

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



FINANCIAL EXAMINATION
OF

**WASHINGTON DENTAL SERVICE
SEATTLE, WASHINGTON**

NAIC CODE 47341
DECEMBER 31, 2002

Exhibit A
Order No. G06-5
Washington Dental Services

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Washington Dental Service of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2002.



Patrick H. McNaughton
Chief Examiner



Date

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SALUTATION

Seattle, Washington
February 27, 2006

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
301 14th Avenue SW
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

**Washington Dental Service
of
Seattle, Washington**

hereinafter referred to as "WDS" or the "Company," at the location of its home office, 9706 Fourth Avenue Northeast, Seattle, Washington. This report is respectfully submitted showing the condition of the Company as of December 31, 2002.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1998 through December 31, 2002 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), 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 that were noted during the examination. The findings of the previous examination report were reviewed and any items that were not satisfactorily addressed by the Company are discussed later in the report.

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 2002 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the Annual Statement in accordance with the Annual Statement Instructions published by the NAIC and if its accounts and records were prepared and maintained in accordance with Title 48 of the Revised Code of Washington, Title 284 of the Washington Administrative Code and the NAIC's Accounting Practices and Procedures Manual.

The following summarizes the exceptions noted while performing this review.

1. Record of Investments Signed by Officer

The Company does not maintain a written record showing the authorization of investments by an officer of the Company. RCW 48.13.350 requires a written record in permanent form showing authorization signed by an officer of the insurer or by the chairman of such committee authorizing the investment or loan.

The Company is instructed to maintain a written record showing the authorization of investments by an officer of the Company in accordance with RCW 48.13.350.

2. Approval of Investments by Board of Directors (BOD)

Formal approval of investment transactions were not documented in board minutes for the year 2002. In addition, BOD minutes were not taken for the Investment Review Committee (IRC) meeting on October 25, 2002. Important decisions were made by the committee members during

the meeting. Committee members and chair were appointed. A unanimous vote was made by the IRC to switch the Company's entire investment portfolio to the custody and management of Goldman Sachs. Lack of BOD approval was also included in the prior OIC Financial examination for the period ending December 31, 1988.

The Company is instructed to have all investment transactions authorized or approved by its BOD or by a committee charged by the BOD in accordance with RCW 48.13.340. The minutes of any such committee shall be recorded and reports thereof shall be submitted to the BOD for approval or disapproval in accordance with RCW 48.13.340.

3. Unauthorized Custodian

The Company placed its securities in the custody of the brokerage firm Goldman Sachs, which is an investment advisor, broker and custodian of the investments for WDS. The securities in the custody of the brokerage firm do not comply with RCW 48.13.450(6) which defines a qualified custodian and "means either a participating financial institution or a clearing corporation, or both. A qualified custodian does not include a broker."

The Company is instructed to secure an authorized custodian as required and defined by RCW 48.13.450.

4. EDP Equipment not disclosed in CPA Audited Financial Report

Descriptions of the method(s) used in computing depreciation and amortization with respect to major classes of depreciable assets and electronic data processing equipment, and software were not disclosed in the Notes to the Company's 2002 CPA Audited Financial Report as required by SSAP No. 16, paragraph 5 and 6.

The Company is instructed to include descriptions of the method(s) used in computing depreciation and amortization with respect to major classes of depreciable assets, electronic data processing equipment, and software as required in SSAP No. 16, in compliance with WAC 284-07-050.

5. Furniture and Fixtures not disclosed in CPA Audited Financial Report

The Company's 2002 CPA Audited Financial Report did not disclose the depreciation and amortization expense for the period. It also failed to disclose a general description of the method(s) used in computing depreciation and amortization with respect to major classes of depreciable assets and leasehold improvements. This is not in accordance with SSAP No. 19, paragraph 14.

The Company is instructed to disclose the depreciation and amortization for the current year in accordance with SSAP No. 19, paragraph 14, in compliance with WAC 284-07-050.

