

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
VISION SERVICE PLAN
SEATTLE, WASHINGTON

NAIC CODE 47317
December 31, 2010

Order No. 12-172
Vision Service Plan
Exhibit A

SALUTATION

Seattle, Washington
June 27, 2012

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

Vision Service Plan

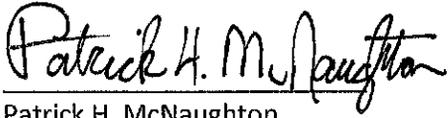
of

Seattle, Washington

hereinafter referred to as "VSP" or the "Company" at the location of its administrative office, 3333 Quality Drive, Rancho Cordova, California 95670. This report is respectfully submitted showing the financial condition and related corporate matters of VSP as of December 31, 2010.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Vision Service Plan of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2010.



Patrick H. McNaughton
Chief Examiner

6-27-12

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2006 through December 31, 2010 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 (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of fieldwork on May 16, 2012.

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 Accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2010 NAIC FCEH 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, to allow the examiners to focus on the Company's greatest areas of risk, and to provide assurance on the Company's financial statements as of the examination date.

INSTRUCTIONS

The examiners reviewed the Company's filed 2010 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. Access to Records

In order to facilitate the examination as required, VSP did not always produce and make freely accessible to the examiners its accounts, records, documents and files. Some requests for information were not responded to timely resulting in delays in the assessment of internal controls, procedures, and processes. For example, the examiners' ability to rely on control reviews conducted by VSP's external auditors was significantly reduced because of delays; the examiners' ability to rely on control reviews conducted by VSP's internal auditors regarding their work performed in compliance with the Model Audit Rule (MAR) was also significantly reduced because of delays; and, the assessment of information technology (IT) security policies, controls and test results was significantly delayed because the Company did not provide requested information in a timely manner.

The Company is instructed to comply with RCW 48.03.030(1), RCW 48.31C.070(1), and WAC 284-30-650 by facilitating the examination, producing information timely, and making freely accessible to the examiners requested books, accounts, records, documents, and files.

2. Compliance with Holding Company Regulation

Both the Administration and Marketing Agreement effective December 31, 2007, between VSP and Vision Service Plan (California) (VSPCA); and the Intercompany Tax Sharing Agreement dated August 15, 2008 for taxable years commencing on and after January 1, 2008 and signed May 11, 2010, between VSPCA and its affiliates, including VSP, were not filed on a Form D in accordance with RCW 48.31C.050(2) and WAC 284-18A-420.

The Company is instructed to comply with RCW 48.31C.050(2) and WAC 284-18A-420 by properly filing agreements subject to the Holding Company Regulation.

3. NAIC Annual Statement Errors, Omissions, and Misclassifications

The results of the examination disclosed several instances in which the Company's filing of the 2010 NAIC Annual Statement did not conform to the AP&P 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. In its 2010 NAIC Annual Statement, the Company incorrectly classified Federal Home Loan Bank (FHLB) investments as a U.S. Government agency that was reported on Line 1.21 of the Summary Investment Schedule. According to the 2010 NAIC Annual Statement Instructions, FHLB investments should be classified as U.S. Government sponsored agency investments and reported on Line 1.22 of the Summary Investment Schedule.
- b. In its 2010 NAIC Annual Statement, Schedule E – Part 1 – Cash, Column 1 – Depository, the Company reported the incorrect custodian's name and location for two accounts: Wells Fargo Advisors, LLC (Wells Fargo) in Folsom, California was reported as Robert Baird & Co. in Roseville, California, and The Bank of New York Mellon in New York was reported as Wells Fargo Advisors, LLC in Folsom, California.
- c. In its 2010 NAIC Annual Statement, on Lines 9 and 10 of Schedule D- Summary by Country, the Company reported a total of \$2,814,666 book/adjusted carrying value in foreign investments. In contrast, the 2010 Supplemental Investment Risks Interrogatories, Line 5.01, reported a total of \$1,811,236 book/adjusted carrying value in foreign investments.

