

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



TARGET FINANCIAL EXAMINATION  
of  
Timber Products Manufacturers Trust  
Spokane, Washington

NAIC CODE 12239  
April 30, 2010

Order No. 11-10  
Timber Products Manufacturers Trust  
Exhibit A

**SALUTATION**

Seattle, Washington  
January 24, 2011

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 48.125.140 and RCW 48.03.010, a target examination was made of the corporate affairs and financial records of

**Timber Products Manufacturers Trust**

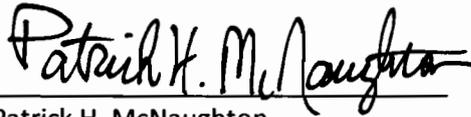
of

Spokane, Washington

hereinafter referred to as “Timber” or the “Trust.” The examination was conducted at the statutory home office located at 951 East Third Avenue, Spokane, Washington 99202-2287. This report is respectfully submitted showing the financial condition and related corporate matters of the Trust as of April 30, 2010.

**CHIEF EXAMINER'S AFFIDAVIT**

I hereby certify I have read the attached Report of the Target Financial Examination of Timber Products Manufacturers Trust of Spokane, Washington. This report shows the targeted financial condition and related corporate matters as of April 30, 2010.



Patrick H. McNaughton  
Chief Examiner

1-24-2011

Date

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## **SCOPE OF THE EXAMINATION**

A targeted, limited-scope examination was called on May 1, 2010 based on the financial condition of the Trust for the period December 31, 2009 through April 30, 2010. The primary objective of the examination was to review the accuracy of its monthly financial reporting to the OIC by conducting a focused review of the books and records and targeting the financial reporting accuracy of premium revenue, claim reserves, and cash balances, plus a review of investments, and capital structure and subsequent events that could impact the Trust's solvency.

This examination covers the period January 1, 2008 through April 30, 2010. The examination followed the statutory requirements contained in Title 284 of the Washington Administrative Code (WAC), Title 48 of 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 Trust'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 Trust's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

Because this examination is a limited scope examination, it is not intended to communicate all matters of importance for an understanding of the Trust's financial condition.

The examination emphasis was targeted to the following areas:

- Risk Based Capital (RBC) Plan Accuracy
- Going Concern
- Liquidity and Cash Flow
- Changes in Senior Management and Succession Planning
- Outsourced Services Performed by Third Parties
- Review of Year-End 2009 External CPA Audit

## **INSTRUCTIONS**

The examiners reviewed the Trust's filed 2009 NAIC Annual Statement and subsequent financial statements filed with the OIC through April 30, 2010. This review was performed to determine if the Trust completed the statements in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory of Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

### **1. RBC Plan Accuracy**

On March 2, 2010, the OIC asked the Trust to submit a RBC Plan by April 16, 2010 in accordance with RCW 48.43.310(2) which requires projections for the financial results for the current and the four succeeding years. Our review determined the RBC Plan was inaccurate and not viable. Further, the Trust

was not able to provide the documentation or support for the projections. For example, the RBC Plan projects the Trust to generate a net income of \$2.7 million over the five year period from 2010 through 2014 with no significant corresponding increase in surplus. In addition, the Trust could not provide an explanation of the key assumptions impacting the projections as required by RCW 48.43.310(2)(e).

**The Trust is instructed to comply with RCW 48.43.310(2) and file an accurate RBC Plan that; identifies the conditions that contributed to the Trust action level event; contains proposals of corrective actions that the Trust intends to take to eliminate the Trust action level event; provides financial projections that are based on realistic assumptions; and identifies those key assumptions that can be supported.**

## COMMENTS AND RECOMENDATIONS

### 1. Surplus Decrease

The Trust's surplus declined more than 49 percent in 2009 and continued to decline in the first quarter of 2010. Most of the surplus decline was caused by the Trust's underwriting results. Other factors contributing to the Trust's surplus decline were caused by the following:

