

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



FINANCIAL EXAMINATION

OF

**LIFEWISE HEALTH PLAN OF ARIZONA, INC.
MOUNTLAKE TERRACE, WASHINGTON**

**NAIC CODE 65105
DECEMBER 31, 2007**

**Participating State:
Washington**

Order No. 09-41
Lifewise Health Plan of Arizona, Inc.
Exhibit A

SALUTATION

Seattle, Washington
April 8, 2009

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building-Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

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

The Honorable Morris Chavez, Superintendent
New Mexico Insurance Division
NAIC Secretary, Western Zone
PO Drawer 1269
Santa Fe, NM 87504-1269

Dear Commissioners and Superintendent:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

LifeWise Health Plan of Arizona, Inc.

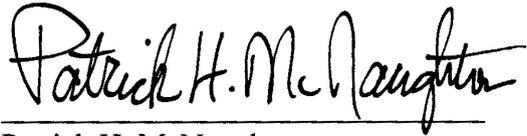
of

Mountlake Terrace, Washington

hereinafter referred to as "LWAZ" or "the Company," at its home office, 7001 220th Street, Mountlake Terrace, Washington 98043. This report is respectfully submitted showing the condition of the Company as of December 31, 2007.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of LifeWise Health Plan of Arizona, Inc., of Mountlake Terrace, Washington. This report shows the financial condition and related corporate matters as of December 31, 2007.



Patrick H. McNaughton
Chief Examiner



Date

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SCOPE OF EXAMINATION

This examination covers the period January 1, 2003 through December 31, 2007 and comprises a comprehensive review of the books and records of the Company. 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.

Corporate records, external reference materials, and various aspects of the Company'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 Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2007 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P). The following summarizes the exceptions noted while performing this review.

1. Annual Statement Errors

The results of the examination disclosed several instances in which the Company's filing of the 2007 NAIC Annual Statement did not conform to the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions. While the Company needs to correct these practices, none of the following items in this instruction were material to the financial statements and no examination adjustments were necessary.

- a. **Schedule S – Part 3 – Section 2** - The Company has a Medical Excess of Loss Reinsurance Contract with BCS Insurance Company (NAIC No. 38245). The Company is reporting a contract with BCS Life Insurance Company on its NAIC 2007 Annual Statement (NAIC No. 80985).
- b. **General Interrogatories** – The Company did not answer General Interrogatory No. 23.1 correctly. If securities are loaned to others, they are considered not in exclusive control of the Company and the Company should answer yes to No. 23.1. The amount loaned should be reported on line 23.21.

The Company is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

2. Approval of Investment Transactions

RCW 48.13.340 requires all investments, loans, sales or exchanges to be approved or authorized by the Board of Directors (BOD) or by a committee charged by the BOD with the duty of making said investment, loan, sale or exchange. The minutes of any said committee shall be recorded and reports thereof shall be submitted to the BOD for approval or disapproval. Investments were not documented as approved in the Board of Directors' meeting minutes for the third and fourth quarter of 2006.

The Company is instructed to document approval by the BOD for all investments purchased. Under RCW 48.13.350(1), a permanent written record of investment transactions must be kept and authorized by an officer or by the chairman of the committee authorizing the investment.

3. Custodial Agreement Deficiencies

The Company responded in its 2007 NAIC Annual Statement General Interrogatories 26.01 that its custodial agreement with the Bank of New York complied with the FCEH. However, it did not contain several provisions required by the FCEH. RCW 48.05.250 requires a company to file a true statement of its financial condition, transactions, and affairs.

The Company is instructed to comply with RCW 48.05.250 by filing a true statement of its financial condition, transactions and affairs and to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is also instructed to execute a revised or amended custodial agreement that complies with the FCEH.

4. Unpaid Claim Adjustment Expenses

The claim adjustment expenses for paid claims in 2007 were 9.9% of the paid claims. In estimating its claim adjustment expenses for unpaid claims, LWAZ used the parent company's experience percentage of 3%. Per SSAP No. 55, paragraph 8, claim adjustment expenses on unpaid claims should be calculated using past experience adjusted for current trends. Because the estimate for unpaid claims was overstated, the combined provision for unpaid claims and unpaid claim adjustment expenses was sufficient.