6. Registration Forms B and C

The Company filed forms B and C for the year ended 2002 on June 16, 2003. The deadline for the filing of registration forms B and C is May 15 as required by RCW 48.31C.040. In addition, the Company repeated the same errors as listed below as it did in its 2001 filings which it was required by OIC to correct and resubmit:

- a. Per WAC 284-18A-920 Item 2 – The Organization Chart did not indicate the type of organization (e.g., corporation, trust, partnership) and did not identify the state of domicile for all entities shown.
- b. Per WAC 284-18A-920 Item 3(h) – Clarify whether there are any court proceedings pending involving a reorganization or liquidation.
- c. Per WAC 284-18A-920 Item 5 - specifically address each paragraph (a) through (i). If the answer to a particular item is “none” or the paragraph is “not applicable”, please so state. All agreements need to be identified, whether formal or otherwise, if they are material under the Holding Company Act.

The Company is instructed in future filings to file Form B in accordance with WAC 284-18A-920 and to file timely Forms B and C in accordance with RCW 48.31C.040.

7. Claims Liabilities incorrectly recorded as IBNR

Incomplete claims or claims that contain errors are not recorded as Claims Liability in the NAIC Annual Statement but instead are incorrectly included in Reserves as part of the IBNR. The 2002 NAIC Annual Statement Instructions for Underwriting and Investment Exhibit, Part 2A, Claims Liability End of Current Year states that unpaid reported claims should appear as Claims Liability in the NAIC Annual Statement.

The Company is instructed to follow the NAIC Annual Statement Instructions in accordance with WAC 284-07-050(2).

8. Development of Paid and Incurred Claims

The Company did not fully complete Schedule Part 2C, Development of Paid and Incurred Claims Section C, of the 2002 NAIC Annual Statement. Section C schedule did not include incurred year claims and claims adjustment expense ratio amounts for years 1998 through 2001. In addition, the amounts for the years do not equal the recorded totals.

The Company is instructed to follow the NAIC Annual Statement Instructions in accordance with WAC 284-07-050(2).

COMMENTS AND RECOMMENDATIONS

1. Conflict of Interest

Conflict of interest disclosure statements were completed by the directors of the Company, but the vice presidents, other executive staff, and key employees did not complete the disclosures for 2002.

It is recommended that the directors, vice presidents, executive staff, and other key employees complete a conflict of interest disclosure statement annually.

COMPANY PROFILE

Company History

The Company was incorporated and commenced business on October 18, 1954. The Company is registered as a health care service contractor and is a tax-exempt organization. It is subject to regulation by the OIC.

Territory and Plan of Operation

Washington Dental Service only conducts business in the state of Washington. The Company is a provider of dental benefits with approximately one-third of the market share in Washington. The Company markets primarily to large groups where it controls almost one-half of the market. The Company maintains one of the largest networks within the state of Washington. WDS has indicated it has no current plans for expansion of its coverage area into other states and offers a diversified product portfolio with an emphasis on prevention. The products have a hold harmless provision which guarantees participating dentists may not bill the patient for fees over the agreed-upon charges.

Growth of Company

The following schedules reflect the growth of the Company by year beginning in 1998. The amounts shown were compiled from the Company's filed NAIC Annual Statements.

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2002	\$101,486,071	\$39,600,443	\$61,885,628
2001	117,761,843	42,545,000	75,216,843
2000	120,453,290	43,107,072	77,346,218
1999	117,139,545	36,229,142	80,910,403
1998	107,930,419	36,467,156	71,463,263

