

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
COMMUNITY HEALTH PLAN OF WASHINGTON  
SEATTLE, WASHINGTON

NAIC CODE 47049  
December 31, 2012

Order No. 14-115  
Community Health Plan of Washington  
Exhibit A

**SALUTATION**

Seattle, Washington  
March 4, 2014

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

Dear Commissioner Kreidler:

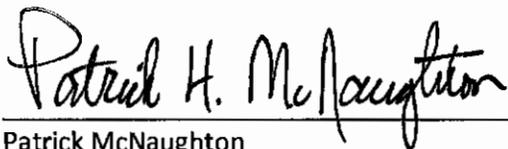
In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

**Community Health Plan of Washington  
of  
Seattle, Washington**

hereinafter referred to as "CHPW," or the "Company" at its home office located at 720 Olive Way, Suite 300, Seattle, WA 98101. This report is respectfully submitted showing the condition of CHPW as of December 31, 2012.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Financial Examination of Community Health Plan of Washington of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2012.



Patrick McNaughton  
Chief Examiner

6-5-14

Date

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## **SCOPE OF THE EXAMINATION**

This examination covers the period January 1, 2009 through December 31, 2012 and comprises a risk focused review of the books and records of the Company. The examination followed 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. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of field work on March 4, 2014.

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 section of this report. In addition, the Company's Certified Public Accountants' (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2012 NAIC Financial Condition Examiners Handbook which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

## **INSTRUCTIONS**

The examiners reviewed the Company's filed 2012 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 outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review:

### **1. NAIC Annual Statement Errors, Omissions, and Misclassifications**

The results of the examination disclosed instances in which the Company's filing of the 2012 NAIC Annual Statement did not conform to the NAIC AP&P Manual and the NAIC Annual Statement Instructions. While the Company needs to correct these practices, none of the following items in this instruction were believed to be material to the financial statements and no examination adjustments were necessary.

- a. **Retrospective Premiums** – In the 2012 NAIC Annual Statement, page 2, Assets, the Company reported the retrospective premiums on Line 15.1, Uncollected premiums and agents' balances in the course of collection. The 2012 retrospective premiums should have been reported on Line 15.3, Accrued retrospective premiums.

- b. Schedule D – Securities Designation - In Schedule D, Part 1 of the 2012 NAIC Annual Statement, the Company reported designations for two long-term bond securities which do not match the designations in the NAIC database.
- c. Claims Unpaid – The Company reported hemophiliac receivables of \$33,715 on Line 1, claims unpaid. This amount should have been reported on Line 22, health care and other amounts receivable. Also, the Company did not disclose its risk sharing receivable with Department of Social and Health Services (DSHS) for hemophiliac drugs in Note No. 27 to the 2012 NAIC Annual Statement.
- d. Washington State Health Insurance Pool (WSHIP) Assessment - The Company reported the 2012 Washington State Health Insurance Pool (WSHIP) assessment in the amount of \$7,071,648 as a part of the 2012 General administrative expenses. This assessment should have been reported as hospital/medical benefits per SSAP No. 35R.

**The Company is instructed to comply with RCW 48.43.097, RCW 48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statements in accordance with the NAIC Accounting Practices and Procedures Manual, and the NAIC Annual Statement Instructions.**

## **2. Written Investment Policy Requirements**

The Company's written investment policy omitted the following written guidelines per RCW 48.13.051: RCW 48.13.051(1) requires the delegation and monitoring of policies, procedures, and controls covering all aspects of the investment function; RCW 48.13.051(4) requires professional standards for the individuals making day-to-day investment decisions to assure that investments are managed in an ethical and capable manner; and, RCW 48.13.051(7) requires the manner in which the insurer intends to implement RCW 48.13.041 (Prudent Investment).

**The Company is instructed to comply with RCW 48.13.051, and ensure that its written investment policy meets all requirements of this section.**

## **COMMENTS AND RECOMMENDATIONS**

### **1. Diagnosis Codes/Medicare Risk Adjustment Factors**

The Company's internal controls over timely and accurate diagnosis codes related specifically to Medicare patients could be strengthened. The examiners noted that since 2007, when the Company began to service Medicare enrollees, no audits have been performed by the Centers for Medicare and Medicaid Services (CMS). In addition, no internal audit has been performed.

