	

**BACKGROUND**

An examination of the financial condition of **KPS HEALTH PLANS** (the Company) as of December 31, 2006, 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 9, 2008. 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 **KPS HEALTH PLANS** 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 1-5.

1. The Company is ordered to file an accurate statement of its financial condition, transactions, and affairs in compliance 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. Instruction 1, Examination Report, page 2.
2. The Company is ordered to file an accurate statement of its financial condition, transactions, and affairs in compliance 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 in regards to its unpaid claims. Instruction 2, Examination Report, page 2.
3. The Company is ordered to file an accurate statement of its financial condition, transactions, and affairs in compliance 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 in regards to its unpaid claims adjustment expenses. Instruction 3, Examination Report, page 3.

4. The Company is ordered to keep and maintain sufficient detail records in accordance with RCW 48.03.030(1) and RCW 48.44.145(2). Instruction 4, Examination Report, page 3.
5. The Company is ordered to file an accurate statement of its financial condition, transactions, and affairs in compliance with RCW 48.43.097, which requires the filing of its financial statements in accordance with the NAIC AP&P and pursuant to WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions. It is also ordered that the Company amend its custodial agreement with US Bank in accordance with the NAIC Financial Condition Examiners Handbook, Part 1 – General, Section IV.J – Custodial or Safekeeping agreements. Instruction 5, Examination Report, page 4.
6. The Company is ordered to comply with RCW 48.31C.050(2)(d) which requires prior notification of all administrative service agreements before execution. Instruction 6, Examination Report, page 4.
7. The Company is ordered to comply with RCW 48.31C.040 and WAC 284-18A-370 to properly disclose inter-company agreements annually or by reporting all material changes within fifteen (15) days after the end of the month when the material change occurred. Instruction 7, Examination Report, page 4.
8. It is ordered that the Company consider reviewing the business continuity plan on a regular basis, as necessary. Testing of the business continuity plan should be performed annually, as recommended by NAIC guidelines. Comments and Recommendations 1, Examination Report, page 5.
9. It is ordered that KPS consider following its conflict of interest policy requiring officers, directors of the board, and employees to complete annual conflict of interest forms going forward. It is also ordered that the compliance officer consider documenting his/her review when a potential conflict is declared on a conflict of interest disclosure form. Comments and Recommendations 2, Examination Report, page 5.

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 13th day of August, 2008.

A handwritten signature in black ink, appearing to read "Mike Kreidler". The signature is fluid and cursive, with the first name "Mike" written in a larger, more prominent script than the last name "Kreidler".

MIKE KREIDLER  
Insurance Commissioner

July 28, 2008

James T. Odiorne, CPA, JD  
Deputy Insurance Commissioner  
Company Supervision Division  
Office of the Insurance Commissioner  
P.O. Box 40255  
Olympia, WA 98504-0255

**RECEIVED**

JUL 28 2008

INSURANCE COMMISSIONER  
COMPANY SUPERVISION

RE: Financial Examination of KPS Health Plans

Dear Deputy Commissioner Odiorne:

We appreciate the opportunity to respond to the draft financial examination report from the Office of the Insurance Commissioner (OIC) prepared for KPS Health Plans (KPS) on July 9, 2008. As you requested, this response contains our position on substantive issues, which we offer in comment to the statements, analyses, comments, recommendations and instructions of the OIC. We understand that KPS' response will be included with the OIC's final examination report of KPS.

**Instructions.**

KPS provides the following responses and corrections to the OIC Instructions.

**1. NAIC Annual Statement Errors and Misclassifications**

***1a. Special Deposits Schedule***

***1b. Security Rating for Long-Term Bonds***

KPS intends to fully comply with RCW 48.43.097, WAC 284.07.050(2), and the NAIC Accounting Policies and Procedures Manual.

The two instructions above represent inadvertent and unintentional reporting errors within the large collection of investment schedules in the 2006 Annual Statement.

These minor reporting errors had no impact on KPS' results of operations or financial position and no effect on security deposits covering KPS' insured members or valuation of KPS' long-term or special deposit invested assets.

To enhance the accuracy of information reported in the NAIC Annual Statement, KPS instituted a formal internal review process as part of filing the 2007 Annual Statement.

*1c. Reclassification of Claim Expenses to Claim Adjustment Expenses*

KPS intends to fully comply with RCW 48.43.097, WAC 284.07.050(2), and the NAIC Accounting Policies and Procedures Manual.