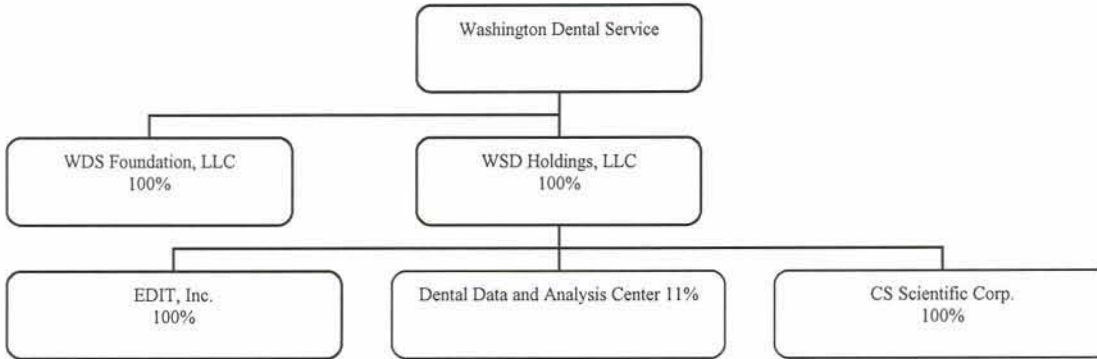
<u>Year</u>	<u>Premiums Earned</u>	<u>Underwriting Deductions</u>	<u>Underwriting Gain or (Loss)</u>	<u>Investment and Other Income</u>	<u>Pre-Tax Income</u>
2002	\$305,801,220	\$304,777,062	\$1,024,158	\$(10,518,689)	\$(9,494,531)
2001	284,289,655	281,165,178	3,124,477	963,363	4,087,840
2000	258,096,484	255,072,147	3,024,337	14,554,234	17,578,571
1999	234,014,913	232,370,396	1,644,517	2,168,163	3,812,680
1998	209,090,764	207,417,173	(1,619,591)	6,208,542	4,588,951

AFFILIATED COMPANIES

- WDS Holdings, LLC
On October 30, 2001, the Company formed WDS Holdings, LLC as a wholly owned subsidiary to hold investments in non-insurance ventures.
- Washington Dental Service Foundation, LLC
On April 30, 2002, Washington Dental Service Foundation (the “Foundation”), an independent Washington 501c3 corporation primarily funded by the Company, transferred the majority of its assets to Washington Dental Service Foundation, LLC, a wholly owned 501c4 subsidiary of the Company. The purpose of the transfer was to combine the public benefit programs of the Company and the Foundation and simplify its administration. As a result of the transfer, the Company recognized \$1,875,000 of non-operating revenue. The Company intends to continue to conduct its public benefit initiatives through the new Foundation and to fund them through periodic contributions to the Foundation.
- Dental Data and Analysis Center
On July 1, 2001, the Company invested \$50,000 in Dental Data and Analysis Center (DDAC) which was established to provide a repository of dental data, for use in research or marketing. This investment has been transferred to WDS Holdings, LLC. WDS Holdings, LLC owns 11% of the outstanding stock of DDAC.
- C3 Scientific Corporation
On June 21, 2002, the Company invested \$1,510,000 in C3 Scientific Corporation, a California corporation, through its subsidiary WDS Holdings, LLC. C3 Scientific was formed to conduct research into the mechanisms of dental disease and commercialize the results of that research. WDS owns 65% of the stock of C3 Scientific Corporation.
- EDIT, Inc.
WDS Holdings, LLC owns 100% of EDIT, Inc. On August 13, 2002, the Company through its subsidiary WDS Holdings, LLC purchased the assets of EDIT, Inc., a Georgia corporation that facilitates electronic transactions to administer dental insurance. The

purchase was accounted for by the statutory purchase method. The cost of the purchase was \$800,000, all of which was recognized as goodwill and will be amortized over five years.

Organization Chart



MANAGEMENT AND CONTROL

Ownership

Any dentist licensed by the state of Washington and who executes a service contract with WDS is eligible for membership in the Company. The word “member” means a person holding a membership in the Company. Vacancies in the membership are filled by a majority vote of the current members. No member has a greater voice, vote or authority in the Company than any other member. Members have no interest in the property of the Company. Each member is entitled to one vote on a matter submitted to a vote of the membership at an annual or special meeting. The Board of Trustees is elected by the members at their annual meeting. The Board of Trustees elects the BOD, except three public directors who are elected by a provider compensation committee.

Board of Trustees

The Board of Trustees is composed of member dentists who represent various geographic areas of the state. Each geographic area is entitled to be represented by at least one trustee plus one additional trustee for each 100 members who practice in the geographic area. As of December 31, 2002, the Board of Trustees had 36 members.

Board of Directors

The Articles of Incorporation and Bylaws vest the management and control of the affairs of the Company in a Board of Directors (BOD). The Board of Trustees elects the BOD which includes nine (9) member directors and six (6) public directors. Three (3) additional public directors are

elected by the Provider Compensation Committee. The BOD consists of no fewer than 14 members and no more than 18 members, with an equal number of member directors and public directors.