**It is recommended that the Company strengthen its review processes and monitoring controls over the accuracy of diagnosis codes.**

## **2. Reporting Structure of Chief Information Officer**

The Company's Chief Information Officer (CIO) does not report to the Chief Operating Officer (COO). Instead, the CIO of the Company reports to the Chief Financial Officer (CFO). The current reporting structure of the Company does not conform to the Control Objectives for Information and Related Technology (COBIT) Framework standards, which recommends the CIO report to either the COO or the Chief Executive Officer (CEO).

**It is recommended the Chief Information Officer report to either the Chief Executive Officer or the Chief Operating Officer.**

## **3. Inadequate Fidelity Bond Coverage**

The Company has a fidelity policy that provides employee dishonesty/employee theft, and depositor's forgery coverage with a limit of \$600,000, which is less than the NAIC suggested minimum amount of \$1,500,000.

**It is recommended the Company increases its employee dishonesty coverage to the NAIC suggested minimum of \$1,500,000.**

## **4. Annual Audits of Pharmacy Rebates and Claims**

The Company has not performed any annual audits of the pharmacy rebate process or the accuracy of pharmacy claims for the years 2011 and 2012. The Company does not currently have an internal process to review and verify the accuracy of the rebate amounts based on member utilization data. Without the annual audit, the Company does not have any internal process for dispute resolution of pharmacy rebate amounts or the accuracy of pharmacy claims.

**It is recommended that the Company perform annual audits of pharmacy rebates and claims to verify the accuracy of pharmacy rebates and claims reported by its pharmacy benefit manager.**

## **COMPANY PROFILE**

### **Company History**

Community Health Plan of Washington was incorporated under RCW 24.06.207 as a non-profit tax exempt corporation in the state of Washington, and commenced business in July of 1996. The Company was issued a certificate of registration as a health care service contractor (HCSC) on August 16, 1996 pursuant to RCW 48.44.015. The Company is exempt from federal income tax under Internal Revenue Code Section 501(c)(4).

### **Capitalization**

Pursuant to RCW 48.44.037, the Company met minimum capital requirements of \$3 million with \$126,091,618 of capital and surplus as of December 31, 2012.

### Territory and Plan of Operation

The Company conducts business in the state of Washington. The Company provides health insurance coverage to enrollees of the Washington State Health Care Authority's (HCA) managed Medicaid and managed care services: Healthy Options, Children's Health Insurance Program, Washington Health Program, Basic Health Plan, and Medical Care Services.

The Company also provides health insurance coverage to enrollees of the Centers for Medicare and Medicaid Services' (CMS) Medicare Advantage program. Coverage is provided pursuant to global capitation arrangements with CMS. Under the arrangements, services are provided for a certain amount per enrollee per month regardless of the frequency, extent or nature of the covered services provided to enrollees.

### Growth of Company

The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the four year period under examination:

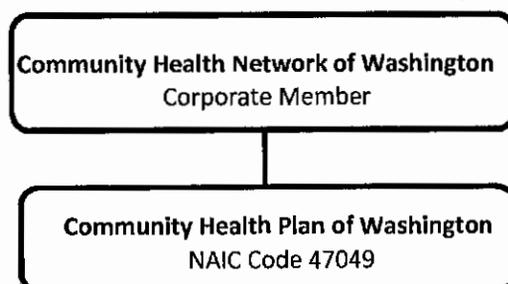
Year	Admitted Assets	Liabilities	Capital & Surplus
2012	\$313,999,249	\$187,907,631	\$126,091,618
2011	210,711,434	105,662,170	105,049,264
2010	183,279,638	90,690,621	92,589,017
2009	150,862,399	81,411,386	69,451,013

Year	Total Revenue	Net Underwriting Gain (Loss)	Net Investment Gain (Loss)	Net Income
2012	\$876,212,768	(\$46,292)	\$10,665,597	\$8,824,359
2011	706,397,907	6,120,986	3,853,398	11,415,928
2010	610,158,112	16,026,995	5,358,555	21,385,469
2009	558,581,353	3,335,403	(13,424)	4,149,230

### Affiliated Companies

The Company is a controlled affiliate of Community Health Network of Washington (the Network). The following is an organization chart as of December 31, 2012:



**Community Health Network of Washington**

Community Health Network of Washington, a Washington State nonprofit corporation, is a managed health care delivery network which operates under the direction of 20 community and migrant health centers.