- **High Utilization:** Members accelerated medical procedures prior to their termination of insurance benefits due to lay-offs during the down turn in the economy in late 2008 and continuing through 2009.
- **Delayed Large Claims Reporting:** No system was in place with the Trust's third party administrator (TPA), Allegiance Benefit Plan Management, Inc. (Allegiance), to provide timely notice of emerging claims experience and large claim amounts. This caused future premium calculations to be underpriced.
- **Reserves Adjustments:** Strategic Health Proactive Solutions, Inc. (SHPS), the Trust's consulting actuary, changed prior reserves estimates several times in 2008 and 2009 that were due to undetected and unanticipated large claims. Therefore, the Trust was not able to timely include increases in reserve adjustments in product pricing since premium renewals rates are based on prior results plus a very thin margin.
- **Membership Loss:** The Trust experienced a significant membership reduction due to the recession and layoffs that was not sufficiently offset by adding new groups to replace the reduction in members and premiums. The membership reduction created adverse selection that left higher risk individuals in the Trust. Moreover, renewal premiums had already been set on member group demographics prior to layoffs.

**It is recommended that the Trust maintain an adequate surplus that would enable it to cope with large and unexpected losses. The Trust has taken several steps to conserve cash and align its expenditures with its revenues, a process that started in early 2009 and has continued in 2010. For example, the Trust increased premiums for the next renewal period, did not renew high utilization members, reduced and eliminated certain benefits, and renegotiated its contract with the drug benefit manager in order to achieve better savings.**

### 2. Liquidity and Cash Flow

The Trust experienced higher than anticipated cash outflows that started in early 2009 and continued in 2010. In order to avoid liquidating bonds as much as possible, the Trust decided to time claim payments

with incoming premiums. However, the Trust maintains that the delay did not cause any significant issues with its payees and met provider network contract provisions.

**It is recommended that the Trust closely monitor its cash flow and implement a cash management process that ensures asset liability matching. The Trust was able to timely process and pay claims in the second quarter of 2010.**

### **3. Changes in Senior Management and Succession Planning**

In early 2009, Timber Products Manufactures Association (Association), an affiliate, created a senior management position titled Health Plan Director to run the daily affairs of the Trust. The Trust could not provide any discussion or documentation on a succession plan if the Health Plan Director should leave the Association. The position of Health Plan Director is vital to maintain the daily operations of the Trust. Currently, the Association does not have another staff person with the knowledge, experience, and background to handle the daily duties and responsibilities for the Trust.

**It is recommended that the Trust have a succession plan in place for key positions such as the Health Plan Director position which is vital to the on-going operations of the Trust.**

### **4. Outsourced Services Provided By Third Parties**

The Trust does not have any employees and relies on its affiliate, the Association, to perform all services that are not outsourced to third parties. Third parties provide most services such as underwriting, claims processing, general ledger activities, actuarial services, and cash collections.

The Trust has had difficulty negotiating favorable contracts with third party vendors due to its smaller size and volume in the health care markets. This has caused difficulty in the oversight and control of the services outsourced. The Trust recently reviewed its relationships and contracts with several third parties and made major changes in order to have better oversight and controls over its affairs. In addition, it is re-evaluating whether to terminate and/or renegotiate contracts. The following list illustrates the extent of the outsourced services and the changes that the Trust made to its third parties structure:

- **Allegiance Benefit Plan Management, Inc.** is the TPA that does claim processing, premium collection, case management, rental of network providers, general ledger and bookkeeping services, monthly financial statements, utilization reports, and ad hoc reports as needed. The Trust is not certain that it is receiving the best value in its current TPA and ran into difficulties when it attempted to conduct a full scope claims audit. The Trust is currently evaluating replacing the current TPA.
- **Ingenix Consulting, Inc. (Ingenix)**, a United Health Healthcare subsidiary, became the Trust's consulting actuary as of March 2010. It provides reserve estimates, premium trends, and all underwriting and renewal pricing services.

Ingenix replaced the consulting actuary firm, SHPS. The Trust was not satisfied with SHPS' services partially due to SHPS failing to recognize medical cost increase trends as well as not establishing the appropriate reserves. For example, the 2008 monthly reserves that SHPS calculated for the Trust were inadequate resulting in numerous subsequent adjustments. This problem was eliminated in the second half of 2009 when the Trust increased the reserves in order to account for the regular reserve deficiencies. In addition, SHPS' actuaries failed to detect

an increase in claims cost and trends when the timber industry started laying off workers during the housing and financial crises in the economy.

