

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
PUGET SOUND HEALTH PARTNERS, INC.
FEDERAL WAY, WASHINGTON

NAIC CODE 12909
December 31, 2010

Order No. 12-207
Soundpath Health, Inc.
Exhibit A

SALUTATION

Seattle, Washington
August 20, 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

Puget Sound Health Partners, Inc.

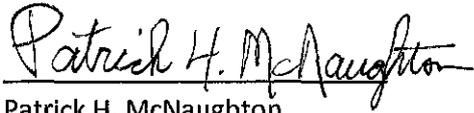
of

Federal Way, Washington

hereinafter referred to as "PSHP," or the "Company" at the location of its home office, 32129 Weyerhaeuser Way S., Suite 201, Federal Way, Washington 98001. This report is respectfully submitted showing the financial condition and related corporate matters of PSHP as of December 31, 2010.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Puget Sound Health Partners, Inc. of Federal Way, Washington. This report shows the financial condition and related corporate matters as of December 31, 2010.



Patrick H. McNaughton
Chief Examiner

8-20-12

Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 18, 2007 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 June 6, 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 PSHP'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 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. Annual Statements Errors

The examination team discovered several instances in which the Company's 2010 NAIC Annual Statement did not conform to the AP&P and the NAIC Annual Statement Instructions.

- The Company incorrectly overstated the receivable from its parents by including a balance of \$45,558 that was over 90 days past due. The amount should have been nonadmitted according to SSAP No. 25, paragraph 6. (See Notes to the Financial Statements No. 1.)
- The Company incorrectly included First American Treasury Obligations Money Market Funds on Schedule E - Part 1 - Cash. This amount should have been classified as a Short Term Investment and included on Schedule DA according to the NAIC Annual Statement Instructions.
- The Company incorrectly completed Schedule D - Part 1 by omitting foreign designation information for two securities. The Company's investments in Kreditanstalt für Wiederaufbau (KfW), and Shell International, should have been classified as foreign investments.

- The Company incorrectly completed its Risk Based Capital (RBC) calculations by omitting an indemnity deposit and by including non-admitted furniture and aggregate write-ins.
- The Company incorrectly reported Commissions and Expense Allowances on Reinsurance Ceded in the Aggregate Write Ins for Other Health Care Related Revenues rather than report the balance as an offset to administrative expense as required by SSAP 61, paragraph 30.
- The Company did not segregate its liabilities and expenses among covered and uncovered columns as outlined in the NAIC Annual Statement Instructions. The uncovered columns in various statements and exhibits of the 2010 NAIC Annual Statement should reflect the liability and expense for uncovered claims using management's best estimates.
- The Company incorrectly classified salaries payable and employee benefits as Amount withheld or retained for the account of others when they should have been classified as General expenses due or accrued.
- The Company was not able to substantiate and reconcile paid and reserved claims balances that were included in Underwriting and Investment Exhibit, Part 2B.
- The Company overstated retrospective premiums receivable from Centers for Medicare and Medicaid Services (CMS) by \$210,615. As a result, the Company overstated its liabilities under the capitation arrangements by \$112,137 and overstated its medical and pharmacy revenues by \$98,478. (See Notes to the Financial Statements No. 2.)

The Company is instructed to comply with RCW 48.43.097 by filing its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

2. Intercompany Agreements

The Administrative Services Agreement and Claims Delegation Agreement between the Company and Physicians of Southwest, LLC (PSW) were not filed with the OIC as required by RCW 48.31C.050(2). In addition, the fee structure is not based on actual cost or a cost study as required by RCW 48.43.097 and SSAP No. 70, paragraph 8. The agreements did not comply with RCW 48.31C.050(1)(c) which requires expenses incurred and payment received to be allocated to the insurer in conformity with customary insurance accounting practices consistently applied. Also, the agreements did not comply with RCW 48.31C.030(1)(d) which requires the Company to maintain adequate records to support and disclose the nature and details of the charges. The documentation for such intercompany charges did not support that the charges were computed on a purely cost basis.

The Claims Delegation Agreement between the Company and Northwest Physicians Network, LLC (NPN) was not filed with the OIC as required by RCW 48.31C.050(2).

In addition, the Administrative Services Agreement for care management between the Company and NPN was not filed timely with the OIC as required by RCW 48.31C.050(2). The agreement was effective January 1, 2010 but not filed with OIC until May 12, 2011.