**Intercompany Agreements**

As of December 31, 2012, the Company was a party to various intercompany agreements which were in compliance with SSAP No. 70.

**Paymaster and Shared Services Agreement**

The Company provides certain administrative functions for the Network under a written paymaster and shared service arrangement. Salary, benefits, and various other operating costs relating to these services are paid by the Company and allocated to the Network.

**Health Care Services Agreement (HCSA)**

The Company has a global capitation arrangement with the Network to provide certain health care services and administrative services to the Company's enrollees. The Company makes monthly capitation payments to the Network for the covered health care services.

**MANAGEMENT AND CONTROL**

**Board of Directors (BOD)**

Directors of the Company as of December 31, 2012:

Peggy Hopkins – Chair	Cristobal Guillen
Diana Bader	Michael Hassing
Teresita Batayola	Barbara Malich
Sheila Chilson	Linda McVeigh
Steven Clark	Anita Monoian
Dian Cooper	Mark Secord
Juan Cordova	Desmond Skubi
Carla DewBerry	Desiree Sweeney
Robert Farrell	Thomas Trompeter
David Flentge	

**Officers**

Officers of the Company as of December 31, 2012:

Lance Hunsinger	Chief Executive Officer
Sheila Chilson	Treasurer
Barbara Malich	Secretary
Stacy Kessel	Chief Financial Officer
Marilee McGuire	Chief Operating Officer
Wade Harman	Chief Legal Officer
Alan Lederman	SVP Business Intelligence & TPA Operations

**Conflict of Interest**

The Company's Conflict of Interest Policy requires that all employees at the director level position and above complete annually a conflict of interest and disclosure statement. Our review did not disclose any exceptions.

**Fidelity Bond and Other Insurance**

The Company is a named insured on a fidelity insurance policy purchased by the Network. Our review indicated that the aggregate amount of coverage under this policy does not meet the recommended guidelines of the NAIC to cover the exposure risk of the Company and its affiliates. (See Comments and Recommendations No. 3.)

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

The Company participates through the Network's defined contribution and profit sharing retirement savings plan pursuant to section 401(k) of the Internal Revenue Code which covers all employees who meet certain eligibility requirements.

**CORPORATE RECORDS**

The Articles of Incorporation, Bylaws, Certificate of Registration, and minutes of the BOD and committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. The minutes supported the transactions of the Company and actions taken by the officers.

**ACTUARIAL REVIEW**

The OIC actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2012. 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 (7) and (8), and SSAP No. 54 (12), (13), (18), and (19); 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 2012 NAIC Annual Statement; and, estimating claims unpaid for the valuation date of December 31, 2012.

The OIC actuary determined reserves were in compliance with statutory requirements, and the methods, assumptions, and methodologies used by the Company were appropriate.

**REINSURANCE**

The Company is a party to a medical excess of loss reinsurance agreement for hospital claims. The Company's retention is \$250,000 with a limit of \$2,000,000 per covered person.

On March 15, 2013, CHPW replaced its Full Risk Agreement, with Columbia United Providers (CUP), with a quota share reinsurance agreement made retroactively effective as of July 1, 2012. Under the agreement, CUP assumes 100 percent of the risk for the Healthy Options and the Basic Health Plan business that CHPW assigns to CUP in Clark County.

The reinsurance agreements were reviewed and found to comply with Washington State reinsurance statutes. The agreements transfer risk in accordance with SSAP No. 61R, paragraph 17. The Company utilizes the services of a reinsurance intermediary to solicit, negotiate, and place reinsurance cessions on its behalf.

#### STATUTORY DEPOSITS

The Company maintains the following statutory deposits as of December 31, 2012:

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
Washington	US Treasury	\$524,650	\$524,650

#### ACCOUNTING RECORDS AND INFORMATION SYSTEM

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is 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 two exceptions were noted. (See Comments and Recommendations Nos. 1 and 4.)