The BOD and officers serving the Company on December 31, 2002, were as follows:

Board of Directors

Lawrence E. Mast	WDS Chairman of Board/Pediatric dentist
Neil L. McReynolds	WDS Vice-Chair/President, McReynolds Consulting
Roberta Greene	WDS Board Secretary/Vice President, Empire Ford
Richard D. Leshgold	WDS Board Treasurer/General dentist
Richard R. Albrecht	Counsel, Perkins Coie (law firm)
G. Douglas Beck	General dentist
James D. Dwyer	President and CEO, Washington Dental Service
Irene F. Hunter	General dentist
Wally W. Kegel	Periodontist
Alan O. Link	Secretary-Treasurer, WA State Labor Council
Donald P. Nielsen	Chairman, TeachFirst, Inc.
Martin J. Nigrelle	General dentist
Robert P. Parker	General dentist
Allen W. Puckett	Gordian LLC
R. Gary Schweikhardt	President and COO, Epigenomics, Inc.
Steve Talbot	General dentist

Officers

James D. Dwyer	President and CEO, Washington Dental Service
Dr. Max Anderson	Vice President/Dental Director
John Bursett	Senior Vice President, Underwriting & Actuarial
Tom Gates	Director of Planning and Business Analysis
Craig Gowdey	Vice President/Chief Information Officer
Robin Hilleary	Vice President, Group Sales and Support
Larry Leopold	Director, Human Resources
Kristin Merlo	Director, Marketing
Josh Smith	Controller
Tracy Warner	Chief Financial Officer
David O. Thoen	Independent Consulting Actuary

On December 31, 2002, the BOD appointed committees were as follows:

- Audit and Finance Committee
- Dental Policy Committee
- Governance and Nominating Committee
- Human Resources Committee

Investment Review Committee
Marketing Committee
Provider Compensation Committee
Strategic Positioning Committee

Conflict of Interest

Conflict of interest disclosure statements were completed by the directors of the Company, but the vice presidents on the Jurat page as well as other executive staff and key employees did not complete the disclosures in 2002. (See Comments and Recommendations No. 1)

Fidelity Bond and Other Insurance

The Company is insured against loss for any dishonesty or the fraudulent act of directors and officers to \$10,000,000. The Company is insured for losses resulting from employee dishonesty up to \$2,000,000. The NAIC suggests a minimum level of fidelity bonding for the size of this company of at least \$1,000,000 to \$1,250,000. WDS meets the NAIC minimum coverage levels recommended for fidelity bonding.

Coverage is provided against the Company's buildings (office, parking garage, and Spokane office) and personal property loss up to \$24,678,000. Data processing is protected up to \$2,000,000. The Company has other coverage for travel and accident, fiduciary pension and trust liability, funds transfer fraud, business auto coverage, and employee benefit liability. In addition, the Company has an umbrella liability policy with limits of \$10,000,000.

Officer's, Employees', and Agents' Welfare and Pension Plans

The Washington Dental Service Retirement Plan is a non-contributory defined benefit plan for qualified employees. Benefits are payable upon retirement based on earnings and years of continuous service. The Company makes contributions to the plan as required. The assets are held in trust by the Harris Bank N.A.

The Company also has a defined contribution, 401(K) plan. Fidelity Investments is the trustee.

The Incentive Compensation Plan is paid out annually to eligible employees. Payments levels are approved by the BOD.

CORPORATE RECORDS

Articles of Incorporation were executed on October 10, 1954. Articles of Amendment to Articles of Incorporation were executed July 1, 1991. There have been no changes since July 1, 1991.

The minutes of meetings of members, directors and committees adequately approve and support the Company transactions and events with the exception of the instructions noted in this report. (See Instruction No. 2)

LOSS EXPERIENCE

The Company's actuarial report claims unpaid, and other claim liabilities as of December 31, 2002, were reviewed by OIC actuarial staff. There have been no changes in methodologies, lines of business, marketing focus, incentive programs, underwriting standards or claims handling procedures that could impact reserve projections. The reserving model and methodologies for claims unpaid is one of the methods prescribed by the American Academy of Actuaries.