The Company is instructed pursuant RCW 48.31C.050(2)(d) to properly file all intercompany management agreements, service contracts and cost sharing arrangements before implementation. In addition, the Company is also instructed to comply with RCW 48.43.097 which requires adherence to the AP&P, specifically SSAP No. 70, paragraph 8, which requires intercompany transactions under the terms of administrative service agreements or cost sharing

arrangements to be apportioned to the entities incurring the expense as if the expense had been paid solely by the incurring entity. Also, the Company is instructed to comply with RCW 48.31C.050(1), which requires the terms of the agreement to be fair and reasonable.

3. Transfer of Risk and Quota Share Reinsurance

The Company entered into a quota share (QS) reinsurance arrangement with The Canada Life Assurance Company (Canada Life) where the Company cedes certain capitated business to Canada Life. The QS reinsurance arrangement is based on ceding capitated business where the Company is not at risk. Our review of the QS reinsurance arrangement revealed that the arrangement lacked insurance risk transfer and therefore is not considered reinsurance as outlined by SSAP No. 61, paragraph 17.

The Company is instructed to comply with SSAP No. 61, paragraph 17, by recording the arrangement as Deposit Accounting and following the guidance of Deposit Accounting as prescribed in the SSAP No. 61, paragraph 51. Also, the Company is instructed to comply with RCW 48.43.097 by filing its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

4. Loss Reserve Understated

The OIC actuary reviewed the loss reserve as of December 31, 2010 and concluded that the amount reserved for incurred but not reported (IBNR) claims was understated and did not cover the actual amount paid in 2011 for claims incurred in 2010. The Company's loss reserve was understated by \$157,000 as of December 31, 2010. (See Notes to the Financial Statements No. 4.)

The Company is instructed to comply with RCW 48.12.080(2) by holding adequate reserves to cover its obligations and to ensure that the underlying data and calculation are accurate.

5. Part D Settlements Receivables

The Company overstated its balance for Amount Receivable Relating to Uninsured Plans by \$48,888 as of December 31, 2010. (See Notes to the Financial Statements No. 3.)

The Company is instructed to comply with RCW 48.43.097 by filing its financial statements in accordance with the AP&P, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

COMMENTS AND RECOMMENDATIONS

1. Deferred Tax Assets (DTA) Valuation Allowance

The Company has elected not to adjust its DTA with a valuation allowance amount that was recommended by its external CPA's. SSAP No. 10R, paragraph 6(e), requires reduction in gross DTA's by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the gross

DTA's will not be realized. The Company reported negative income in the last couple years and it is not likely to report significant profits in the near future.

It is recommended the Company adjust its deferred tax assets with a valuation allowance that reflects and takes into account realistic forecasts.

2. Information Technology (IT) Department Reporting Structure

The Director of IT reports to the Chief Financial Officer. Control Objectives for Information and related Technology (COBIT) framework standards recommend the oversight of the IT department should be separate from operational departments within the Company.

It is recommended the Director of Information Technology report directly to either the Chief Executive Officer or Chief Operating Officer.

3. Business Continuity and Disaster Recovery Plans

As a result of our review of business continuity and disaster recovery plans, certain internal controls matters were noted that are considered to be ineffective and are not in conformance with industry best practices or with COBIT framework standards.

- The Company does not have a formal, written, Business Continuity Plan.
- The Company does not have a formal, written Disaster Recovery Plan.
- The Company has not undergone a Business Impact Analysis, which is utilized during the preparation of the Business Continuity Plan and Disaster Recovery Plan.
- The Company did not provide evidence that the Disaster Recovery Plan has been tested recently. When the Company prepares a Business Continuity Plan, it needs to be tested regularly.

It is recommended the Company develop a formal written business continuity plan and a disaster recovery plan, conduct a formal 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 RCW 48.07.205 to create and maintain business continuity and disaster recovery plans.

4. Fidelity Bond

The Company has a commercial policy that provides an employee dishonesty coverage with a limit of \$250,000 which is less than the NAIC suggested amount of \$500,000 to \$600,000.

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

COMPANY PROFILE

Company History

The Company was incorporated in the state of Washington on January 18, 2007 as a for-profit company. The Company received its Certificate of Registration on February 9, 2007 as a health care service contractor. The Company offers Medicare Advantage plans through its contract with the Center for Medicare and Medicaid Services (CMS). The Company was formed through equal stock ownership by three local independent physician associations (IPA); Northwest Physicians Network, LLC, Physicians of Southwest Washington, LLC, and Highline Medical Services Organization (HMSO).