The Company is instructed to adequately account for unpaid claims adjustment expenses using past experience adjusted for current trends, pursuant to SSAP No. 55, paragraph 8, and comply with RCW 48.05.250 by filing a true annual statement and to follow the NAIC Annual Statement Instructions and the AP&P as required by WAC 284-07-050(2).

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

MSC Life Insurance Company (MSCL) was incorporated on June 1, 1992. MSCL sold primarily group stop-loss coverage for self-insured groups administered by its parent, Medical Service Corporation of Eastern Washington (MSC), or later Premera Blue Cross (PBC). MSCL was authorized to do business only in the state of Washington. On March 17, 2003, MSCL changed its name to LWAZ and on September 16, 2003, received a certificate of authority from the Arizona Department of Insurance to sell life and disability insurance.

Territory and Plan of Operation

LWAZ is licensed to transact business in the states of Arizona and Washington. Although LWAZ has retained its Washington certificate of authority, it operates exclusively in the state of Arizona selling individual and group health insurance policies.

Growth of Company

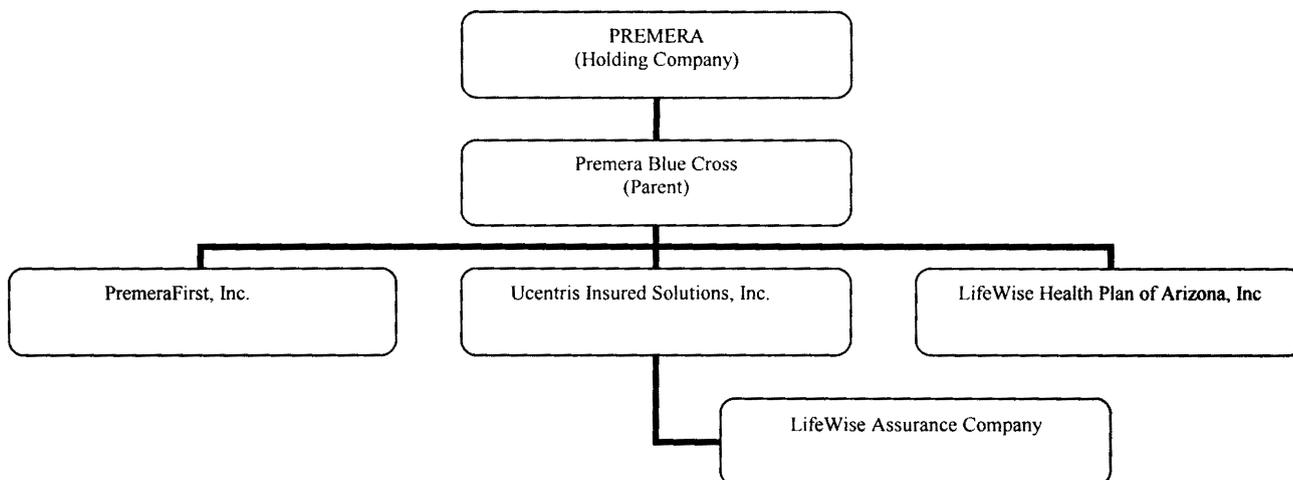
<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2007	\$37,649,228	\$18,889,848	\$18,759,380
2006	27,519,227	16,676,121	10,843,106
2005	31,341,675	10,320,382	21,021,293
2004	13,416,156	9,139,507	4,276,649
2003	7,394,344	1,099,533	6,294,811

<u>Year</u>	<u>Total Revenue</u>	<u>Underwriting Gain (Loss)</u>	<u>Investment Income</u>	<u>Net Income</u>
2007	\$65,564,859	(\$23,785,302)	\$1,335,774	(\$14,426,104)
2006	43,788,017	(16,793,250)	1,246,828	(11,004,628)
2005	15,566,490	(9,950,010)	673,979	(6,627,713)
2004	2,266,625	(9,776,752)	210,436	(7,952,323)
2003	0	(4,309,198)	386,558	(3,071,171)

AFFILIATED COMPANIES

LWAZ is a wholly owned subsidiary of PBC, a Washington non-profit corporation organized under RCW 24.03. PBC provides basic medical, hospital, major medical, comprehensive, and other prepaid health care benefits for its subscribers. PBC is a registered health care service contractor. PBC is ultimately owned by PREMERA, a Washington non-profit corporation organized under RCW 24.06.