- **Western Benefits, Inc.** (Western Benefits) started on June 1, 2010 preparing the Trust's financial statements. Previously, the financial statements were prepared in-house by an employee of the Association whose employment was terminated on April 30, 2010.
- **CVS Caremark, L.L.C. (CVS)**, provides prescription drugs, prescription drug management, and utilization reports. The Trust renegotiated its contract with CVS effective April 1, 2010 that resulted in significant savings.

**It is recommended that the Trust closely monitor its arrangements with third parties and increase its oversight over essential financial and non-financial functions in order for the Trust to have accurate and timely information needed to manage its affairs.**

## **TRUST PROFILE**

### **History**

The Trust was organized on August 4, 1960 by Timber Products Manufacturers, Inc., and operates under Title I of the Employee Retirement Income Security Act (ERISA) as a non-profit entity registered under the provisions of the Internal Revenue Code of 1986, Section 501(c)(9). Timber Products Manufacturers, Inc., is also known as, and commonly referred to as, Timber Products Manufacturers Association. Effective March 31, 2004, the Washington State Legislature enacted Senate Bill 6112 which authorized the amendment of several chapters and sections in Title 48 RCW and the addition of a new Chapter 48.125 RCW titled, "Self-Funded Multiple Employer Welfare Arrangements" (MEWA). In addition to ERISA, effective January 1, 2005, the Trust was licensed as a MEWA pursuant to Chapter 48.125 RCW.

### **Capitalization**

The Trust is a non-stock entity. Employer contributions fund the Trust. MEWAs must continuously maintain a surplus equal to at least ten percent of the next twelve months projected incurred claims or two million dollars, whichever is greater.

### **Territory and Plan of Operation**

The Trust has Certificates of Authority in the states of Idaho, Montana, Oregon, Washington, and operates as a legally recognized ERISA Employee Welfare Plan in Wyoming. The Trust was established to provide health, dental, vision, life and short-term disability benefits to participating employers.

The Association developed a self-funded health care plan (Plan Document) for the benefit of participating employers, their eligible employees and dependents. The purpose of the Plan Document is to provide reimbursement for eligible expenses incurred for covered services, treatment or supplies as a result of medically necessary treatment for illness or injury of the participating employers' eligible employees and their eligible dependents. The Association, by and through the Trust, agrees to make payments as provided in the Plan Document.

### **Acquisitions, Mergers, Disposals, Dissolutions, Purchases, and Sales**

There are no plans for acquisitions, mergers, disposals, dissolutions, purchases or sales.

## Growth

The Trust began operations as a MEWA under Chapter 48.125 RCW in January 2005. The following reflects the growth of the Trust based on information filed in its NAIC Annual Statements for the five years ended December 31, 2009:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
2009	\$8,156,509	\$5,316,480	\$2,840,029
2008	11,771,591	6,199,460	5,572,131
2007	9,535,430	4,263,999	5,271,431
2006	8,227,957	3,714,840	4,513,117
2005	8,763,156	3,376,811	5,386,345

<u>Year</u>	<u>Earned Premiums</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2009	\$28,815,793	(\$3,238,519)	\$506,417	(\$2,732,102)
2008	31,126,765	254,151	142,390	396,541
2007	28,025,705	355,512	275,942	633,552
2006	28,473,098	(1,179,005)	264,859	(912,359)
2005	24,398,335	1,502,914	256,644	1,759,558

## AFFILIATED ENTITIES

### **Timber Products Manufacturers Association**

The Association was founded in 1916 and is an association of member companies in the wood products industry and is the sponsor of the Trust. The Association is a non-profit, non-stock corporation with a mission to improve, promote and advance the common interests and welfare of employers in the timber products industry. Dues from each member company fund the Association.

## MANAGEMENT AND CONTROL

The Trust is controlled by the Association with management vested in a Board of Trustees. The Trust has no Articles of Incorporation or Bylaws. Instead, a Trust Agreement was first executed between the Trust and the Association on August 4, 1960 to serve the same purpose. It has been amended and restated several times with the most recent amendment and entire restatement effective January 2010. The Trust obtained a Washington State Certificate of Authority to function as a MEWA pursuant to Chapter 48.125 RCW on January 1, 2005.

### **Board of Trustees (BOT)**

Management of the Trust is vested in a board of nine trustees appointed by the Board of Directors of the Association. Trustees are appointed for a three year term. There are three trustees appointed each

year to achieve continuity in the BOT. The BOT will select a chairman and a vice chairman from among its members to serve as officers of the Trust.