The three IPAs founded PSHP to access the higher premium rates under the Medicare Advantage programs and to keep patients in their network. In 2009, NPN and PSW together acquired all the shares owned by HMSO.

Capitalization

As of December 31, 2010, the Company had 1,200,000 shares of common stocks with a \$10 par value authorized, and 910,000 shares issued and outstanding. The minimum capital requirement of \$3 million pursuant to RCW 48.44.037 was met with \$5.8 million in capital and surplus as of December 31, 2010.

Territory and Plan of Operations

The Company writes Medicare Advantage coverage for parts A, B and D exclusively in Washington State primarily in King, Lewis, Pierce, Snohomish, and Thurston Counties. The Company received CMS approval to expand into four additional counties: Chelan, Douglas, Grant and Whatcom Counties. PSHP notified the OIC that it plans to expand services to those counties starting January 1, 2012.

Growth of Company

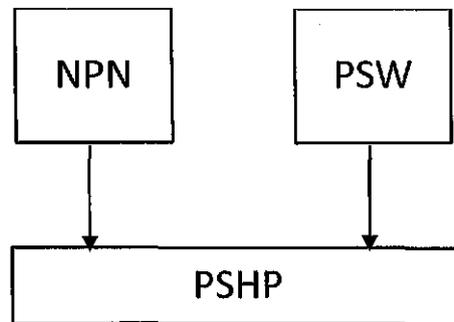
The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>	
2010	\$18,835,669	\$13,013,336	\$5,822,333	
2009	7,872,785	2,236,820	\$5,635,965	
2008	5,237,356	1,832,686	\$3,404,670	
2007	4,459,897	620,751	\$3,839,146	

<u>Year</u>	<u>Total Revenue</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2010	\$54,047,471	\$19,811	\$148,407	(\$5,296)
2009	53,350,973	487,190	145,322	633,234
2008	43,482,321	(750,942)	103,975	(646,967)
2007		(3,836,349)	216,769	(3,619,579)

Affiliated Companies

PSHP is owned by two IPAs, NPN and PSW, each of them own 50 percent of the Company. The following organization chart is taken from PSHP's filed 2010 NAIC Annual Statement:



Intercompany Agreements

As of December 31, 2010, the Company had the following intercompany agreements in force:

- Contractor and Participant Agreements (Founder Agreement) with its founders, NPN and PSW effective March 1, 2007. The Founder Agreements provide that NPN and PSW receive 85 percent of the Part C Medicare premiums and 85 percent of Part C Member Premium for their assigned members to provide benefits on a capitated basis. The Founder Agreements have been amended each year to update the plan carve outs related to plan benefits and vendor agreements.
- Claims Delegation Agreement with PSW effective March 1, 2007. The agreement provided that PSW receives 2.5 percent of premiums of each assigned member for processing claims. January 1, 2009, the agreement was amended by changing the fee structure to a flat fee of \$18.50 per member per month for each member who was assigned to PSW. (See Instruction No. 2.)
- Administrative Services Agreement with PSW effective March 1, 2007. The agreement provided that PSW receives 2.5 percent of premiums of each member not assigned to PSW or NPN for processing claims. January 1, 2009, the agreement was amended by changing the fee structure to a flat fee of \$18.50 per member per month for each member who was assigned to PSW. January 1, 2011, the agreement was amended and a new sliding scale fee schedule was added to the agreement. (See Instruction No. 2.)
- Claims Delegation Agreement with NPN. The agreement provides that NPN receives 2.5 percent of premiums for each assigned member effective March 1, 2007. January 1, 2009, the agreement was amended by changing the fee structure to a flat fee of \$18.50 per member per month for each member who was assigned to NPN. (See Instruction No. 2.)
- Administrative Services Agreement for care management with NPN. The agreement provides that PSHP agrees to reimburse NPN \$8 per member per month to provide care management services to certain PSHP members effective January 1, 2010. (See Instruction No. 2.)

MANAGEMENT AND CONTROL

Board of Directors

Directors of the Company as of December 31, 2010:

Mariella H. Cummings	Chairperson
Leonard B. Alenick, M.D.	
Patricia C. Briggs	
Joseph P. Clabots, M.D.	
Stanley L. K. Flemming, D.O.	
Gary R. Goin, M.D.	
Patrick J. Halpin, M.D.	
Laurence C. Schadt, M.D.	