This reclassification between claims expense and claims adjustment expense (CAE) Instruction relates to a specific and limited type of transaction. Since the reclassified amount is below the examination team's materiality threshold, KPS' 2006 Annual Statement was materially accurate.

KPS will accurately classify CAE before filing the 2008 Annual Statement to adhere fully with SSAP 85, paragraph 4.a.

*1d. Amounts Receivable Relating to Administrative Services Only (ASO) Plans*

KPS intends to continue fully complying with RCW 48.43.097, WAC 284.07.050(2), and the NAIC Accounting Policies and Procedures Manual, which require KPS to file an "accurate" statement of its financial conditions.

KPS' position is that it has filed an accurate Annual Statement with respect to its accounting for ASO plans. Since the OIC's reclassification Instruction falls below the examinations materiality threshold, KPS' 2006 Annual Statement was not materially affected.

KPS' position is that KPS cannot claim the right to cash balances for checks prepared and dated prior to year end since claims checks represent KPS' right to receive payment from its uninsured plan owner. KPS interprets the whole context of SSAP 48 rather than one sentence identified in the Instruction. SSAP 48, paragraph 8 states:

Amounts receivable from uninsured plans for (a) claims and other costs paid by the administrator on behalf of the third party at risk and (b) fees related to services provided by the administrator to the plan meet the definition of assets as set forth in SSAP No. 4 – Assets and Nonadmitted Assets. A receivable shall not be recorded for unpaid claims.

SSAP 48 recognizes the transfer of rights and obligations; it provides for the more conservative accounting position, which is to record a receivable over cash. The SSAP eschews recording a receivable for an inventory of unpaid, unprocessed claims, which is not the OIC's concern in this Instruction. Since KPS has already processed and prepared claim payments, KPS feels it has met the spirit and intent of SSAP 47.

*1e. Health Care Receivable Balance Inconsistent*

KPS intends to fully comply with RCW 48.43.097, WAC 284.07.050(2), and the NAIC Accounting Policies and Procedures Manual.

The Instruction above represents an inadvertent, minor and unintentional reporting error in the fill-in amounts. The assets reported in the balance sheet for Health Care Receivables were accurately stated. To enhance the accuracy of detailed information reported in the NAIC Annual Statement, KPS instituted formal internal review process as part of filing the 2007 Annual Statement to limit inadvertent errors.

## **2. Claims Unpaid**

KPS identified this understatement of its Unpaid Liability of claims in the first quarter of 2007. The Incurred But Not Received (IBNR) estimate is always subject to a certain degree of inaccuracy, which is disclosed in Notes in the Annual Statement. In January 2007, KPS changed its methodology for estimating monthly IBNR. The methodology, while providing no more or less assurance on the accuracy of the IBNR estimate, has resulted in a more actuarially sound estimate. As evidenced by month-to-month comparisons since January 2007, it does appear that the retrospective accuracy of the estimates has improved under the new methodology as compared to the degree of retrospective accuracy of the December 2006 estimates, which used methodologies formulated under the period of receivership.

## **3. Unpaid Claims Adjustment Expenses**

KPS intends to continue fully complying with RCW 48.43.097, WAC 284.07.050(2), and the NAIC Accounting Policies and Procedures Manual.

KPS employed an estimation method to reflect only costs that will be incurred to pay claims outstanding at year end. This approach is consistent with general guidance in SSAP 55, paragraph 9, which states "various analytical techniques can be used to estimate loss/claim adjustment expenses." Examples in SSAP 55 refer generally to the cost of "disbursing loss payments, maintaining records, occupancy costs, utilities..." all of which are direct costs associated with paying claims. The costing methodology used took into account only costs required to process claims. The method was consistent with that deployed during the period of receivership. While KPS believes that the estimation processes were consistent with the SSAP, we are evaluating existing methodologies and are considering revising estimates as a result of this evaluation.

## **4. Paid Claims Reconciliation**

KPS intends to fully comply with RCW 48.03.030(1) and RCW 48.44.145(2).

KPS' processes for reporting paid claims triangles in its Annual Statement were developed during the period of receivership and included identified adjustments that did not align to Annual Statement Instructions. The unintentional error did not affect the amount of claims liability reported, claims expense reported in the Statement of Revenue and Expenses, or Capital and Surplus. KPS has changed its processes for reporting paid claims in the Underwriting and Investment Schedule in 2008.

## **5. Custodial Agreement**

KPS intends fully to comply with RCW 48.43.097, WAC 284-07-050(2), and other applicable provisions as required by law.