Trustees as of December 31, 2009:

Harry E. Cheff  
Gregory Lambert  
Lawrence N. Schmedding

William A. Clawson  
Richard E. Molenda  
Andrew E. Tomlinson

James M. Clements  
Loren R. Rose

### **Officers**

Officers as of December 31, 2009:

Loren R. Rose  
Gregory Lambert

Chairman  
Vice Chairman

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

The Trust has no employees. The Association performs services for the Trust and its participating employers pursuant to an administrative services agreement between each participating employer and the Association.

### **Significant Agreements**

The Trust is operated by a small staff of employees of the Association subject to the Trust Agreement. Additionally, the Trust has contracts in place with third party administrators for the performance of various administrative services as enumerated under the Trust Agreement. These include the maintenance of all plan records regarding eligibility, coverage, claims, contributions, and pharmaceutical benefit services.

## **CORPORATE RECORDS**

The Trust Agreement, Certificate of Authority, and minutes of the BOT and committees were reviewed for the period under examination. No exceptions were noted and all BOT meetings were conducted with a quorum present.

## **ACTUARIAL REVIEW**

An independent consulting actuary with SHPS, and a member of the American Academy of Actuaries, performed a review of the Trust's loss reserves, actuarial liabilities, and related items as of December 31, 2009.

The reserves as of December 31, 2009 were reasonable and adequate as evidenced by a subsequent review that Ingenix performed when the Trust switched vendors in March 2010, as well as the subsequent actual payment patterns.

## **REINSURANCE**

Effective April 1, 2010, the Trust entered into an excess of loss reinsurance agreement with Transamerica Life Insurance Company, an authorized and licensed insurance company in the state of Washington. The maximum amount of retention per year, per covered person is \$350,000. The overall maximum reimbursement that the reinsurer will be liable for over a person's lifetime is \$2,000,000. The aggregate reimbursement that the reinsurer will reimburse in any policy year is \$1,000,000. The policy runs for a twelve month term and has a twenty-four month incurred claims cut-off period.

## **SPECIAL DEPOSITS**

MEWAs are required to have a reserve for the payment of claims if the MEWA becomes insolvent, pursuant to RCW 48.125.040(1)(b). The Trust has a special deposit of \$204,039 which satisfies this requirement.

## **ACCOUNTING RECORDS AND INFORMATION SYSTEMS**

The Trust maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to a Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. The Trust is audited annually by the certified public accounting firm of Schoedel & Schoedel, PLLC. The Trust received an unqualified opinion for all years under review.

All information systems (IS) processing has been outsourced to a TPA, Allegiance Benefit Plan Management, Inc., in Missoula, Montana.

## **SUBSEQUENT EVENTS**

### **1. Resubmission of RBC Plan**

In a letter dated June 14, 2010, from the OIC, the Trust was notified that the RBC Plan dated April 16, 2010 including the Trust's May 3, 2010 letter providing further explanation was inadequate. The Trust was instructed under RCW 48.43.310(4) to submit a revised RBC Plan. (See Instruction 1.)

The Trust provided a revised RBC Plan on July 28, 2010. However, the OIC asked the Trust to make additional corrections to the revised RBC Plan on September 13, 2010. The Trust submitted the revised the RBC Plan on October 14, 2010.

### **2. Recoverable from Providers**

As of July 31, 2010, the Trust recorded \$789,374 of receivable from providers for payments previously made for ineligible members. Collectability of the receivable is not certain and non-admitting this amount would create surplus impairment since the amount represents more than 27% of the Trust's surplus as of July 31, 2010.