Officers

Officers as of December 31, 2010:

April D. Golenor	Chief Executive Officer (CEO)
Zachary A. Smulski	Chief Financial Officer (CFO)
Hugh L. Straley	Chief Medical Officer (CMO)
Christine M. Tomcala	Chief Operating Officer (COO)
Leonard B. Alenick	Secretary
Laurence C. Schadt	Treasurer

Conflict of Interest

The Company requires the annual completion of a conflict of interest statement by directors, officers, and key employees. The purpose of the statement is to detect any activities or participation on the part of the directors and officers that could possibly be interpreted as a conflict of interest. No conflicts of interest were disclosed in the statements that were submitted to the board of directors (BOD) for the period of examination.

Fidelity Bond and Other Insurance

The Company has employee dishonesty coverage as part of its commercial policy with a limit of \$250,000. The aggregate amount of coverage does not meet the recommended guidelines of the NAIC to cover the exposure risk of the Company. (See Comments and Recommendations No. 4.)

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

The Company offers its employees medical, dental and vision coverage; and an opportunity to participate in a 401(k) or Roth IRA plan.

CORPORATE RECORDS

Our review of the minutes of the BOD indicated that the minutes supported the transactions of the Company and the actions taken by its officers. All BOD meetings were conducted with a quorum present. The Articles of Incorporation and the Bylaws were amended and restated on July 28, 2010.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

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 for the valuation date of December 31, 2010.

The OIC health actuary reviewed the reserves as of December 31, 2010 and concluded that the reserves were in compliance with statutory requirements except for the following item (See Instructions No. 4):

- The amount reserved for the IBNR claims was understated and did not cover the actual amount paid in 2011 for claims incurred in 2010. The Company's loss reserve deficiency amounted to \$157,000, which has been adjusted for the purposes of this examination report. (See Notes to the Financial Statements No. 4.)

REINSURANCE

The Company is a party to the following two reinsurance agreements:

- Stop-loss reinsurance agreement with Physicians Insurance A Mutual Company effective January 1, 2008. Based on our review of the 2010 NAIC Financial Statement, PSHP did not reach the attachment limit of the treaty in 2010. The reinsurance agreement was reviewed and found that it complies with Washington State reinsurance statutes.
- Quota share with The Canada Life Assurance Company effective April 1, 2010 to cede 25 percent of its capitated business. Effective July 1, 2010, the Company increased the quota share percentage to 70 percent. The reinsurance agreement was reviewed and found that it did not comply with Washington State reinsurance statutes due to lack of risk transfer. (See Instructions No. 3.)

STATUTORY DEPOSITS

The Company 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	Cash and Bonds	\$4,512,316	\$4,595,357

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 was audited annually by the certified public accounting firm of Moss Adams, LLP (Moss Adams). 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 exceptions or significant weaknesses were noted.

The Company's IT environment was reviewed during the planning and testing phase of the examination, focusing on the following 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 general IT 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. Several control weaknesses were noted during the examination. (See Comments and Recommendations No. 2 and 3.)

SUBSEQUENT EVENTS

- Effective June 1, 2011, the Company's name was changed to Soundpath Health, Inc.; the Articles of Incorporation were amended to reflect the name change.
- CEO, April Golenor, departed the Company in August 2011 and the BOD appointed Christine Tomcala as acting CEO. Ms. Tomcala was subsequently appointed as CEO on December 1, 2011.
- CMO, Dr. Hugh Straley, retired in September 2011 and was replaced by Dr. Ze'ev Young on September 26, 2011.
- Compliance Officer and General Counsel, Mike Jensen, resigned in February 2012 and was replaced by Robin Larmer on April 11, 2012.
- NPN's independent audit opinion issued by Moss Adams as of December 31, 2010 states that there is substantial doubt about the ability of NPN to continue as a going concern.
- In 2011, the Company withheld \$1.2 million from the capitated payments to NPN due to concerns about NPN's financial condition. The funds are held in a security reserve that covers the Company's potential legal liability in case NPN is unable to pay its claims.
- Christine Turner was appointed as a new COO on March 26, 2012.
- CFO, Zachary Smulski left the Company in April 2012.
- In April 2012, the Company recovered \$631,500 from a former employee during its investigation of accounting irregularities that took place in 2011. The recovered amount significantly increases the Company's surplus by more than 15 percent compared to the reported surplus as of December 31, 2011.
- In April 2012, the Company's counsel contracted with a forensic accountant to investigate the accounting irregularities that occurred in the second half of 2011.
- On April 5, 2012, the OIC called a target financial examination to focus on expense and lease transactions that occurred during 2011 and on some balances reported by the Company on its 2011