The following organizational chart illustrates the Company's direct line affiliates within the organization.



Intercompany Agreements

The Company was a party to various intercompany contracts with PBC and affiliates. Significant agreements in force at December 31, 2007 were: Federal Income Tax Allocation Agreement used to determine allocation of federal income tax among affiliates, Funding and Billing Services Agreement used to charge the Company for billing and collection services performed by an affiliate, Intercompany Agreement used for allocation of operational expenses performed for affiliates by the parent, and two administrative services agreements used to charge the Company for services provided by two affiliates.

MANAGEMENT AND CONTROL

Ownership

LWAZ is a wholly owned subsidiary of PBC, a registered health care service contractor.

Board of Directors (BOD)

Directors as of December 31, 2007:

Heyward Donigan	Chairman
Brian Ancell	Director
Thomas Dameron	Director
Audrey Halvorson	Director
Kent Marquardt	Director

Officers

Officers as of December 31, 2007:

<u>Name</u>	<u>Title</u>
Thomas Dameron	President and Chief Executive Officer
Audrey Halvorson	Senior Vice President, Actuarial Services, and Chief Actuary
Richard Maturi	Senior Vice President, Health Care Delivery Systems
Sharilyn Campbell	Vice President, Finance, and Treasurer
Dan Evans	Vice President, Sales and Marketing
John Pierce	Vice President, General Counsel, and Corporate Secretary
Jeffrey Roe	Vice President, Individual Sales

Conflict of Interest

The Company requires the annual completion of a conflict of interest statement by officers, directors, and key employees. All are required to disclose to the corporate counsel relevant outside interests, memberships, associations, and affiliations. Our review did not disclose any exceptions.

Fidelity Bond and Other Insurance

LWAZ is a named insured on a financial institution fidelity bond insurance policy purchased by PBC. The aggregate amount of coverage meets the recommended guidelines of the NAIC to cover the exposure risk of the parent and its affiliates.

Officers', Employees', and Agents' Welfare and Pension Plans

The Company's employees participate in a PBC sponsored pension equity defined benefit plan, contribution retirement savings plan, and postretirement benefit plan. In addition, the Company's executive management employees participate in a nonqualified defined benefit supplemental retirement program and nonqualified contribution retirement program.

CORPORATE RECORDS

The corporate records were reviewed for the period under examination. The initial Articles of Incorporation were adopted on April 30, 1992. The Articles of Incorporation, Article 8, "Limitation of Liability", was amended on December 16, 2002, by deleting it in its entirety and its provisions were included in Article 9, "Limitation of Liability and Indemnification". The Articles of Incorporation were again amended on February 20, 2003; the name of the Company was changed to LifeWise Health Plan of Arizona, Inc. On August 13, 2003, LWAZ amended the Bylaws to reflect changes in the organization of the Company.

MORTALITY AND LOSS

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2007. The claim liabilities were determined to be within a reasonable range. The review included examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities; verifying that claim liabilities include provisions for all components noted in SSAP No. 55, paragraphs 7 and 8; reviewing historical paid claims and loss ratios; checking the consistency of the incurred-paid data from the Company's system with the figures reported in the 2007 NAIC Annual Statement; and estimating claims unpaid for the valuation date of December 31, 2007. The Company did not correctly calculate claim adjustment expenses on unpaid claims. (See Instruction No. 4.)

REINSURANCE

The Company is a party to a medical excess of loss reinsurance agreement for all health insurance policies on a claims incurred basis. The reinsurer is liable for up to \$4,500,000 of claims per insured in excess of \$500,000.

The reinsurance agreement was reviewed and found to be in compliance with Washington State reinsurance statutes. The Company reports a reinsurance contract with BCS Life Insurance Company, NAIC No. 80985 on its NAIC 2007 Annual Statement. The actual contract is with BCS Insurance Company, NAIC No. 38245 (See Instruction No. 1(a).)

The Company has controls in place to monitor its reinsurance program including the financial condition of the reinsurers. In addition, LWAZ utilizes the services of a reinsurance intermediary to solicit, negotiate, and place reinsurance cessions on its behalf.