Additionally, on Line 4.02 of the 2010 Supplemental Investment Risks Interrogatories, \$1,781,196 total admitted assets held in foreign investments was reported at fair value, but the amount should have been reported at book/adjusted carrying value equal to the total for Lines 9 and 10, Column 1, of Schedule D- Summary by Country.

Also, VSP incorrectly stated that its aggregate foreign investments did not exceed 2.5 percent of its total admitted assets in the 2010 Supplemental Investment Risks Interrogatories, Line 4.01. The error caused the Company to omit completing line 5 through 10 of the Supplemental Investment Risks Interrogatories.

The Company is instructed to comply with RCW 48.43.097 and RCW 48.44.095 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.

4. Custodial Agreement

The Company responded in its 2010 NAIC Annual Statement, General Interrogatories, Question 27.01, that its custodial agreement with Wells Fargo complied with the FCEH. However, the Wells Fargo custodial agreement did not contain several provisions as required by the FCEH and RCW 48.13.480.

The Company is instructed to execute a revised or amended custodial agreement that complies with the FCEH and RCW 48.13.480. The Company is also instructed to comply with RCW 48.43.097 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).

5. Actuarial Memorandum

The Actuarial Memorandum incorrectly classified the entire balance of Aggregate Health Policy Reserves for the period ended December 31, 2010 as premium deficiency reserve, although most of the balance pertains to the experience rated refunds component for client refunds. As a result, the wording and language used in the Actuarial Memorandum discussed the entire aggregate health policy reserves in the context of premium deficiency while not including the context and calculation methodology of the experience rated refunds.

The Company is instructed to comply with the NAIC Annual Statement Instructions as required by WAC 284-07-060(2)(a) by ensuring that the Company's Actuarial Memorandum accurately describes the specific components and the calculation methodology for Aggregate Health Policy Reserves.

COMMENTS AND RECOMMENDATIONS

1. Unpaid Claims Reserves Adequacy

The Company understated its unpaid claims reserves in 2010. The Company's method for calculating the amounts for the liability of claim reserves and claim liabilities did not follow SSAP No. 55, paragraph 8, which requires these expenses to be based on the estimated ultimate cost of settling claims, using past experience adjusted for current trends, and any other factors that would modify past experience.

After reviewing VSP's NAIC Annual Statements, Underwriting and Investment Exhibit, Part 2B – Analysis of Claims Unpaid (U&I, Part 2B) filed during the examination period, the examiners found that reserves have been adequate in covering VSP's incurred claims in a particular year that were subsequently paid in following years. However, the OIC determined that VSP's unpaid claims paid in 2011 for the 2010 estimate exceeded the estimate by nine percent and exceeded the Company's independent actuary's estimate by 17 percent.

Although no examination adjustment was made for the understated unpaid claims reserve for 2010, VSP should continue to monitor its claims outcomes and identify adverse claims trends that may impact reserve development.

It is recommended the Company adequately estimate unpaid claims reserves based on the estimated cost of settling claims, using past experience adjusted for current trends, and any other factors that would modify past experience, which includes monitoring its claims outcomes and identifying adverse claims trends early that may impact reserve development.

2. Business Continuity and Disaster Recovery Plans

The OIC found the Company's Business Continuity Plan (BCP) and Disaster Recovery Plan (DRP), to be outdated and not updated on a regular basis. Both plans were based upon a contract, which was terminated during the examination period, with an outside vendor's alternate recovery site. The Company also did not complete a Business Impact Analysis, which should be the foundation upon which the BCP and DRP are designed and written. In addition, the Company did not test its BCP and DRP during 2011.

It is recommended the Company complete a business impact analysis and annually test the business continuity and disaster recovery plans. Effective January 1, 2011, the Company is required by RCW 48.07.203 and WAC 284-16-710 to test the plans at least annually.