- NAIC Annual Statement.
- On May 18, 2012, the Company filed a request for hearing on the findings in this report and on the target financial examination.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and recommendations were corrected and satisfactorily addressed.

FINANCIAL STATEMENTS

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

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Four Year Reconciliation of Surplus
Analysis of Changes in Financial Statements Resulting from the Examination

Puget Sound Health Partners, Inc.
Assets, Liabilities, Capital and Surplus
December 31, 2010

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>	<u>Notes</u>
Assets				
Bonds	\$4,858,962	\$0	\$4,858,962	
Common stocks	1,209,794		1,209,794	
Cash and short-term investments	798,730		798,730	
Subtotals, cash and invested assets	6,867,486	0	6,867,486	
Investment income due and accrued	41,633		41,633	
Uncollected premiums and agents' balances in course of collections	73,686		73,686	
Accrued retrospective premiums	840,000	(210,615)	629,385	2
Amounts recoverable from reinsurers	8,349,355		8,349,355	
Other amounts receivable under reinsurance contracts	1,375,188		1,375,188	
Amounts receivable relating to uninsured plans	208,357	(48,888)	159,469	3
Current federal and foreign income tax recoverable and interest thereon	12,128		12,128	
Net deferred tax asset	778,370		778,370	
Electronic data processing equipment and software	51,039		51,039	
Receivables from parent, subsidies and affiliates	109,523	(45,558)	63,965	1
Health care and other amounts receivable	128,903		128,903	
Total Assets	\$18,835,668	(\$305,061)	\$18,530,607	
Liabilities, Capital and Surplus				
Claims unpaid	\$1,656,378	\$44,863	\$1,701,241	2, 4
Accrued medical incentive pool and bonus amounts	97,166		97,166	
Unpaid claims adjustment expenses	42,417		42,417	
Aggregate health policy reserves	264,811		264,811	
Premiums received in advance	107,010		107,010	
General expenses due or accrued	698,253		698,253	
Ceded reinsurance premiums payable	9,822,770		9,822,770	
Amounts withheld or retained for the account of others	324,530		324,530	
Total Liabilities	13,013,335	44,863	13,058,198	
Aggregate write-ins for special surplus funds	259,460		259,460	
Common capital stock	9,100,000		9,100,000	
Unassigned funds (surplus)	(3,537,127)	(349,924)	(3,887,051)	1, 2, 3, 4
Total capital and surplus	5,822,333	(349,924)	5,472,409	
Total Liabilities, Capital and Surplus	\$18,835,668	(\$305,061)	\$18,530,607	

Puget Sound Health Partners, Inc.
Statement of Revenue and Expenses
For the Year Ended December 31, 2010

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>	<u>Notes</u>
Member months	84,963		84,963	
Net premium income	\$51,280,435	(\$259,503)	\$51,020,932	2, 3
Change in unearned premium reserves and reserve for rate credits	432,219		432,219	
Aggregate write-ins for other health care related revenues	2,334,817		2,334,817	
Total revenues	54,047,471	(259,503)	53,787,968	
Hospital and Medical:				
Hospital/medical benefits	54,657,461	44,863	54,702,324	2, 4
Other professional services	848,194		848,194	
Emergency room and out-of-area	855,472		855,472	
Prescription drugs	6,610,081		6,610,081	
Incentive pool, withhold adjustments and bonus amounts	97,166		97,166	
Subtotal	63,068,374	44,863	63,113,237	
Less:				
Net reinsurance recoveries	19,845,945		19,845,945	
Total hospital and medical	43,222,429	44,863	43,267,292	
Claims adjustment expenses	2,721,408		2,721,408	
General administrative expenses	8,083,824		8,083,824	
Total underwriting deductions	54,027,661	44,863	54,072,524	
Net underwriting gain or (loss)	19,810	(304,366)	(284,556)	
Net investment income earned	143,936		143,936	
Net realized capital gains or (losses)	4,471		4,471	
Net investment gains or (losses)	148,407	0	148,407	
Net gain or (loss) from agents' or premium balances charged of	(160,988)		(160,988)	
Net income or (loss) after capital gains tax and before all other federal income taxes	7,229	(304,366)	(297,137)	
Federal and foreign income taxes incurred	12,525		12,525	
Net income (loss)	(\$5,296)	(\$304,366)	(\$309,662)	
CAPITAL AND SURPLUS ACCOUNT				
Capital and surplus prior reporting year	\$5,635,964	\$0	\$5,635,964	
Net income (loss)	(5,296)	(304,366)	(309,662)	
Change in net deferred income tax	10,067		10,067	
Change in nonadmitted assets	181,598	(45,558)	136,040	1
Net change in capital and surplus	186,369	(349,924)	(163,555)	
Capital and surplus end of reporting period	\$5,822,333	(\$349,924)	\$5,472,409	