The Company's IT environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and Related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT systems and controls were evaluated to gain an understanding of general IT control risks and assess the effectiveness of these controls. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. The Company has an effective Business Continuity Plan and Disaster Recovery Plan, which have been tested on a regular basis and include the availability of an alternate site.

#### SUBSEQUENT EVENTS

On April 23, 2013, the OIC approved the cancellation of a surplus note of \$12.4 million, plus interest, less expenses, with Columbia United Providers (CUP) that the Company subsequently paid off on April 26, 2013. (See Note 1 to the Financial Statements.)

The Company and CUP executed a Quota Share Reinsurance Agreement, retroactively effective to July 1, 2012, which allowed CHPW to utilize SSAP No. 61 for the reinsurance accounting treatment. (See page 6, Reinsurance.)

The Company participates in the Health Benefit Exchange of Washington State in 2014. Since the beginning of the open enrollment in October 2013 for Washington consumers, CHPW has made three plans available in 26 counties via Washington's Health Benefit Exchange. The exchange has enabled consumers to purchase coverage that begins January 1, 2014 and applies subsidies based on income level to pay for insurance premiums.

### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of the Company as of December 31, 2012:

Assets, Liabilities, Capital and Surplus  
Statement of Revenue and Expenses  
Five Year Reconciliation of Surplus

**Community Health Plan of Washington  
Assets, Liabilities, Capital and Surplus  
December 31, 2012**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>ASSETS</b>			
Bonds	\$141,586,485	\$0	\$141,586,485
Stocks	31,166,550		31,166,550
Cash	117,624,627		117,624,627
Investment income due and accrued	1,022,351		1,022,351
Premiums and considerations			
Uncollected premium and agents' balances in the course of collection	11,905,713		11,905,713
Reinsurance			
Amounts recoverable from reinsurers	2,413,015		2,413,015
Amounts receivable relating to uninsured plans	3,112,906		3,112,906
Electronic data processing equipment and software	777,481		777,481
Health care and other amounts receivable	3,677,450		3,677,450
Aggregate write-ins for other than invested assets	712,672		712,672
<b>Total assets</b>	<b><u>\$313,999,249</u></b>	<b><u>\$0</u></b>	<b><u>\$313,999,249</u></b>
<b>LIABILITIES, CAPITAL AND SURPLUS</b>			
Claims unpaid	\$117,286,539	\$0	\$117,286,539
Accrued medical incentive pool and bonus amounts	49,282		49,282
Unpaid claim adjustment expenses	3,543,727		3,543,727
Aggregate health policy reserves	803,732		803,732
Premium received in advance	39,962,385		39,962,385
General expenses due or accrued	16,027,360		16,027,360
Amounts due to parent, subsidiaries and affiliates	7,804,458		7,804,458
Payable for securities	2,430,148		2,430,148
<b>Total liabilities</b>	<b><u>187,907,631</u></b>	<b><u>0</u></b>	<b><u>187,907,631</u></b>
Gross paid in and contributed surplus	14,738,448		14,738,448
Surplus notes (See Note 1)	12,400,000		12,400,000
Unassigned fund (surplus)	98,953,170		98,953,170
<b>Total capital and surplus</b>	<b><u>126,091,618</u></b>	<b><u>0</u></b>	<b><u>126,091,618</u></b>
<b>Total liabilities, capital and surplus</b>	<b><u>\$313,999,249</u></b>	<b><u>\$0</u></b>	<b><u>\$313,999,249</u></b>