COMPANY PROFILE

Company History

VSP is a state of Washington domiciled non-profit, non-stock corporation organized pursuant to Chapter 24.03 RCW and is registered as a limited health care service contractor pursuant to Chapter 48.44 RCW. The Company is engaged in the business of accepting prepayments for vision care services in the state of Washington.

The Company was first incorporated as Washington Vision Services, Inc., on March 6, 1959. The corporate name was amended to Western Vision Services (WVS) on June 7, 1968. On January 10, 1990, VSPCA entered into an agreement for a change of member control whereby VSPCA became the sole voting member of WVS. The name of the Company was again changed on April 11, 1990, to its current name, Vision Service Plan.

As of December 31, 2010, VSP was wholly-owned by its parent, VSPCA. The owner and ownership percentage for VSP has not changed since the last examination.

Capitalization

Every limited health care service contractor must have and maintain a minimum net worth of \$300,000 pursuant to RCW 48.44.035(3). VSP's capitalization includes membership contributions in the amount of \$300,000 and unassigned funds in the amount of \$67,619,378.

Territory and Plan of Operations

The Company is authorized to write contracts for the prepayment of vision care for subscriber groups on a risk basis in the state of Washington. Subscriber groups that purchase risk plans pay an agreed upon monthly premium based upon the total number of eligible members. The Company also services subscriber group self-funded programs which reimburse the Company for benefits paid and pay an administrative fee.

Growth of Company

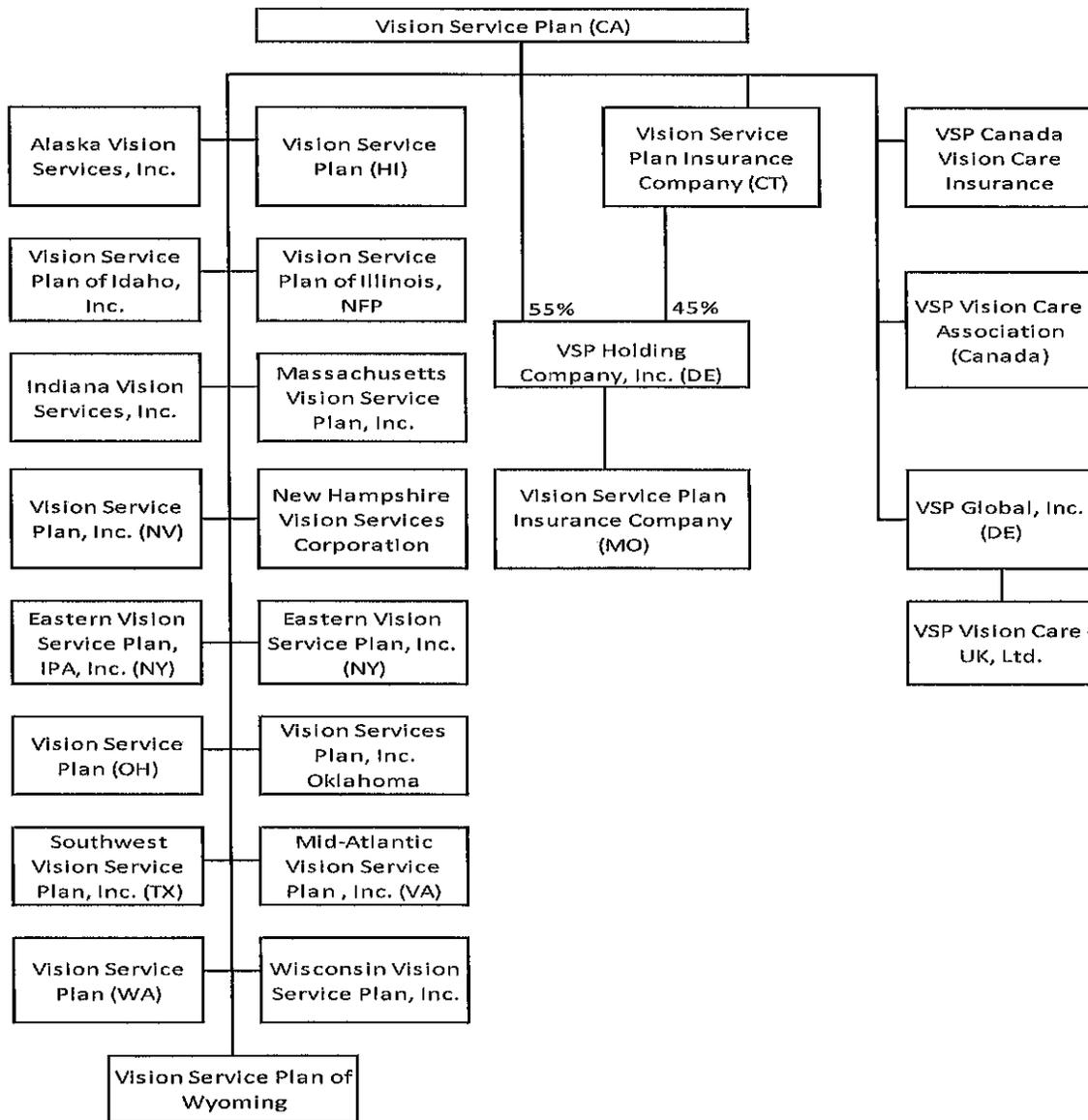
The following reflects the Company's growth as reported in its filed NAIC Annual Statements for the five year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2010	\$77,835,890	\$9,916,512	\$67,919,378
2009	76,519,052	13,168,449	63,350,603
2008	69,347,416	10,267,634	59,079,782
2007	62,030,265	2,980,414	59,049,851
2006	54,518,183	2,397,333	52,120,850