Aggregate reserves were compared to prior years' reserves for consistency and reasonableness. They are consistent with the block of business of the Company. No adjustment to reserves was necessary.

Reviewing the Company's five-year historical data, the trend in incurred claims is reasonable. From 1998 to 2002, the total claims incurred increased by 27% while during the same period, the total revenues increased by 46%. In all five years, estimates were within 5.7% of actual figures.

Based on claims history, we determined that the premiums are adequate to cover the benefits provided. The company has no long term liabilities. All contracts are on an annual basis. Hence, there is no need for a premium deficiency reserve.

The analysis of Company provided worksheets for development of completion factors showed that appropriate methods were used in the calculation. Analysis of the completion factors showed that the IBNR reserve calculations were reasonable and consistent with its claims history. The calculation method used was appropriate.

Reserve for unearned premiums is immaterial for the Company since it does not have long term liabilities.

REINSURANCE

The Company did not have reinsurance ceded or assumed in the examination period.

STATUTORY DEPOSITS

The Company has short term U.S. treasury/agency obligations and money market mutual funds held in trust for the OIC by U.S. Bank as the custodian in the amount of \$2,125,125 as of December 31, 2002. RCW 48.44.030 requires a health care service contractor to place securities on deposit with the state of Washington in the amount equal to or greater of \$150,000 or the amount necessary to cover incurred but unpaid reimbursements. The Company is in compliance with RCW 48.44.030.

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company utilizes the Navision software accounting system for its general ledger accounting. The processing of accounting records was evaluated by the independent audit firm of Deloitte and Touche. Various controls were checked to determine if WDS had appropriate methods for recording its accounting activities. Appropriate internal controls, separation of duties, compilations and reconciliations were present based on the Deloitte and Touche's audit of the 2002 records supporting the corresponding NAIC Annual Statement.

The management of WDS is sufficiently knowledgeable of the IS process. Systems development, acquisition and maintenance controls were evaluated to gain assurance that appropriate controls are in place for a company the size of WDS.

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 controls exercised to maintain data security. The Company utilizes the services of an outside service provider for the issuance of claim checks. The service provider has sufficient internal controls in place and the process is monitored by the Company.

The Company has a formal, written Disaster Recover Plan and a Business Contingency 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 required by NAIC Guidelines.

SUBSEQUENT EVENTS

There were no material events impacting the Company between the examination date and the last day of our field work that came to our attention.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The prior examination report was reviewed by the Company's directors. Instructions and comments from the prior examination report as of December 31, 1988 have been corrected by the Company with the exception of the following:

- Formal approval of investments by the BOD did not occur in 2002. (See Instruction No. 2)

- The Company had an established conflict of interest procedure for its directors; however, it was recommended that the Company broaden its statements to include executive staff and key employees. Conflict of interest disclosure statements were completed by the directors of the Company, but the vice presidents on the Jurat page, other executive staff and key employees did not complete the disclosures in 2002. (See Comment and Recommendation No. 1)

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of the Company as of December 31, 2002

Statement of Assets, Liabilities, Capital and Surplus

Statement of Revenue and Expenses

Five Year Reconciliation of Surplus

**WASHINGTON DENTAL SERVICES
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
DECEMBER 31, 2002**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAM
Assets				
Stocks:				
Preferred stocks	\$49,009			\$49,009
Common stocks	19,830,497			19,830,497
Properties occupied by the company	6,571,923			6,571,923
Cash and short-term investments	51,703,280			51,703,280
Other invested assets	467,025			467,025
Receivable for securities	491,358			491,358
Subtotal cash and invested assets	79,113,092			79,113,092
Investment income due and accrued	3,374			3,374
Accident and health premiums due and unpaid	8,622,776			8,622,776
Amounts receivable relating to uninsured accident and health plans	11,791,524			11,791,524
EDP equipment and software	1,880,628			1,880,628
Receivables from parent, subsidiaries, and affiliates	57,177			57,177
Aggregate write-ins for other than invested assets	17,500			17,500
Total assets	\$101,486,071		\$0	\$101,486,071
Liabilities, Capital and Surplus				
Claims unpaid	\$22,911,000			\$22,911,000
Unpaid claims adjustment expense	1,513,750			1,513,750
Premiums received in advance	3,385,013			3,385,013
General expenses due or accrued	4,496,272			4,496,272
Amounts withheld or retained for account of others	3,524			3,524
Liability for amounts held under uninsured accident and health plans	1,973,727			1,973,727
Aggregate write-ins for liabilities	5,317,157			5,317,157
Total Liabilities	39,600,443			39,600,443
Unassigned funds (surplus)	61,885,628			61,885,628
Total capital and surplus	61,885,628			61,885,628
Total liabilities, capital and surplus	\$101,486,071		\$0	\$101,486,071