**Community Health Plan of Washington  
Statement of Revenue and Expenses  
For the Year Ended December 31, 2012**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	3,610,250		3,610,250
Net premium income	\$876,212,768	\$0	\$876,212,768
Total revenues	<u>876,212,768</u>	<u>0</u>	<u>876,212,768</u>
<b>Hospital and Medical:</b>			
Hospital/medical benefits	727,828,624		727,828,624
Prescription drugs	55,646,583		55,646,583
Incentive pool, withhold adjustments and bonus amounts	(788,224)		(788,224)
Subtotal	<u>782,686,983</u>	<u>0</u>	<u>782,686,983</u>
<b>Less:</b>			
Net reinsurance recoveries	5,527,149		5,527,149
Total hospital and medical	777,159,834	0	777,159,834
Claims adjustment expenses	21,451,860		21,451,860
General administrative expenses	77,647,366		77,647,366
Total underwriting deductions	<u>876,259,060</u>	<u>0</u>	<u>876,259,060</u>
Net underwriting gain or (loss)	(46,292)	0	(46,292)
Net investment income earned	3,519,320		3,519,320
Net realized capital gains (losses) less capital gains tax	7,146,277		7,146,277
Net investment gains (losses)	10,665,597	0	10,665,597
Aggregate write-ins for other income or expenses	(1,794,946)	0	(1,794,946)
Net income or (loss) after capital gains tax and before all other federal income taxes	<u>8,824,359</u>	<u>0</u>	<u>8,824,359</u>
<b>Net income or (loss)</b>	<u><b>\$8,824,359</b></u>	<u><b>\$0</b></u>	<u><b>\$8,824,359</b></u>
	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>			
Capital and surplus prior reporting year	<u>\$105,049,264</u>	<u>\$0</u>	<u>\$105,049,264</u>
Net income or (loss)	8,824,359		8,824,359
Change in net unrealized capital gains (losses)	(2,382,647)		(2,382,647)
Change in nonadmitted assets	2,201,930		2,201,930
Change in surplus notes	12,400,000		12,400,000
Aggregate write-ins for gains or (losses) in surplus	(1,288)		(1,288)
Net change in capital and surplus	<u>21,042,354</u>	<u>0</u>	<u>21,042,354</u>
Capital and surplus end of reporting period	<u><b>\$126,091,618</b></u>	<u><b>\$0</b></u>	<u><b>\$126,091,618</b></u>

**Community Health Plan of Washington  
Four Year Reconciliation of Surplus  
For the Years Ended December 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>Capital and surplus, December 31, prior year</b>	<b>\$105,049,264</b>	<b>\$92,589,017</b>	<b>\$69,451,013</b>	<b>\$63,431,290</b>
Net income or (loss)	8,824,359	11,415,928	21,385,469	4,149,230
Change in net unrealized capital gains (losses)	(2,382,647)	(286,092)	2,058,633	17,804,474
Change in nonadmitted assets	2,201,930	1,304,374	(306,098)	(5,204,585)
Change in surplus notes	12,400,000	0	0	0
Aggregate write-ins for gains or (losses) in surplus	(1,288)	26,038	0	(10,729,396)
<b>Net change in capital and surplus</b>	<b>21,042,354</b>	<b>12,460,247</b>	<b>23,138,004</b>	<b>6,019,723</b>
<b>Capital and surplus, December 31, current year</b>	<b>\$126,091,618</b>	<b>\$105,049,264</b>	<b>\$92,589,017</b>	<b>\$69,451,013</b>

## NOTES TO THE FINANCIAL STATEMENTS

### **1. Surplus Notes**

Effective July 1, 2012, the Company and Columbia United Providers entered into an arrangement whereby the Company paid CUP to assume the full risk for healthcare services provided by the Company for Healthy Options and Basic Health Plans (the Full Risk Agreement). The OIC approved the surplus note with the Company and CUP which resulted in an arrangement requiring CUP to deposit \$12,400,000 into an account held by the Company. The Company subsequently issued CUP a surplus note for that amount, in accordance with RCW 48.09.320 and SSAP No. 41. On April 26, 2013, the surplus note was paid off by the Company as approved by the OIC.

## ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Community Health Plan of Washington and its affiliates during the course of this examination.

In addition to the undersigned, Michael Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Timothy Hays, CPA, JD, Investment Specialist; Scott Fitzpatrick, FSA, MAAA, Actuary; Susan Campbell, CPA, CFE, FLMI, ARA, Life Field Supervising Examiner and Reinsurance Specialist; Katy Bardsley, CPA, CFE, Financial Examiner; Albert Karau, Jr., CPA, CFE, FLMI, Financial Examiner; and Zairina Othman, Financial Examiner, all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



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Youngjae Lee, CPA, CFE  
Examiner-in-Charge  
State of Washington