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2010	\$31,320,770	\$5,875,573	\$1,286,162	\$4,569,971
2009	27,641,078	5,216,598	1,539,138	4,292,414
2008	26,342,792	5,121,222	2,315,203	(363,150)
2007	24,873,334	4,295,077	2,649,730	6,945,130
2006	24,200,226	4,919,250	1,997,263	6,915,221

Affiliated Companies

The following is an abridged organization chart as of December 31, 2010:



VSPCA is a not-for-profit, non-stock corporation organized under the laws of California to market and administer vision care plans that provide access to professional optometry services to eligible members of participating groups. VSP is part of VSPCA's Vision Benefits (Vision Benefits) strategic business unit, consisting of VSPCA's group of insurance companies. In addition to being the ultimate owner of 22 corporations comprising the Vision Benefits strategic business unit, VSPCA is also the ultimate owner of subsidiaries for ophthalmic operations (lenses); for producing eyewear that can be found in independent optical offices owned by VSPCA panel doctors; and for providing a range of services over the internet for the independent VSPCA panel doctors and optical offices.

Intercompany Agreements

As of December 31, 2010, the Company had the following intercompany agreements in force, with the effective date indicated:

Administration and Marketing Agreement
Intercompany Tax Sharing Agreement

December 31, 2007
January 1, 2008

MANAGEMENT AND CONTROL

Board of Directors (BOD)

Directors of the Company as of December 31, 2010:

James R. Lynch	Chairman of the Board
Donald J. Ball	
Gary N. Brooks	
Cheryl A. Johnson	
Lawrence D. Price	
Kate A. Renwick-Espinosa	
Richard W. Steere	

Officers

Officers of the Company as of December 31, 2010:

James R. Lynch	President
Gary N. Brooks	Secretary
Lester E. Passuello	Treasurer and Chief Financial Officer

Conflict of Interest

All BOD members and officers signed a Conflict of Interest Statement as of December 31, 2010. The purpose of the statement is to detect any activities or participation on the part of the BOD members and officers that could possibly be interpreted as a conflict of interest. No conflicts were noted in our review.