## **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of Timber Products Manufactures Trust as of April 30, 2010:

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

**Timber Products Manufactures Trust**  
**Assets, Liabilities, Surplus and Other Funds**  
**April 30, 2010**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Assets</b>			
Bonds	\$5,240,317	\$0	\$5,240,317
Cash and short-term investments	1,698,999		1,698,999
<b>Subtotal, cash and invested assets</b>	<u><b>6,939,316</b></u>	<u><b>0</b></u>	<u><b>6,939,316</b></u>
Investment income due and accrued	70,769		70,769
Uncollected premiums and agents' balances in course of collections	123,539		123,539
<b>Total Assets</b>	<u><u><b>\$7,133,624</b></u></u>	<u><u><b>\$0</b></u></u>	<u><u><b>\$7,133,624</b></u></u>
<b>Liabilities, Surplus and Other Funds</b>			
Claims unpaid	\$3,924,130	\$0	\$3,924,130
Unpaid claims adjustment expenses	116,250		116,250
Premiums received in advance	431,231		431,231
General expense due and accrued	43,532		43,532
<b>Total Liabilities</b>	<u><b>4,515,143</b></u>	<u><b>0</b></u>	<u><b>4,515,143</b></u>
Unassigned funds (surplus)	2,618,481		2,618,481
<b>Surplus as regards policyholders</b>	<u><b>2,618,481</b></u>	<u><b>0</b></u>	<u><b>2,618,481</b></u>
<b>Total Liabilities, Surplus and Other Funds</b>	<u><u><b>\$7,133,624</b></u></u>	<u><u><b>\$0</b></u></u>	<u><u><b>\$7,133,624</b></u></u>

**Timber Products Manufactures Trust**  
**Statement of Income and Capital and Surplus Account**  
**For Period Ended April 30, 2010**

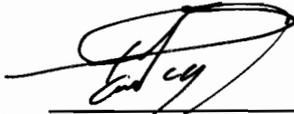
	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	59,364		59,364
Net premium income	\$9,018,231		\$9,018,231
Fee-for-service	48,179		48,179
Total revenues	<u>9,066,410</u>	<u>\$0</u>	<u>9,066,410</u>
<b><u>Hospital and Medical:</u></b>			
Hospital/medical benefits	9,334,981		9,334,981
Subtotal	<u>9,334,981</u>	<u>0</u>	<u>9,334,981</u>
<b><u>Less:</u></b>			
Total hospital and medical	9,334,981		9,334,981
Claims adjustment expenses	466,923		466,923
General administrative expenses	214,026		214,026
Increase in reserves for A&H contracts	(609,201)		(609,201)
Total underwriting deductions	<u>9,406,729</u>	<u>0</u>	<u>9,406,729</u>
Net underwriting gain or (loss)	<u>(340,319)</u>	<u>0</u>	<u>(340,319)</u>
Net investment income earned	89,042		89,042
Net realized capital gains or (losses)	<u>29,729</u>		<u>29,729</u>
Net investment gains or (losses)	<u>118,771</u>	<u>0</u>	<u>118,771</u>
Net income or (loss) before FIT	<u>(221,548)</u>	<u>0</u>	<u>(221,548)</u>
Federal and foreign income taxes incurred	0		0
<b>Net Income (Loss)</b>	<b><u>(\$221,548)</u></b>	<b><u>\$0</u></b>	<b><u>(\$221,548)</u></b>
<b><u>CAPITAL AND SURPLUS ACCOUNT</u></b>			
<b>Capital and surplus prior reporting period</b>	<b><u>\$2,840,029</u></b>	<b><u>\$0</u></b>	<b><u>\$2,840,029</u></b>
Net Income (Loss) from above	<u>(221,548)</u>		<u>(221,548)</u>
Net change in capital and surplus	<u>(221,548)</u>		<u>(221,548)</u>
<b>Capital and surplus end of reporting period</b>	<b><u>\$2,618,481</u></b>	<b><u>\$0</u></b>	<b><u>\$2,618,481</u></b>

**ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Timber Products Manufacturers Trust during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Health Field Supervising Examiner, all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'T. Subbagh', is written over a horizontal line.

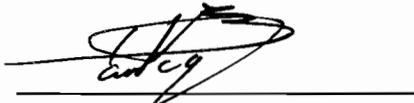
Tarik M. Subbagh, CPA, CFE  
Property & Casualty Field Supervising Examiner  
Examiner-in-Charge  
State of Washington

**AFFIDAVIT**

STATE OF WASHINGTON                    }  
  } ss  
COUNTY OF KING                        }

Tarik M. Subbagh, CPA, and CFE, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the target examination of Timber Products Manufacturers Trust was performed in a manner consistent with the standards and procedures required by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners.



Tarik M. Subbagh, CPA, CFE  
Property & Casualty Field Supervising Examiner  
Examiner-in-Charge  
State of Washington

Subscribed and sworn to before me this 24th day of January, 2011.



Notary Public in and for the  
State of Washington.