We agree that the three items noted in Request No. RFI-T041 were not addressed precisely as noted above in the US Bank agreement dated April 29, 2003 or the amendment dated February 6, 2004, both of which were executed while KPS was under OIC receivership.

While KPS management determined that the 2003 and 2004 custody agreements substantially complied with the NAIC Financial Examiner's Handbook (even in light of the

minor wording issues noted above), management also concluded that new custody agreements with US Bank would be appropriate to improve the business terms in this important arrangement.

Thus, KPS executed a new custody agreement with US Bank effective December 31, 2007 that contains the specific language referenced in the NAIC Financial Condition Examiners Handbook, Part 1 General Section IV.H, *including* force majeure language referenced in the 2004 Handbook. The new agreement also contains superior business terms, including enhanced termination and warranty provisions. Via this custody agreement, KPS was in full compliance with the provisions noted above as of 12/31/07, as reflected in the KPS 2007 Annual Statement filing.

#### **6. Administrative Services Agreement**

KPS intends to fully comply with RCW 48.31C.050, WAC 284-18A-420 and other applicable provisions as required by law.

KPS and its parent corporation, Group Health Cooperative (GHC) take the approach that the "ultimate controlling person," as that term is used in RCW 48.31C and WAC 284-18A, is responsible for filing the Form D if the ultimate controlling person in the holding company system is a party to the agreement being submitted. This approach ensures that duplicate filings will not be made by multiple carriers in the same system, and the OIC has never raised a concern with this approach. Accordingly, GHC has taken responsibility for filing the Form D documents for Administrative Service Agreements (ASAs) to which GHC is a party, including the ASA with KPS and the ASA with GHC's other subsidiaries. GHC submitted the Form D for both the original and amendment to the GHC-KPS ASA on January 11, 2008 and received a "does not disapprove" letter from the OIC on February 21, 2008.

#### **7. Form B Disclosure**

KPS intends to fully comply with RCW 48.31C.040, WAC 284-18A-370 and other applicable provisions as required by law regarding disclosure of intercompany agreements. KPS is a member of the health carrier holding company system of which Group Health Cooperative (GHC) is the "ultimate controlling person." As the "ultimate controlling person," GHC files the Form B under RCW 48.31C.040(8) and WAC 284-18A-920, and reports required information pertaining to KPS and Northwest Credentials Verification Service.

RCW 48.31C.040(4) clarifies that health carriers need not file *all* agreements, service contracts and cost-sharing arrangements between companies in a holding company system. That section provides:

(4) No information need be disclosed on the registration statement filed under subsection (2) of this section if the information is not material for the purposes of this section. Unless the commissioner by rule or order provides otherwise, sales, purchases, exchanges, loans or extensions of credit, investments, or guarantees, involving two percent or less of a health carrier's admitted assets as of the 31st day of the previous December are not material for purposes of this section.

James T. Odiorne, CPA, JD  
July 28, 2008  
Page 5

Because the agreements between KPS and Northwest Credentials Verification Service referenced in Instruction 5 did not meet the materiality threshold described in RCW 48.31C.040(4), these contracts were not filed with the Form B for 2005 and 2006.

### **Comments and Recommendations**

#### **Comment and Recommendation 1: Business Continuity Plan**

KPS intends to administer its BCP considering elements contained in the NAIC Guidelines. This includes an annual update and test of the BCP. The update and test will be documented and retained by the Compliance Officer.

#### **Comment and Recommendation 2: Conflict of Interest Disclosures**

KPS' management and Board of Directors devoted considerable effort in a fourteen month period during 2006 through 2008 updating and revising its Conflict of Interest Policy and Conflict of Interest Disclosures for key employees, Officers and Board members. In January of 2008, KPS fully instituted a new policy and disclosure form for all officers, key employees and Board members. At the beginning of 2005 when conflict of interest disclosures were to be completed, KPS was under OIC Receivership. In 2006, KPS obtained Conflict of Interest forms as management and the Board evaluated aligning policies and disclosures to those used by KPS' parent organization, GHC.

This concludes our comments and responses to the draft report from the OIC to KPS.

Again, thank you for the opportunity to review and comment on the report. Please contact me if you have any questions. My telephone number is 360-478-6795.

Sincerely,



W. James Page Jr.  
Chief Financial Officer, KPS Health Plans  
Treasurer, KPS Health Plans

cc: Richard Marks, President, KPS Health Plans