Fidelity Bond and Other Insurance

The Company was a named insured on a financial institution fidelity bond purchased by its parent, VSPCA. VSP's fidelity bond was adequate and exceeded the prescribed minimum coverage specified by the NAIC.

Additionally, the Company has coverage for directors and officers, employment practices, managed care errors and omissions, general liability, and umbrella.

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

The Company does not have any direct employees, so it does not have any direct obligations for any retirement plans, deferred compensation, post employment benefits, compensated absences or other post retirement benefit plans. VSPCA performs services for VSP pursuant to an Administration and Marketing Agreement. The officers and BOD members of VSP are either current or retired VSPCA employees.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration and minutes of the BOD were reviewed for the period under examination. No exceptions were noted and all VSP BOD meetings were conducted with a quorum present.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following exhibit reflects VSP's loss experience from 2006 through 2010:

<u>Year</u>	<u>Total Revenue (1)</u>	<u>Total Expenses (2)</u>	<u>Medical Loss Ratio =(2)/(1)</u>
2010	\$31,320,770	\$22,854,881	73.0%
2009	27,641,078	20,477,256	74.1%
2008	26,342,792	19,460,100	73.9%
2007	24,873,334	18,364,643	73.8%
2006	24,200,226	17,710,620	73.2%

ACTUARIAL REVIEW

The OIC health actuary reviewed the Company's actuarial report, claims unpaid, and other claim liabilities as of December 31, 2010. 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, and SSAP No. 54, paragraphs 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 2010 NAIC Annual Statement; and estimating claims unpaid at December 31, 2010.

Reserves were within a reasonable range and in compliance with statutory requirements as of December 31, 2010. The OIC health actuary, however, noted two items during his review. (See Instructions No. 5 and Comments and Recommendations No. 1.)

REINSURANCE

VSP had no reinsurance arrangements in effect during the examination period.

STATUTORY DEPOSITS

VSP maintained the following statutory deposit as of December 31, 2010:

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
Washington	Bonds	\$590,228	\$648,317

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of PricewaterhouseCoopers, 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 significant weaknesses were noted.

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 system and controls were evaluated to gain an understanding of the IT general control risks and assess the effectiveness of these controls to determine if appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. (See Comments and Recommendations No. 2.)

SUBSEQUENT EVENTS

Gary Brooks retired December 31, 2011 as Secretary and was replaced, effective January 1, 2012, by James McGrann.

Similarly, Lawrence Price retired December 31, 2011 as a Director and was replaced, effective January 1, 2012, by Lester Passuello.

There were no additional, material events impacting the Company between the examination date and the last day of our fieldwork on May 16, 2012.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report recommendations were satisfactorily addressed. No instructions were made in the previous financial examination.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of VSP as of December 31, 2010:

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

**Vision Service Plan
Assets, Liabilities, Capital and Surplus
December 31, 2010**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
Assets			
Bonds	\$64,946,411	\$0	\$64,946,411
Cash, cash equivalents and short-term investments	7,841,447		7,841,447
Subtotals, cash and invested assets	<u>72,787,858</u>	<u>0</u>	<u>72,787,858</u>
Investment income due and accrued	485,565		485,565
Uncollected premiums and agents' balances in course of collections	837,623		837,623
Amounts receivable relating to uninsured plans	3,371,231		3,371,231
Net deferred tax assets	353,613		353,613
Total Assets	<u>\$77,835,890</u>	<u>\$0</u>	<u>\$77,835,890</u>
Liabilities, Capital and Surplus			
Claims unpaid	\$1,419,612	\$0	\$1,419,612
Unpaid claims adjustment expenses	16,031		16,031
Aggregate health policy reserves	502,451		502,451
Premiums received in advance	64,695		64,695
General expenses due or accrued	203,261		203,261
Current federal and foreign income tax payable and interest thereon	6,122,166		6,122,166
Amounts due to parent, subsidiaries and affiliates	1,193,075		1,193,075
Liability for amounts held under uninsured plans	274,172		274,172
Aggregate write-ins for other liabilities	121,049		121,049
Total Liabilities	<u>9,916,512</u>	<u>0</u>	<u>9,916,512</u>
Aggregate write-ins for other than special surplus funds	300,000		300,000
Unassigned funds (surplus)	67,619,378		67,619,378
Total capital and surplus	<u>67,919,378</u>	<u>0</u>	<u>67,919,378</u>
Total Liabilities, Capital and Surplus	<u>\$77,835,890</u>	<u>\$0</u>	<u>\$77,835,890</u>