**WASHINGTON DENTAL SERVICES
STATEMENT OF REVENUE AND EXPENSES
DECEMBER 31, 2002**

	<u>BALANCE PER COMPANY</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	<u>10,013,818</u>		
Net premium income	<u>\$305,801,220</u>	<u>\$0</u>	<u>\$305,801,220</u>
Total revenues	<u>305,801,220</u>		<u>305,801,220</u>
Hospital and Medical:			
Other professional services	<u>278,150,165</u>		<u>278,150,165</u>
Subtotal:	<u>278,150,165</u>		<u>278,150,165</u>
Less:			
Total medical and hospital	<u>278,150,165</u>		<u>278,150,165</u>
Claim Adjustment expenses	<u>11,864,078</u>		<u>11,864,078</u>
General administrative expenses	<u>14,762,819</u>		<u>14,762,819</u>
Total underwriting deductions	<u>304,777,062</u>		<u>304,777,062</u>
Net underwriting gain or loss	<u>1,024,158</u>		<u>1,024,158</u>
Net investment income earned	<u>2,582,897</u>		<u>2,582,897</u>
Net realized capital gains or (losses)	<u>(12,368,232)</u>		<u>(12,368,232)</u>
Net investment gains or (losses)	<u>(9,785,335)</u>		<u>(9,785,335)</u>
Aggregate write-ins for other income or expenses	<u>(733,354)</u>		<u>(733,354)</u>
Net income of (loss) before federal income taxes	<u>(9,494,531)</u>		<u>(9,494,531)</u>
Federal and foreign income taxes incurred	<u>0</u>		<u>0</u>
Net income (loss)	<u>(\$9,494,531)</u>	<u>\$0</u>	<u>(\$9,494,531)</u>
Capital and Surplus Account			
Capital and surplus, prior reporting year	<u>\$75,216,843</u>	<u>\$0</u>	<u>\$75,216,843</u>
Net Income	<u>(9,494,531)</u>		<u>(9,494,531)</u>
Net unrealized capital gains and losses	<u>2,520,327</u>		<u>2,520,327</u>
Change in nonadmitted assets	<u>(6,357,011)</u>		<u>(6,357,011)</u>
Net change in capital and surplus	<u>13,331,215</u>		<u>13,331,215</u>
Capital and surplus, end of reporting year	<u>\$61,885,628</u>	<u>\$0</u>	<u>\$61,885,628</u>

WASHINGTON DENTAL SERVICES
FIVE YEAR RECONCILIATION OF CAPITAL AND SURPLUS
FOR THE YEARS ENDED DECEMBER 31,

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Capital and Surplus, prior reporting year	\$ 75,216,843	\$ 77,346,218	\$ 80,910,403	\$ 71,463,263	\$ 65,230,784
Net income	(9,494,531)	4,087,840	17,578,571	3,812,680	1,349,769
Net unrealized capital gains or (losses)	2,520,327	(5,577,151)	(17,803,076)	6,007,857	6,478,297
Aggregate write-ins for gains		61,348	275,074	14,195,708	2,452,895
Change in nonadmitted assets	(6,357,011)	(701,412)	(3,614,754)	13,822,311	(4,048,482)
Change in surplus as regards policyholders for the year	(13,331,215)	(2,129,375)	(3,564,185)	9,447,140	6,232,479
Capital and Surplus, end of reporting year	\$ 61,885,628	\$ 75,216,843	\$ 77,346,218	\$ 80,910,403	\$ 71,463,263

NOTES TO THE FINANCIAL STATEMENTS

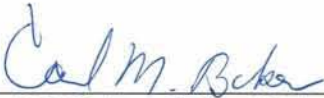
The Company has no special consents, permitted practices or orders from the state of Washington.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Washington Dental Service during the course of this examination.