STATUTORY DEPOSITS

The Company maintained its statutory deposit as of December 31, 2007 in the state of Arizona with a fair value of \$562,977.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) accrual basis. For the years 2006 and 2007, the Company was audited annually by the certified public accounting firm of KMPG, LLP. For the years, 2003 through 2005, the Company was audited annually by the certified public accounting firm of Ernst & Young, LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no material exceptions were noted.

Management is sufficiently knowledgeable of the information system (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate internal controls are in place.

Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the internal controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company.

The Company has a formal written disaster recovery plan for the restoration of the IS and an equally formal, written business continuity plan that addresses 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 NAIC Guidelines.

SUBSEQUENT EVENTS

In July 2007, the Company filed an application for redomestication from Washington to Arizona, and Articles of Domestication were filed with the Arizona Department of Insurance.

In May 2008, Thomas H. Dameron resigned as President and Chief Executive Officer (CEO) of LifeWise Health Plan of Arizona, Inc.

Majd F. El-Alma became President and CEO of the Company in June 2008.

In February 2009, the Company notified the OIC that it was withdrawing its application for redomestication to the state of Arizona, filed on July 27, 2007. The Company also announced in February 2009 that it would cease operations in Arizona.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The Company remedied all prior examination instructions and implemented the recommendations.

FINANCIAL STATEMENTS

Statement of Assets, Liabilities, Surplus and Other Funds
Statement of Income and Capital and Surplus Account
Reconciliation of Surplus

LIFEWISE HEALTH PLAN OF ARIZONA, INC.
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2007

Assets	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
Bonds	\$34,352,467	\$0	\$34,352,467
Receivables for securities	2,879		\$2,879
Cash and short-term investments	(840,276)		(840,276)
Subtotal, cash and invested assets	33,515,070	0	33,515,070
Investment income due and accrued	288,356		288,356
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	348,646		348,646
Current federal and foreign income tax recoverable	611,347		611,347
Net deferred tax asset	1,772,743		1,772,743
Electronic data processing equipment and software	23,191		23,191
Receivable from parent, subsidiaries and affiliates	723,304		723,304
Health care and other amounts receivable	312,062		312,062
Aggregate write-ins for other than invested assets	54,509		54,509
Total Assets	\$37,649,228	\$0	\$37,649,228
Liabilities, Surplus and other Funds			
Claims unpaid	\$11,167,687	\$0	\$11,167,687
Accrued medical incentive pool and bonus amounts	50		50
Unpaid claims adjustment expenses	460,976		460,976
Aggregate health policy reserves	4,433,195		4,433,195
Premiums received in advance	860,160		860,160
General expenses due or accrued	1,044,736		1,044,736
Ceded reinsurance premiums payable	52,931		52,931
Amounts withheld or retained for the account of others	595		595
Remittances and items not allocated	32,157		32,157
Amounts due to parent; subsidiaries and affiliates	517,108		517,108
Aggregate write-ins for other liabilities	320,253		320,253
Total Liabilities	18,889,848	0	18,889,848
Common capital stock	2,400,000		2,400,000
Gross paid in and contributed surplus	51,769,664		51,769,664
Unassigned funds (surplus)	(35,410,284)		(35,410,284)
Surplus as regards policyholders	18,759,380	0	18,759,380
Total Liabilities, Surplus and other Funds	\$37,649,228	\$0	\$37,649,228

LIFEWISE HEALTH PLAN OF ARIZONA, INC.
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2007