**Vision Service Plan
Statement of Revenue and Expenses
For the Year Ended December 31, 2010**

	Balance Per Company	Examination Adjustments	Balance Per Examination
Member months	7,331,607		7,331,607
Net premium income	\$29,815,661	\$0	\$29,815,661
Fee-for-service	1,327,658		1,327,658
Risk revenue	177,451		177,451
Total revenues	31,320,770	0	31,320,770
Hospital and Medical:			
Other professional services	22,854,881		22,854,881
Subtotal	22,854,881	0	22,854,881
Less:			
Total hospital and medical	22,854,881		22,854,881
Claims adjustment expenses	187,607		187,607
General administrative expenses	2,421,517		2,421,517
Increase in reserves for life and accident and health contracts	(18,808)		(18,808)
Total underwriting deductions	25,445,197	0	25,445,197
Net underwriting gain or (loss)	5,875,573	0	5,875,573
Net investment income earned	1,193,340		1,193,340
Net realized capital gains or (losses)	92,822		92,822
Net investment gains or (losses)	1,286,162	0	1,286,162
Net gain or (loss) from agents' or premium balances charged off	(2,798)		(2,798)
Net income or (loss) after capital gains tax and before all other federal income taxes	7,158,937	0	7,158,937
Federal and foreign income taxes incurred	2,588,966		2,588,966
Net income (loss)	\$4,569,971	\$0	\$4,569,971
CAPITAL AND SURPLUS ACCOUNT			
Capital and surplus prior reporting period	\$63,350,603	\$0	\$63,350,603
Net income (loss)	4,569,971		4,569,971
Change in net deferred income tax	(29,057)		(29,057)
Change in nonadmitted assets	27,861		27,861
Net change in capital and surplus	4,568,775	0	4,568,775
Capital and surplus end of reporting period	\$67,919,378	\$0	\$67,919,378

**Vision Service Plan
Five Year Reconciliation of Surplus
For the Years Ended December 31,**

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital and Surplus prior reporting year	\$63,350,603	\$59,079,782	\$59,049,851	\$52,120,850	\$45,208,491
Net income or (loss)	4,569,971	4,292,414	(363,150)	6,945,130	6,915,221
Changes in net deferred income tax	(29,057)	9,321	373,350		
Changes in nonadmitted assets	27,861	(30,914)	19,731	(16,129)	(2,862)
Net change in capital and surplus	4,568,775	4,270,821	29,931	6,929,001	6,912,359
Capital and Surplus end of reporting period	\$67,919,378	\$63,350,603	\$59,079,782	\$59,049,851	\$52,120,850

NOTES TO THE FINANCIAL STATEMENTS

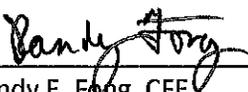
The Company has no special consents or permitted practices from the state of Washington.

ACKNOWLEDGMENT

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

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, AES, Automated Examination Specialist; Shiraz Jetha, FSA, FCIA, MAAA, Health Actuary; Timothy F. Hays, CPA, JD, Investment Specialist; Tarik Subbagh, MSBA, CPA, CFE, Property and Casualty Field Supervising Examiner; and, Edsel R. Dino, 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,



Randy E. Fong, CFE
Examiner-in-Charge
State of Washington