In addition to the undersigned, Mike Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Kathy Hicks, CPA, Insurance Examiner; Friday Enoye Insurance Examiner; John Jacobson, AFE, IS Specialist; and Alexis Santos, ASA, MAAA, Actuary; all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON

}

} ss

COUNTY OF KING

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Carl M. Baker, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his or her knowledge and belief.

He attests that the examination of Washington Dental Service was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Carl M. Baker

Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 27th day of February, 2006.

Colleen Jansen

Notary Public in and for the
State of Washington.



 **DELTA DENTAL®**
Washington Dental Service

Washington Dental Service is a member of the
Delta Dental Plans Association

January 17, 2006

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Company Supervision Division
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INSURANCE COMMISSIONER
COMPANY SUPERVISION

Re: Examination Report of Washington Dental Service as of December 31, 2002

Dear Mr. Odiorne:

I am writing in response to your letter dated December 20, 2005, regarding Washington Dental Service's examination report as of December 31, 2002. Upon reviewing the examination report, we have included our comments below.

1.) Record of Investments Signed by Officer

The Company does not maintain a written record showing the authorization of investments by an officer of the Company. RCW 48.13.350 requires written record in permanent form showing authorization signed by an officer of the insurer or by the chairman of such committee authorizing the investment or loan.

The Company is instructed to maintain a written record showing the authorization of investments by an officer of the Company in accordance with RCW 48.13.350.

WDS response:

Authorizations provided by Chief Financial Officer as outlined in the Investment guidelines. The CFO reviewed the investment transactions, but no written records are kept. The Company has maintained written record of authorization of investments.

2.) Approval of Investments by Board of Directors (BOD)

Formal approval of investment transactions were not documented in board minutes for the year 2002. In addition, BOD minutes were not taken for the Investment review Committee (IRC) meeting on October 25, 2002. Important decisions were made by the committee members during the meeting. Committee members and chair were appointed. A unanimous vote was made by the IRC to switch the Company's entire investment portfolio to the custody and management of Goldman Sachs. Lack of BOD approval was also included in the prior OIC financial examination for the period ending December 31, 1988.

The Company is instructed to have all investment transactions authorized or approved by its BOD or by a committee charged by the BOD in accordance with RCW 48.13.340. The minutes of any such committee shall be recorded and reports thereof shall be submitted to the BOD for approval or disapproval in accordance with RCW 48.13.450(6).

WDS response:

As you mentioned, the 10/25/02 board minutes refer to a 10/25/02 Investment Committee meeting, where investments were changed to active management by Goldman Sachs. It appears that the decision to make the change was mentioned at the end of the 9/25/02 Investment Committee minutes rather than being specifically noted in minutes for the 10/25/02 committee meeting. In fact, the committee met for about 20 minutes prior to the 10/25/02 board meeting – specifically for the purpose of adding Tracy Warner and Jim Dwyer as committee members, naming Dick Albrecht as committee chair and appointing Goldman Sachs to actively manage WDS' reserve fund investments. Unfortunately, through an oversight, no minutes were recorded from this meeting. However, clear reference to the meeting and the decision was made in the open session of the 10/25/02 meeting, which immediately followed the 10/25/02 brief meeting of the Investment Committee. Going forward, the minutes of any such committee will be recorded and reports thereof will be submitted to the BOD for approval or disapproval in accordance with RCW 48.13.450(6).

3.) Unauthorized Custodian

The Company placed its securities in the custody of the brokerage firm Goldman Sachs, which is an investment advisor, broker and custodian of the investments for WDS. The securities in the custody of the brokerage firm do not comply with RCW 48.13.450(6) which defines a qualified custodian and “means either a participating financial institution or a clearing corporation, or both. A qualified custodian does not include a broker.”

The Company is instructed to secure an authorized custodian as required and defined by RCW 48.13.450.

WDS response:

We appointed a new custodian in 2004, State Street Bank.