STATEMENT OF INCOME	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENT</u>	<u>BALANCE PER EXAMINATION</u>
Net premium income	\$65,760,652	\$0	\$65,760,652
Change in unearned premium reserves and reserve for rate credits	(195,793)		(195,793)
Total revenues	<u>65,564,859</u>	<u>0</u>	<u>65,564,859</u>
Hospital/medical benefits	51,458,023		51,458,023
Emergency room and out-of-area	8,423,857		8,423,857
Prescription drugs	8,211,300		8,211,300
Incentive pool; withhold adjustments and bonuses	37		37
Subtotal (hospital and medical)	<u>68,093,217</u>	<u>0</u>	<u>68,093,217</u>
Net reinsurance recoveries (less)	32,293		32,293
Total hospital and medical	<u>68,060,924</u>	<u>0</u>	<u>68,060,924</u>
Claims adjustment expenses	6,556,602		6,556,602
General administrative expenses (less)	15,202,909		15,202,909
Increase in reserves for life and health contracts	(470,274)		(470,274)
Total underwriting deductions	<u>89,350,161</u>	<u>0</u>	<u>89,350,161</u>
Net underwriting gain or (loss)	<u>(23,785,302)</u>	<u>0</u>	<u>(23,785,302)</u>
Net investment income earned	1,335,774	0	1,335,774
Net realized capital gains or (losses)	56,840		56,840
Net investment gains or (losses)	<u>1,392,614</u>	<u>0</u>	<u>1,392,614</u>
Aggregate write-ins for other income or expenses	(6,015)		(6,015)
Net income (loss); after capital gains tax and before all other federal income taxes	<u>(22,398,703)</u>	<u>0</u>	<u>(22,398,703)</u>
Federal and foreign income taxes incurred	(7,972,599)	0	(7,972,599)
Net income (loss)	<u><u>(\$14,426,104)</u></u>	<u><u>\$0</u></u>	<u><u>(\$14,426,104)</u></u>
CAPITAL AND SURPLUS ACCOUNT			
Surplus as regards policyholders, December 31 prior year	<u>\$10,843,106</u>	<u>\$0</u>	<u>\$10,843,106</u>
Gains and (Losses) in Surplus			
Net income	(14,426,104)		(14,426,104)
Change in net unrealized capital gain/losses	9,290		9,290
Change in net deferred income tax	(184,240)		(184,240)
Change in nonadmitted assets	517,328		517,328
Paid in (surplus adjustments)	22,000,000		22,000,000
Change in surplus as regards policyholders	7,916,274	0	7,916,274
Surplus as regards policyholders, December 31 current year	<u><u>\$18,759,380</u></u>	<u><u>\$0</u></u>	<u><u>\$18,759,380</u></u>

LIFEWISE HEALTH PLAN OF ARIZONA, INC.
RECONCILIATION OF SURPLUS
FOR YEAR ENDED AS OF DECEMBER 31, 2007

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Capital and surplus, December 31, previous year	<u>\$10,843,106</u>	<u>\$21,021,293</u>	<u>\$4,276,649</u>	<u>\$6,294,811</u>	<u>\$9,534,588</u>
Net income (loss)	(14,426,104)	(11,004,628)	(6,627,713)	(7,952,323)	(3,071,171)
Change in net unrealized capital gain/losses	9,290	(3,188)			
Change in net deferred income tax	(184,240)	743,446	581,761	613,406	87,459
Change in nonadmitted assets	517,328	86,183	(232,261)	(223,599)	(261,263)
Paid in (surplus adjustments)	22,000,000		22,000,000	5,000,000	
Aggregate write-ins for gains or (losses) in surplus			1,022,857	544,354	5,198
Change in surplus as regards policyholders for the year	<u>7,916,274</u>	<u>(10,178,187)</u>	<u>16,744,644</u>	<u>(2,018,162)</u>	<u>(3,239,777)</u>
Surplus as regards policyholders, December 31, current year	<u>\$18,759,380</u>	<u>\$10,843,106</u>	<u>\$21,021,293</u>	<u>\$4,276,649</u>	<u>\$6,294,811</u>

NOTES TO THE FINANCIAL STATEMENTS

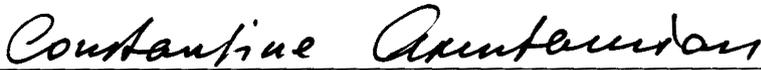
None

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers and staff of LifeWise Health Plan of Arizona, Inc. during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Susan Campbell, CPA, CFE, FLMI, ARA, Reinsurance Specialist, Life and Disability Field Supervisor; Shiraz Jetha, FSA, FCIA, MAAA, Life & Health Actuary; John R. Jacobson, AFE, CISA, AES, Automated Examination Specialist; Richard Bologna, Financial Examiner; Cynthia Clark, Financial Examiner; and Kathy Hicks, CPA, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Constantine Arustamian, CPA, CFE, ARC, ARM, ARe, AIS, AIAF
Examiner-in-Charge
State of Washington