Puget Sound Health Partners, Inc.
Four Year Reconciliation of Surplus
For the Years Ended December 31,

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital and Surplus prior reporting year	\$5,635,965	\$3,404,671	\$3,839,146	\$0
Net income or (loss)	(5,296)	633,235	(646,967)	(3,619,579)
Changes in net realized capital gains and (losses)		(28,605)	9,121	
Changes in net deferred income tax	10,067	(207,068)	287,337	
Changes in nonadmitted assets	181,598	658,012	(383,966)	(341,275)
Capital changes - paid in		1,000,000	300,000	7,800,000
Aggregate write-ins for gain or (losses) in surplus		175,720		
Net change in capital and surplus	<u>186,369</u>	<u>2,231,294</u>	<u>(434,475)</u>	<u>3,839,146</u>
Capital and Surplus end of reporting year	<u>\$5,822,334</u>	<u>\$5,635,965</u>	<u>\$3,404,671</u>	<u>\$3,839,146</u>

Puget Sound Health Partners, Inc.
Analysis of Changes in Financial Statements Resulting from the Examination
December 31, 2010

	<u>Balance Per</u> <u>Company</u>	<u>Balance Per</u> <u>Examination</u>	<u>Notes</u>	<u>Increase</u> <u>(Decrease)</u> <u>In Surplus</u>	<u>Total</u>
Capital and Surplus, December 31, 2010 - per Annual Statement					\$5,822,333
Assets					
Accrued retrospective premiums	\$840,000	\$629,385	2	(\$210,615)	
Amount receivable relating to uninsureds plans	208,357	159,469	3	(48,888)	
Receivable from parent, subsidies and affiliates	109,523	63,965	1	(45,558)	
Liabilities					
Claims unpaid	\$1,656,378	1,611,515	2, 4	(\$44,863)	
Change in surplus					<u>(349,924)</u>
Capital and Surplus, December 31, 2010 - per Examination					<u>\$5,472,409</u>

NOTES TO THE FINANCIAL STATEMENTS

Examination adjustments to the Company's financial statements are as follows:

1. Past Due Receivable

The Company admitted \$45,558 receivable from its parent that was more than 90 days past due. The amount is nonadmitted according to SSAP No. 25, paragraph 6. (See Instructions No. 1.)

2. Retrospective Premiums Receivable

The Company overstated its retrospective premiums receivable from CMS by \$210,615. As a result, the Company overstated its liabilities under the capitation arrangements by \$112,137 and overstated its medical and pharmacy revenues by \$98,478. (See Instructions No. 1.)

3. Part D Settlements Receivables

The Company overstated its balance for Amount Receivable Relating to Uninsured Plans by \$48,888 as of December 31, 2010 due to a clerical error. (See Instructions No. 5.)

4. Loss Reserves Understated

Based on the OIC actuarial review, the Company had an indicated net loss reserve deficiency of \$157,000 as of December 31, 2010. (See Instructions No. 4.)

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Puget Sound Health Partners, Inc. 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; Susan Campbell, CPA, FLMI, CFE, Reinsurance Specialist; Timothy F. Hays, CPA, JD, Investment Specialist; Tarik Subbagh, MSBA, CPA, CFE, Property and Casualty Field Supervising Examiner; Euli Rath, CPA, Financial Examiner; Katy Bardsley, CPA, AFE, Financial Examiner; and Friday Enoye, AFE, 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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Examiner-in-Charge
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