4.) EDP Equipment not disclosed in CPA audited Financial Report

Descriptions of the method(s) used in computing depreciation and amortization with respect to major classes of depreciable assets and Electronic Data Processing Equipment, and Software were not disclosed in the Notes to the Company's 2002 CPA Audited Financial Report required by SSAP No. 16, paragraph 5 and 6.

The Company is instructed to include description of the method(s) used in computing and amortization with respect to major classes of depreciable assets, electronic data processing equipment, and software as required in SSAP No. 16, in compliance with WAC 284-07-050.

WDS response:

Going forward, WDS will disclose this Note in the Annual Audited Financial Statements.

5.) Furniture & Fixtures not disclosed in CPA Audited Financial Report

The Company's 2002 CPA Audited Financial Report did not disclose the depreciation and amortization expense for the period. It also failed to disclose a general description of the method(s) used in computing depreciation and amortization with respect to major classes of depreciable assets and leasehold improvements. This is not in accordance with SSAP No. 19, paragraph 14.

The Company is instructed to disclose the depreciation and amortization for the current year in accordance with SSAP No. 19, paragraph 14, in compliance with WAC 284-07-050.

WDS response:

Going forward, WDS will disclose this Note in the Annual Audited Financial Statements.

6.) Registration Forms B and C

The Company filed Forms B and C for the year ended 2002 on June 16, 2003. The deadline for the filing of registration forms B and C is May 15 as required by RCW 48.31C.040. In addition, the Company repeated the same errors as listed below as it did in its 2001 filings which it was required by OIC to correct and resubmit:

- a. Per WAC 284-18A-920 Item 2 – The Organization Chart did not indicate the type of organization (e.g., corporation, trust, partnership) and did not identify the state of domicile for all entities shown.
- b. Per WAC 284-18A-920 Item 3(h) – Clarify whether there are any court proceedings pending involving a reorganization or liquidation.
- c. Per WAC 284-18A-920 Item 5 – specifically address each paragraph (a) through (i). If the answer to a particular item is "none" or the paragraph is not applicable, please so state. All agreements need to be identified, whether formal or otherwise, if they are material under the Holding Company Act.

The Company is instructed in future filings to file Form B in accordance with WAC 284-18A-920 and to file timely Forms B and C in accordance with RCW 48.31C.040.

WDS response:

WDS has timely filed form B and C for 2003 and 2004 and will incorporate any other changes for future filings.

7.) Claims Liabilities incorrectly recorded as IBNR

Incomplete claims or claims that contain errors are not recorded as Claims Liability in the NAIC Annual Statement but instead are incorrectly included in Reserves as part of the INBR. The 2002 NAIC Annual Statement Instructions for Underwriting and Investment Exhibit, Part 2A, Claims Liability End of Current Years states that unpaid reported claims should appear as Claims Liability in the NAIC Annual Statement.

The Company is instructed to follow the NAIC Annual Statement Instructions in accordance with WAC 284-07-050(2).

WDS response:

WDS will incorporate the finding for future filings.

8.) Development of Paid and Incurred Claims

The Company did not fully complete Schedule Part 2C, Development of Paid and Incurred Claims Section C, of the 2002 NAIC Annual Statement. Section C schedule did not include incurred year claims and claims adjustment expense ratio amounts for year 1998 through 2001. In addition, the amounts for the years do not equal the recorded totals.

The Company is instructed to follow the NAIC Annual Statement Instructions in accordance with WAC 284-07-050(2).

WDS response:

WDS will incorporate the finding for future filings.

COMMENT AND RECOMMENDATION

1. Conflict of Interest

Conflict of interest disclosure statements were completed by the directors of the Company, but the vice presidents, other executive staff, and key employees did not complete the disclosures for 2002.

It is recommended that the directors, vice presidents, executive staff, and other key employees complete a conflict of interest disclosure statement annually.

WDS response:

WDS agrees with this recommendation and has already completed annual conflict of interest statements for all employees.

Sincerely,



James D. Dwyer
President and Chief Executive Officer
Washington Dental Service

cc: Tracy Warner, Chief Financial Officer
Marie Faulring, Director of Accounting Operations